



Technical Assistance Report

Project Number: 48010-001
Policy and Advisory Technical Assistance (PATA)
October 2014

People's Republic of China: Study on Local Financial Market Development and Supervisory Framework

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Asian Development Bank

CURRENCY EQUIVALENTS

(as of 15 October 2014)

Currency unit	–	yuan (CNY)
CNY1.00	=	\$0.1632
\$1.00	=	CNY6.1255

ABBREVIATIONS

ADB	–	Asian Development Bank
FAOL	–	Financial Affairs Office of Liaoning Province
GDP	–	gross domestic product
OTC	–	over-the-counter
PRC	–	People's Republic of China
TA	–	technical assistance

NOTE

In this report, "\$" refers to US dollars.

Vice-President	S. Groff, Operations 2
Director General	A. Konishi, East Asia Department (EARD)
Director	Y. Qian, Public Management, Financial Sector, and Regional Cooperation Division, EARD
Team leader	S. Lee, Financial Sector Specialist, EARD

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POLICY AND ADVISORY TECHNICAL ASSISTANCE AT A GLANCE

1. Basic Data		Project Number: 48010-001	
Project Name	Study on Local Financial Market Development and Supervisory Framework	Department /Division	EARD/EAPF
Country Borrower	China, People's Republic of N/A	Executing Agency	Liaoning Provincial Financial Department
2. Sector		ADB Financing (\$ million)	
✓ Finance	Finance sector development		0.20
	Money and capital markets		0.20
		Total	0.40
3. Strategic Agenda		Climate Change Information	
Inclusive economic growth (IEG)	Pillar 1: Economic opportunities, including jobs, created and expanded	Climate Change impact on the Project	Low
4. Drivers of Change		Gender Equity and Mainstreaming	
Governance and capacity development (GCD)	Public financial governance	No gender elements (NGE)	✓
5. Poverty Targeting		Location Impact	
Project directly targets poverty	No	Nation-wide	High
6. TA Category:	B		
7. Safeguard Categorization	Not Applicable		
8. Financing			
Modality and Sources		Amount (\$ million)	
ADB		0.40	
Sovereign Policy and advisory technical assistance: Technical Assistance Special Fund		0.40	
Cofinancing		0.00	
None		0.00	
Counterpart		0.04	
Government		0.04	
Total		0.44	
9. Effective Development Cooperation			
Use of country procurement systems		No	
Use of country public financial management systems		Yes	

I. INTRODUCTION

1. During the 2013 country programming mission, the Government of the People's Republic of China (PRC) requested the Asian Development Bank (ADB) to provide technical assistance (TA) for a Study on Local Financial Market Development and Supervisory Framework.¹ Following a fact-finding mission in June 2014, ADB and the government reached an understanding on the objectives, scope, implementation arrangements, costs, and terms of reference for the TA. The design and monitoring framework is in Appendix 1.²

II. ISSUES

2. The PRC's successful transition to a market-based economy has resulted in remarkable economic growth. The country's financial system contributed to this growth; its rapid development was attributed to various successful financial sector reforms by the central government. However, the national financial system of the PRC is still dominated by banks—total credit provided by the banking system reached 160% of gross domestic product (GDP) in 2012, whereas the stock market's overall capitalization was 45% of GDP and insurance sector assets accounted for less than 10% of GDP. The government's recent policy shift to quality, balanced, and sustainable economic growth called for the development of regional and local economies across different provinces, and the role of provincial and local governments has become more important. Regional³ or local financial institutions developed to meet local needs, especially micro, small, and medium-sized enterprises and rural households. The local financial markets have become more diversified thanks to city commercial banks, rural credit cooperatives, village and township banks, microcredit companies, guarantee companies, and regional over-the-counter (OTC) equity markets. However, no concrete studies have been carried out to assess the local and regional financial markets development and to define an effective regulatory and supervisory framework promoting more locally diversified financial markets.

3. Despite the rapid economic growth of the country as a whole, the uneven economic growth in different regions and provinces has been a major concern for policymakers and academic researchers. Research was conducted to determine the factors that contribute to provincial and regional economic growth. Although empirical literature had been pointing to various factors for some time, the disparity in financial sector development and its effects across the provinces and regions has become more highlighted in recent studies.⁴ The PRC's financial system is still dominated by major state-owned and large nationwide commercial banks, transferring the deposited funds from underdeveloped inland regions to more developed coastal provinces. In contrast, smaller and more locally focused financial institutions that form part of provincial and regional financial markets have more efficiently channeled funds to individuals and industries in the region. As a consequence, policymakers are now trying to determine the correlations between local and regional financial market development and local and regional

¹ The TA is included in ADB. 2014. *Country Operations Business Plan: People's Republic of China, 2014–2016*. Manila.

² The TA first appeared in the business opportunities section of ADB's website on 1 October 2014.

³ In this report, "region" refers to an area that consists of geographically neighboring provinces with similar agricultural or industrial base and characteristics. The distinction is made between local, provincial, regional, and national financial markets, since financial markets and systems often develop at different levels to support local, provincial, regional, and national economic activities.

⁴ Peng, Jing, Li, and Yu. 2008. Regional Finance and Regional Disparities in China, *China Economic Review*; and C. Hao. 2006., Development of Financial Intermediation and Economic Growth: The Chinese Experience. *China Economic Review*.

economic development, and the preconditions and specific policy measures taken to promote the regional financial markets. This will enable them to formulate an appropriate development strategy and policies. Liaoning Province is ideally suited to a case study, given its unique industrial development history and relatively well-diversified financial markets, which include state-owned banks, local commercial banks, securities and insurance companies, rural financial institutions, and OTC stock markets. Lessons from the case study in Liaoning Province could be applied to other local and regional financial markets in the PRC.

4. The PRC lacks a policy stance on how supervisory and regulatory authority should be assigned to central and provincial regulators, and this, too, requires a systematic study. The current financial regulatory structure in the PRC is subsector-based; as the central bank, the People's Bank of China is responsible for monetary policy and the stability of the financial system in general, while the China Banking Regulatory Commission, the China Securities Regulatory Commission, and the China Insurance Regulatory Commission are central authorities responsible for regulating the banking, securities, and insurance subsectors. Since 2008, the decentralization of financial supervision has gradually begun. This was reinforced by the PRC's Twelfth Five-Year Plan, 2011–2015⁵, which set out the goal of improving local financial management systems and strengthening the responsibility of provincial governments for managing the local small and medium-sized financial institutions. In 2012, former Premier Wen Jiabao also proposed to strengthen the provincial governments' awareness of and responsibility for financial supervision. As a result, the provincial governments were empowered with supervising authority for microcredit companies, new rural financial institutions, and credit guarantee companies based on the China Banking Regulatory Commission's regulations. In 2012, the State Council and the China Securities Regulatory Commission vested provincial governments with the authority to oversee regional OTC markets. However, the absence of systematic research on how to decentralize financial regulation and supervision in the PRC, and the lack of in-depth analysis and a clear plan to assign these responsibilities among central and provincial authorities have created uncertainty and the need for strategic directions.

5. Aligned with the PRC's Twelfth Five-Year Plan, ADB's country partnership strategy, 2011–2015 for the PRC identifies inclusive growth as one of the strategic pillars. The TA supports inclusive growth by improving access to finance through the development of local financial markets and by enhancing the supervisory and regulatory framework. This TA builds on the findings and lessons from the continuous ADB supports on this area such as TAs to improve capacity of the statistical competence of local financial institutions⁶ and development of rural financial system and supervision.⁷

III. THE POLICY AND ADVISORY TECHNICAL ASSISTANCE

A. Impact and Outcome

6. The impact will be the development of more effective and sustainable local financial systems. The outcome will be the successful implementation of local and regional financial sector and regulatory reforms based on the study outputs of the TA.

⁵ Approved in March 2011 by National People's Congress

⁶ ADB. 2012. Technical Assistance to the *People's Republic of China* for Capacity Building on Statistical Competence for County-Level Financial Institutions. Manila

⁷ ADB. 2008. Technical Assistance to the People's Republic of China for Rural Finance Development and Supervision. Manila

B. Methodology and Key Activities

7. The TA consulting team will prepare a main report on local financial market development and a supervisory framework. The report will include (i) an overview of the PRC's local and regional financial markets with clear definitions and data as general background, (ii) an analysis of the history and conditions of local and regional financial market development based on the survey conducted among locally or regionally focused financial institutions in Liaoning Province, (iii) in-depth analysis of the impact of the local financial industry on the economic and social development in Liaoning Province, (iv) lessons from exploring international case studies and good practices through desk studies and an international study tour in two selected countries that have successfully decentralized regulatory authority, and (v) recommendations and a road map for reforms needed to promote local and regional financial market development with a more efficient and decentralized regulatory system. Outputs for (i), (iii), and (iv) of the main report will be separately published as sub-reports, and as knowledge products and services (policy briefs) for policymakers.

8. The TA consulting team will also prepare a report with policy recommendations for formulating a road map and business strategy for Liaoning Province's regional OTC market. The report will (i) review the role and regulatory structure of the regional OTC markets in the PRC, (ii) define an efficient regulatory and supervisory regime, and (iii) provide a clear business and policy road map to promote a regional OTC market in Liaoning Province.

9. The TA will help strengthen the capacity of provincial regulatory authorities. A study tour, seminars, and workshops will be organized to also boost the Liaoning provincial government's capacity to handle the issues that arise from local financial market development and a decentralized supervisory and regulatory system. Market participants and central and provincial supervisory authorities will be invited as well. A final dissemination workshop will allow industry experts, government officials, and regulators to share their views and provide feedback on the reports.

C. Cost and Financing

10. The TA is estimated to cost \$440,000, of which \$400,000 will be financed on a grant basis by ADB's Technical Assistance Special Fund (TASF-other sources). The government will provide counterpart support in the form of staff time, access to data sources, assistance to field trips and meetings, use of office space and facilities, logistical support, and other in-kind contributions.

D. Implementation Arrangements

11. The executing agency is the Financial Affairs Office of Liaoning Province (FAOL) and the implementing agency is the Capital Market Division of FAOL. FAOL will administer training, seminars, and conferences. The advance payment facility procedure will be adopted, in line with ADB's *Technical Assistance Disbursement Handbook* (2010, as amended from time to time), to enable timely organization of training, seminars, and conference activities.

12. The TA will be implemented from 1 November 2014 to 31 July 2016. International consultants and national consultants will be engaged in accordance with ADB's *Guidelines on the Use of Consultants* (2013, as amended from time to time), and proceeds will be disbursed in accordance with ADB's *Technical Assistance Disbursement Handbook*. Output-based contracts with specified milestones will be used for all individual consultants. An advance payment facility

will be made available to FAOL to administer the workshops and study tour only when direct payment to service providers and suppliers is not practical.

13. Three international consultants for 8 person-months in total (financial sector specialist, financial sector regulatory specialist, and OTC market specialist) and two national consultants for 12 person-months in total (financial market specialist and financial market regulatory specialist) will be individually selected and engaged by ADB in accordance with its Guidelines on the Use of Consultants. The terms of reference for consultants are in Appendix 4.

IV. THE PRESIDENT'S DECISION

14. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$400,000 on a grant basis to the Government of the People's Republic of China for the Study on Local Financial Market Development and Supervisory Framework, and hereby reports this action to the Board.

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
<p>Impact Development of a more effective and sustainable local financial system</p>	<p>Decentralized and effective financial regulations and supervision systems adopted by 2017.</p>	<p>FAOL, People's Bank of China, China Banking Regulatory Commission, China Securities Regulatory Commission</p> <p>FAOL reports</p>	<p>Assumption Recommendations will be adopted and implemented.</p> <p>Risks Adverse changes in global and local financial market environment</p> <p>FAOL and State Council reject the recommended policies.</p>
<p>Outcome Successful implementation of local and regional financial sector and regulatory reforms based on the study outputs of the technical assistance</p>	<p>Reform measures and policy recommendations adopted and implemented by policymakers and regulators by 2017</p>	<p>FAOL reports</p>	<p>Assumption Recommendations will be adopted and implemented.</p> <p>Risk Unfavorable policy changes by central government and regulatory authorities</p>
<p>Outputs</p> <p>1. Three sub-reports and policy briefs on (i) analysis of the history and conditions of local financial market development in Liaoning province, (ii) lessons from exploring international case studies and good practices, and (iii) recommendations and road map for reforms to build more efficient and decentralized regulatory system</p> <p>2. A main report with summary of sub-reports on local financial market development and supervisory framework</p> <p>3. A report with policy recommendations on developing a road map and business strategy for Liaoning Province's</p>	<p>Three policy briefs for high-level decision makers as KPS and sub-reports published by 2016</p> <p>A study tour to foreign countries with successfully developed local and regional financial markets and supervisory frameworks by 2016^a</p> <p>Final report published by 2016</p> <p>A report and a policy brief published by 2016</p> <p>A clear business and policy road map to</p>	<p>Consultant reports and policy briefs endorsed by FAOL</p> <p>Study tour report submitted by the executing agency</p> <p>Consultant report endorsed by FAOL</p> <p>Report and policy brief endorsed by FAOL</p> <p>Business strategy and policy road map endorsed</p>	<p>Assumptions Sufficient data will be provided by government agencies.</p> <p>Good coordination among ADB, FAOL, and other relevant agencies</p> <p>FAOL's support and commitment</p> <p>Risks Unfavorable policy changes by FAOL</p> <p>Delay in mobilizing qualified consultants</p>

Design Summary	Performance Targets and Indicators with Baselines	Data Sources and Reporting Mechanisms	Assumptions and Risks
regional OTC market	promote a regional OTC market in Liaoning Province by 2016	by FAOL	
4. Enhanced capacity of provincial regulatory authorities	Training and workshops for relevant authorities by 2016	Minutes of workshop and evaluation by the participants	

Activities with Milestones	Inputs
<p>1. Three sub-reports and policy briefs on local financial market development and supervisory framework.</p> <p>1.1 Conduct a survey on local financial market development in Liaoning Province by month 6.</p> <p>1.2 Undertake study tour by month 7.</p> <p>1.3 Submit the interim sub-reports by month 8.</p> <p>1.4 Submit the final draft sub-reports and policy briefs by month 12.</p> <p>2. A main report on local financial market development and supervisory framework</p> <p>2.1 Submit inception report by month 4.</p> <p>2.2 Submit final draft report and final draft policy brief by month 14.</p> <p>2.3 Final report and a policy brief published by month 18.</p> <p>3. A report with policy recommendations on developing a road map and business strategy for Liaoning Province's regional OTC market</p> <p>3.1 Establish a road map and business strategy for developing Liaoning Province's OTC market by month 8.</p> <p>3.2 Prepare and review interim report and by month 11.</p> <p>3.3 Submit final draft report and final draft policy brief by month 14.</p> <p>4. Enhanced capacity of provincial regulatory authorities</p> <p>4.1 Conduct the first seminar and training by month 8.</p> <p>4.2 Conduct the second training and workshop by month 13.</p> <p>4.3 Conduct the final workshop by month 16.</p>	<p>ADB: \$400,000</p> <p>Note: The government will provide counterpart support in the form of staff time, access to data sources, assistance to field trips and meetings, use of office space and facilities, logistical support, and other in-kind contributions.</p>

ADB = Asian Development Bank, FAOL = Financial Affairs Office of Liaoning Province, KPS = knowledge products and services, OTC = over-the-counter.

^a The destinations will be ADB member countries found suitable after assessing international case studies and good practices in developing regional financial markets and supervisory frameworks. The study tour report submitted by the regulators will be used to draw lessons for sub-report 2.

Source: Asian Development Bank.

COST ESTIMATES AND FINANCING PLAN
(\$'000)

Item	Amount
Asian Development Bank^a	
1. Consultants	
a. Remuneration and per diem	
i. International consultants (8 person-months)	160.00
ii. National consultants (12 person-months)	60.00
b. International and regional travels	60.00
c. Reports and communication	30.00
2. Training, seminars, and conferences	
Study tour ^b	20.00
Seminars and workshops ^c	20.00
Resource persons	10.00
3. Miscellaneous administration and support costs ^d	20.00
4. Contingencies	20.00
Total	400.00

Note: The technical assistance (TA) is estimated to cost \$440,000, of which contributions from the Asian Development Bank (ADB) are presented in the table above. The government will provide counterpart support in the form of staff time, access to data sources, assistance to field trips and meetings, use of office space and facilities, logistical support, and other in-kind contributions. The value of the government's contribution is estimated to account for 9.1% of the total TA cost.

^a Financed by ADB's Technical Assistance Special Fund (TASF-other sources).

^b The study tour will be conducted in eligible ADB member countries.

^c Includes the costs for arranging venues, translating and/or interpreting, and disseminating the final report. Specific budgets and arrangements are subject to prior approval by ADB.

^d Includes one full-time assistant to handle workshop arrangements and market consultations with field teams. Costs of translation for the TA are included in this line item.

Source: Asian Development Bank estimates.

OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

1. Three international consultants (8 person-months total) and two national consultants (12 person-months total) will be individually selected and engaged by the Asian Development Bank (ADB) in accordance with its Guidelines on the Use of Consultants (2013, as amended from time to time). Output-based contracts will be used for all individual consultants and the specific milestones for payment are the submission of an inception report, interim report, and final report. The consultants will be required to provide (i) an inception report within 4 weeks of starting their assignment, defining a detailed work plan and milestones consistent with the design and monitoring framework (DMF); (ii) deliverables consistent with the DMF activities, outputs, and delivery dates; (iii) other papers and submissions required by the Financial Affairs Office of Liaoning Province (FAOL) to submit to ADB and FAOL. Reports are to be of high quality and in English, with copies in Chinese also produced by the report delivery dates.

Indicative Individual Consulting Services Inputs

Position	Person-Months
A. International consultants	
1. Financial sector specialist	4.0
2. Financial sector regulatory specialist	2.0
3. Over-the-counter market specialist	2.0
Subtotal (A)	8.0
B. National consultants	
1. Financial market specialist	8.0
2. Financial market regulatory specialist	4.0
Subtotal (B)	12.0
Total	20.0

Source: Asian Development Bank estimates.

A. International Consultants (8 person-months)

2. **Financial sector specialist and team leader** (4 person-months, intermittent). As a team leader, the specialist will be responsible for the timely delivery of high-quality reports, knowledge products including three subreports, and policy briefs. The specialist will also provide necessary support to FAOL (the executing agency) and ADB for arranging workshops and training. The specialist will deliver a main report on local and regional financial market development and supervisory frameworks, and three subreports that are components of the main report: (i) an overview of the local financial markets of the People's Republic of China (PRC) and an analysis on the history and conditions of local financial market development, including in Liaoning Province; (ii) lessons from the international case studies and good practices; and (iii) reforms to promote local and regional financial market development with efficiently decentralized supervisory systems. As a financial market specialist, the consultant must have sufficient knowledge of overall financial sector development and financial regulatory systems with at least 10 years of practical experience in the field. The expert will have strong English language skills. A university degree in economics, finance, or related fields, preferably a master's degree or higher, is required. The tasks and responsibilities of the specialist are:

- (i) Review the development of local financial system development in the PRC and identify preconditions through desk studies, surveys, interviews, and field visits. Assess how authority over financial market regulation and supervision is currently assigned.

- (ii) Identify the correlations between local and regional financial market development and local and regional economic growth.
- (iii) Review international best practices and deliver case studies of successfully developing a regional financial market and decentralized supervisory system.
- (iv) Lead the consulting team in producing and delivering an inception report, an interim report, and a final report with three subreports and policy briefs.
- (v) Write two subreports on (a) an overview of the PRC's local financial markets and an analysis of the history and conditions of local financial market development, including in Liaoning Province; and (b) lessons from international case studies and good practices.
- (vi) Prepare policy briefs based on two subreports.
- (vii) Conduct seminars and workshops for disseminating the findings of the studies among relevant authorities.
- (viii) Arrange and manage the meetings and the schedule for the study tour to the most relevant location.
- (ix) Control the quality of the final English version of all reports.

3. **Financial sector regulatory specialist** (2 person-months, intermittent). The specialist will have suitable knowledge and international experience in the field of financial regulatory and supervisory frameworks. The specialist will work with the financial sector specialist and provide necessary inputs for preparing the main report and three subreports. The specialist will be directly responsible for producing a subreport: reforms to promote local financial market development with efficiently decentralized supervisory systems, and a policy brief based on it. The specialist should have at least 8 years of relevant experience. A university degree in law, economics, finance, or related fields, preferably a master's degree or higher, is required. The expert will have strong English language skills. Experience in Asia, and particularly in the PRC, will be an advantage. The tasks and responsibilities of the specialist are:

- (i) Assist the financial sector specialist and provide necessary inputs, especially on the regulatory and supervisory regime of financial markets in the PRC, for preparing the main report and three subreports.
- (ii) Write a subreport and a policy brief on reforms to promote local and regional financial market development with efficiently decentralized supervisory systems.
- (iii) Work with the over-the-counter (OTC) market specialist to analyze the existing regulatory and supervisory framework for OTC markets and formulate appropriate policy recommendations.
- (iv) Arrange and manage the meetings and schedule for the study tour to the most relevant location.
- (v) Control the quality of the final English version of the report for publication.

4. **Over-the-counter market specialist** (2 person-months, intermittent). The specialist will be responsible for preparing a report on a road map and business strategy for Liaoning Province's regional OTC market. The specialist should have at least 8 years of relevant working experience. The specialist will also organize and arrange necessary trainings and workshops related to OTC market development. The specialist should possess strong English language writing and speaking skills. A university degree in economics, finance, or related fields, preferably a master's degree or higher, is required. The consultant will perform the following tasks in cooperation with international and national consultants:

- (i) Review and analyze the development of regional OTC markets, roles, and challenges.
- (ii) Assess the current supervisory framework for OTC markets and present policy recommendations to improve oversight and management.

- (iii) Study cases of successful OTC market development in other countries and regions, and draw lessons.
- (iv) Prepare a report and a policy brief on a sound and effective strategy for regional OTC market development and a road map of policy measures to be taken for Liaoning Province.
- (v) Locate, process, and provide necessary inputs and information to the consultant team, FAOL, and ADB.
- (vi) Be responsible for the content and accuracy of the final report version in Chinese.
- (vii) Organize training events, seminars, and workshops for regional OTC market development.

B. National Consultants (12 person-months)

5. **Financial market specialist** (8 person-months, intermittent). The specialist will assist the financial sector specialist and the financial sector regulatory specialist and provide necessary inputs. The specialist should have at least 7 years of relevant working experience. A university degree in economics, finance, or related fields, preferably a master's degree or higher, is required. The expert will have strong English language skills. The consultant will perform the following tasks in collaboration with the team leader and other consultants as appropriate:

- (i) Manage overall technical assistance (TA) implementation and quality, and ensure timely completion of the study tour, conferences, and reports as per the TA's DMF.
- (ii) Conduct surveys of, interviews on, and field visits to local financial institutions in Liaoning Province and provide any necessary inputs for the main report and three subreports.
- (iii) Arrange and manage the meetings and schedule for the seminars and workshops.
- (iv) Coordinate the implementation of the TA between the consulting team, executing agency, and ADB.
- (v) Provide any necessary logistical support for organizing seminars or workshops.
- (vi) Manage team discussions, ongoing stakeholder dialogue, and construction of the final reports to help ensure that international good practice is taken into account.
- (vii) Control the quality of the final Chinese version of all reports.
- (viii) Be responsible for the content and accuracy of the Chinese version of the final report.

6. **Financial market regulatory specialist** (4 person-months, intermittent). The specialist will provide necessary research input for analyzing the financial regulatory and supervisory structure in the PRC to assist the financial sector specialist and financial sector regulatory specialist. The expert will have sufficient knowledge and at least 7 years of experience in financial markets and legal and regulatory frameworks. A university degree in law, economics, finance, or related fields, preferably a master's degree or higher, is required. The specialist should possess strong English language writing and speaking skills, and have worked with law firms, financial institutions, or preferably with regulators. The consultant will perform the following tasks in cooperation with the international and national consultants:

- (i) Analyze and inform on the PRC's history of developing regulatory and supervisory frameworks for financial markets, and of policy changes with a focus on decentralization.
- (ii) Provide logistical support for organizing seminars or workshops and an international conference.

- (iii) Manage team discussions, ongoing stakeholder dialogue, and construction of the final report and subreports to help ensure that international good practice is taken into account.
- (iv) Control the quality of the final Chinese version of all reports.
- (v) Be responsible for the content and accuracy of the Chinese version of the final report.