Testimony before the U.S.-China Economic and Security Review Commission

"U.S. Access to China's Consumer Market: E-Commerce, Logistics and Financial Services"

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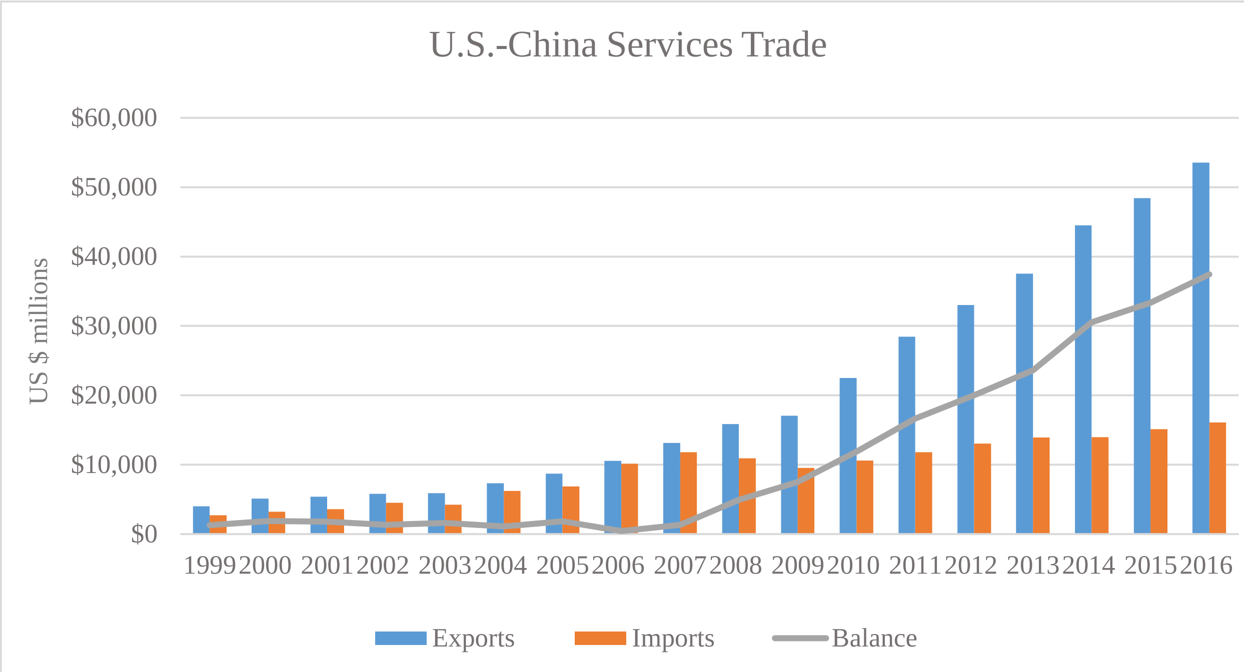
The Coalition of Services Industries (CSI) appreciates the opportunity to submit testimony to the U.S.-China Economic and Security Review Commission for its hearing on "U.S. Access to China's Consumer Market: E-Commerce, Logistics and Financial Services." As requested, this testimony will cover U.S. access to China's financial services market.

CSI, established in 1982, is the leading industry association devoted exclusively to helping America's services businesses, increasingly digitally enabled services, and workers compete in world markets. CSI member companies represent a broad spectrum of the U.S. services sector, including distribution services, express delivery, financial services, media and entertainment, telecommunications, information and communication technology (ICT) services, and professional services. These services are a critical enabler for U.S. economic growth.

Current State of Play in China

China was the second largest services export market for U.S. services providers in 2016, with $53.5 billion in U.S. services exports, and a $37.4 billion services trade surplus.[1] From 1999 to 2007, the United States maintained a services bilateral trade surplus with China of around $1 billion. Since then, U.S. services exports have more than quadrupled, resulting in the U.S. services trade surplus with China growing from $1.3 billion in 2007 to $37.4 billion in 2016.[2] This growth over the last decade in U.S. services exports to China and the bilateral services trade surplus exceeds the growth in total U.S. services exports, which have grown by 54 percent, and the increase in the global U.S. services trade surplus, which has risen by 115 percent.[3] China has thus become one of the fastest growing markets for U.S. services.



The financial services sector has been an area of great strength for U.S. services providers. Over the last decade, the United States has increased its financial services exports to China by 347 percent, totaling over $3 billion in 2015.[4] This growth rate is the second highest among all U.S. trade partners and nearly triple the average global financial services export growth rate.[5]

Despite the growth of U.S. financial services exports and China's stated intent to provide greater services market access, significant market access barriers remain, including existing and proposed discriminatory regulations in areas such as restrictions on data flows, information technologies, equity cap limitations, licensing restrictions, and outright bans on foreign investment.

China has long insisted that it is an open market with clear rules. Unfortunately, this position does not match reality. While China continues to increase its investments abroad and engage in more trade with its partners, U.S. firms have an increasingly difficult time competing on a fair playing field in China. At a time when China's economy is growing exponentially and its population is aging at arguably the fastest rate in the world, China needs U.S. services, especially those in the financial services sector. U.S. firms have considerable experience that could prove beneficial to China as its economy develops further, but this requires that U.S. companies have non-discriminatory access to the Chinese market. China's current short-sighted approach means that China risks losing the significant benefits and expertise of U.S. financial services firms.

China's Treatment of Data and Technology

The free flow of data across borders is critical in every business sector as it is necessary for businesses to operate globally in an efficient and secure manner. In addition to the free flow of data, businesses also need ICT services, platforms, and other infrastructure, to provide their services, which are increasingly digitally enabled. This is especially true in the financial services sector, where U.S. financial services firms are employing digital services and technologies to access and operate in the Chinese consumer market.

The free flow of data means that these companies can easily integrate staff around the world, maintain their customer networks as well as their supply chain, and ultimately build their competitiveness. Financial services companies rely on the ability to transfer data quickly and easily across the globe to provide better service to their clients at lower cost. This means that consumers can access their accounts from any location, whether they are performing a simple bank transfer or more complex transactions. Further, cross-border data flows increase access to capital for start-ups and allow small businesses, through digital marketplaces, to tap into foreign markets and receive payment from customers.

Over the last decade, China has taken wide-ranging steps to restrict data flows, including through requirements to localize data and servers in China. Because of the widespread use of and reliance on customer data by many financial services firms, these practices have significant impacts, including in insurance, banking, and cloud computing, among other areas.[6] These data-restrictive policies impede the ability of U.S. financial services firms to supply cross-border services to and make investments in China. The inability to operate cross-border, the loss of efficiency, and increase in costs, among other impediments to operating in China, reduce U.S. competitiveness.

Moreover, as noted in the letter to China's Cybersecurity Administration signed by a global coalition of industry associations, including CSI, it appears that China's Cyber Security Law (CSL), along with other current and proposed regulations, has the potential to create additional, discriminatory barriers and impose significant compliance burdens, especially for financial services companies, due to its broad and vaguely defined scope. Particularly concerning is China's proposed requirement that all Chinese personal data must be stored domestically. The CSL also potentially subjects U.S. companies to security reviews. This includes the proposed requirements to review companies' proprietary source code and allow the government to review and approve encryption measures. The industry association letter called on China to delay implementation of the CSL along with other recent ICT regulatory and legislative actions, to allow sufficient time to work with U.S. industry and government experts to revise implementing measures that create technical barriers to trade, hinder market access, and/or diminish cybersecurity.[7] While China recently announced that some aspects of the implementation would be delayed, the data flow and storage restrictions mandated by the CSL, as well as other discriminatory aspects, remain unaddressed.

In addition, China has proposed new draft regulations regarding cloud computing services which, if implemented, combined with existing Chinese laws, would force U.S. cloud service providers to transfer valuable U.S. intellectual property, surrender use of their brand names, and hand over operation and control of their business to a Chinese company in order to operate in China. These proposed regulations are of concern to financial services companies. Cloud services provide an effective and secure way for financial services companies to provide their services cross-border as well as within China. To address this, the United States should secure China's commitment that it will allow U.S. cloud service providers to obtain and hold all necessary licenses for the operation and provision of cloud services in China, including those related to software, hardware, facilities, and infrastructure; allow foreign investment in Chinese companies established to provide cloud services in China; and allow U.S. cloud service providers to sign contracts for the provision of cloud services in China and use their trademarks and brands to market their cloud services. China should also allow U.S. cloud service providers to procure telecommunication services (including bandwidth) for the provision of cloud services on the same terms available to Chinese companies.

China has cited concerns over national security as the justification for these restrictions, but in September 2015 and June 2016, China committed to the United States that measures it has taken to enhance cybersecurity in commercial sectors would be non-discriminatory and would not impose nationality-based conditions or restrictions. These restrictions are in direct contradiction of these commitments.

Insurance Markets in China

U.S. access to China's insurance and retirement securities markets remains difficult as a result of restrictive Chinese measures. Foreign insurers have less than a 5 percent cumulative market share in what is the third-largest insurance and pensions market in the world.[8] Given the size and future growth of China's insurance markets, and the relatively small market share of foreign firms, the economic opportunity for foreign insurers, absent the discriminatory equity cap and prohibition on U.S. companies in the enterprise annuities sector (401k), is exponential and would deliver significant commercial benefits to U.S. industry. Profits generated from overseas operations would help fund long-term infrastructure investments in the United States, creating jobs, and supporting high-paying service jobs.

Current Chinese regulation places a 50 percent cap on foreign equity in life, health, and pension companies, a restriction that has been in place since China's accession to the World Trade Organization (WTO) in 2001. While U.S. industry and the U.S. government have worked for years across different fora and platforms to eliminate this barrier to the Chinese insurance market, China has been unwilling to budge. In fact, a revised 2017 draft of the "Catalogue for the Guidance of Foreign Investment Industries" shows that China will maintain the 50 percent cap on foreign equity for life insurance companies. Removing this equity cap has been a top priority for the U.S. financial services industry for over a decade, and liberalization in this area would send a strong signal that the U.S.-China bilateral trade and investment relationship is entering a new, more balanced era.

China has made some progress in liberalizing the non-life insurance sector. In 2013, China removed all restrictions on foreign non-life insurers. In January 2017, China's State Council issued the "Circular on Several Measures to Expand the Opening-up and Actively Utilize Foreign Investment," which committed to lower entry restrictions on foreign investment in several service sectors, including insurance, banking, and securities.[9] Further action is needed. The elimination of the equity cap aligns well with China's domestic policy goals and economic reform agenda, which emphasizes the need to grow the services sector, deepen financial inclusion, and enhance the participation of foreign financial services firms in China. Liberalization in the life insurance sector would benefit Chinese consumers who need greater access to insurance and more stable protection and investment options in light of China's recent market volatility.

China has not yet authorized any U.S. investment in the enterprise annuities industry, which is China's 401k. Further to equity restrictions in China, there is a 33 percent cap in the securities sector. There is also a recent proposal for new regulations to restrict domestic shareholding in foreign-invested insurance companies (both life and property casualty), which will diminish the value of existing investments. The United States should seek confirmation from China's insurance regulator that the existing "Foreign-Invested Measures" will continue to govern, with respect to foreign equity and all other issues involving insurers, with at least 25 percent foreign investment. It should also seek confirmation that the proposed regulations will not be applied retroactively to foreign-invested insurance companies.

China has made several commitments on insurance at the WTO. This includes allowing 100 percent foreign equity in property insurance and reinsurance, as well as prohibitions on creating conditions of ownership for existing foreign suppliers of insurance services that are more restrictive than they were on the date of China's accession to the WTO. Both of these commitments are formalized in the 2004 "Detailed Rules on the Measures for the Administration of Foreign-Invested Insurance Companies."

However, questions remain on how well these commitments have been followed. In short, explicit and implicit barriers in China's insurance sector mean that U.S. firms are unable to fully tap into this critical market.

Banking and Securities Barriers

China has exercised great caution in opening its banking sector to the United States. In particular, China has imposed capital requirements and other rules that that have made it more difficult for foreign banks to establish and expand their market presence in China. It is then unsurprising that foreign banks' collective market share in 2013 was below 2 percent.[10]

U.S. banks, securities, and other bodies are unable to compete on an equal footing with domestic institutions. U.S. banks are subject to a 20 percent investment ceiling (for single foreign shareholders) and a 25 percent investment limit (for multiple foreign shareholders) in local Chinese banks. Further, once a foreign-funded business in the banking sector is established, it is limited in its activity for two years. Following this waiting period, a business can expand the scope of the business, assuming it has met certain conditions, which includes holding over $10 billion in total assets.[11] There are also other restrictive regulations, including stipulations that foreign banks in China must work through branches, as opposed to subsidiaries, which have legal and economic impacts.

Equity caps on foreign ownership of securities joint ventures have not been lifted in China since 2012, and remain at 49 percent, despite the commitment to "gradually raise" the equity caps from the 2016 Strategic & Economic Dialogue (S&ED).[12] A commitment to ensuring that a foreign firm can establish a wholly-owned company in its market is a bedrock free market principle that the U.S. and a significant number of other countries committed themselves to many years ago. It is time for China to make the same positive step by allowing U.S. securities firms to establish wholly-owned subsidiaries without subjecting them to additional requirements that would hamper their ability to conduct business onshore on the same terms as domestic players. Lifting equity caps only nominally, while imposing additional onerous requirements that effectively impede the business of foreign securities firms, would not be a commercially meaningful outcome.

China has also committed to expand opportunities for U.S. financial services firms to acquire settlement and underwriting licenses as part of the 2016 S&ED.[13] CSI's member companies look forward to working with the U.S. and Chinese governments to ensure proper and effective implementation of these licenses is underway.

Electronic Payment Services (EPS)

China has placed restrictions on foreign companies that provide EPS, only allowing a Chinese entity to process a payment that handles renminbi. The United States brought this dispute to the WTO in September 2010, where the dispute panel ruled in the United States' favor in 2012. The following year, China announced it had implemented the WTO's ruling, but the United States disagreed with that assessment, noting that further corrective action is needed.[14] The People's Bank of China is effectively further restricting U.S. companies' already-limited market access in the cross-border/international space at a time when it should be moving to open China's domestic market. China had previously allowed cards with the logos of both UnionPay and a foreign payment company to be issued, but the People's Bank of China pressured banks in fall 2016 to stop issuing these "dual-branded, dual currency" (DBDC) cards, and many Chinese banks followed suit. By restricting the issuance of new DBDC cards, U.S. payments companies have already experienced declines in their reported DBDC volumes; this negative trend is expected to continue.

The 100-Day Action Plan announced that U.S. EPS firms would be licensed.[15][16] While EPS licensing is a positive step, the real impact will be unclear until licenses are actually approved and banks are issuing foreign brand cards for domestic use.

A Path Forward Through Continued Bilateral Engagement

The U.S.-China Comprehensive Economic Dialogue (CED) launched this year will host four bilateral talks throughout the remainder of 2017 on a variety of issues, including on security, the economy, trade, and investment.[17] We look forward to the implementation of the initial commitments that China made as part of the 100-Day Action Plan, particularly on EPS and bond and settlement licensing, and further commitments to address other concerns in financial, cloud, and other key services sectors. Outside of this forum, the U.S.-China Bilateral Investment Treaty (BIT) would create rules for foreign investment, allowing U.S. investors better access, and on fairer terms, to China. While the BIT would not address the full scope of industry concerns with China, this negotiation would represent another outlet for continued engagement with China. These venues remain viable options to continue pressing China to address U.S. services industry concerns, but must produce tangible results that would provide greater market access for U.S. services firms.

Conclusion

Significant market access barriers remain for U.S. financial services companies in China. China continues to impose restrictions on foreign financial services firms, including equity cap limitations, licensing restrictions, and outright bans on foreign investment. Further, because of the important role that data plays in a modern, competitive economy, China's restrictions on data flows, ICT, cloud technologies, and services also obstruct U.S. financial services firms from effectively accessing the Chinese market. While China has announced, as part of recent bilateral discussions with the Administration, some initial steps in the right direction, problem areas remain. These barriers ultimately make the Chinese consumer market still largely untapped for U.S. financial services firms.

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