Remarks by Assistant Secretary for International Finance Brent Neiman at the Program on International Financial Systems’ U.S.-China Symposium in Hong Kong

September 15, 2023

As Prepared for Delivery

Thank you to the organizers at the Program on International Financial Systems (PIFS), Harvard Law School, and the China Development Research Foundation for hosting this “Symposium on Building the Financial System of the 21st Century: An Agenda for China and the United States.” Prior to joining the U.S. Treasury, I enjoyed teaching here in Hong Kong as an economics professor. I always admired the intense curiosity and respect for academics and analytical rigor that I found in my students. Not to mention my taste for dim sum, a love that even made it into my professional bio.

This symposium comes at a difficult but fascinating time for the global financial system, which has been charged with channeling massive amounts of capital to support the public sectors’ pandemic responses, has been stressed by the rapid tightening of financial conditions worldwide, and has been confronted by substantial technological change and innovation. It also comes at an important time for U.S.-Chinese economic relations, the recent course of which was charted late last year, when President Biden and President Xi met in Bali and tasked their teams with following up on a range of important issues.

In July, I accompanied Secretary Yellen on her trip to Beijing, where she reiterated the three key elements in our economic approach to China. First, the United States seeks healthy economic competition with China where both countries play by the rules of fair competition, a system that can foster growth and innovation and bring benefits to both countries. Second, the United States and China have a duty both to our own countries and to the world to cooperate and show leadership on important global challenges. And third, the United States will pursue targeted actions that protect our national security interests and will oppose policies that do not reflect our values, such as the recent steps taken in Hong Kong that have weakened social and political freedoms. We will protect human rights, and we will clearly communicate to the PRC our concerns about its behavior.
Secretary Yellen and I agree that it would be disastrous for both our countries were our economies to fully separate or “decouple.” After all, our economies are connected through trade in goods and services between the United States and China, which exceeded $750 billion last year. When we take actions to protect our national security, such as targeted sanctions against specific PRC companies identified as having provided support for Russia’s invasion of Ukraine, these measures are narrowly tailored to achieve our national security objectives. They are not used to stifle China’s economic development or to provide a competitive advantage to U.S. companies.

Similarly, our economies are connected through trade in assets, or investments made by U.S. households and firms into China and Chinese investment in U.S. assets. Both the United States and China are woven into the global financial system, and China’s total stock of foreign direct investment (FDI) is second in the world only to the United States. Moreover, the stock of bilateral FDI is also substantial, with U.S. FDI in China standing at over $120 billion and China’s stock of direct investment into the United States totaling nearly $30 billion. Members of the S&P 500 generate almost 8 percent of their revenue in mainland China, the biggest international source by far and a larger share than the next three countries combined. And around 250 Chinese companies are listed on U.S. exchanges with a total market capitalization of over half a trillion dollars. After accounting for positions intermediated through third countries, Americans in 2020 owned more than $1 trillion in the bonds and common equity of Chinese firms.

There are some restrictions to cross-border financial activity between our two countries, but as with our trade-based national security tools, our investment-based tools are narrowly scoped and not designed to achieve competitive advantage or to stifle China’s financial development. China’s financial restrictions are more extensive, in part based on its capital controls on inflows and outflows and in part based on its own national security framework. China’s increasing data security measures and restrictions on cross-border information flows also pose growing challenges for our financial institutions operating or investing in China.

The recently announced U.S. outbound investment executive order is one example of our small yard, high fence approach to protecting national security technologies. Last month, the President signed an Executive Order, or E.O., to address the national security threat to the United States from certain countries of concern that are engaged in comprehensive, long-term strategies to acquire and develop sensitive technologies critical for military, intelligence,
surveillance, or cyber-enabled capabilities that threaten our national security. This policy action is designed to be narrow and address particular national security risks.

I want to emphasize that this program is not an attempt to financially decouple our economies or substantially change the investment climate between our two countries. And, I believe it was helpful that Secretary Yellen was able to deliver this same message, directly to her Chinese counterparts, during her trip to Beijing. She noted that China has for many years now had its own outbound investment regime, with relatively limited transparency, and she explained that any potential U.S. program would follow a highly transparent rule making process with a period in which comments could be submitted and considered. Being in a position to meet face-to-face, to clearly characterize the concerns underlying this action, but also to explain the careful steps taken to avoid unintended consequences, reduces the risk of misunderstanding. And whether we agree or disagree on a particular issue, reducing misunderstandings on new policy areas is in the interest of both countries.

The importance of having a channel to discuss each other's economic approach and sharing technical assessments of global trends extends to financial policy broadly, including to financial regulation and supervision and efforts to preserve financial stability. After all, the financial stability of the United States and China depends on much more than cross-border holdings of debt and equity securities. The essential interconnections in the global financial system can be subtle or indirect, and the financial centers in our two countries, including Hong Kong, where we are meeting now, are disproportionately large and central nodes.

Financial stability, and the conversations among policymakers that underlie it, is a global public good that brings important benefits for the United States, for China, and for the rest of the world. After the global financial crisis of 2008, the G20 – a group that includes both China and the United States – established the Financial Stability Board, or FSB. It did so in recognition that maintaining financial stability requires both high-level political support and broad-based technical collaboration to identify vulnerabilities that could travel from one corner of the financial system to another, and to take coordinated steps to address those vulnerabilities before they result in a broader crisis.

Countries should invest in a baseline level of working relationships with their international financial counterparts. When crises happen, everyone is better off if regulators and other policymakers already know their counterparts and have an expectation of where and how to engage. As a complement to multilateral efforts, I believe bilateral discussions between
officials responsible for financial stability, supervision, and regulation in the United States and China remain important, particularly given the size of our financial systems.

Take banking, for example. Hong Kong’s and China’s banking assets relative to their respective GDPs are among the highest globally. The United States has the second largest banking sector in the world by assets. Together, the United States and China account for over 40 percent of global banking assets. Of the 30 global systemically important banks, or G-SIBs, eight are headquartered in the United States and four are headquartered in China.

The recent stress at Credit Suisse, and its subsequent acquisition by UBS, should remind us of the critical importance of global coordination for the regulation and supervision of G-SIBs, in both going-concern and gone-concern settings. It is important for official sector authorities to discuss and refine recovery and resolution regimes, which are a pillar of post-2008 policy reforms and reflect a complex mix of legal, regulatory, and financial measures to minimize disruption to the financial system. The United States has held regular engagements with the United Kingdom and the European Union on identifying challenges with the resolution of a cross-border G-SIB for over a decade, and the knowledge-sharing that occurs not only improved our readiness for cross-border resolution but also improved our domestic capacity for large-bank resolution. Treasury is considering broadening these types of exchanges in order to include many more countries that are the home or host authority of G-SIBs, including Japan, Canada, and Switzerland. If we do in fact stand up something of this nature, China’s participation would be valuable to all participants, including China itself.

Earlier this year, the United States also experienced the failure of several regional banks. We took decisive and necessary actions to shore up public confidence in the banking system. Following these failures, the Federal Reserve Board and FDIC conducted self-assessments of their oversight of certain failed banks, which will help inform ways to improve our domestic bank regulation and supervision framework. Further, work continues at the international level to better understand the international dimension of the recent bank failures. We do not view this ongoing work, which is crucial to addressing specific issues, as calling into question the banking and resolution framework that was put into place following the global financial crisis. Indeed, these frameworks may well have prevented recent incidents from leading to broader stresses in the banking system.

Meanwhile, Chinese authorities are considering substantive changes to their domestic banking framework. Last year, China published a draft of a new Financial Stability Law which is, in our understanding, the first law in China intended to formalize a process for the
resolution of systemic risks at financial institutions, rather than dealing with these incidents on a case-by-case basis. With both of our jurisdictions considering changes to domestic banking supervision and regulation in the pursuit of domestic financial stability, it would be mutually beneficial to share information on our evolving frameworks.

Also consider non-bank financial institutions, or NBFI, which form critical parts of both the U.S. and Chinese economies. NBFI includes segments of the financial system including money market funds, insurance companies, hedge funds, private equity, and venture capital. It tends to be one of the most innovative parts of countries’ domestic financial sectors, but also tends to be an area where concentrated risk accumulates. Relative to banking, which has generally received more supervisory and regulatory attention over a longer period of time, the comparative complexity, opacity, and lack of data on NBFI makes oversight more difficult.

Addressing vulnerabilities in NBFI has been a priority in recent years, and the U.S. Treasury is committed to the FSB’s ambitious workplan to enhance the resilience of the sector. For example, in November 2022, the U.S. Securities and Exchange Commission published proposed amendments to its current rules for open-end funds focused on addressing liquidity risk. And in July the SEC published its final money market funds rule, which will strengthen liquidity and reporting requirements. Treasury and the Financial Stability Oversight Council, chaired by Secretary Yellen, is also prioritizing addressing risks to U.S. financial stability posed by hedge funds. The Council has reestablished its Hedge Fund Working Group, which has developed an interagency risk-monitoring framework to assess hedge fund-related risks to U.S. financial stability. Though total global hedge fund assets are only around $7 trillion, some hedge funds pursue highly leveraged strategies that can pose a significant financial stability risk.

Chinese hedge fund assets have been growing quickly, now accounting for close to 15 percent of all global hedge fund assets according to the latest available statistics. In addition to being able to share best practices developed for our own domestic oversight of the hedge fund space, we could both benefit from a better understanding of each other’s approaches on NBFI, in part, because NBFI is another source of substantial, but difficult to trace economic interlinkages that have historically led to financial stability risks. Take, for example, the recent reduction by Chinese authorities in the minimum margin financing requirement ratio for securities investors from 100 percent to 80 percent. On the one hand, alongside the recent growth in domestic hedge fund assets, this could represent a new domestic vulnerability. On the other hand, a 100 percent minimum margin financing requirement for all equity securities is far higher than in most other countries, including what is generally required by U.S.
regulators. U.S. financial regulators would benefit from a better understanding of the intent of the policy shift, and given substantial experience working with lower margin requirements, can lend expertise to Chinese regulators as they update their risk modeling to account for the likely increase in financial leverage.

Both banks and non-bank financial institutions carry key exposures to real estate, an asset class commonly identified as posing among the most salient risks to current global financial stability. We are closely monitoring vulnerabilities in the U.S. commercial real estate (CRE) market. These pressures are elevated due in part to the after-effects of the Covid-19 pandemic—which has particularly reduced the demand for office properties. CRE analysts forecast substantial price declines for office space in the coming years, and according to some private data providers, we have already seen a double-digit decline in broader CRE prices. Banks hold an estimated 40 percent of the aggregate $4.5 trillion of CRE loans outstanding in the United States, with exposures concentrated in small and midsize banks.

The Chinese banking and non-bank system also have considerable exposures to real estate, with more than a quarter of total bank loans tied to the property sector and approximately 5 percent of the trust sector’s $3 trillion in assets directly linked to real estate. This year’s continued slowdown in Chinese property sales, combined with Chinese property developers’ high leverage, have strained some developers’ ability to repay their debts, with possible financial spillovers. We have, for example, seen recent stress in some trust companies, which can have opaque ties to local governments. These vulnerabilities are emerging against the backdrop of a slower-than-expected economic recovery—marked by both near-term growth headwinds and long-term structural challenges. This situation warrants close monitoring, especially as authorities balance the need to prevent a renewed buildup in debt against broader financial stability concerns.

Because of the significance of property investments across the financial sectors of both economies, a shared understanding of these issues would be useful for financial regulators. Direct comparisons are not the goal nor likely to be useful given significant differences in domestic exposures, regulations, and institutional features. Yet it is precisely these distinct features that can make regulatory and supervisory exchange useful. Chinese regulators would be better able to understand the challenges facing the U.S. CRE sector since the beginning of the pandemic, including the geographic distribution and cross-sectoral implications of those risks. Similarly, though Secretary Yellen has noted that the U.S. economy is well-placed to withstand spillovers from China’s economic slowdown and there are limited direct financial
interlinkages between our financial systems, U.S. regulators would still benefit from a more thorough understanding of Chinese real estate conditions and of the recent measures taken to stimulate housing demand and to ease developers’ access to financing.

And beyond public-sector regulation of financial risk, it is also important for efficiency and stability that private investors have access to the information they need to conduct proper risk assessments. We are pleased that the Public Company Accounting Oversight Board has had complete access to inspect registered public accounting firms headquartered in mainland China and Hong Kong since the signing of the Statement of Protocol with China last year. Oversight is critical to ensure that investors receive informative, accurate, and independent audit reports. But it is concerning that the Chinese government recently halted publication of some micro and macro data and have raided some corporate due diligence firms. Such actions may lead some companies to avoid certain investments in China – and such reduced transparency in the world’s second largest economy can increase risks and challenges for investors and policymakers globally. It is important for U.S. and Chinese regulators to be able to candidly discuss such concerns.

Next, consider financial market innovation. Digital assets and infrastructures built using new technologies may increasingly affect the evolution of commerce and finance across borders. Both the United States and China have an interest in fostering responsible innovation in this area and protecting their consumers, financial stability, and market integrity. In 2022, President Biden signed an Executive Order on the responsible development of digital assets which outlined a whole of government approach to achieve these objectives. The United States and China have also cooperated in the context of the FSB on development of the recently published high-level principles for regulation, supervision, and oversight of crypto-assets and global stablecoin arrangements. The Hong Kong Monetary Authority and Securities and Futures Commission are also pursuing a regulatory regime for crypto-assets to mitigate risks while promoting potential benefits of innovation.

In other parts of the digital asset ecosystem, official-sector activity may extend beyond regulation. For example, public sector authorities are experimenting and investing in new technology to support faster, cheaper, more transparent and more accessible payment systems. Robust standards in this area are essential – not just for monetary policy, financial stability and integrity, and the safety and soundness of financial institutions, but also related to issues like user privacy, financial inclusion, and private sector innovation. The United States believes the digital future of money should be grounded in transparency, sound economic
Remarks by Assistant Secretary for International Finance Brent Neiman at the Program on International Financial Syste...
The United States and China have the largest two economies in the world, supported by the largest two financial systems in the world. As Secretary Yellen has said, negotiating the contours of engagement between great powers is difficult. This challenge will differ across topics, but financial regulation and supervision strikes me as one natural area primed for progress. We have serious concerns and differences that we must acknowledge and deal with. But both of our countries are linked through our efforts on financial stability, bank and non-bank oversight, resilience and investor protection in the face of innovative financial technologies, and the financial implications of climate change. Discussions of financial policy, bilaterally and multilaterally, is an important component of responsible economic relations that can benefit the United States, China, and the rest of the world.

###