Harvard Law School
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Symposium on Building the Financial System of the 21st Century: An Agenda for China and the United States

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Final Report

SYMPOSIUM ON BUILDING THE FINANCIAL SYSTEM OF THE 21ST CENTURY: AN AGENDA FOR CHINA AND THE UNITED STATES

The 20th China-U.S. Symposium of the Program on International Financial Systems was held in Hong Kong on September 13-15, 2023. It was the first in-person China-U.S. Symposium since 2019. Participants reaffirmed the importance of the bilateral relationship and the interdependence of the two economies. Topics included how U.S.-China tensions impact transnational financial institutions, innovation and regulation of digital assets, lessons of financial crises, and the U.S. and Chinese approaches to the global financial regulatory framework.

Topic 1: How Do U.S.-China Tensions Impact Transnational Financial Institutions?

The Symposium was held at a time of considerable tension between the U.S. and China over a variety of political and economic issues. In Topic 1, participants discussed the impacts of these tensions on financial institutions and on China-U.S. economic interdependence. They addressed the likelihood of improvement or deterioration of relations, potential costs of decoupling, and opportunities for continued mutual economic benefit.

U.S.-China Relations

Participants expressed concerns about the state of U.S.-China relations. Many felt that tensions had worsened over recent years. Reasons included geopolitical issues ranging from technological rivalry and allegations of spying to differing approaches to the Russian invasion of Ukraine to possible conflict across the Taiwan Strait. Economic tensions were also pronounced, with ongoing concerns about intellectual property, subsidies, and excess capacity; the maintenance of Trump-era tariffs and U.S. imposition of restrictions on technology transfer; and growing calls to de-risk or even decouple supply chains. Many participants were particularly concerned over the recent U.S. executive orders limiting outbound investment to China in the areas of semiconductors, quantum computing, and artificial intelligence.

Participants expressed at least two different concerns over the U.S.-China tensions. The main concern was that continued deterioration would over time make it more difficult and costly to conduct cross-border business and investment. Already, they noted declines in cross-border investment, as well as an increased tendency among U.S. and other foreign firms to pursue "China+1" investment strategies in order to diversify supply chains. Meanwhile, both the U.S. and Chinese governments were seen to be pursuing policies meant to reduce their dependence on the outside world, including the Inflation Reduction Act and continuation of Trump-era tariffs on the U.S. side and the Made in China 2025 and related policies by China to emphasize indigenous technological development and "domestic circulation."

Some participants also raised the prospect of more sudden shifts, such as large-scale sanctions over the Ukraine war, Chinese de-dollarization, a Taiwan Straits crisis, or direct military confrontation between the two countries. Crises could lead to Chinese and U.S. investors finding their assets in the other country inaccessible and to severe disruption of supply chains for essential goods including IT hardware and pharmaceuticals. Participants noted that some observers had argued that the prospect of such a rupture meant that companies should accelerate efforts to divest investments and reconfigure supply chains. These participants noted that the Russian invasion of Ukraine had created significant costs for U.S. firms that had been forced to divest quickly, but argued that a U.S.-China crisis would be much costlier for U.S. and Chinese firms since interdependence was so much higher and the two economies were so enmeshed in a variety of industrial supply chains.

All of these potential scenarios were of deep concern to participants, who emphasized the economic benefits that U.S.-China interdependence had brought both countries, as well as the

global economy. They noted the important role of trade and inward FDI in Chinese industrialization, as well as the benefits to U.S. firms of sharing in China's rapid economic development through investment and trade. Those benefits had been made possible both by the complementarities of the two economies and the liberalization of cross-border trade and investment. The possible reversal of openness would, in contrast, be a drag on the U.S., Chinese, and global economies. Several noted estimates by the IMF that global GDP would decline by 1% (2% in the long-term) if decoupling led to the conclusion of two separate economic blocs.

Some participants also argued that bilateral tensions reduced the ability of the U.S. and China to cooperate to provide vital global public goods, including leadership in addressing climate change, promoting development, and maintaining an open trading system. This could further contribute to slower global economic growth.

Thus, participants agreed that it was imperative that the two countries find a way to better coexist despite their very different economic and political systems, as well as their sometimes divergent global aims and approaches to international relations. Rather than seeking convergence in economic policy, it was argued that the two governments could effectively coexist by delineating areas of cooperation, competition, and contention, with the goal of keeping areas of contention as small and separated from cooperative and competitive areas as possible. Some participants argued that this was the distinction that U.S. officials were trying to make by using the terminology of "de-risking" instead of decoupling, or by describing national security-based economic barriers as "small yard, tall fence." They further argued that China had similar or perhaps more extensive national security-based barriers, and that recognizing these carve-outs was essential to cooperation and openness in other areas. Other participants were skeptical that the "small yard, tall fence" approach could work, and warned that it was likely to accelerate decoupling and exclusion well beyond a small set of agreed technologies and products.

Declines in Cross-Border Financial Activity

Participants discussed evidence that declines in cross-border financial activity were already underway. Several pointed to across-the-board declines in U.S. FDI into China, including in M&A, private equity, and venture capital. It was argued that foreign banks' enthusiasm for expanding their presence in China had also declined, as reflected in the decline of their share of Chinese banking assets in recent years from a high of around 2% to 1.5%. Portfolio investment into China, which had peaked at only 4% of total bond and equity holdings in 2021, was also down.

Similarly, new Chinese company listings in the U.S. had plummeted in 2021 and 2022, although it was noted that IPOs had risen somewhat in 2023. Some participants also observed that Chinese companies had become increasingly apprehensive about investing in U.S. companies and that deal flow had dropped. Chinese IPOs in Hong Kong—a key conduit for foreign investors—were also down, as was turnover.

While some of the reasons for these declines were seen as cyclical or short-term in nature, including the effects and aftermath of COVID and interest differentials, many participants felt

that they were likely to reflect a longer-term trend. They cited both economic and political reasons for this expectation.

Economically, declining FDI to China was occurring within the context of slowing economic growth and domestic private investment. The slowdown of domestic private investment was seen as reflecting declining returns in the Chinese economy, combined with already-high leverage for many firms. While the slowdown was particularly notable in real estate and construction, lower returns and investment rates were observed across a wide range of sectors and companies. With China's growth potential declining due to a shrinking labor force and declining returns to investment, some participants argued that there was much less incentive for foreign firms to invest in the Chinese market. In banking, several participants noted that low margins made banks reluctant to expand their presence.

Others were more sanguine about the attractiveness of Chinese markets to foreign investors. They noted China's centrality in global supply chains. Moreover, for U.S. firms, China offered economic complementarities with the U.S. economy as well as higher growth rates in spite of the slowdown. With the world's largest and fastest growing middle class, China's market also offered enormous growth opportunities for some sectors. Several participants also pointed to the quality and quantity of Chinese scientists and engineers, which continued to attract foreign interest in R&D facilities—at least in technologies that had not been targeted by the U.S. government as strategic.

Meanwhile, political factors loomed large in this discussion. Chinese companies contemplating U.S. listings worried about whether their shares would be allowed to continue to trade, while firms looking to acquire U.S. companies or facilities worried that those acquisitions could be blocked for national security reasons. U.S. firms expressed concern about Chinese capital controls, indigenous technology promotion policies, and what some perceived as greater difficulty in gaining approvals for direct investments and acquisitions. U.S. outbound investment restrictions prevented investment in specific areas of technology—and, despite the policy of "small yard, high fence," a number of participants argued that firms in other sectors were also skittish about investing in China, out of concern that new technologies or sectors might be targeted.

Many participants argued that regulatory uncertainty was as important as formal restrictions. Partly, this was a reflection of the rapidly changing political environment, and fears that tensions would continue to rise and lead to further restrictions. A number of participants also pointed to the effects of ambiguities over rules and enforcement in China. Approvals processes remained opaque for many foreign firms and the lines between legal and illegal behavior were blurry, as seen in recent actions against foreign due diligence firms and ambiguity over what constituted national secrets under China's "comprehensive national security" policy. Some participants noted that policy making processes in China were also often murky, with lack of public comment and consultation making it hard to plan, especially for foreign firms.

Countercurrents and Opportunities

Despite significant concerns about the impact of U.S.-China tensions on financial institutions and cross-border economic activity, participants did note some hopeful signs and bilateral progress toward cooperation. The resumption of high-level visits between Chinese and U.S. officials, including visits to China by Treasury Secretary Yellen, Commerce Secretary Raimundo, and Secretary of State Blinken, as well as the planned visit to the U.S. by Chinese Foreign Minister Wang Yi and groundwork for a meeting between Presidents Xi and Biden, appeared to a number of participants to show an increased appreciation by both governments of the importance of dialing down confrontation, improving communication, and finding areas of cooperation.

More concretely, participants lauded the 2022 agreement to allow Public Company Accounting Oversight Board (PCAOB) inspection of auditors in China and Hong Kong. Following the Holding Foreign Companies Accountable Act in 2020, the ability of Chinese firms to list and trade in U.S. markets had been in jeopardy. The law requires the PCAOB to inspect auditors of all U.S.-listed companies, and if a foreign government does not allow full access, then trading in the shares of all U.S.-listed firms from that jurisdiction would be suspended. Following the memorandum of understanding between the PCAOB and the China Securities Regulatory Commission (CSRC), the PCAOB had been able to do full reviews of four major auditors in Mainland China and Hong Kong and certify that the agreement had been honored. Participants saw this as a big step in bringing Chinese company IPOs back to the U.S. While it was possible that the PCAOB may not find these jurisdictions compliant in the future, again jeopardizing the U.S. listing status of Chinese firms, participants expressed confidence in the transparency of the process and the will of both the CSRC and PCAOB to act cooperatively. Indeed, a number of participants made the point that the auditing agreement was beneficial for the CSRC and for Chinese markets more generally, as it would have the effect of increasing transparency and accuracy of information in Chinese securities markets for all investors, both foreign and domestic.

Many participants also observed that, despite the political tensions, Chinese authorities had maintained their pursuit of financial opening and liberalization, including for U.S. investors and financial institutions. One example was the upcoming shift of all securities listing to a registration system, following several years of pilot programs in Shanghai and Shenzhen. Participants also highlighted improved investor protection, including class-action suits, which had been used several times in practice. Improved access to Chinese markets for foreigners included the 2020 elimination of ownership restrictions for foreign securities firms, as well as increasing the limits on use of the various Stock and Bond Connects. While some participants cautioned that approvals processes were sometimes unpredictable, several participants spoke of positive personal experiences in investing in Chinese financial markets.

Future Prospects

Looking forward, participants offered a mixed picture of the prospects for financial institutions and markets. Politically, many participants felt that U.S. sentiment toward China was increasingly negative, especially among politicians. Thus, they expected further moves to restrict cross-border capital flows and technology-related investments. Moreover, some noted that some public pension funds in the U.S. were becoming increasingly wary of investing in China out of concern that state governments might require them to reduce their exposure. In contrast, several

argued that Chinese people's views of the U.S. remained positive and that many U.S. investors were still interested in the Chinese market, despite the rising tensions at the official level. They expressed hope that this could incentivize greater policy flexibility on both sides. On the other hand, several also noted that "black swan" events, such as Ukraine-related U.S. sanctions on China, military conflict in the Taiwan Strait, or financial crisis could lead to abrupt shifts that could adversely affect financial markets and cross-border investment and trade. They expressed hope that mutual interests in economic growth and provision of global public goods like climate change mitigation and developing country debt relief could act as buffers against the swings of public opinion and negative surprises.

A number of participants made the case that rising U.S.-China tensions offered potential opportunities for Hong Kong. With U.S. firms potentially wary of having trapped assets in China and Chinese firms uncertain about the durability of direct access to U.S. markets, they argued that Hong Kong was well placed to be a connector between the two markets, replaying its traditional role. Among Hong Kong's advantages as a conduit for cross-border finance, participants noted the attractiveness of its common law system, its regulatory and supervisory capacity, and its continuing reputation for rule of law in economic and financial matters. Several participants also argued that Hong Kong was well-placed if political tensions were to lead China and some of its trading partners to shift away from transacting in dollars to transacting in RMB. With its open capital account and advantages in managing RMB assets, Hong Kong would likely attract many RMB-based transactions and accounts and be in a good position to intermediate RMB-denominated trade. In these ways, it was argued, the principle of "one country, two systems" was proving its value to China and to foreign firms and financial institutions.

Not all participants were as sanguine about Hong Kong's role as a financial hub, however. One participant compared Hong Kong to a child caught in the middle of a troubled marriage, noting that trading volume had dropped precipitously across a range of markets and securities. Another concern for some participants was what they described as the rise of "double hubbing," in which financial institutions were building second business hubs for their Asia business in addition to Hong Kong, typically in Singapore and sometimes in Tokyo or other markets. They worried that this would further draw business away from Hong Kong.

Finally, a number of participants noted that several companies, including venture capital giant Sequoia Capital and pharma firm AstraZeneca had recently undergone internal reorganizations to formally separate their China business from their U.S. or global business. Some participants saw this as a hopeful sign that Western companies would find a way to stay involved in Chinese markets despite political tensions. Others disagreed. They argued that such reorganizations reflected an expectation that tensions would worsen; moreover, a number of participants expressed doubt that such internal reorganizations would actually protect companies from the prospect of trapped assets in the event of a serious schism.

Topic 2: Digital Assets: Innovation and Regulation

In Topic 2, participants discussed the present and future of digital assets and blockchain-based financial technology in Hong Kong, China, and the U.S., as well as globally. They considered potential benefits of blockchain and use-cases for digital assets. A major focus of discussion was how regulation should be configured to balance innovation, efficiency, and investor protection.

Blockchain Technology in Finance

Participants considered several different aspects of blockchain technology and digital assets. There was particular interest in the use of blockchain technology for facilitating financial transactions. In addition, participants discussed at length the potential proliferation of digital assets such as central bank digital currency (CBDC), privately-issued crypto assets, stablecoins, and tokens, as well as the role of regulators in overseeing growing use of digital assets.

A number of participants felt that blockchain technology presented an important alternative rail for financial transactions and communication, offering several major advantages. Perhaps most important, blockchain technology could provide a comprehensive and verifiable record of all trades in a particular asset. This could increase visibility to regulators and financial institutions. Importantly, blockchain trading could enable either verification of identity of an asset owner or just verify that the asset is owned by the entity that is selling or offering it for collateral without providing the legal identity. Thus, it could enable either identification or anonymity, depending on the type of transaction and the preferences of the parties. Blockchain could also reduce settlement risk and the need for escrow by allowing assets to change hands simultaneously in one operation. This would also allow for faster transaction speed, even though blockchains might not operate as quickly as current systems, because it would eliminate the need for additional steps of verification and transfer of value. For these reasons, blockchain was also seen to have the potential to reduce costs for financial transactions.

While blockchain was not yet widely used in finance other than in the trading of crypto assets, participants noted a wide variety of potential uses. Moreover, a variety of financial institutions, fintechs, and digital marketplaces were already making use of blockchain in pilot projects. Much of the activity to date was seen in the form of permissioned blockchains rather than distributed blockchains. With regard to trading, as well, traditional financial institutions were focused on intermediated trading rather than fully decentralized finance (DeFi). Already, blockchains were proving useful in trade finance and supply chain management, by enabling verification of the origin and authenticity of products or components, as well as tracking their progress through the supply chain (including conditions of transit such as temperature and vibration). For financial institutions, payments and custodianship were seen as particularly attractive functions in which to use blockchain. Current payment systems were seen by a number of participants as unnecessarily cumbersome and multilayered, which in principle could be simplified with blockchain. Custodianship was also seen as a natural fit for blockchain, as it could provide verification with a high degree of certainty at low cost.

As participants noted, a variety of traditional financial institutions were experimenting with the use of permissioned blockchains. However, some participants cautioned that there was still much

to be learned about how blockchain would work in practice on a large scale. They also noted that additional experimentation would be needed to assure regulators about blockchain's potential impacts on investor protection and financial stability.

Digital Assets

While participants agreed that blockchain technology had the potential to improve the speed and efficiency of financial transactions and custodianship in the traditional financial sector, there was more disagreement about the benefits and costs of digital assets. The mix of potential costs and benefits was also seen to vary depending on the type of digital asset in question, with discussion ranging across CBDC to stablecoins, crypto assets, and tokenized assets.

Participants noted that China was moving ahead in experimenting with CBDC, having first introduced a digital yuan in some cities in 2020 and gradually expanded its geographical scope. The digital yuan was increasingly widely used for payments in electronic commerce sites as well as some in-person transactions such as public transportation on the retail level, as well as in a variety of business-to-business transactions. Pilot projects had also begun to allow for cross-border transactions by banks in China, Hong Kong, and some other countries. Benefits of retail CBDC could include financial inclusion for currently unbanked individuals in addition to ensuring the security of transactions.

In contrast, the Federal Reserve had been cautious in its approach to CBDC; while research and discussion were underway at the Federal Reserve Bank of Boston, no pilot projects had been undertaken. Fed discussions had focused on wholesale rather than retail uses of a possible digital dollar, due to concerns about disintermediation and harm to the banking system. Given the essential global role of the dollar, the Fed had decided to carry out exhaustive research and testing to ensure that a digital dollar would not endanger domestic and global payments, financial institutions, and financial stability. Thus, participants agreed that it would be at least several years before a digital dollar could be issued. CBDC was also a matter of considerable political contention in the U.S. While Congressional supporters had introduced legislation to mandate the development of a digital dollar in the name of technological innovation and financial inclusion, other legislators had introduced legislation to prevent the introduction of a digital dollar. Congressional opposition to the digital dollar focused on privacy issues raised by its traceability by government authorities and its possible use as a tool of surveillance of citizens.

There was also considerable discussion about the potential role of CBDC, and the digital yuan in particular, in enabling de-dollarization. Several participants made the case that a number of countries, including China as well as some its major trading partners in Southeast Asian and the Middle East, were increasingly dissatisfied with their reliance on the dollar for cross-border trade and financial transactions—as evidenced, for example, in Saudi Arabia's recent agreement to accept RMB for oil. The expanded use of financial sanctions as an instrument of national security by the U.S. compounded existing concerns about the dollar-based global system. These participants argued that the digital yuan could allow economies to transact more directly with China without having to touch the U.S. financial system, where they could be subject to U.S. regulations and sanctions.

Participants noted various use-cases for private-sector digital assets. Stablecoins were seen as potentially particularly important, not only for providing a bridge between the worlds of crypto and traditional finance but also as a potential means of improving efficiency and lowering costs for private payments and cross-border remittances. Some participants saw stablecoins as a way of improving digital financial inclusion, allowing unbanked people to store and transfer value safely and inexpensively. There was some skepticism about the potential of stablecoins, however. In particular, there were concerns over whether stablecoins could in fact maintain a stable value against their target currency, as well as what would be the financial stability impact if a widely-used stablecoin was unable to do so. While some participants saw stablecoins as essentially underregulated money market funds, others pointed to examples of stablecoins such as Circle's USDC that were fully backed with liquid assets as models for how stablecoins could credibly maintain their value. An additional question was whether privately-issued stablecoins would be useful or attractive in economies where retail CBDC was available—it was argued by some participants that retail CBDC would be both more reliable and cheaper, and thus could crowd privately-issued stablecoins out of the market.

A third category for discussion was crypto assets, whose values fluctuated according to supply and demand conditions and many of which were designed to be held by individuals in electronic wallets and traded either through decentralized finance or exchanges. Ownership and transactions of these assets are established cryptographically. In the case of Bitcoin, the largest crypto asset by market capitalization, the process of verification was via "proof of work," which requires significant use of electricity and therefore had been criticized as contributing to global warming. While proof of work remained common, other crypto assets such as Ethereum had switched to "proof of stake," which required over 99% less energy consumption. While "proof of stake" appeared to provide an effective solution to the problem of energy usage, participants remained divided over the value and usefulness of pure crypto assets. Some argued that they were a legitimate, albeit volatile, financial asset that investors could benefit from having in their portfolios. They noted that crypto assets had developed a track record and several had been seen to hold value over time. Others were skeptical that such assets provided value, insofar as, unlike securities or money, they were not based on real assets or obligations. While their anonymity could make them helpful for facilitating illegal transactions or hiding assets, these participants argued that they were illiquid, easily manipulated, and poor stores of values, all of which made them inappropriate for investors.

The final category discussed was tokenized assets. A number of participants argued that tokenization could facilitate investments and make transactions more efficient. Tokenization of financial assets like stocks and bonds could allow for 24-hour trading and lower costs via either disintermediation or more efficient intermediated trading on permissioned blockchains. Some argued that the biggest benefit of tokenization would be in allowing frictionless trading of assets that were currently illiquid or difficult to trade. One example offered was the possibility of using tokenized Treasuries as collateral for intraday repo—by allowing instantaneous changes of control over the asset, this could lower risks of lending and costs of borrowing. It was also pointed out that tokenization would also allow for fractionalization, potentially increasing small-lot trading. Some participants further argued that tokenization of illiquid assets like art or commercial real estate could further expand opportunities for retail investors. Others disagreed, questioning how price determination would work and whether a liquid market in tokens based on

illiquid assets was actually possible. Others wondered if tokenization of a commercial real estate portfolio would be essentially a reinvention of a closed-end REIT with a different name, and whether it was worth creating a whole new legal infrastructure to recreate an investment option that already existed.

Regulation of Digital Assets

Although Bitcoin and some other digital assets had initially been heralded as an alternative to fiat money that would allow users freedom from financial institutions and government oversight, regulators around the world were increasingly extending their reach into the realm of digital assets. Concerns about investor protection, fraud, and market stability had been driven by a series of failures of crypto assets and exchanges, ranging from Mount Gox in 2014 to Terra/Luna and FTX in 2022. A variety of jurisdictions had already implemented comprehensive regulatory regimes for digital assets and exchanges, including Japan, the EU, Singapore, and Hong Kong.

Participants discussed principles for how best to regulate digital assets. They focused particularly on investor protection, market integrity, financial stability, and prevention of criminal activities such as tax evasion, money laundering, and terrorist financing. Participants cautioned that regulation of digital assets should not stifle innovation, especially where technological innovation could improve efficiency or performance in trading, payments, settlement, custodianship, and allocation of credit as opposed to creating meme coins, evading taxes, or increasing risk to investors and the financial system. There appeared be a strong consensus on the notion of technological neutrality as a basic principle for regulation of digital assets—or as the Financial Stability Board had put it, "same activity, same risk, same regulation."

Despite these common principles, different jurisdictions had implemented radically different regulatory approaches to digital assets. Mainland China, which had once been the largest market for Bitcoin, had famously banned all crypto assets in 2021 over concerns about criminal activity, monetary sovereignty, and investor protection. At the same time, participants observed that it had been somewhat more open to other forms of innovation in blockchain and digital assets. As noted, China had become a global leader in CBDC. Moreover, Chinese electronic commerce sites were experimenting with blockchain as a way of improving supply chain management, using tokenization to reduce risks of lending to vendors, and allowing regional government's consumption vouchers to be used as payments. Innovation remained restricted, however, as the Chinese government remained wary of introducing new forms of digital payment. At the same time, a number of participants made the point that many Chinese investors were still interested in crypto assets, even though they could no longer invest in them from home. As a result, some were using accounts in other jurisdictions such as Singapore to invest in crypto assets.

While China was leery of digital assets, participants saw the U.S. as a laggard among advanced financial systems. They described U.S. regulation of crypto assets and exchanges as a complicated and incomplete web based on sometimes contradictory interpretations of existing financial laws. Crucially, no legislation had been passed that explicitly regulated or even provided legal definitions of digital assets. One reason for this was basic political disagreements on how to categorize crypto assets and the benefits and costs of innovation and regulation. Some legislators wanted minimal regulation because they believed that crypto assets were a valuable

financial innovation and that regulation would squash their development. Others considered crypto assets to be rife with fraud and abuse of investors and called for highly restrictive rules. While these camps did not divide simply along party lines, polarization within Congress further complicated the task of moving through regulation, even on issues on which there was a fair amount of bipartisan consensus, like prudential regulation of stablecoins.

With no legislative mandate, market regulators had been left to come up with their own interpretations of how digital assets and exchanges fit into existing law, and then seek to enforce those rules subject to oversight by the courts. This "regulation by enforcement" was seen by participants to be exacerbated by the country's divided regulatory system—not only did the SEC and CFTC have differing interpretations of how to categorize crypto assets and exchanges, but payments systems were regulated at the state level, leading to a hodge-podge of rules and expectations. Court rulings on particular enforcement decisions had further confused matters for many participants. Moreover, even if the regulatory agencies had identical views on how best to define and regulate digital assets, the lack of legislation had left regulatory gaps in which exchanges and coin issuers could operate freely. The lack of a clear regulatory regime, as well as ambiguity over whether some digital assets should be classified as securities, was seen as a problem by many participants, regardless of whether they were digital asset enthusiasts or skeptics. Regulatory ambiguity was seen as increasing risks for investors and keeping reputable financial institutions from committing to the markets. There were also concerns for financial stability—for example, it was noted that there were no capital requirements or a special resolution mechanism for crypto exchanges, meaning that investors with accounts at a failed exchange could lose access to their assets indefinitely while bankruptcy proceedings grinded on, as seen with FTX.

Finally, participants saw Hong Kong as a leader in regulating digital assets, along with Japan, the EU, and Singapore. As of the summer, the Hong Kong Securities and Exchange Commission had introduced a mandatory licensing system for digital asset trading platforms that required them to meet the same standards as brokers and exchanges, including market integrity, segregation of assets, custody, anti-money laundering regulations, etc. It had also authorized ETFs based on virtual asset futures (but not virtual assets themselves) and was enforcing conduct rules for asset managers and brokers advising and dealing in digital assets. Many participants considered Hong Kong's approach to be an appropriate balancing of investor protection, market integrity, and allowance of innovation by financial institutions and exchanges. While Hong Kong was not seeking to be a magnet for crypto, regulators had recognized that Hong Kong investors were interested in virtual assets and had therefore decided to create a well-regulated market to protect them from fraud and mismanagement. Perhaps ironically, this had made the territory an attractive place for a number of fintechs and exchanges to set up operations, and a number of participants argued that Hong Kong had the opportunity to become one of the world's leading markets in digital assets. They noted several key advantages, including high quality technological infrastructure and expertise, access to capital, regulatory capability, and regional connectivity. Perhaps most important, they argued that Hong Kong was a natural destination for the many Chinese investors who were still interested in digital assets but could not access them on the Mainland.

Discussions on digital assets and blockchain also highlighted several questions that remained unanswered. A central question for participants was how these financial innovations would affect macroeconomic variables and financial stability. One issue was whether central banks would still be able to effectively manage monetary policy if increases in the use of digital assets led to disintermediation from fiat currencies or enabled capital flight. As with other forms of unregulated or lightly regulated finance such as "shadow banking," there were also questions about how to prevent failures or runs in the digital finance world from spreading into the banking system and traditional financial markets. While crises in the crypto world, such as the failure of FTX, had so far had few reverberations into the broader financial system, some participants worried that contagion would become a larger problem as digital finance grew in size and in interconnectedness with banks and financial markets. The difficulty of monitoring and gauging risks in digital assets compounded this problem, perhaps especially in the U.S., where large regulatory gaps remained. Moreover, the non-territorial nature of some crypto exchanges and especially of DeFi would inevitably complicate the task of investor protection. And, unlike in traditional banking and finance, where centuries of experience provided lessons and principles for regulating safety and soundness, there were questions about how to apply those lessons to fintechs in the digital finance space. To address these open questions, participants urged regulators to cooperate with their counterparts in other jurisdictions—in a potentially borderless industry, it was argued, a common regulatory approach would be essential. While the work of regulators in first-mover jurisdictions like Japan, the EU, Singapore, and Hong Kong, as well as at the FSB and IOSCO, was seen as providing the basis of a common approach, many participants worried that competitive pressures to lure digital finance could lead to regulatory arbitrage that would make markets less safe. There was also considerable frustration with the fragmented approach taken by the U.S., and participants expressed the wish that the U.S. would also move toward a consistent regulatory system for digital finance.

Topic 3: Financial Crises: Have We Learned from History?

In Topic 3, participants discussed how China, the U.S., and the world had learned from financial crises. They noted the role of crises as catalysts for large-scale regulatory and economic policy changes and reflected on whether those changes had made the financial sector more stable and resilient.

Lessons of Financial Crises

Participants agreed that financial crises had repeatedly played a formative role in the development of financial regulation and the behavior of financial institution. In the U.S., major regulatory changes had nearly always been associated with the lessons of a crisis or large-scale failure of financial regulation, with the creation of the Securities and Exchange Commission (SEC) as a reaction to the Great Depression, the Sarbanes-Oxley reform of corporate auditing as a reaction to the failures of Enron and WorldCom, and the Dodd-Frank Act as a reaction to the Global Financial Crisis of 2008.

The Global Financial Crisis had been particularly notable not only in the U.S., but around the world. International cooperation in its aftermath had led to the creation of global standards across banking and a variety of financial markets, as well as the establishment of the G20 and Financial Stability Board. In the years since, regulators around the world had implemented the G20 financial regulatory agenda, including rules on bank capital and liquidity, central clearing of derivatives, and other reforms. These reforms had made major financial institutions safer and more resolvable and had given authorities essential tools to monitor financial institutions and markets and to deal with financial institution failures. However, participants cautioned that authorities must continue to keep an eye out for systemic risk. This was seen as all the more important as financial technology had increased the speed of bank runs and transmission of risks and losses.

One question raised by participants was how to distinguish financial crises from market corrections. While market corrections could be quite large and lead to significant losses for investors, it was argued that they only became crises when the damage extended beyond the immediate participants (and especially when it extended into the real economy), and resolution could not be managed without extraordinary measures by the government or central bank. Participants noted a variety of significant corrections or financial institution failures that had raised fears of a broader crisis but had actually had only localized effects, including the burst of the U.S. dot.com bubble, the nearly 50% drop in the Shanghai Composite Index in 2015, and failures like Archegos. The 2023 failures of Credit Suisse and U.S. regional banks including Silicon Valley Bank, as well as the 2022 Gilt crisis in the UK, were seen as more ambiguous—while quickly contained, they had required active intervention by authorities.

Both crises and corrections were seen as important stress tests for the financial system. The Global Financial Crisis had led to long-term, structural changes in the ways in which financial markets and institutions operated. Looking back over various corrections and financial institution failures that had occurred in the ensuing years, it was argued that some of the major post-crisis

reforms, including increased bank capital, resolution planning and stress tests, central clearing of OTC derivatives, and changes to margining rules had made the system less brittle. Also, it was argued that lender of last resort facilities must be timely and credible. For example, the sheer size of the Fed backstop during the March 2020 liquidity freeze had provided the assurance that market participants could resume active trading. Some participants also argued that one lesson of crises and corrections was that restrictions on market functions, such as short-sale bans and price controls, were problematic, as they could lead to liquidity freezes and price distortions.

China and the Lessons of Financial Crises

Looking back to the early days of the Symposium and of China's financial liberalization, several participants noted that China had drawn important lessons from the Asian Financial Crisis in 1997-98. At the macro level, the crisis taught Chinese authorities about the dangers of unrestrained capital flows. Over time, China had significantly liberalized capital flows, but had done so in a careful, sequenced manner and continued to maintain significant regulation surrounding portfolio investment. At the micro level, big banks had been pushed to clean up their balance sheets before going public, and had mostly kept them healthy since.

Participants noted that these lessons had served China well in the Global Financial Crisis, as Chinese banks had been well-capitalized and exchange controls ensured that the RMB remained stable. However, that crisis raised new concerns. It was argued that some investors and financial institutions had faced troubles by having purchased assets that they did not really understand, including banks purchasing collateralized debt obligation. This taught the lessons of the importance of investor education and protection, as well as improving due diligence and compliance.

In the years since the Global Financial Crisis, it was argued that banks had done a good job of responding to new regulations and accounting standards and that stress tests had significantly improved resilience and planning. However, a number of participants noted that one reason that big Chinese banks had been relatively unscathed was that they were risk-averse, which came at the expense of higher returns and of needed capital provision to the private sector and SMEs. Major banks' lending skewed toward SOEs and the vast majority of bank lending to households was in the form of mortgage debt. Second-tier banks were seen as less risk-averse, perhaps because of their greater dependence on private capital. Some participants also argued that one beneficial effect of the Global Financial Crisis was that Chinese financial institutions had learned not to invest in assets that they did not understand. For example, while CDOs had been a small part of banks' assets, the experience of losing money on them had made them banks more rigorous about due diligence and risk management surrounding their holdings.

Looking forward, real estate markets were seen as the most likely issue to trigger a major correction in Chinese finance. Some participants cautioned about the potential dangers of insufficient attention to risk management relating to real estate. They called for measures to improve banks' understanding of their own and of their clients' off-balance sheet risks and liabilities. A number of participants also expressed concern about non-bank lending to the sector, which they saw as likely to be much riskier than bank lending. It was noted that real estate had come to comprise an unusually large portion of Chinese economic activity—one participant

estimated, together with construction supply chains, real estate accounted for 25-30% of total GDP (compared to roughly 20% in the U.S. when the subprime crisis hit in 2008). A number of participants expressed concern about the potential impact on the Chinese economy of the weakening real estate sector and overextended developers that had not escrowed purchasers' payments. However, it was also noted that, in spite of widely publicized failures in real estate markets including the 2021 failure of Evergrande, there had as yet been no major contagion to the financial sector. Participants attributed this financial stability to two factors. First, the strong capital position of Chinese banks had kept them healthy. Second, since mortgage down payments averaged 50-60%, some suggested that housing was unlikely to trigger a crisis.

Unlearned Lessons?

The fact that post-Global Financial Crises market corrections and financial institution failures had so far been containable using existing tools and authorities was seen by many participants as evidence that regulators had learned the right lessons from that crisis. However, some participants also expressed concerns about unlearned lessons or unforeseen consequences of regulatory reforms.

Several noted that one of the long-term effects of crisis-era mergers, large-scale capital raising, and increased compliance costs was the expanding scale of many global financial institutions, including banks and clearinghouses. They expressed concern about the rise of "too big to fail" and concentration of risk despite the efforts made by governments to reduce those risks after the global crisis. In fact, interventions by authorities in response to the 2023 bank failures had further exacerbated the size problem—most notably in the UBS takeover of Credit Suisse, but also in the acquisition of First Republic by JP Morgan Chase.

Some participants argued that regulators and supervisors had yet to wring moral hazard out of their financial systems, although one can question whether this could ever be fully achieved. In the case of SVB, for example, some expressed skepticism of the appropriateness of bailing out uninsured depositors. Similarly, some argued that Chinese investors and lenders, including in some of the troubled real estate firms, had anticipated that they would be bailed out by the government if anything went wrong, and therefore took on excessive risk. Indeed, it was argued that the central government would have to provide support to ensure that paid-up units were completed in order to protect homebuyers. However, this too could create problems of moral hazard if it had the effect of bailing out builders or lenders instead of households.

Another lesson of SVB for several participants was that stress testing had misunderstood or neglected to model some of the risks of rising interest rates. They expressed concern that continued high interest rates in the U.S. and Europe would lead to further bank failures both in those jurisdictions and in emerging markets where dollar dependence was high.

Finally, looking forward, some concerns were expressed regarding the structure of the U.S. Treasuries market. Despite its reputation as the most liquid debt market in the world, it was argued that immediate action was needed to ensure long-term resilience and liquidity in that market. It was noted that outstanding Treasuries, which currently totaled around $26 trillion,

would likely reach over $40 trillion by 2032, even as the number of primary dealers had stagnated.

Topic 4: Global Financial Regulatory Framework and the U.S. and Chinese Approaches

In Topic 4, participants discussed the U.S. and Chinese approaches to financial regulation, as well as the effects of those regulations on financial institutions seeking to do business in their respective countries. While some of the discussion addressed the ways in which the two countries were implementing the aspects of the post-Global Financial Crisis G20 regulatory reforms, there was also considerable discussion of new developments in the two economies.

U.S. Financial Regulation

Participants discussed various aspects of U.S. financial regulation, including its underlying principles and recent regulatory actions. With the largest financial markets in the world, it was seen as essential that the regulatory system support not only innovation and competition, but also market integrity, financial stability, and investor protection.

A particular strength of the U.S. financial regulatory system was seen by a number of participants to be its emphasis on legal clarity and transparency on the part of all players, including financial institutions and regulators. Notably, rulemaking was subject to the Administrative Procedures Act, which requires public notice and public comment, as well as court review to ensure that rules are not arbitrary and that they lie within the legal authorities of the regulators. Rule of law was described as essential: financial regulators and supervisors were required to operate according to law and rulemakings in a way that is fair and consistent. The ability of financial institutions to appeal to courts and the willingness of courts to overrule decisions and rules seen as arbitrary or unlawful provided further assurances to financial institutions that they would not be punished unfairly, while the strict implementation of rules provided reassurance that other financial institutions were also behaving in predictable ways.

Transparency was a key requirement for financial institutions and listed companies as well, via the requirement to disclose accurate and timely information to markets. Several participants emphasized that disclosure was essential to ensuring market integrity and investor protection. Like rules against insider trading and market manipulation, disclosure rules would allow investors to make their own judgments and investment choices.

Finally, regulators were expected to act at arm’s length rather than intervening behind the scenes to affect business and investment choices. All financial institutions, whether domestic or foreign, were expected to follow a common set of rules and regulators and supervisors were not supposed to treat foreign institutions differently from domestic ones.

Although U.S. market regulators were seen as following these common principles, participants noted that the fragmented nature of the regulatory system meant that differing priorities of regulatory leaders could lead to differing outcomes. This was often seen in different regulatory approaches between the CFTC and SEC, and many participants agreed that such divergence was particularly evident in recent years.

The CFTC was generally seen by many participants as less interventionist and more focused on supporting market forces than the SEC. In recent years, moreover, many participants argued that the SEC had been far more aggressive in expanding its regulation of financial institutions and markets, rather than strictly following the principles of consultation and cost-benefit analysis.

This aggressiveness was surprising to a number of participants. They felt that U.S. financial markets had performed outstandingly in the face of major strains due to the COVID-19 pandemic and its dislocations, as well as shocks elsewhere in the financial system, including various crypto asset and exchange failures in 2022 and the failure of SVB and other large regional banks in 2023. In other words, they argued, the G20 reforms had been remarkably successful at ensuring financial stability, just as they had been designed to do. Moreover, competition and innovation had brought fees down to historically low levels while market liquidity had remained robust. Nonetheless, they observed that the SEC was introducing nearly unprecedented levels of new and proposed regulation, of a level not seen since the passage of Dodd-Frank. One participant described this paradoxical situation as “rules looking for problems.”

Participants described many of the rule changes as having major impact on the behavior of financial markets and institutions. With unusually short periods for public comment and rapid turnarounds, there were concerns that financial institutions and experts would be unable to adequately understand the changes and calculate costs and benefits of each individual reform. Moreover, with so many major rule changes at once, participants considered it impossible to predict the cumulative effects and unintended consequences, especially as some reforms would likely contradict each other or work at cross-purposes.

Several participants predicted that the barrage of new and expanded regulation would be challenged in court, on the basis that it was not fully complying with the Administrative Procedures Act or carrying out adequate cost-benefit analyses. If so, at least some of the rules would likely be tied up in court for several years or might need to be scaled back.

Similar concerns about overreach were raised concerning U.S. banking regulation. Several participants characterized bank regulators as having been very aggressive, including most significantly in the July 2023 proposal regarding U.S. implementation of Basel III/IV. They pointed out that this proposal would effectively raise capital requirements for the biggest U.S. banks by 20% beyond Basel requirements, substantially raising their costs. With no other global regulators gold-plating their capital requirements to the same extent, it was argued that major U.S. banks would lose competitiveness relative to international rivals.

Crypto assets were another contested space in U.S. regulation. With no legislative action to create a regulatory framework for digital assets and exchanges, the SEC and CFTC were left to make use of existing laws to protect investors. Here too, the approach was seen as different. The SEC had taken several enforcement actions, including one against Binance for offering unregistered securities to U.S. investors and against Coinbase for acting as an unregistered exchange. The cases were filed despite underlying legal ambiguities about whether the crypto assets in question were actually securities or whether crypto exchanges were actually securities exchanges or brokers under existing law. The SEC’s willingness to pursue the cases nonetheless was seen by participants as reflecting a growing sense of urgency following major failures like Terra/Luna and FTX that had severely harmed investors. Nonetheless, the SEC had not acted to

force crypto exchanges to register in a workable framework, leaving the system exposed to other FTX type frauds or failures.

In contrast, the CFTC had adopted a somewhat more legally cautious approach, focusing on the powers it had clearly been granted by law. For example, it had clear statutory authority to regulate all derivative products and markets. The CFTC also had the authority to pursue cases fraud and manipulation, and had pursued over 70 cases, including against major players like FTX and Binance.

Current Trends in Chinese Financial Regulation

Turning to Chinese financial regulation, participants agreed that capital markets had continued moving steadily in the directions of internationalization, liberalization, and rule of law. Indeed, some felt that the reform agenda had accelerated, despite the challenges of the COVID-19 pandemic and U.S.-China tensions.

Several reforms were cited as important steps toward liberalization. One major example was that the securities listing system had shifted to registration system. Starting with pilot programs in Shenzhen and Shanghai, the reform extended to all Chinese exchanges as of fall 2023. Major changes to the securities law in 2019 and the 2022 introduction of a new futures and derivatives law were also increasing the legal clarity and regulatory predictability for financial institutions. In 2023, the CSRC also updated regulations for overseas listings and for private equity funds. Importantly, regulators had begun to adopt public consultation before changing rules, increasing regulatory transparency and accountability.

For China, capital market liberalization had been accompanied by internationalization. Participants noted the 2020 elimination of ownership restrictions for foreign securities firms and the success of Citi in obtaining a custodian license as evidence of a significantly improved environment for foreigners doing business in China. At the same time, the Stock Connects were seen as providing increased access for investors located outside the country, as had the creation of cross-border ETFs.

International cooperation had also been an important element of both liberalization and internationalization of Chinese markets. Chinese regulators were active in international forums including IOSCO, as well as in working with regulators in other jurisdictions. It was noted that CSRC had concluded 67 MOUs with regulatory counterparts and had cooperated extensively with U.S. regulators including the SEC and CFTC to learn about best practices and develop rules that were attractive to foreign financial institutions and investors as well as appropriate to Chinese markets.

Several participants cited the PCAOB-CSRC agreement as a good example of cooperating, even though media had portrayed it as being negotiated under duress due to the pressures imposed by the Holding Foreign Companies Accountable Act. The agreement was seen as improving the quality of auditing in China, and therefore improving the quality of information available to investors. The agreement was made possible due to common interests, rather than just U.S. pressure.

Areas for Further Cooperation

Looking ahead, participants urged regulators to improve cooperation in several areas. In particular, several participants made the case that there were significant opportunities for China-U.S. cooperation in developing climate finance and ESG markets. Given their size and their leading roles both economically and in terms of carbon emissions, it was argued that the two countries had a special responsibility to work with other regional regulators to make sure that these markets worked for Asia.

Climate finance was presented as an enormous need, as countries sought to meet ambitious net-zero targets. Asia alone was estimated to require over $60 trillion in investment over the next 30 years to achieve the needed energy transition, but economies varied enormously in terms of their levels of development and ability to generate the funds needed. Moreover, in order for emerging economies to experience continued economic development and for energy transitions to be politically sustainable, it was argued that ESG frameworks would need to be designed to ensure reliability of energy supply and affordability in addition to reducing greenhouse gas emissions reductions.

It was noted that rules on taxonomies varied enormously, creating pressure for harmonization. Participants noted that at least 20 jurisdictions had designed classification systems for their home markets, but these were as yet not well aligned. Carbon trading was also seen as a potentially useful tool for accumulating the funds needed for energy transition, but there too, rules were highly fragmented. For financial institutions to be able to comply with regulations and the preferences of investors, they would need to have clear measures for how to classify green assets. Progress toward common standards of disclosure, such as the establishment of the International Sustainability Standards Board, was seen as a positive sign, but the persistent variety of taxonomies, rules on stress testing, and standards of measurement would necessitate further international cooperation.

Delivering sufficient and appropriate climate finance to Asia was seen to be a significant challenge. Regulatory fragmentation and differing levels of development were seen to create one set of problems. Another was that many investors were from outside the region, where home-country ESG rules could collide with developmental realities in emerging Asian economies. For example, EU investors had strict rules on ESG and climate investments that did not always take into account the need for transitional investments (e.g., natural gas-fired electrical power generation), so international cooperation in defining appropriate transition thresholds and sunset dates would be essential. Blended finance in the form of public-private partnerships involving both bilateral funders and multilateral development banks would likely be essential as well, but this would require some flexibility from the multilateral banks. China and the U.S. could take an important leadership role in assuring sufficient climate finance for the region in both these respects.

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