China issues new rules targeting wealth management fund pools - sources

China's bond market regulator closed off a loophole on Friday that allowed banks that sell high-yielding wealth management products (WMPs) to evade regulatory requirements by moving money between the WMP accounts they manage and their own proprietary accounts, bond traders at four Chinese banks told reporters.

The four traders, who spoke on condition of anonymity because they are not authorised to speak to media, told reporters that the China Government Securities Depository Trust & Clearing Co Ltd (CDC) and the Shanghai Clearing House had jointly notified commercial banks they could no longer trade bonds between their own proprietary accounts and the WMPs they manage for clients.

The rules will go into effect Friday afternoon, the sources said.

"Yesterday we could do it, today everybody has to undo it; it's new regulation after new regulation," said one of the traders.

The CDC did not answer calls from reporters requesting comment.

The traders said the new rule would prevent a common practice in which banks shift bonds back and forth between their own balance sheets and the WMP accounts they manage for clients, allowing them to deliver promised payouts to WMP investors, even if the underlying bonds have not yet matured or have declined in value.

Such transactions have also enabled banks to temporarily shift WMP funds back onto bank balance sheets at quarter-end, as a way to window dress their financial statements by boosting the customer deposits they report.

In other cases, a bank may use its own account to purchase a bond in the primary market before it has completed fundraising for a WMP, then sell the bonds on to the WMP account later. That allows the banks to deliver higher yields to their WMP investors, since yields are typically higher in the primary market.

The **China Banking Regulatory Commission** (CBRC) announced a crackdown on fund pooling in January, and has been implementing new rules ever since.

Industry observers are concerned that the practice is akin to a Ponzi scheme because of the way such pools allow inflows from the sale of new products to deliver the promised returns on previously issued products.

The complex and interlocking nature of such pools, supporting a wide variety of different WMPs with different maturity periods, also exposes banks to significant liquidity risk, analysts have warned.

The rise of WMPs has been fuelled by Chinese depositors' hunger for yields above the central bank's benchmark deposit rate, currently set at 3.0 per cent for one year, and economists say Beijing has tolerated the explosive growth in the sector because WMPS can deliver higher yields to ordinary investors, serving as a backdoor way to liberalise interest rates and increase the propensity to consume.

Banks have been quick to issue WMPs to attract customers, and also sell third-party WMPs through their retail channels.

However, the collapse of several WMPs amidst fraud allegations, and the generally opaque nature of the products has attracted concern. State media has taken to warning investors that such products are not tacitly guaranteed by the government, but China has yet to experience a corporate bond default.

Standard & Poors estimated that WMPs offered by Chinese banks grew 56 per cent in 2012 to 7.12 trillion yuan ($1.16 trillion), equivalent to 7.6 per cent of the system's total deposits at the end of the year.

($1 = 6.1309 Chinese yuan)

(Economic Times)