ocean finance

The Transformation of Shanghai/Pudong into a Global Shipping Finance Center

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Executive Summary

World domination in exports and manufacturing, a young dynamic population and central economic planning has led to tremendous accumulation of foreign exchange reserves for China and it is a truism among economists that China will be the leader in the so-called BRIC (Brazil, Russia, India, China) group of countries in the new century. A dynamic, mature capital market in Shanghai / Pudong is a prerequisite for an efficient capital allocation and the attraction of further foreign direct investments. What is more, China has already had several competitive and comparative advantages in shipping, such as being the largest consumer of raw materials charterer of vessels both in bulk and container shipping and having 6000 shipping companies and a flourishing shipbuilding sector. The time, when it will surpass London and New York in influence in the shipping sector is approaching. Shanghai has the world's third largest stock market by market capitalization at US$3.07 trillion as of May 2010, a derivatives and commodity exchange, investment funds, shipping companies and foreign and domestic banking units.

China is already the second largest economy internationally and will most probably become the number one economic superpower in one or two decades. It is a quite natural development to rival with the traditional Anglo-Saxon financial centers of New York and London and this post recession period of 2010- 2020 is probably an excellent timing as after almost two centuries western banking plunged into an unrivalled crisis. The development of a leading Chinese domestic and global shipping and finance center is imperative for the ongoing stability and future growth of the local Pudong /Shanghai economy in addition to the larger Chinese and Asia / Pacific region.

The present study begins by examining the special features of OFCs (Offshore Financial Centers), i.e. definition issues, the evolution of the socioeconomic phenomena, its implementations in other parts of the world and potential useful applications of offshore finance guidelines in a future OFC developed in Shanghai. The Controversial aspects of OFC and the reigning views about them are also discussed. Finally recommendations on taxation and other aspects regarding future reforms in policy endorsing the development of an OFC in Shanghai are made, justifying the necessity of such a policy shift, in order to attract overseas capital inflows.

Subsequently, analysis is made of the conditions required in order to render a city like Shanghai into a global shipping center, by adopting the characteristics of the major established financial centers (London, New York, Singapore, Oslo, etc.) The concept of maritime cluster is also introduced with typical successful instances from other countries. It is evident that an OFC has important synergies for the maritime hub of Shanghai in attracting foreign shipping firms, so the financial reforms demanded by shipping firms to move their business to a new maritime center are also presented. What is more, we approach topics regarding brokers, cruise operators / agencies as well as the central role of arbitration centers.

In the next section we deal with the competitive advantages of London’s position in the international financial system vis-a-vis New York, Frankfurt, or Singapore, as the UK capital is the ultimate paradigm of global financial centers.

Furthermore , we present the difficulties of overseas firms in conducting business in China and deterring factors for selecting Shanghai as headquarters. Relevant topics such as China's commitments to WTO and the Business climate regarding relations with foreign companies, as well as recommendations are made for Shanghai.

Next, we approach Stock exchange operations and equities markets: The special characteristics of Chinese equities markets, with their inherent weaknesess and how these could be overcome. In this context, the importance of high-frequency trading platforms and dark liquidity pools is highlighted, in order to make Chinese stock market more attractive to foreign capital inflows. The fixed income / money / interbank markets in China, their special features, and propositions on how they could be enhance are presented in the next section.

In the Mergers & Acquisitions, Leveraged Buyouts, Initial Public Offerings section, we discuss the legal framework for M&A in China, and as well as the state of the art regarding IPOs, as both are major activities in the financial sectors, highly lucrative and knowledge intensive. Financial centers excelling in this market segment have a central role in the World Economy. In this aspect, a comparison of the advantages of London and New York regarding IPOs is made. The Hedge fund industry, a very promising field for China in the future, is examined next, with special focus on the necessary reforms that have to be made, e.g. in securities lending are introduced.

In the shipping finance section, we define the field, we discuss the ship mortgage mechanism worldwide, as well as proposed reforms for China, and the current state of new shipbuilding financing which is going through a difficult phase everywhere in the world at the moment. China's dominant role in the present phase is also discussed. The advantages of the ship financing mechanism through IPOs in the U.S.A. is analysed in this context.

However, the financial system of U.S.A. additionaly suffers from fatal flaws, which are presented next: the perils of Universal Banking and overexpansion of credit are addressed and there is a parallel juxtaposition of the American as well as the Chinese banking systems and the pitfalls they entered in the last 20 years. In this context, the financial segregation in China, the problematic aspects of Financial Services Modernization Act of 1999 / (Gramm–Leach–Bliley Act) in the U.S.A., as well as the modern threats for China's banking system (the current overexpansion / overheating and the competition from the entrance of foreign institutions into the domestic market) are presented.

Subsequently, the peculiarities of the transitional phase that the global financial system, is going through are analysed. This also implies that big opportunities are emerging for China due to the recent developments of heavy over-regulation of the banking system in the U.S.A. and the U.K. This will give China and specifically Shanghai/Pudong a huge competitive advantage with respect to the other financial centers if a correct set of reforms is successfully implemented. In this context, the pressure on China exerted by the U.S.A. is also discussed.

The report cocludes by summarising and generalising proposed recommendation for the transformation of Shanghai into a global shipping financial center.

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1. Introduction to Offshore Finance

1.1.Definition and Characteristics

An Offshore Financial Center (or OFC), is most often a small, low-tax jurisdiction / with significant volume of corporate and commercial services to non-residents whose legal entities are called offshore companies and their assets represent offshore funds.

The entire concept is relatively recent, vaguely defined (the degree to which an economy qualifies as OFC also varies by case), as it emerged in the 80s describing all economies with financial sectors disproportionate to their resident population ("on a scale that is incommensurate with the size and the financing of its domestic economy", according to the International Monetary Fund).

It is a controversial subject, although, OFCs have become essential, in the globalization of economies across the world, for various, entirely legitimate, economic applications.

As a rule in OFCs, the greatest share of financial transactions is offshore on the assets and liabilities (coming from and controlled by non-residents) sides of the balance sheet and they are motivated by low or zero tax policies, loose financial regulations, inexistent exchange controls, banking confidentiality and anonymity.

Advantages regarding financial secrecy / tax avoidance, are not standard because many OFCs do not have banking secrecy laws, and gradually the majority of them have been forced to adopt so-called tax information exchange protocols permitting tax evasion controls form third countries.

OFCs include cases like Hong Kong, Luxembourg and Singapore, with robust regulatory framework and capital markets (non-residents select these for their excellent provision of banking services), but very frequently also centers with smaller populations, like certain Caribbean or Pacific Ocean island states, where just booking of the transactions, not any value adding financial activity, takes place.

Shanghai as a financial center will definitely aim at the first category of OFCs by incorporating certain advantageous features through reforms, in order to serve its maritime firms and other global business activities like fund management, insurance, trust business, tax planning, so that they are not forced to operate offshore legal entities overseas.

1.2.A Historical Survey in Global Offshore Finance Records (introduction)

- Paradoxically, the first form of tax haven emerged in New Jersey and Delaware, U.S.A., in the 1880s, providing 'easy incorporation' through easy to comply with, rules and in parallel introducing a franchise tax on all corporations domiciled in New Jersey. This was very attractive to non-resident entrepreneurs, because, owing to the 1720 South Sea bubbles, there were severe complexities in opening incorporations, back then.

- The 1929 case of “Egyptian Delta Land and Investment Co. Ltd. V. Todd”, in the British courts, created the precedent / loophole of “virtual residencies” and tax havens for corporations registered in London, without business in UK, and non subject to British taxation. This case created, argues Picciotto, "a loophole which, in a sense, made Britain a tax haven". Companies could now incorporate in Britain but avoid paying British tax. The ruling applied for the British Empire, as well, which was adopted by the jurisdictions of Bermuda, Bahamas, and the Cayman Islands.
- In the 1920s, certain poor Swiss Cantons e.g. Glarus, Zug, close to Zurich introduced such liberal incorporation laws to the Old Continent for the first time.
- 1934, Swiss banking law: From the moment that the funds have crossed the Swiss border, there is a guarantee from the Swiss state for non prosecution and “absolute silence in respect to a professional secret”. Any enquiry constituted criminal offence.
- The rise of Zurich-Zug-Liechtenstein financial cluster in the 1920s due to offshore holding companies, trusts, societé anonyme and mailbox companies: Liechtenstein also launched a new corporate structure, the “Anstalt”, closely related to the Austrian version of the foundation through its own Civil Code. The novel Company Law set no constraints about the origin of stockholders for Liechtenstein based firms.
- 1929: Luxembourg adopts the legal entity of holding company.
- 1920-1940: Bermuda, the Bahamas, Jersey and Panama also act as tax heavens, to a lesser extent though.
- 1957: The Bank of England decides that transactions of UK banks for lenders/borrowers, who are non UK residents, are not considered to be subject to UK banking regulations.
- 1960-70s: Rising taxation in the Old Continent, and distortionary banking regulations leads to the offshore interbank market that offers alternatives to reserve requirements, interest rate capping, financial instruments constraints for supervised institutions and capital controls.
- The Euromarket in the City of London and some ex British colonies (Jersey, Guernsey, and the Isle of Man) emerges.
- Soviet Union’s opening of dollar deposits in the UK (City) essentially gave birth to the Eurodollar market, with a view to hide U.S.A. dollar transactions from the U.S.A. State and to give flexibility to the Russians to have access to their dollars reserves in a potential Cold War Crisis. This gave a prominent role for non-U.S.A. banks in Offshore Banking, because such deposits would not be easily frozen in a future episode between the super powers.
- During 1966-77, the volume of the Euromarket (all Eurocurrency liabilities) surges from US$18 billion to US$310 billion. The phenomenon leads to a credit crunch for U.S. banks that also resort to the Euromarket (Citibank, Chase Manhattan, and the Bank of America), where no interest rate ceilings on dollar deposits apply.
- 1960s: The Cayman Islands enact various laws on Banks / Trust Companies / Exchange Control / tax havens which will transform the ex British colony into the No.4 financial center, in the coming years.

- 1960s: The wars in the Indochina region lead to a dollar flood in Asia. Singapore provides incentives to international banks to relocate and establishes the Asian Dollar Market (ADM) (Rival of the London Eurodollar market) and the Asian Currency Units (ACUs) through the Bank of America, with separate set of accounts for non-residents. These initiatives were the base for the future establishment of Singapore as a private banking super power ($1.173 trillion assets under management in 2007).
- 1970s: Luxembourg, Channel Islands and the Isle of Man introduce favorable tax regime (low income tax rates, no withholding taxes for nonresidents on interest and dividend income) which leads to increased capital flows from other countries of the region. The Bahamas and later the Cayman Islands also imitate this paradigm successfully which is later adopted (by copying laws) by other small jurisdictions of the Pacific region, like Norfolk Island (1966), Vanuatu (1970-71), Nauru (1972), the Cook Islands (1981), Tonga (1984), Samoa (1988), the Marshall Islands (1990), and Nauru (1994) that mainly manage to appeal to illegal financial activities. However, offshore insurance flags of convenience for shipping fleets, aircraft leasing e-commerce and online gambling are also encouraged through special legislative arrangements.
- 1975: Bahrain (and later Dubai) license offshore banking units (OBUs). Offshore banks in the Persian Gulf region act as accumulators of petrodollars thanks to tax incentives.
- 1981: U.S.A. launch the International Banking Facilities (IBFs)
- 1986: Establishment of the Japanese Offshore Market (JOM)
- 1987: Irish Financial Services Center is established in Dublin with favorable treatment of the banking sector and low corporate tax rate.
- 2000: the *Financial Action Task Force* (*FATF*), an inter-governmental body publicizes its first blacklist of 'Non-Cooperative Countries and Territories' (NCCT) highlighting issues on compliance with its Forty Recommendations against money laundering and criminal financial activity. The OECD, FATF, and other organizations / initiatives propose revised policies through standards and best practices, peer monitoring, and review. The measure of blacklists has to a certain degree forced offshore jurisdictions to try to be removed from the blacklists by adopting certain proposed practices, due to the fear of possible damage to reputations. Nevertheless, the most recent BIS statistics indicate no drop in the total volume of capital transacted via Offshore Centers.
- Tax havens are now found everywhere, but they form somehow separate categories that have major differences among them. The most important category is the UK-established or former British Empire-based tax havens. The core of the system (comprised of the Crown Dependencies, Overseas Territories, Pacific atolls, Singapore, Cyprus and Hong Kong) is the City of London and vast amounts of capital are channeled through its Euromarket. The second class includes continental European jurisdictions (e.g. Liechtenstein, Switzerland, Luxembourg), with specialist services. The third class is a diversified group of imitators, such as Panama, Dubai, Uruguay and other developing countries, even in Africa.

1.3.The Financial Services Modernization Act of 1999 / Gramm–Leach–Bliley Act and the Last Financial Crisis (introduction)

We will try to summarize in this section the perils of *universal banking* and *overexpansion of credit*.

Financial segregation in the banking system of China has old roots, as the Commercial Banking Law of 1995 dictated that commercial banks shall have trust investment and stock operations or invest in immovable property in China for non proprietary use.

The Securities Law of 1998 also excluded securities businesses from being operated and regulated along with banking, trust and insurance businesses.

Nevertheless, according to the Chinese Commercial Banking Law, commercial banks may issue financial bonds, buy/sell government bonds and or operate as brokers for insurance activities, but they cannot form or operate investment and securities businesses on trust within the jurisdiction of China. There is some degree of flexibility in the segregation policy.

Thus, China Everbright Group (Everbright) controls banks, securities companies and trust companies. The China International Trust & Investment Corporation (CITIC) also has a portfolio banks, securities companies and insurance companies by means of financial holding companies.

All these policies on financial segregation reflected the officials' concerns, because the whole scene reminded of the U.S.A. before the Great Depression: four big commercial banks in China were controlling 84% of financial assets of the country, and the systemic risk had become gigantic. Eventually, however, this financial segregation succeeded in strengthening the overall stability of the financial system.

It was a great achievement given that the volume of accumulated bad debt from the 1980s and '90s, was threatening: in 2003, nonperforming loans accounted for 20.4% of banks' overall loan portfolio, with a nominal value reaching 16.5% of GDP.

The government with its capital, the new China Banking Regulatory Commission and foreign "strategic partners", who introduced international best practices, managed to decrease the number of nonperforming loans down to 2.5% in 2008. From then on, banking started to resemble the typical Western model and after a decade of tough reforms and even IPOs in Hong Kong, for Bank of China, Industrial and Commercial Bank of China and China Construction Bank, China's banks have good fundamentals, as nonperforming loans fall both as a fraction of the assets and in absolute terms as well.

On the other hand, the perils of universal banking were somehow forgotten in 1999, when the U.S.A. enacted the Gramm–Leach–Bliley Act (GLB), also known as the Financial Services Modernization Act of 1999, signed into law by President Bill Clinton which repealed part of the Glass-Steagall Act of 1933. It radically changed market rules for banking institutions, securities firms and insurance companies. Until 1999 The Glass-Steagall Act forbade any financial institutions from operating as any combination of an investment bank, a commercial bank, and an insurance company. These restrictions were viewed as against the profitability and the general interests of the financial services industry; therefore they had strongly lobbied against it:

Many of the largest banks, brokerages, and insurance companies supported this Act at the time. The rationale behind this was that individuals normally invest in financial boom periods, but they conservatively allocate their capital in bank deposits, as a defense in recessions. By means of this law, financial firms could manage savings and investment vehicles under the same umbrella and theoretically achieve more stability and higher returns on capital, as well.

Of course, most financial services companies were already giving both saving and investment options to their clientele before this reform and generally, there were many relaxations, but under many constraints, which mostly had to do with limitations in mergers & acquisitions that could be made.

Thus, the GLB Act eventually passed in 1999, cancelling parts of the Glass-Steagall Act, enabling banks, brokerages, and insurance companies to merge; even the gigantic CitiCorp/Travelers Group merger became real.

However, the GLB did not lift constraints on banks by the Bank Holding Company Act of 1956 which did not permit financial institutions to own non-financial corporations, while it prohibits non banking / financial corporations outside the industry from engaging in retail and/or commercial banking.

Some prohibitions still apply to achieve a certain degree of segregation between the investment and commercial banking divisions of a company and most of the controversy has to do with permitting or not the banking, brokerage, and insurance divisions of a company from cooperating.

Opponents of the legislation argue that GLB let the newly-merged banks to undertake riskier investments and in this new regime, assets of banking customers acted as equity / collateral for the bank.

On the other hand, investment banks were already trading the securities that sparked the mortgage crisis, when GLB was passed. Subsequently, just a few investment banks merged with depository commercial banks and these dealt with the crisis much better than those that did not. In fact, in Europe, where an act like Glass-Steagall did not apply, banks were also affected and firms like Lehman, were the least diversified, while the ones that survived, such as J.P. Morgan, were highly diversified.

What is more, GLB set the Federal Reserve as super regulator, controlling all Financial Services Holding Companies which were not deregulated in any way by the reforms of the Act. The Act simply maintained the same jurisdiction for the regulators, as they applied prior to GLB.

The GLB definitely had an indirect contribution to the recent financial crisis, although this could have been avoided, if the absurd securitization process of the subprime market had not entailed common financial fraud, in a collision of credit agencies, investment banks and home loan banks and a blind faith in an everlasting increase of the Real Estate market from the investor base.

As far as the Chinese Banking system is concerned, new challenges arise in the horizon: the accession of China to the WTO dictates limitless access to banking, securities and insurance activities for foreign financial institutions. This is somehow posing a significant threat, as wealthy clients residing mainly in Beijing, Shanghai and Guangzhou could move their activities to competing foreign banks, at some point in the future, but definitely not in the short-term horizon.

What is more, there's even a possibility that the short-term stimulus could make the banks repeat older mistakes.

The decrease in Chinese exports, combined with the deterioration of credit spreads globally, jeopardize the Chinese loan portfolios. Furthermore, the reduction of nonperforming loans is attributed by many to the rolling over / extending maturities.

Meanwhile, NPLs of foreign banks in China with much stricter regulations have gone up more than 100% since 2008. Non-Chinese banks struggle to develop their business reporting very modest profits, as they are restrained by Chinese regulatory limits regarding local banking operations.

This of course immunized the China's financial system during the last global crisis. However, non-Chinese banks have a secondary role and they cannot benefit so much from China's robust economic growth in 2009.

The profit drop for foreign banks is also due to a smaller spread between lending rates of loans and rates and deposit interest rates, which naturally affects Chinese banks too, but they have dealt with it by increasing the issuance of new loans by 100% from 2008 to 2009.

Small branch networks and slow expansion owing to State regulations (slow approval process for licenses required by foreign financial institutions for deploying retail-banking networks) lead to less deposits for non-Chinese banks. At the same time, local foreign banks and local lender units are obliged to decrease their loans-to-deposits ratio to 75% by the end of next year. However, a lot of foreign banks are also in dire straits due to the financial crisis, so they have become rather reluctant in lending policies which forces them to abandon clients who are attracted by the Chinese homologues which are more aggressive, as a result of Chinese government's stimulus spending: this drives down corporate-lending rates.

If these regulations for foreign banks were relaxed, Shanghai could accelerate its development as a global financial center.

Existing loans are of minor concern compared to new ones being issued at such fast pace. At the moment, China's banks have started issuing loans again not backed by positive economic forecasting, objective credit analysis and expected gains, probably with insufficient provisions and inadequate reserves.

These new loans are supposed to finance stimulus projects supported by the government, which could be repaid under normal conditions, but ongoing infrastructure projects may diverge from revenue projections and this may simply lead to renegotiating repayment conditions.

But the majority of new loans are not for financing infrastructure projects: Increased short-term, low-interest loans for covering corporate payables are very worrying, because they signal cash flow issues / pending bankruptcy for certain companies or just high-risk bets in stocks and real estate.

In the past, the nonperforming loan ratio was over 20%. If the history repeats itself, China's banks could accumulate 3.6 trillion RMB of bad loans, which is even more than the 2.2 trillion RMB injected capital into banking system during its history. Of course, a small fraction of the massive foreign currency reserves and the contribution of the development of an Offshore Banking system attracting global capital as well as domestic funds from the parallel economy could eventually support the banks, although their shareholders could eventually suffer losses and dilution due to the needed recapitalization / bailout of banks, if NPLs surge. All this could be another serious divergence of the banking system away from commercial principles and efficient allocation of capital resembling the Western past banking crises.

1.4.Controversial Issues in Offshore Finance Centers

Banking secrecy also has broad applications in tax evasion and money laundering.

Such purposes are served by limited liability corporate schemes registered in an OFC, called offshore corporations / international business corporations (IBCs). They have multiple uses in owning / financing or operating firms, but they often constitute complicated financial structures with just a director only, or even nominee directors from the OFC hiding the real owner. Opacity is further enhanced by bearer share certificates or registered share certificates and the absence of public registry of shareholders (in certain jurisdictions).

Setup costs of IBCs are often negligible and these vehicles are, as a rule, exempt from any kind of tax, needless to say that as a legal entity, they are designed to serve totally legitimate interests, e.g. running investment funds.

It is even estimated that US$11.5 trillion (no corporate assets included) is kept offshore by wealthy individuals alone. The sheer volume shows the extent and consequences of the so called Harmful Tax Competition, which forces even governments to tax the real economy and residents higher. Nevertheless, the importance of tax incentives for the success of offshore financial centers is declining lately.

Another concern is the so-called regulatory arbitrage, which feeds a so-called race to the bottom. This is not accurate however, as most investors appear to select better regulated offshore centers, in practice, as they are generally concerned about the safety of their deposits/investments.

Opponents of offshore centers also criticize excessive secrecy in those jurisdictions, especially the controversial issue on the confidentiality of ownership for offshore companies and offshore bank accounts.

This is, however, a standard practice for banks in many States worldwide, not just for OFCs, and furthermore, the major offshore jurisdictions have nowadays regulations for law enforcement agencies, if they seek information about certain bank accounts. There are also additional procedures for criminal offence cases (such as Anton Piller orders).

What is more, in the majority of U.S. states, share registers or company accounts are not freely accessible and few jurisdictions worldwide, require trusts and unlimited liability partnerships to be registered, or publicize information on the individuals that control them.

Although Statutory banking secrecy applies for Switzerland and Singapore, other jurisdictions do not provide this statutory right. Finally, many major offshore centers (e.g., the Bahamas, Bermuda, the Cayman Islands, Jersey, Guernsey, the Isle of Man, etc.) have adopted so-called tax information exchange agreements regarding non residents who may be involved in the tax evasion cases.

2. World Offshore Finance Aspects

2.1. Initial Public Offerings

2.1.1. London vs. New York comparison in terms of IPOs (aspects)

Capital coming from the Middle East, Russia, India, China, and the U.S has been traditionally rejuvenating all aspects of the London economy. Approximately 40% of foreign equities are traded in London exceeding even New York. Over 30% of international currency exchanges are transacted, more than the aggregate volume of New York and Tokyo. Although New York and Tokyo depend on the vast American and Asian domestic markets, 80% of UK business is international. New York is going through a difficult phase with various issues in too much litigation over-regulation which jeopardises competitiveness of U.S. capital markets.

In 2001, 12 of the top 20 global IPOs were listed in the U.S.A., but in 2006, the last year before the recession which started to emerge in the financial sector in 2007 and peaked in 2008-9, only two of them were listed there.

It is claimed that this phenomenon in the U.S. is due to the 2002 Sarbanes-Oxley Act and other post-Enron financial regulation while London has adopted a more flexible regulatory system that simplifies business, regardless of nationality, currency, or accounting system. The U.S. set many constraints after 9/11, but London is relatively more open regardless of its existing concerns about terrorism.

The U.S. are renowned for their class-action lawsuits, whereas G.B. provides a fiscal system in favor of residents not officially domiciled in Britain who are taxed only based on their British income (at least until recently), not their international revenues.

London is attractive for emerging economies firms seeking financing and is No.1 financial center in the old continent but also in over-the-counter derivatives, foreign exchange, and metals trading. U.K. capital strengthens its position in private equity and hedge funds.

What is more, many foreign firms decide to delist (e.g. TNT, Siemens, and Daimler Benz) from the New York Stock Exchange: a recent reform in SEC rules simplifies procedures for delisting from U.S. exchanges. This is a global trend for listed companies (even not so well known firms dare this) to delist from large international exchanges and return to their home market. Especially due to electronic trading and increased investor expertise, there are many changes of business methods for international investors who can open long equity positions overseas with great ease and cheaply, nowadays. Since 2000, the set of foreign firms listed on London's main exchange has also dropped significantly by almost 200 in 2007, roughly 40%.

London's IPO performance is attributed mostly to smaller foreign firms entering the AIM exchange and it has even attracted firms in Russia and other former Soviet republics. Chinese firms have preferred mainly New York, but Indian firms are divided between these two possible options. AIM appeals to small and medium sized growth firms that would not be able to be financed in other markets. Listing is a simplified process, with no prospectus, no minimum float, and no financial history required. AIM firms do not fall into the jurisdiction of the Financial Services Authority, but they are controlled by an approved financial firm known as a "nomad", or nominated advisor whose reputation capital is at risk. Although regulatory standards are viewed as extremely loose, the number of problematic cases is comparable to more regulated markets.

However, the U.S. capital markets have found certain ways to gain competiveness: SEC's adoption of International Financial Reporting Standards that diverge from U.S. Generally Accepted Accounting Principles and simplifying the most cost intensive and debated section of Sarbanes-Oxley (Section 404) dictating that outside auditors monitor internal controls. Euronext, the French stock exchange combining the Paris, Amsterdam, Brussels, and Lisbon bourses gives an opportunity to firms intending to be listed on a market affiliated with NYSE but they do not wish to be under the jurisdiction of the SEC or subject to Sarbanes-Oxley corporate-governance rules. Nasdaq has a similar policy through a merger with Stockholm's OMX combining seven Nordic exchanges.

2.1.2. The Advantages of the Ship Financing Mechanism through IPOs in the U.S.A.

The U.S.A. equities markets had stayed out of the international shipping sector until the mid-1990s. This policy changed and numerous international shipping companies resort to initial public offerings in the U.S.A. It has been a very successful policy shift that should be imitated by China, not only for funding domestic shipping companies, but also for foreign ones.

The American SEC does not consider the issuer as “foreign private issuer”, if over 50% of its outstanding shares, by persons for whom a U.S.A. address appears on the records and either the majority of the executive officers or directors of the issuer are U.S.A. citizens or residents; or over 50 per cent of the company assets are in the United States; or the business of the company is run mainly in the United States. This means that a privately owned company with a real U.S.A. presence could be considered foreign private issuer at the beginning of the IPO, due to majority of non U.S.A. shareholders, but then this status may change.

The SEC Office of International Corporate Finance has different procedures for IPO reviews of foreign private issuers who can submit draft Registration Statements without being charged with filing fees. The SEC Staff however treats filings by foreign private issuers equally, and provides guidance as they would to domestic issuers.

This confidential preliminary review stage gives foreign private issuers the chance to have a first experimental contact with the SEC. If the issuer decides not to continue before filing its “red herring” Registration Statement, then the process stops and the company’s plans to become listed will not become known to the public.

In U.S.A., it is quite common that the issuer does not close an underwriting agreement with the underwriter, until the offered stocks start to trade. This is different from Europe, where there is a priori a binding underwriting contract. Sometimes, there is just an engagement letter stating merely a non-binding intention of the underwriter and it is a commitment for the issuer to cover the underwriter's expenses, optionally select counsel and accountants approved by the underwriter, and pay fees of counsel to the underwriter regarding the U.S.A. state "blue sky" securities registration compliance. All these terms are not fixed and lately, competition tends to drive underwriters not to demand an engagement letter. They are willing to do hundreds of man hours of specialized work and risk significant amounts of money without any commitment.

What is more, even the quantitative listing conditions for the listing of equity in the NASDAQ National Market System treats equally "foreign private issuers" and other issuers.

This openness of the system to foreigners and the abundance of capital of the U.S.A. markets have attracted many shipping companies. The U.S.A. capital markets are welcoming firms that can present a decent case and have no intent to conceal material.

2.2.Maritime Clusters

National shipping industry cluster policies are a European concept originating from the competition of flags of convenience after World War II. A ship flying a flag of convenience is registered in a foreign country aiming at driving down operating costs and dealing easier with government regulations. Affluent European nations, such as the UK, Norway, the Netherlands, etc., used to be the primary owners of shipping fleets, in terms of dead weight tonnage. The flags of convenience were a great opportunity, so they eventually attracted the greatest share of the world fleet.

A cluster is a group of collocated firms, specialized suppliers, service providers, businesses in related sectors, and associated institutions that face competition but also have ties and collaborations with each other. (This definition may also apply to the emerging shipping center of Shanghai, which must gather relevant competences for conducting shipping business as a cluster.)

Oslo, Singapore, New York, London are considered to be the primary shipping centers today. High end services related to banking, insurance, lawyers, suppliers, shipbrokers, etc. are provided, while company executives can meet to discuss shipping and other issues, network, and exchange opinions and ideas.

For instance, New York, has such a high status due to the availability of funds from all leading global investment banks, two major stock exchanges, a gigantic private equity network and of course 250 shipping companies and thousands of maritime professionals, including a multitude of top law firms specializing in maritime arbitration.

The social aspects are crucial, as the owners and their families also constitute part of the cluster. Only gigantic shipping companies, like A. P. Moller-Maersk, Teekay, and Seaspan, have the option not to establish their headquarters within a cluster, as they have an increased autonomy and proprietary professional networks. However, when it comes to global competition, nothing is permanent and experts claim that Norwegian government economic policy measures for shipping, could harm Oslo's status; the same applies to London as well.

Although most Norwegian vessels do not fly a Norwegian flag, the Norwegian International Ship Registry (NIS) offers incentives regarding taxes, crewing, etc. but the high level of personal taxation for owners and top management executives can harm the maritime cluster and drive away the headquarters of shipping firms.

Significant shipping centers are Rotterdam, Singapore and Hong Kong. Dubai and Shanghai are very serious contestants, but Singapore is considered establishment at the time.

Tokyo, Hamburg (focusing on ship financing and container ships), Limassol, Vancouver and Piraeus are a secondary class of shipping centers with specific weaknesses. Spasmodic government policies have also contributed to this.

It is the Netherlands that gave birth to the concept of an organized maritime cluster: In the past, policies aimed at maintaining the Dutch flag fleet and crew, and deploying competitive vessels. The maritime cluster, on the other hand, focused on maximizing profits of Dutch owners, maritime activity and employment (although not exclusively for Dutch seafarers.)

It is estimated that just 30% of the added value for the shipping industry is related to sea related activities, while 70% of the added value takes place onshore. Up to that moment, typical shipping policies were aiming at sea related activities picture. The Dutch approach also emphasizes its efforts on keeping the headquarters of firms in the country, unlike Norway. This new, ingenious concept entailed coordinated initiatives from the public and private sector in all aspects including even lobbying. Norway, the UK, Denmark, Germany were among the first imitators.

The idea of shipping cluster has been very successfully implemented in Singapore. The government has contributed in many ways, e.g., thanks to the Singapore Maritime and Port Authorities (MPA), a favorable tax regime, or specialized education from Nanyang Technological University (NTU) and Singapore Maritime Training Foundation (SMTF).

The Singapore Maritime Foundation intends to propose a new form for ship sale and purchase, as alternative choice to the dominant Norwegian Sale Form and the Nippon Ship Form, which has the potential to further strengthen Singapore's role as a maritime arbitration center, at the expense of London and New York.

Ship sale forms, which have nothing to do with newbuilding contracts, are standardized form contracts for sale or purchase of ships.

The old Norwegian form was compiled by the Norwegian Shipbrokers' Association and adopted by the Baltic and Maritime Council in 1956, while the revised version emerged in 1993, popular in Europe. On the other hand, Japanese sellers generally show a preference for the Nippon Ship Form.

The SSF is designed to be an updated sales contract that takes into consideration contemporary banking methods due to which Singapore could gain comparative advantage for ship closing business. Under the new SSF, Singapore shall be designated as the location for arbitration. Until now, under NSF's article 16, in the event of a dispute, London is designated for arbitration and the English Law applies. New York can also apply though, under U.S.A. Code and Law of the state of New York. Generally, if the parties cannot agree on the location, then arbitration takes place in London according to the contract.

Singapore Chamber of Maritime Arbitration was reconstituted in May 2009, as a separate organization from the Singapore International Arbitration Center, from now on. This independence is supposed to strengthen the entity towards this direction. The whole plan regarding SSF is at a preparatory stage and last April, its first edition was officially reviewed. However, this shows Singapore's determination to become an arbitration center in maritime affairs and steal this role from London. Singapore is also a leader with a liberal businesses environment, the availability of specialized human resources and its strategic position on the World map. Other advantages are a modern port and the size of its clientele, the shipbuilding industry, major shipping firms like APL; traders; maritime law firms, shipbrokers; financiers including a thriving asset /wealth management sector rivaling even Switzerland nowadays. A similar case is Denmark, where several top international ship owning firms have headquarters there.

Regarding equity capital of shipping companies, the maritime cluster phenomenon has also a very significant impact: In 2008, Denmark (Copenhagen), Japan (Tokyo), Norway (Oslo), and Singapore accounted for 60% of international shipping listed equity market, while U.S.A. (NY) alone controlled 27.1%. Other players are China, Finland, Taipei, South Korea, Finland, Netherlands and Hong Kong.

On the other hand, the governments are rather restrained nowadays, as shipbuilding subsidies are now prohibited by the Organization for Economic Co-operation and Development (OECD). Nevertheless, national pro-shipbuilding policies, resort to practices like shipbuilding price discounts, favorable special financing (which might be considered as indirect protectionism.) In Asia, stimulus packages, favorable financing, capped interest rates, tax breaks, even trade tariffs, etc. Also, specialized governmental fiscal policies are prohibited within the EU Budgetary fiscal discipline which is another obstacle for EU states. Therefore, taxation gives some significant freedom of choices for governments, when it comes to promoting shipping, at least in Europe.

Shanghai could also follow London's example by making efforts to attract the headquarters of marine services companies and even provide financing through IPOs. Shipping company IPOs opportunities are becoming very scarce lately, but technical and commercial marine services are much less saturated and diversified regarding their business activities. These stocks fall into various classifications such as industrials, engineering, logistics or ports, equipment manufacturers, ship-to-ship transfers, marine oil services, environmental services or brokers. Marine services may have lower profit margins but their income is more stable unlike highly cyclical ship broking business and also in the market sector, Singapore is a strong opponent as a center thanks to its favorable tax regime. Furthermore, marine services are coping with market crises much better than ship owners, since they are related with operations and maintenance expenses and not so much capital expenses.

2.3.The Competitive Advantage of London's Position

There is a question whether Shanghai will grow to resemble onshore Manhattan or become more like an offshore London, as the third Global financial center. Frankfurt, Paris, Hong Kong, Singapore and Tokyo are perceived as powerful regional financial centers, London and New York are currently considered the only two genuinely global financial centers. Issues such as availability of skilled personnel, or regulatory environment, government responsiveness, corporate tax regime and personal tax regime constitute important advantages for the two cities, as well as their cosmopolitan status. While Frankfurt and Tokyo, for example, are mainly markets for domestic players where foreigners are also welcome, London, and much less, New York are considered trading centers for foreigners conducting business with each other.

It is no wonder that the UK has the largest trade surplus in financial services in the world, followed by Switzerland, representing a major sector of the UK economy and continuing a long tradition since the 18^{th} and 19^{th} centuries, having imposed the English language globally and taking advantage of a geographical position between the U.S.A. and Asian time zones. On the other hand, New York reaps the benefits of the largest, most liquid domestic economy, which means a guaranteed status for years to come.

This primacy is becoming uncertain, however, given the fact that information technology and improved telecommunications infrastructure reduce importance of proximity to the financial markets and firms evolve by managing operations remotely through outsourcing and "offshoring". Furthermore, London is an extremely expensive city to conduct business from, the transport infrastructure is unsatisfactory and terrorism concerns sporadically reemerge.

In the distant past, a similar genre of financial centers also existed in the form of Babylon, or Constantinople, almost like today's London, New York, or Shanghai. Cities like London play a much greater role than the United Kingdom as a whole, by combining residential, industrial, business and administrative activity with much higher population concentration, dimensions, social or legal status and all sectors of finance, not just wealth management or reinsurance for example, as in specific tax heavens: these financial centers having reached critical mass in all financial subsectors.

Generally, there is a hub-and-spoke structure regarding global financial centers connecting regional centers, however regional financial centers are not always acting as sub-hubs, because an institution's international dealings may involve London or New York as counter-parties without intermediaries.

There are naturally cross border deals which will not necessitate the participation of the two global financial centers. However, as a general rule, a financial institution will turn to London or New York for a better quote or increased liquidity (i.e. a broader customer network). Only if, for instance, there have been successful transactions in the past and mutual trust, two regional banks will exclude the participation of global financial centers.

Financial services do not follow a classical, business/commercial model, as in logistics and commerce, which leads to implications in trying to define an offshore financial center or regional financial centers like Hong Kong, Singapore or Luxembourg, which include highly developed financial markets / infrastructure /international investment funds but the local economy is relatively small.

Regarding human resources, it is widely accepted that experienced financial experts in international financial centers significantly outperform regional financial personnel, when it comes to international, complex deals involved highly specialized skills in trading / investment banking / quantitative modeling are sought after in the London and New York job markets, despite significantly higher remuneration packages.

The so-called ‘availability of skilled personnel’ has a self-reinforcing nature because an international financial center grows, and human resources (HR) build skills and increase availability of skilled HR which further strengthens expansion of the international financial center. Thus, financial services headhunters even amplify this positive reputation of the international financial centers, as the best job market to find highly qualified personnel. What is more, layoffs / downsizing in London are very easy, unlike the trade union consent in Paris, and search for the right executives is very rapid and cost efficient in the U.K. capital with guaranteed results, unlike in Frankfurt or Paris. London can provide “just-in-time” workforce, with high quality work ethics, as there is a mentality for hard work, long hours and flexibility. Nevertheless, growing EU labor regulation could even harm London’s dominant competiveness.

Visa and travel difficulties, however, complicate the situation in the two global financial centers, while the ease with which employers can obtain work visas for prospective foreign employees is an important issue and countries like Singapore (which is also strong in shipping and wealth management) have an advantage in attracting foreign talent.

Regarding the so-called regulatory environment, there is a positive feedback mechanism here, as deals tend to be closed, where regulators facilitate the whole process, but it is also imperative that regulators be trusted, so regulators in financial centers must not lose credibility by being too draconian, or too tolerant. Regulatory regimes are constantly being tried and inherent errors can lead to catastrophic failures, or over-regulation. For instance, the importance of the regulatory framework became clearly apparent, when the Eurodollar markets grew rapidly in the 1960s as U.S.A. tax rule changes led multinational companies to leave dollars outside the control of U.S.A. authorities.

Both centers were badly affected in August 2007, when the crisis broke out: London’s status deteriorated by the collapse and the handling of Northern Rock case along with reforms in taxation of non domiciled residents of the UK or corporate tax; the U.S. suffered, of course, from the Lehman Brothers incident. However, the regulatory environment is deemed superior in London and New York in comparison to Paris and Frankfurt. The Financial Services Authority (FSA) has a very good status, although it is sometimes found to be “overstretched”, as it promotes principles of regulation and allowing a degree of discretion in terms of final implementation. The FSA also supports a flexible, risk-based approach to regulation, so that financial institutions can focus their compliance mechanisms mainly in high risk areas. In the U.S.A., there are more explicitly set rules, which are more detailed / analytical with an excessive number of regulatory bodies. However, there is a growing concern that over regulation could eventually render London less competitive in the future, a fact that applies for the rest of Europe, as well.

Hong Kong and Singapore are frequently praised for their excellent regulatory environment, nowadays, while Tokyo greatly lacks in competitiveness due to poor reform efforts, rule complexity and inefficient governance structures. However, Hong Kong also needed certain regulatory changes: For example, according to Hong Kong's stock exchange rules, public companies were obliged to report results twice a year and have an inordinately long time to publicize them — three months after the end of the period for the half-year report, four months for the year-end. This was an incompatibility with American financial standards, where financial statements, which are reported in quarterly intervals, must be disclosed within 40 days of a quarter-end and 60 days of a year-end. The full implementation of this new rule had been postponed until the 1st of April 2009.

Thus, financial centers in Europe and Asia, aggressively target sub-sectors of the financial services industry, especially after the significant losses for New York and London from the credit crisis, due to the heavy dependence on revenues produced by the financial sector. London is even more vulnerable than New York as international financial services count for a larger percentage of GDP. New York can also rely on the domestic U.S.A. economy, which is bound to create a guaranteed volume of financial services activity for an indefinite period of time.

To complicate things even more for London, the government is considering revising the current regulatory structure, by assigning a super-regulator called the Council for Financial Stability, comprised of the Treasury, the FSA and the Bank of England judging periodically whether to bring in stricter requirements on banks or not. The FSA could also impose even higher capital requirements, lower leverage ratios, and reject remuneration packages.

2.4.Global Ship Finance

Shipping is generally dependent on bank finance. Because of the bad reputation for its boom-and-bust cycles, it is claimed that the rewards are not worth the risks for most time periods, being a specialized high-risk sector where extreme events can occur.

The 1970s and 1980s had long and severe reversions for bulk shipping, multiple ship-owners bankruptcies and banks losses. In the last 10 years, some particular years have been the best for shipping in the last 50 years. It was considered the longest period of stable profits for the sector, as freight rates and vessel prices broke several records, but also plunged in a very spectacular way in the 2008-9 crisis.

Shipowners have constant dilemmas about the timing and the method for the expansion or renewal of their fleet and how to reach the ideal balance between debt and equity.

Shipping finance offers 3 basic choices to investors:

Debt finance:

- bank loans
- bond issues
- private placements
- leasing

Mezzanine finance:

- Preferred stock
- Hybrid structures (warrants and convertibles)
- subordinated loans

Equity finance:

- private equity
- company reserves
- public or private (partnerships like K/S and KGs) equity offerings

Roughly half of ship funding deals are plain 'bilateral' (just two parties – bank/client), but syndicated loans - issued by one or several banks and then forwarded to others- are also very important. They can be syndicated on a “best efforts” basis (if there is insufficient investor interest, the financing will simply fail) or 'fully underwritten” (if there is insufficient investor interest, the underwriters absorb the loan, so the fees are charged with an a priori premium to compensate for this risk).

2.4.1. The Ship Mortgages

The ship mortgage is essential in ship finance transactions, as it determines the lender rights against the mortgaged vessel, the priority of lender vis-a-vis other unsecured creditors of the shipowner, and the right to take possession and liquidate the vessel in case of a default. The roots of the ship mortgage are the bottomry bonds in the English legal system.

A ship mortgage is governed by the law of the flag, if the loan collateral is the ship. Mortgages in the ship registration jurisdictions are either the statutory mortgage, or the preferred mortgage.

Jurisdictions, of the former British Empire, imitating the English legal have adopted the system of the prescribed statutory form of mortgage, with some minor variations, though. The Bahamas, Bermuda, Cyprus, Hong Kong, Malta, and Singapore are the most usual jurisdictions for registering ships.

The UK and ex British colonies statutory forms are short and just describe the registered particulars of the vessel. In the United Kingdom and affiliated jurisdictions, the owner and the mortgagee have a separate agreement, the so-called deed of covenants, additional to the statutory mortgage, setting protective provisions for mortgagees. For maximum coverage, the mortgage must be registered against the vessel at the related ship registry.

Other major ship registration jurisdictions like Liberia, Marshall Islands, and Panama, use more detailed forms of mortgage with analytical provisions aiming at safeguarding the mortgagee's security interests. In the UK, and in most other jurisdictions, mortgages base their priority on the date and time of registration. An unregistered mortgage has a lower priority to another that has been registered.

A far as registering and mortgage procedures in the Chinese jurisdiction are concerned, foreign exchange controls also play here a role: If the mortgagee is a foreign company, the ship-owner must first seek approval from the local branch of the State Administration for Foreign Exchange. Subsequently, the owner must declare the mortgage to the local branch of the State Administration for Foreign Exchange, as registration to the Ship Registration Authority is not enough. What is more, the value of debt secured by the mortgage, in these cases, must not be over the owner's income in foreign exchange of the previous year. In case the ship-owner is a Chinese-owned enterprise, evidence documents proving that the State Administration for Foreign Exchange has granted the owner approval to serve these debts to the foreign party, must be presented, at the filing process.

2.5.The Transitional Phase of the Global Financial System - Arising Opportunities

The financial overhaul bill will bring transformations in the American financial system and the rest of the world by restricting proprietary trading and allowing big Wall Street firms to invest just 3% of their capital in their own internal hedge funds. This acts as a loophole and gives the chance to big banks to keep operating on the same way.

Nevertheless, future developments are uncertain because Morgan Stanley, JP Morgan and Goldman Sachs all intend either to close their proprietary trading units or to sell their interests in the hedge funds they control although they lobbied against the proprietary trading prohibition. The Chinese banks must seriously take into consideration the transformations of the American competition

There are different scenarios for the reactions of the American investment banks. It is hypothesized that in a smaller and less competitive financial industry, they want to improve business ethics and abandon proprietary trading and adopt a more ethical profile.

Another theory claims that the proprietary trading business is no more profitable as noise traders and generally a large part of naïve market players have withdrawn their interest in participating and now they stay out of trading activity.

Finally, they could just give proprietary game a different name and dismantle the units called "proprietary trading" by shifting the trading volume onto trading desks dealing directly with customers.

For example, Goldman Sachs' notorious Abacus program – which persuaded American International Group to sell vast amounts of low cost insurance to offset subprime mortgage risk, and then sold short the contracts they had underwritten themselves was not an action from the prop trading desk but from a division called "Client Facing Group."

Naturally, none of the above speculations may turn out to be true or a combination of the three scenarios may finally prevail. However, this entire situation highlights the transitional phase of the global financial system, and gives Chinese banks the opportunity to expand in all sectors.

3. China Status Obstacles and Recommendations towards the Transformation of Shanghai/Pudong into a Global Shipping OFC

3.1. Shanghai's Status as a Maritime Cluster (MC)

Shanghai may incorporate various features of an Offshore Center, including a favorable tax regime, in order to grow as a shipping center. In Shanghai it may be safe to assume that a shipping cluster has already been formed. Despite fierce competition from London, Bermuda, and Cyprus and Singapore has already attracted famous Norwegian ship-owners and shipping companies. However, the idea is to go one step beyond and establish itself as an international shipping financial center as well.

Governments yield to global pressure, because corporate tax rates vary widely across jurisdictions and even business sectors that are enjoying special tax privileges within a country. The development of the shipping sector is deeply affected by choices on personal tax rates, wealth tax policies, or even inheritance tax issues, therefore the executives of shipping forms are enjoying lower taxes in certain jurisdictions. As a result of specific policies, a great number of ship-owners traditionally prefer to reside in London.

Shanghai may also follow London's example by making efforts to attract the headquarters of marine services companies and even provide financing through IPOs. Shipping company IPOs opportunities are becoming very scarce lately, but technical and commercial marine services are much less saturated and diversified regarding their business activities. These stocks fall into various classifications such as industrials, engineering, logistics or ports, equipment manufacturers, ship-to-ship transfers, marine oil services, environmental services or brokers. Marine services may have lower profit margins but their income is more stable unlike highly cyclical ship broking business. In the market sector, Singapore is a strong opponent as a center thanks to its favorable tax regime. What is more, marine services are coping with market crises much better than ship owners, since they are related to operations and maintenance expenses and not so much capital expenses.

3.1.1. Recommended MC and Other Policy Measures

Western companies tend to be discouraged from entering the Chinese markets due to "buy Chinese" government procurement policies, and increasing limitations on foreign investments. For instance, the National Development and Reform Commission, the leading economic planning organization in China, has given instructions to national, provincial and local government agencies to purchase exclusively Chinese-made products with the funding originating for $600 billion economic stimulus program.

Imported goods are eligible only in the absence of relevant Chinese programs. Nevertheless, the country has committed itself, when China joined the W.T.O. in November 2001, to allow free trading in government procurement.

Furthermore, there are export restrictions, such as steep export tariffs to tonnage quotas and even export bans, for minerals which China has in very high production volumes, e.g. zinc for making galvanized steel, bauxite, and rare earth elements which have countless applications in modern manufacturing.

Shanghai could establish an organized commodity exchange for these raw materials, using the existing platform of Shanghai Futures Exchange, for example. This could increase China's revenues from the rare, sought-after commodities, by forcing market participants from all over the world to bid up prices. This could remove in the short term some element of competitive advantage to certain manufacturers in China, but it would be compatible with WTO commitments and such a policy increases economic efficiency in China, as a whole.

What is more, by reforming government procurement policies, China would encourage more multinationals to establish headquarters in Shanghai, and in parallel, the financial center would benefit from this change of attitude towards foreign companies, as the collocation to the headquarters of multinational firms will boost the financial sector.

The role of shipbrokers has always been strategic in maritime clusters, due to their access to accurate local knowledge. London's broking network may is already doing business in China, but never as full partners. Up to now, the majority international shipping companies had offices in China, and unofficially they acted as brokers and they could not even issue and collect invoices in RMB. The Chinese State has already proceeded with granting licenses to Braemar, Clarksons, and Simpson Spence & Young and this policy could continue, as it is very beneficial for strengthening the shipping cluster in Shanghai, and business relationships. What is more, a similar policy must be followed by allowing international cruise operators to register and establish agencies in Shanghai.

The contribution of London's shipping professionals will enhance legal, financial, underwriting and broking services. Shanghai's move to grant licenses to foreign will regulate much better the industry and exclude unwanted outsiders. Thus, top foreign ship brokers can expand the scope of the business without restrictions that the status of a "representative office" poses.

Shanghai must also take initiatives to play a leading role as a maritime hub, relying on the Chinese shipping sector at first, before Asian competition renders this impossible. Shanghai could enhance its position as a maritime hub, if these procedures were simplified and converged to the legal system of the Bahamas, Panama or Singapore.

3.2.Stock Exchange Operations and Equities Markets

3.2.1. Chinese Equities Markets

Chinese financial markets are characterized by high stock market capitalization, although bank financing still plays a predominant role in the economy.

There are, however some deterring factors for foreign investors, that are obstacles for an even faster inflow of funds into the Chinese equities markets, mostly regulatory ones. For instance, poor corporate governance and the phenomenon of not so favorable initial public offerings (IPOs) for investors, where the Chinese State has an interest, are frequently reported as serious issues.

But, the Chinese state is aware of the importance of regulatory overhaul for better informational efficiency of these markets, which would give an incentive to investors to make bigger placements in China and relaxing restrictions, which could stimulate demand for shares of listed firms: indicatively, in 2009, the aggregate market capitalization of the Shanghai and Shenzhen Exchanges was approximately US$2.8 trillion, but the value of non-tradable shares reached roughly US$1.4 trillion.

What is more, foreigners would be motivated to give Shanghai an even greater role, if the following impractical classification of shares soon ended:

- *A shares* (valued in RMB): formerly inaccessible to resident investors & partially state owned. Foreign investors are subject to severe limitations, e.g. quotas under the Qualified Foreign Institutional Investor (QFII)
- *B shares* (valued in RMB but also US$ or HK$): formerly inaccessible to non-residents, but now open to all, including residents with foreign currency dealing accounts
- *C shares*: SOE holdings by public entities with a legal person status, unlisted)
- *H shares*: listed in the Hong Kong Stock Exchange, the New York Stock Exchange, Frankfurt etc. (mainly SOEs.)
- *Common stocks* of Chinese companies are also traded in New York (*N shares*), London (*L shares*), and Singapore (*S shares*) in the form of American Depository Receipts (ADRs). It is claimed that this division into several different share classes (A, B and C on domestic markets and H, N, L and S on offshore markets) is problematic for the overall liquidity of the system. The phenomenon of Chinese companies resorting to foreign stock markets is attributed to the strict rules of the domestic market.

The participation of non-resident funds in the Chinese equities markets still has enormous improvement potential, as they mostly tend to prefer direct investments or placements in offshore markets. In the last 20 years, China was among the top 5 international choices of investors regarding FDI, but we must not overlook that China's FDI have been declining recently because of strict State regulation and macro-economic controls. The costs of labor (mostly in thencoastal area) have also increased, which is otherwise a very positive development for the aggregate economy, but capital has a preference to be directed to inland China, or other markets. In other words, this fierce competition calls for reforms aiming at attracting funds even more intensively in the coming future, as far as China's equities markets are concerned. Domestic demand should also not be taken for granted, as the severe stock market losses due to the recent global financial meltdown, turns individuals into more risk-averse investors who may select the stability of bank deposits, or much worse highly speculative foreign exchange trading, which has nothing to do with investments and it heavily resembles common gambling.

What is more, the opening of Chinese capital markets to overseas companies must be viewed positively, as it does not represent conflict of interest for Chinese interests: it is a very lucrative business for the other global financial centers, and a basic condition for Shanghai, in order to become even more internationalized.

China's stock exchanges are mainly based on 3 business activities only: financial, extractives, and construction (roughly 80% weighting) — main drivers of the country's economic growth, and characterized by partial State ownership.

The Shanghai Exchange has a greater market capitalization than the Shenzhen Exchange and the Hong Kong exchanges, while it focuses on manufacturing and Small and Medium Enterprises (SMEs) and today, it is the 6th largest exchange in the world. However, the skepticism of potential investors often leads Chinese issuers to sell stocks or conduct IPOs on the Hong Kong Stock Exchange, where regulations are claimed to have more credibility.

Reforms regarding the following sector restrictions could boost market capitalization and attract more investments into the country by dealing with issues, such as lack of transparency for minority shareholders, or revising / cleaning up the balance sheets of the company under privatization process, in a more reliable way.

In Agriculture, edible lipids processing, (i.e., soybean and rapeseed oil processing, and biofuel production), chemicals (large-scale coal and chemical product manufacturing), logistics & transportation (e.g. passenger transport companies) could also be financed not only through Joint Ventures under Chinese majority control, but also through the stock markets with fewer restrictions.

Especially, restrictions regarding foreign control of financial firms (with a capping at 50 % for life insurers, 49 % for fund management and futures companies, and 33 % for securities companies), energy and resources restrain the international character of Shanghai as a global financial center.

Another problem is that many listed shares are related with former SOEs which are not particularly profitable, while, on the other hand, the more promising private companies have a preference for financing from their own funds or bank loans.

The market skepticism regarding the intrinsic value of enterprises, combined with frequent dispersion of rumors on intentions to liquidate large volumes of shares from the State, push down equity prices which are also affected by numerous accounting fraud cases, detected by the China Securities Regulatory Commission (CSRC). What is more, China's capital markets lag behind in terms of analyst coverage, if compared with the peer competition and it also represents a deterring factor for foreign investors.

The proportion of stock market participants in China differs from other states. Individual investors control 51.3% of the market volume, while institutional investors have much less power in China compared to other BRIC economies: individual investors constitute 24.4% of the Brazilian market and 13.1% for the case of India.

Individuals will also contribute to the future growth of the markets in the future, but institutional investors have a long-term ‘buy and hold’ policy and their role is promoted by the Chinese government.

Mutual funds control 26% of the market while the pension funds and insurance have a potential to grow from present low levels (0.8% and 2.5%) The influence of foreign investors is small.

Foreign institutional investors are severely restrained a 1.7% of the market, due to quota limitations, a regulation which needs to be revised, as a 30 billion $ quota severely impedes growth of the market. But even this minor foreign investor entrance has, so far, introduced competition, more efficiency to the market and improved corporate governance, but the time is mature for lifting the limits to e.g. 5 billion for every Qualified Foreign Institutional Investor (QFII), without endangering the stability of the system. Towards this end, China should also cooperate with international indices to include A shares. What is more, policies like repatriation of profits permissible only after 12 months, or upfront tax payment for purchasing A shares create frictions in the markets and, therefore, could be revised.

Of course, QFII capital flows will always entail a speculative element, counting on a further appreciation of the RMB for example. Therefore, given the volatility QFII financial flows, just increasing their investment quotas is not enough to bring significant positive impact on the Chinese stock markets

International investors are additionally given the choice of using American Depository Receipts (ADRs) to invest in Chinese companies listed through the NYSE or other U.S.A. markets.

In 2009, there were roughly 158 Chinese ADRs (with a value of approximately US$36 billion), 20 of them from Shanghai or Shenzhen stocks (and the remaining from Hong Kong or other stock markets). A shares trading through ADR is also very thin. In other emerging economies, like Brazil, ADR have a major role, which does not apply for China. Either way, a more globalized financial center of China would eliminate the need for the ADR.

The Asian competition is becoming fierce against Shanghai’s equity market, due to the pending merger of the Singapore Exchange (SGX) and the Australian Securities Exchange (ASX). This was a sudden development, as stock exchange mergers are common practice in the Western countries, but unprecedented in Asia.

However, the consolidated equities market capitalizations of both the ASX and SGX after the merger is lower. Hong Kong in Asia and its futures market for listed contracts is also not very high.

Generally, it is uncertain, whether this merger could further strengthen monopolistic pricing by a resulting more powerful exchange group (ASGX) or transactions costs will drop considerably, which is highly probable, because international competition is a constant threat. Asia still exhibits monopolistic traits in its exchanges with relatively high exchange fees. They have a bad reputation for being expensive for traders not only at the brokerage tier but also regarding the frictional costs which drive away even arbitrageurs.

It is generally accepted that the future belongs to exchange supergiants, and consolidations are the certain trend in the near future. Therefore, a merger of all Chinese exchanges and inclusion of all Chinese shares (even those that are traded overseas) in one exchange 100% open to even nonresident retail investors trading overseas could be the future for Shanghai. Their participation could be feasible via international brokerage firms, or via the future Offshore financial institutions of Shanghai's financial center.

3.2.2. High-Frequency Trading Platforms

High-frequency trading platforms for the Shanghai's capital markets must also be a top priority in its agenda for reforms, with a scope to attract more capital from other international financial centers.

In the U.S.A., high-frequency trading as a fraction of the stock markets has soared in the last 10 years and constitutes almost 75 percent of market volume. Some opponents accuse HFT of creating frictions in the cases of large order executions, but as a rule, high-frequency trading (HFT) increases liquidity (capability of opening and closing positions with low market impact), despite the fact that trading platform firms are not acting as liquidity providers anymore.

The function of the NYSE specialist as a market maker is almost obsolete, because electronic designated market makers (DMMs) and special liquidity providers (SLPs) provide liquidity in the stock markets, so the specialist model has lost its status.

This new system also allows splitting up orders to hide intentions and making frequent cancelling orders, in order to create confusion in the competition. These features are particularly appreciated by traders, because it provides some sort of confidentiality and gives options to maneuver around.

However, these systems are the future of capital markets, and they are here to stay despite the criticism about high cancellation-to-execution ratios, high sensitivity of price to large orders, etc., because market efficiency is growing, the market players are implementing increasingly more intelligent trading systems, and no one can intercept evolution in finance, global markets or any other competitive field, as history has shown.

What is more, no market player could be treated unfairly or sanctioned for totally legal market activities, even if they are controversial, like as the tactics employed in HFT trading. In the final analysis, this stimulates trading interest, attracts more capital and keeps the market alive.

The May 6 "flash crash" (initially triggered by a big automated sell order of a mutual fund manager, but further temporarily amplified by the activity of certain high frequency trading firms in New York), has created a certain degree of skepticism regarding high frequency trading. It is even claimed that other investors are at a disadvantage by front-running their orders and boosting market volatility, which theoretically deteriorates actual transaction costs for institutional investors in a period, when even few basis points as returns are so valuable.

These concerns are not reasonable, as the most recent surveys show that high-speed, high-volume market participants have minimized equity transaction costs, not inflated them. The average total cost of equity trading in the U.S.A. has lately increased due to smaller trading volumes and high volatility, while costs dropped in almost all global markets.

Regulators have considered setting constraints on high frequency trading, but this is bound not to happen, as it reflects 70% of stock trading volume in the U.S.

Market participants highly regard the liquidity from high frequency, although they are sometimes annoyed by marginally abusive methods, such as “pinging” equities, i.e. almost immediately placing and cancelling subsequent orders in order to detect useful “clues” about the existence of some institutional investor’s large intended placement, in order to gain a competitive edge.

3.2.3. Dark liquidity pools (recommendations)

A very useful feature that could be incorporated in China are the so-called dark liquidity pools, very popular in Europe, i.e. electronic trading platforms where institutional investors buy and sell large blocks of stock without publicity. They are usually autonomous, but in 2009, NYSE Euronext started a new initiative, called Smartpool. There are significant synergies here, as Smartpool will use NYSE Euronext’s universal trading platform.

The dark pools also match buyers and sellers, just like exchanges but there is no disclosure of market players’ intentions until the final execution. Due to this confidentiality, the stock price is not easily “lifted” a priori and optimum execution is achieved even in difficult cases, such as large block orders, or illiquid equities.

Traders have also come up with ‘gaming’ methods to exploit the dark pools, such as placing of many buy- or sell- orders in a dark pool, to test if there are any pending orders in it and attempt to gain from this information. However, this or other related practices could be considered serious market manipulation actions.

3.3.The Fixed Income/Money Markets in China

3.3.1. China’s Interbank Market

In China, the inter-bank market has grown into a complex system with various segments: bonds, inter-bank lending, bills, gold and foreign exchange markets in just 10 years.

In inter-bank bond OTC market, the aggregate value of bonds was 10.48 trillion RMB, about 2500% 1997 levels; exceeding 7,137 participants and diversified financial instruments such as government securities and policy financial bonds central bank bills, policy financial bonds, commercial bank financial bonds, enterprise bonds, short-term financing bills, asset-backed securities, bonds issued by international development institutions, U.S. Dollar-denominated bonds, etc.

Regulatory organizations (SROs) such as the National Association of Securities Dealers (NASD), the Japan Securities Dealers Association (JASD), the Korea Securities Dealers Association(KSDA) also contributed to the development of this market.

In recent years, a lot of achievements have been made in China's financial market development. However, the financial sector faces still various issues: there is asymmetry between direct and indirect financing and bank financing is overdeveloped in comparison to corporate bond market.

China has enormous potential for the further growth of the fixed income / money market due to a high level of savings reserved in bank deposits at low yields. Institutional investors could take advantage of these resources and offer better returns to retail investors in exchange, which is a fundamental shift of capital that Bank of China also endorses.

The outstanding volume of fixed income instruments amount in the China is already large, but lags behinds the size of Japan's bond market or other, more evolved markets in Eastern Asia, like its homologues in Korea, Malaysia or Singapore. The growth rates of China's market are very impressive, though.

In China, bonds can be divided into government and central bank sterilization aiming at mitigating overexpansion of credit) bonds, and non-financial or financial (the most common category) corporate bonds. Government bonds are the dominant category in the PRC.

For the moment, Debt instruments valued and traded in RMB are restricted to resident investors and Qualified Foreign Institutional Investors (QFII). Foreign individual investors do not have access to RMB-denominated bonds (treasury, convertible, and corporate), while retail resident investors can open an investment account at the Shanghai or Shenzhen stock exchanges. However, opening the Chinese bond market to retail nonresident investors through an Offshore Financial Center could give a boost to the overall market, because the Western world is lately very excited about investment opportunities in the BRIC economies. A network of Chinese offshore banks could take deposits from non residents, and feed the Chinese bond and money market, while the Central Bank of China could contribute to the system by offering deposit insurance, based on its vast reserves. Thus, Shanghai could become a homologue of Singapore or Switzerland, in the asset/wealth management sector, and guarantee a stable economic regime for non residents who can trust their capital, very well aware that the greatest foreign currency reserves guarantee it.

But first, nonresident investors must be more favorably treated, as the tax regime of capital gains includes a 25% corporate tax, for China Government Bonds, Financial Bonds, Corporate Bonds and

Commercial Paper, while they are also obliged to invest through Qualified Foreign Institutional Investors, exclusively.

What is more, there are serious concerns about the U.S. debt bubble reaching the bust stage in the coming years. It is virtually impossible for the U.S.A. State to pay back the $13.7 trillion it debt (to foreigners mostly) who will be soon discouraged from rolling it over indefinitely. This of course, leads to classical “printing money” solutions (already happening –read quantitative easing - QE), when borrowing money gets infeasible. The Fed Reserve balance sheet surged from $800 billion in 2008 to $2.2 trillion, while Quantitative Easing-Part 2 (deliberately baptized as sequel by the Fed, in order to emphasize that the remedy has been already followed, and there were no side-effects) includes $600 billion more and an additional $500 package in the third quarter of 2011.

The importance of the bond market is also strategic, because it could channel excessive liquidity away from the emerging real estate bubble in China, as it is characterized by Western analysts, who are very judgmental vis-a-vis this situation. The phenomenon of purchasing a multitude of residences just to keep them vacant for an indefinite time horizon, just like gold bullion is economically questionable and leads to distortionary asset pricing. The introduction of national property sales tax, in order to curb speculative purchases, cannot act efficiently in the above phenomena, since it only penalizes buying houses, with a view to getting rid of them fast to reap a profit, not for real use. This is also the reason why a more draconian “property tax” a yearly tax based on property holdings is imposed in Western tax systems. However, this attitude shows the desire of people to invest in relatively tangible assets and it should find a substitute in a more extended bond market.

Especially a highly liquid government bond market offers other advantages, as it could generate a yield curve that that could be a compass for the market participants, since a guaranteed rate for every maturity clearly defines credit risk, when it comes to pricing corporate bonds by dictating the relevant spread.

Thus, credit derivatives could even evolve, in order to “slice and dice” other sources of risk such as liquidity risk, callability and different tax regimes according to the financial engineering methods evolved in more mature markets. Complicated financial instruments cannot evolve of course, when the fundamental interest rates are not set by supply and demand.

When the bond market matures and funds outflows abroad are comparable to funds inflows, the central bank can totally give up capital control policies without negative repercussions from the next panic attacks, or speculative frenzies of foreign investors. The abolition of capital controls can trigger excessive exchange rate volatility, so a revised legal and regulatory system plus a complete range of domestic financial instruments needs to be deployed first, e.g. the development of derivatives / hedging instruments actively traded on a Futures Exchange market. Generally, China follows these principles, unlike the other Asian countries which suffered the consequences of their premature deregulation of capital controls in 1997).

Such a market, essential for institutional investors, could thrive under the right fiscal incentives, and lead to an inflow of personal funds from bank deposits into mutual funds, insurance funds and pension funds. This also spurs competition between banks and other financial centers, in their efforts to attract capital.

Reform in the primary and the secondary markets is needed though, in order to prevent frauds and manipulations as witnessed in the 1990's. After these cases, bond issuance has become complicated, as administrative procedures and a long approval period deter most firms. Especially, in secondary markets, its success is dependent upon its liquidity, which is a function of several factors. One such indicator is market depth, i.e. how robust prices are (how affected they are by the trading of especially large volumes of securities). Turnover ratios are the main proxy for this. Market tightness is reflected by bid/ask or and bond yield volatility. Finally, the so-called market resiliency shows how fast prices move from one equilibrium price range to another. A large-size for bond markets, adequacy and trust in legal and regulatory systems are prerequisites.

At the moment, Commercial banks are allowed to sell subordinated bonds for capital adequacy purposes and financial institutions, in general, have the choice of selling bonds for liability management applications originating from term-structure mismatch. Commercial paper is also a possibility for short term financing and debt securitization initiatives have slowly begun.

The issuance of corporate bonds depends critically on reliable independent reviews and timely announcements by rating agencies. Reliable credit rating agencies are required, a financial activity that could flourish in Shanghai, because they have the duty of independently conducting controls on the corporations and especially their bond collateral. Credit agencies and analyst coverage is also a very intensive business activity in terms of human resources. In the last years, Western agencies (Moody's Fitch, S&P etc.) have failed to inform the public of various negative developments in a timely manner, and it is time for Asian competitors to strike, given the severe loss of reputation capital of the traditional English and American agencies (five rating agencies dependent on the major international rating agencies have already been established). The Asian market is vast, absolutely needs thorough due diligence, and as soon 100% independent Chinese credit agencies are established in Shanghai, they should also expand their business in the Western and other Asian capital markets as well.

3.4.Mergers & Acquisitions, Leveraged Buyouts, Initial Public Offerings

3.4.1. The legal framework for Mergers & Acquisitions

China's M&A laws gradually lift restrictions on foreign investors who desire to restructure investments and strengthen their market position.

They can buy Chinese corporations and restructure present investments in China through mergers, spin-offs, and holding companies and the same applies for domestic Chinese companies, of course which also buy out foreign competitors. There is an expanding mergers-and-acquisitions (M&A) market in China, as China's regulatory framework did not favor M&A transactions very much, in the past. But thanks to China's World Trade Organization (WTO) accession, the game rules are gradually changing.

However, various restrictions and governmental approval requirements govern foreign-invested enterprises (FIEs) for all life cycle stages.

The most efficient method for foreigners to circumvent the regulatory environment, when transferring or buying out Chinese firms is to execute the whole process offshore. If an investment in China is realized via an offshore legal entity, a counterparty offshore vehicle simply acquires the first company according to the laws of the foreign jurisdiction. The Chinese state is not involved in such offshore transactions and no PRC government approvals are needed. Therefore, holdings in China with offshore holding companies, one per FIE, are versatile solutions.

Offshore schemes are not possible, when transfer of an equity stake or assets in China is involved, or from offshore investment into China, state approvals and limitations on foreign investments present obstacles. For instance, a foreign party may desire to sell its stake in an FIE it possesses without the use of an offshore holding company, directly to an offshore legal entity.

As the buyer is offshore, the transfer must meet the conditions set by the Equity Joint Ventures, or Wholly Foreign Owned Enterprises laws, and the Chinese party's approval.

The same applies, when a Chinese partner wants to exit a joint venture and sell their stake to the foreign party. If the foreign investor controls 100% the new scheme, the Joint Venture turns to a WFOE, which is subject to even more restrictions, and there may be complications in the approval process.

The approval process for JVs is complicated, demanding a general approval of the deal, then a feasibility study, and also of the joint-venture agreement and relevant documentation. The majority of JVs involve state-owned enterprises. Concerns about the optimum use of state-owned assets leads to slow valuation process for all assets involved in the deal. Many regulations are valid, but there is significant progress with relaxation of several rules due to the incentives that the government desires to give to foreign investors, in order to invest capital into SOEs.

Due diligence is also problematic as official records on a Chinese firm, e.g. legal titles to land-use rights, documents or litigation issues, priority security interests etc., may lack precision or be inaccessible. What is more, corporate accounting is vague for foreigners; state owned enterprises have severe confidentiality policies. Therefore, overseas parties seek warranties, indemnities for breach, and security for any indemnities. However, Chinese partners are not used to such practices which are common in the West.

Debt financing has complications due to capping for maximum leverage ratios for Foreign Invested Enterprises. As legal processes for pledging equity interests or registering security interests in assets are not complete yet, and their enforcement is problematic, banks are unenthusiastic about financing acquisitions. The inconvertibility of the RMB also complicates cash settlements of such deals. In cases where the government must pay in foreign currency, there may be issues with the State Administration of Foreign Exchange regarding the transaction. Also, investors importing capital into China for acquisition purposes, may not easily convert funds to foreign currency and export them later, after the capital has been converted to RMB and entered the FIE's capital account.

There is significant progress in taxation issues from the State Administration of Taxation by means of "the Circular Concerning Several Income Tax Questions Concerning Enterprise Equity Investments". It introduces income taxes for profits from sale of stakes in an FIE or a Chinese domestic company, 10% withholding taxes for sales via offshore companies; non taxation for transfers among affiliated legal entities, but taxation still remains a problem in many aspects.

What is more, the examination and approval authority (EAA) does not grant approvals for M&A transactions conditional on future events, e.g. payment of the purchase price, granting of a business license from the registration authority, etc. Legislation governing escrow and letter-of-credits as solutions to such problems is incomplete in China.

Multinationals need fast and procedures which are somehow incompatible with central economic planning and draconian regulations over foreign investments.

China's WTO entry gradually changes the country's policies on sectors, such as telecommunications, insurance, financial institutions, distribution and retail activities. A more liberal M&A market could lead to a more globalized role for Shanghai, so that it will not only play a regional financial center, but expand its international impact.

Towards this scope, in 2009, the State Administration of Foreign Exchange enforced new regulations for the administration of foreign exchange intended for overseas investments by Chinese companies: the Administrative Rules for the Foreign Exchange Administration of Domestic Entities' Overseas Direct Investment. These rules are essential for investing in foreign commodities firms and abroad assets, in order to secure raw material supplies.

This extrovert attitude can be seen in the Administrative Measures on Overseas Investment ("Circular No. 5"), by the Ministry of Commerce in 2009, simplifying overseas acquisitions. Central approval now applies only for investments worth more than US$100 million or more, when specific countries, including those with no diplomatic relations with China, are engaged in the deal, multinational Investments, or where an offshore Special Purpose Vehicle must be set up, or when there are national security issues. If these restrictions were lifted, at least gradually, Chinese firms could develop even faster reflexes.

Foreign exchange sources have been significantly enhanced to include domestic foreign exchange loans, foreign exchange from Chinese currency conversion, foreign currency reserves, physical/intangible assets, profits earned abroad, etc. Especially the latter can be kept abroad and channeled in overseas acquisitions, without prior SAFE approval if there are such purposes; nevertheless a SAFE registration for the foreign exchange is obligatory, and foreign currency from liquidations must be remitted back to China, if SAFE has not given the appropriate permission. In this point, there is further potential for relaxation of rules in the future.

3.4.2. Initial Public Offerings (IPOs) in China

In 2010, 33% of the $150 billion of the global IPO volume is conducted in China this year: 358 billion RMB ($53 billion) have been raised in by Shanghai and Shenzhen capital markets since Jan. 1, breaking the 2007 records. However, the average value is relatively low, as these equities go public on Shenzhen's ChiNext startup board which was launched in October and has less stringent listing rules on profit track record and other issues than China's two major stock markets.

Goldman Sachs, has the greatest share regarding overseas IPOs by Chinese firms and has expanded its local investment-banking unit's workforce by about 40 percent in 2010 as it aims at smaller domestic offerings on ChiNext IPO, as well. Shanghai IPOs, the biggest (Agricultural Bank of China Ltd. raised $10.1 billion) on Shenzhen's SME board, have created double revenues for underwriters with average fees 4.5% out of the 144 billion in ChiNext, as the deal workload for small cap firms is the same with large cap companies. ChiNext deals included 6 out of China's 10 worst-performing IPOs in 2010 (which is reasonable considering the inherent risk of small cap firms with small profit history) but just 1 in 10 top performers (a serious sign of weakness.)

Foreign investment banks are rushing to set up local banking units for stock and bond sales in China, which will surpass U.S.A. in equity market capitalization until 2030, according to Goldman Sachs. However, cooperation with a domestic partner is obligatory for foreign securities firms engaging in underwriting within China.

One major problem is human resources: According to the regulatory framework, every underwriting firm must include two so-called sponsors who will also underwrite in the deal. The sponsors are bankers who have passed a special test on underwriting organized by the securities regulator, with a past experience in equity offerings.

What is more, a sponsor can't be involved in more than two IPOs in parallel. A relaxation of these rules would result in a higher IPO deal execution and more Chinese firms could go public faster and raise much needed capital for expansion without being forced to go overseas for their IPOs and not select Shanghai or Shenzhen for investment banking services. The market offers many business opportunities at the moment, as a multitude of small, privately owned companies wish to become listed.

Goldman Sachs set up Goldman Sachs Gao Hua Securities Ltd., in 2004. UBS did the same 2 years later with UBS Securities Co. Deutsche Bank AG, Credit Suisse Group AG and CLSA Asia-Pacific Markets have also entered the IPO business in China, while JPMorgan Chase & Co. is underway.

This is significant competition for China International Capital Corp. and Citic Securities Co., the leading IPO underwriters in China in the last 10 years, whose market share dropped to the lowest levels in the last years, because their IPOs are smaller deals. Nevertheless, they still remain in the first and second position due to the enormous deal of the Agricultural Bank.

Generally, foreign underwriters tend to pay more than their local rivals and employ not so many investment bankers (with higher salaries), so they do not have the resources to consider minor deals, which are the target of domestic securities firms.

3.5.Hedge Funds Specializing in China

Up to now, hedge funds specializing in China have been trading since a long time, but not within the jurisdiction of China. Lately, there are several initiatives to open hedge funds in the country: China's second largest asset management company E Fund Management Co. with $29 billion under control (200 billion RMB in assets under management in March 2010) - is about to start a hedge fund in China. E Fund, which has $29 billion under management, was allowed to be funded from high-net-worth individuals in segregated managed accounts and apply hedge fund strategies in a new trading scheme.

Measure such as allowing index futures (e.g. CSI 300 Index, 300 major stocks on the Shanghai and Shenzhen exchanges) and short selling in April, are in the right direction, so that phenomena such as extreme fluctuations where Shanghai Composite Index soared 80 % in 2009 before crashing, can be prevented to a large degree.

By means of separately managed accounts, asset management firms imitate operation mode and strategies in western hedge funds, with similar "2-20" fees, i.e. 2% management fees plus 20 % from new profits, as it is common in UK/ U.S.A. Gearing ratio is restricted in China for these investment vehicles, as brokerage firms do not operate as one-stop shops like prime brokers in the U.S., so the hedge funds are forced to allocate more capital for their long / short positions. What is more, stock lending is possible for much less listed firms, than what is common abroad.

Short sales is a very important condition, in order to have a developed hedge fund industry and prevention of stock bubbles, as bullish investors can take a position and go short, if current price levels appear overvalued to them.

Rival exchanges like Singapore, and Hong Kong evolved very much in this aspect vis-a-vis Shanghai. Hong Kong's strong equity market with a flourishing IPO market facilitates securities lending, although fixed income securities lending remains small in Asia. 96% of the income originates from the lending fee rather than from cash re-investment as in Europe (83% for lending U.S.A. equities).Hong Kong securities lender revenue derives from a high lending instead of proceeds from re-investing the cash, and these financial operations can be very profitable.

Securities lending proceeds in the developed markets are falling, but this does not apply for Hong Kong, where they are progressively rising, while lending fees are stable. Hong Kong is even threatening the U.K. market, which shows signs of deterioration: 1,900 U.K. small cap shares were eligible 3 years ago, but now they have been limited to 1,400.

In Hong Kong, there are 930 eligible equities besides the main index (HSI) in contrast to 808 choices, 3 years ago. This is due to the increased number of IPO in HK, but also to the large asset managers who are extending their portfolio in this market. As short selling makes markets increase liquidity and price efficiency, the growth of securities lending in HK shows the right direction for all exchanges of the region.

3.6.Shipbuilding Financing

China has beaten South Korea, by becoming the premier shipbuilder in the world in august 2010, according to statistics regarding the first 6 months of 2010, in terms of ship deliveries, deadweight and tonnage. This development is however taking place at a time when shipbuilding boom-bust cycle reaches a plateau and entering a danger zone: Due to the intervention of the Chinese stimulus package, since 2009, China's financial system is also confronted with a growing portfolio of non-performing loans.

According to China's Banking Regulatory Commission request for risk self-assessment of the banking institutions, last July, banks have to deal with default events concerning \$228bn (approximately 20%) out of the \$1.1trn in loans issued to local governments which are financing regional infrastructure plans.

The volume of loans issued to Chinese shipyards is largely unknown, as details shipyards financing are not given. Exim Bank of China, the largest Chinese lender in shipping finance, invested \$23.6bn to the two largest shipbuilders, China State Shipbuilding Industry Corp and China Shipbuilding Industry Corp in 2009. However, Chinese institutions are also financing newbuildings for foreign or domestic parties.

The lending terms from Chinese financial institutions (Exim Bank of China, China Citic Bank, Bank of China, and Bank of China Hong Kong) are becoming very attractive lately for shipbuilding projects. For example, five-year notes issued for the building of new vessels for Cosco had a 4.5% annual rate (28.5% of the total cost of the project), which is very beneficial for a shipping company which also contributes 37% of the budget from reserves, and 34.5% from other bank loans.

The current spreads offered, e.g. at 0.4%-0.5% plus three-month London interbank offered rate, or three-month Libor plus 1.25%, are considered very favorable for a risky sector like shipping, and it is a measure aiming at crushing competition from Korea, which Japan had accused of unfair indirect subsidies to its shipbuilding industry in the past. Korea has also developed dependence on international capital sources, which are now almost depleted, as European ship-owners and firms are responsible for 60% of the orderbook volume. Right now, European financial institutions are also going through a crisis, and they have become more selective when issuing ship loans, and extremely cautious regarding dollar denominated risk exposures.

However, according to the China Association of the National Shipbuilding Industry, \$29.5bn more are needed for the shipbuilding sector to stay healthy, and at the same time there are also growing concerns about the non performing loans. So, ship funds finance shipyards holding contracts that are in default, although their funds are definitely insufficient against the sheer volume of the problem. And to make things even worse, funding costs may rise, although state-owned commercial banks have kept them so low.

As economic recovery is decelerating, major shipping banks worries about the large orderbook, mainly in the dry bulk market segment. At the moment, bank lending generally is severely constrained by capital ratio requirements, loan spreads are much higher than before the recession, but cost of capital for banks is also high which makes their operation more difficult in these times. Thus, banks with significant shipping exposure like RBS have become particularly cautious, while others like Fortis have merged to survive. On the other hand, the two main Nordic shipping banks, Nordea and DnB NOR and the German Commerzbank are well positioned.

Due to limited scrappage potential and decreasing liquidity reserves of clients, the shipping loan portfolio can deteriorate even further to the point of falling into the infamous non-investment grade class.

3.7.Currency policy

Shanghai must find the golden mean in terms of the banking regulatory framework in offshore banking, in order to achieve aggressive expansion in the next year against the Anglo-Saxon competition, but also ensure avoiding the pitfalls of extreme relaxation of regulations as witnessed in the last global financial crash.

Given that America’s banking system will remain very defensive and risk averse in the coming years, Shanghai’s banking industry has a golden opportunity to attract talent and create the relevant corporate culture that will generate Chinese world leaders in investment banking and dethrone the Anglo-Saxon competition. Therefore, proprietary trading, at least for a limited fraction of the reserves, should be allowed for banking institutions under the Chinese jurisdiction and incentives must be given to Western top traders to man the trading desks in Shanghai.

China should avoid the unfortunate path Japan selected in the past regarding its submission to the U.S.A. pressures on currency policies. Japan had managed to accumulate tremendous amounts of U.S. Treasury paper due to long term history of trade surpluses, and thrift and simply gave in to U.S.A. pressures to let the Yen float upwards, so Japan was eventually harmed from its large holdings of U.S.A. paper and in addition its competitiveness was damaged in an irreversible manner.

The American hypothesis that upward-floating of the RMB could contribute positively to U.S.A. competitiveness and increase employment domestically, is considered by many a myth, if we take into consideration the Japanese Yen case. Whatever may be claimed, however, it is a fact that a depreciation of the dollar vis-à-vis the RMB would allow the Chinese industry to outbid American producers in global commodity markets with their stronger currency.

The theorem of Milton Friedman, that a devaluated currency simply boosts exports, has serious defects, as in practice, it lacks verification (it is valid perhaps only in the opposite way, because any competitive edge is lost, as soon as stockpiled imports are consumed.) In the next stages, a soft currency is confronted with expensive imports. What is more, a new American manufacturing base aiming at exports takes years to develop, and after the" offshoring" process of the U.S.A. industry, this is largely an impossible feat. This transformation is to a large extent irreversible.

The argument that the Chinese deliberately keep their currency weak is illusory. The actual power of currencies is a function of the reserves held against them in the Central Bank, and by the volume of the export industry behind them, therefore, RMB can be considered a hard currency.

It is expected that the leadership of China will not give in to external pressure. However, countermeasures against the effects of the U.S.A. Quantitative Easing floods of dollar must be taken. Otherwise the security of the savings of the Chinese people will be compromised. This attack can be intercepted by developing an Offshore Market for debt denominated in RMB and gradually shifting the sovereign debt portfolio of the Central Bank of China to shorter maturities. Unfortunately, we have reached a point, where the sheer volume of unpaid and unmanageable sovereign and private U.S.A. debt exceeds any precedent in history, seeks salvation through debt-abatement, i.e. quantitative easing / "printing money" or default. It may be considered that the U.S.A. ironically put the blame on others. This is one of the fundamental reasons why RMB offshore markets must reach big dimensions in the coming years.

The best countermeasure of China, which can also establish Shanghai as a global financial center, comparable to London, is to aim at making a larger proportion of international balance sheets be denominated in RMB. Offshore markets have the power to impose the currency on exporters, importers, investors, and borrowers outside China. Such policy initiative can commence, even under significant capital controls, so that the Chinese State can still have the upper hand in capital account liberalization process, as monetary and financial stability risks always exist with offshore markets.

A more aggressive currency policy is also implemented by further increasing currency swap contracts with more countries as it is already happening with the Eurozone, Hong Kong, the Republic of Korea, Malaysia, Belarus, Singapore, Indonesia, and Argentina. Swaps with commodities, such as uranium or oil also serve this purpose.

3.8.Proposed Applications of Offshore Finance for Shanghai

3.8.1. Shipping / Aircraft Finance

Shipping and airline companies are similarly attracted by the special features of the so-called special purpose vehicles, in order to pursue financial activities in a more advantageous tax environment. Thus, an onshore corporation opens / icorporates an IBC (i.e. international business corporation, limited liability vehicle registered in an OFC) to proceed with leasing purchases or registering of ships or aircraft.

The common denominator is the “flag of convenience”. Airline or shipping companies are particularly concerned about civil aviation regulations, fears bout about non-cooperation, in cases where the aircraft (from the financing side, when the asset belongs to non-OECD companies) must be surrendered, security interest enforcement, political implications, lawsuits, or potential arrest of legitimately acquired assets. Thus, aircraft and vessels are most often registered in offshore jurisdictions, but funded by financial institutions in onshore financial centers.

Thus, asset holding vehicles are generally preferred by corporate conglomerates as a legal risk immunity countermeasure for high-risk assets in shipping and airlines. The separate ownership represents an excellent legitimate loophole for laws regarding group liability and environmental issues.

3.8.2. Risk and Wealth management for asset protection

Captive insurance companies are common in OFCs, as onshore insurance firms use these subsidiaries, in order to reinsure undertaken risks and minimize total actuarial reserve and capital requirements.

What is more, high net worth individuals and corporations from states with vulnerable economies and financial/banking system, have an incentive to implement overseas companies which provide them immunity from potential domestic currency depreciations or domestic banking crisis, which usually trigger exchange controls, as well. Offshore entities called trusts also offer protection from forced inheritance provisions, lawsuits, confiscations / seizures, etc. For such applications, confidentiality is a required characteristic in the offshore entities.

Another important aspect of wealth management is tax planning via offshore companies, trusts, and foundations. Multinationals also resort to low tax OFC solutions to cut down on tax payments by shifting onshore profits to low tax jurisdictions where invoices are issued (the so-called transfer-pricing method).

3.8.3. Banking

An onshore financial institution usually transfers various assets (mortgages, loans credit card receivables pools) to the offshore SPV which then issues asset-backed securities to the investors, under a more favorable tax regime and lax regulations. Banking institutions, thus, use this method in order to raise Tier I capital, in order to comply with the rules of their regulator.

Applications of offshore bank subsidiaries are FOREX trading, international joint venture funding, offshore fund administration services like integrated global custody, fund accounting, fund administration, and transfer agent services which are critical operations provided via such legal entities in offshore jurisdictions with no capital tax, no withholding tax on dividends or interest, no tax on transfers, no corporation tax, no capital gains tax, no exchange controls and loose regulation, monitoring, reporting rules or trading constraints.

Banking business in OFCs is conducted by branches and affiliates of banks incorporated in major financial centers of developed countries, or leading emerging economies.

The involvement of foreign banks in OFCs could just have an elementary physical presence, as “booking centers”/"shell" branches, but when it comes to OFCs such as Switzerland, Singapore or Luxemburg, these high caliber offshore centers provide specialist services as well.

Typical OFC transactions are foreign currency loans, syndicated loans, as well, keeping of deposits, the issuance of securities, over-the counter (OTC) derivatives, and last but not least asset management.

Eurocurrency funding can be initiated in the OFC or some other country and just booked and transacted in the OFC, due to tax incentives. This creates significant volume of inter-bank capital flows between branches and affiliates of a banking institution with offshore activities.

Eurobonds traded in international capital markets are mainly issued in OFCs, but the promotion and sale occur mainly in the global financial markets. Recently, Special Purpose Vehicles (SPVs) registered in OFCs are often behind structured finance arrangements due to favorable taxation. The issuance of international money market instruments (bonds and notes) are also an important OFC banking activity.

Finally, it must be emphasized that OTC derivative instruments can only be booked in specialist prime OFCs, in general. Furthermore, such contracts are characterized by significant counterparty, settlement, liquidity and legal risks. Therefore, the contribution of major financial centers is needed for the arrangement. Over-the-counter trading in derivatives is thus strong in U.S.A., in International Banking Facilities, in the Japanese Offshore Market, and to a limited degree in other major OFCs.

Deposit from individual clients is also an activity mainly for more sophisticated OFCs by prestigious banks due to the frequent absence of deposit insurance in OFCs. The incentives are income and capital taxes, naturally, and the resulting capital flows are directed to reliable, liquid assets in primary financial centers. These banking transactions take place mainly on-balance sheet, but also via funds run by banks in major centers. Generally, OFCs are popular for personal funds as trusts or other legal entities. Financial institutions, law firms or other specialists are behind them, most of the time.

3.8.4. Investment Management / Hedge Funds

Hedge funds are a strategic field for Shanghai in its course to become a global financial center, since it represents the future of Asset Management, a sector in which Singapore is a powerful player in Asia.

The main reason foreign investors would not invest e.g. into a U.S.A. registered hedge fund, is that they would either be double taxed or they would be obliged to confirm if a tax convention between their country of residence and the U.S.A. applies. Thus, foreign investors resort to jurisdictions without taxes for investment vehicles, which offshore centers are very popular, and especially the Cayman Islands.

The English Common Law (Bermuda, the Cayman Islands, the Bahamas, and the British Virgin Islands), or the European Civil Law (The Netherlands Antilles) are governing contracts of hedge funds most of the time, not U.S.A. common law style corporate laws; taxes, the legal system, and reputation are the criteria of investors when it comes to selecting the domicile.

A credible supervisory authority is essential, since in an international context it facilitates the trust build up process between parties who don't know each. No supervision will discourage the investor from investing but an extreme degree of supervision will be an obstacle for traders, so a golden mean must be found by the jurisdictions. What is more, regulation is costly, i.e. cost of licenses for registered funds, incorporation fees and the cost of the service providers.

Generally speaking, the old European offshore centers are more expensive than the Caribbean islands. In the Caribbean region, cost is correlated with reputation, so the Cayman Islands are considered high end, followed by Bermuda, the British Virgin Islands and the Bahamas. Curacao, for instance, is not popular, since most of the hedge fund managers from the UK and U.S.A. clearly prefer the British legal system to the Dutch Civil Law.

The most powerful funds have global investment outlook and investor base. The ideal legal framework for a legal entity with global assets and liabilities is British common law nowadays, not U.S.A. Federal law. This also gives Cayman Island such a competitive advantage being the home for so many hedge funds as a common law jurisdiction. It is also why Bermuda, the Channel Islands, Singapore, Hong Kong, and the Bahamas, are also legal domiciles for a lot of hedge funds.

Cayman mutual funds are also the example of another success story in OFCs: this jurisdiction has light investment constraints, so it is ideal regulatory framework. Cayman mutual funds are subject to the Mutual Funds Laws securing mutual fund investors from fraudulent professionals. They make provisions for four classes of funds: licensed, administered, registered, and exempted mutual funds. Closed-ended funds do not fall into these categories. A necessary condition is that shares have to be issued first, redeemed or repurchased according to the wishes of the investor and they aim at equally distributing profits/losses, i.e. investment risks among the shareholders.

The Cayman Islands Monetary Authority (CIMA) supervises licensed, administered, and registered mutual funds, the so-called "regulated" mutual funds. The other fund categories do not file documents with the CIMA. If a fund is under US$50,000, then it does not qualify for the "registered" class with the minimum regulatory restrictions. Funds must be incorporated before they can be registered, by first creating the legal entity, and then granting this entity with the right to operate as an investment fund.

The most novel Cayman company structure is the SPC, an evolution of the "umbrella fund", which could originate by founding a Cayman Islands exempted company with a multitude of classes of redeemable shares, corresponding to different assets portfolios.

An SPC can thus have multiple segregated portfolios (SPs), appealing to different investment styles and so fund managers can separate the assets and liabilities per SP or the general assets and liabilities of the

Company. SPC is the sole legal entity, but, the SPC must file an annual notice declaring the name of each SP it has formed.

Funds may implement the SPC structure for all kinds of applications, e.g. a bond, income notes, catering to the tax peculiarities that come up in onshore jurisdictions. The SPC is a typical model for Cayman's efficiency and responsiveness. It shows how hedge funds are not only effective vehicles for global market speculation, but they also use highly sophisticated regulatory framework Shanghai could imitate all the special characteristics that gave Cayman Islands this privileged position among the other OFCs specializing in fund management.

Finally, it must be stressed that hedge funds consider long term institutional investors, as a target group, not retail investors who flee at the first crisis or any political event terrorizing the markets. One such source of funding for hedge funds is the reinsurance company assets. Re-Insurance firms act as accumulators of institutional insurance funds raised at the regional/local level, but they need to be located offshore to be able to achieve returns as high as 18% per annum return, to serve e.g. hurricane claims. The offshore legal separation also offers "protection" from unsuccessful interventions of politicians / regulators, e.g. in the U.S.A.

3.9.General Additional Recommendations for Shanghai

In order to evolve as an Offshore Center, Shanghai's financial centers must give non-residents the opportunity to borrow in the RMB which would create a more extrovert banking activity shifting currency exposure from domestic residents to the best investment opportunities globally. Furthermore, offshore markets boost economic activity as they make possible the separation of currency risk from country risk.

There are enormous potential benefits for the Chinese to distribute financial risk across the globe via Offshore banking transactions. This step was taken by City of London, when the Eurodollar market was gradually developed from the 60's onwards. Without the growth of RMB offshore markets, the RMB will not reach a status as high as the US$ possesses today, in international business and payments.

What is more, Hong Kong has already begun to evolve into an offshore center for RMB, (regarding bank deposits, fixed income products and commercial credit). If China misses the chance of becoming an international financial center, and converges more to the Tokyo / Frankfurt model (with a regional character), non-China residents will conduct RMB transactions with non Chinese banks, although the RMB will have eventually become a reserve currency, a development that is taken for granted by the global markets nowadays.

An official support / endorsement of offshore market is essential, as the U.S.A. paradigm shows: despite the fact that the U.S.A. government had imposed capital controls from the late 1960s until the early 1970s, they never attempted to cause any problems to the flow of payments through U.S.A. banks which was necessary for settling offshore trade and investment transactions. So-called Eurocurrency markets, i.e. money markets outside the borders of the country where it is legal tender, are dependent on the participation of onshore banks, so convertibility of the currency for non-residents must be possible, at least in the worst case, via foreign banks outside the country. As long as this applies, long and short positions in the currency could be opened offshore, also in the absence of complete liberalization of capital account controls by the onshore regulatory authorities, as in the case of the Chinese currency. Even if offshore banks cannot make clearing transactions via onshore banks, offshore markets could also grow, but not to a significant degree.

Significant transformations are already taking place regarding RMB, as a non-deliverable forward exchange market creates an elementary money market and the non-deliverable interest rate swap markets act as a bond market. They are rather developed, if compared with their onshore homologues; therefore even an elementary yield curve for RMB offshore is available offshore. So we come to the conclusion that conditions are mature for launching offshore deliverable money and bond markets.

Offshore yield curves have significant divergences from their domestic, homologues with arbitrage potential, however thin trading cannot make the curves converge together. If the currency became deliverable offshore, the game rules would not change considerably. This already applies to H shares in Hong Kong: the spread between onshore A shares traded in Shanghai and offshore H shares traded in Hong Kong is significant.

It is crucial for Shanghai to adopt the characteristics of Offshore Financial Centers, because all International Financial Centers (IFCs) i.e. London, New York, and Tokyo have created internal offshore markets (Euromarket, IBF, JOM), in order to enhance their regional financial center status and achieve global impact in the finance industry.

As a first step, Shanghai should launch an offshore market, incorporating elements of the Japanese Offshore Market in its first form, but with more advantages and motives for corporations and high net worth individuals to move their business from overseas to Pudong. This is necessary, so that foreigners will have reasons to prefer Shanghai as an offshore financial center to the rest of the global competition. This offshore center should also have as a primary objective the internationalization of the RMB, as well. As a side benefit, the banking system of Chinas will be further strengthened by the inflow of funds into the financial circuit that all these measures will bring along.

These features could be:

- No taxation or limits on the flow of funds into the domestic market
- No withholding tax on interest income for offshore accounts
- No ordinary corporate and local taxation for offshore banking units
- No capping on allowed daily bank into the domestic market
- Provision for issuance of certificates of deposits
- Free floating of securities by non residents
- No documentation requirements to non residents prove such status
- No documentation for the intended destination of the funds for issued loans to nonresidents

- Absence of reserve requirements, not exclusively for the so-called out-out transactions, but also for transfers to the domestic market.
- Possibility for the establishment of IBCs- International Business Companies, i.e. limited liability vehicles registered Shanghai for various purposes, as it is practiced in other OFCs, with a special regulatory framework for shipping firms and other business sectors with mainly overseas physical and financial transactions.
- Development of an offshore deliverable money and bond market not only for RMB, but also for the Brazilian real, and the Indian rupee, given that non-deliverable forward exchange market and non-deliverable interest rate swap markets already trade creating basic yield curves for these currencies offshore. It would be beneficial for Shanghai/Pudong to specialize in Eurocurrency other major emerging markets as well, thus it will be positioned among the competition much better for the future global financial changes.

Considering the vast number of shipping firms of China, and its ambitions to become a maritime hub, characteristics of specialist OFCs should also be incorporated in a future offshore market in Pudong. These can be copied mainly from Panama (international maritime center) and the Bahamas (high number of registered vessels). The harmful Tax Competition issue is very powerful, when it comes to developing a shipping center, and thus the features of a future offshore center should not only be related to facilitating cross border transactions for shipping and other firms conducting international business. In order to attract the headquarters of shipping firms and extremely rich ship-owners, tax incentives are essential.

China's upper personal income tax rate reaching 45% is incompatible with Shanghai's target to become a global offshore / shipping / financial center, given that Hong Kong, a primary competitor has a 16% tax rate.

A 3% revenue tax on service firms, incremental to corporate taxes on profits, is even more deteriorating for Shanghai, so a revision of the tax regime aiming at boosting productivity and penalizing absurd accumulation of idle assets could be beneficial in an effort to develop business activity in Shanghai. For instance, an annual property holding tax that penalizes idle property could be imposed in a revenue-neutral manner, mitigating other taxes. It would also prevent nonresident investors drawn by the offshore financial center from contributing to speculative bubbles in the Real Estate Market. By accumulating properties without economic exploitation, speculators also inhibit the price discovery process on the secondary market, which is common, in certain jurisdictions like Monaco and Hong Kong. Such a policy should not have a temporary, spasmodic character, just to curb the market overheat, otherwise investors are further motivated to buy and keep vacant properties indefinitely speculating on the government's retreat in this issue.

Finally, policies of an offshore center could help the Chinese economy to funnel unreported "grey income" back to the real economy, e.g. by offshore banking. The Chinese bond market would largely benefit from this measure. According to analysts of the China Reform Foundation, the rich Chinese class earn US$1.5 trillion as undeclared revenues (amounting to 30% of GDP), from various, more or less legitimate, activities. They are forced to resort to mobile, non-traceable assets such as gold and jade, in order to warehouse all this wealth, as domestic bank accounts or property registered and officially under the ownership of relatives or other affiliate partners are easily detected and seized. All this naturally leads to other asset bubbles, as well.

On the other hand, Chinese policy makers may decide to impose completely different regulations for nonresidents, and a high degree of bank deposit and/or corporate ownership secrecy, exclusively for this investor category.

As an offshore center, Shanghai/Pudong will function as a pipeline for international capital flows in cross-border deals and support employment in the city: Chinese or foreign corporations will no longer select other OFCs, which are very popular in international joint ventures, where all sides cannot come to an agreement by choosing one of the sides' jurisdiction for taxation regime reasons, or due to a simplified and adequate regulatory framework ensuring formalities for incorporation and immunity of assets from litigation.

Finally, the fierce competition between financial centers boosts liquidity in the onshore market, spurs growth in the nearby, less affluent parts of the region, further drives down credit spreads and generally, credit becomes relatively easier: this drives sustainable growth of the country.

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