On May 9, the State Council of China issued the "Guiding Principles for the Healthy Development of Capital Markets", which layouts the detailed roadmaps of China's future capital market development in nine major areas, including overall requirements, stock market, bond market, private equity, futures market, the competitiveness of the securities and futures sector, capital market openness, financial risks and market regulation. The policy is also referred as the "New National Nine Rules", in contrast to the earlier "National Nine Rules" issued in 2004. Under the nine broad guidelines, details on the directions and goals of reforms for thirty-three areas are specified, signaling the unprecedented resolution of Chinese government to push forward the comprehensive capital market reforms. It is government's aim to establish multi-layer capital markets, enlarge corporate and household investment channel, encourage efficient capital allocation as well as promote the economic restructuring. From macroeconomic perspective, we highlight the below reforms:

Further opening up China's capital markets

Following the recent announcement of Shanghai-Hong Kong Stock Connect Scheme on Apr 10, the Guideline again emphasizes on opening up the capital markets, with an aim to facilitate the cross-border investment and financing activities. Both inward and outward investment quotas under QFII and QDII programs will be increased. The shareholding limits for foreign capital in listcos will be relaxed. Domestic capital market will be steadily opened up for the direct investment of foreign individuals, and the domestic individuals investing in foreign capital market will be orderly pushed forward. Moreover, Xiao Gang, chairman of CSRC said this March that the potential QFII expansion is huge, and he mentioned that CSRC has been working on the QFII tax policy with other government agencies, as part of the effort to help facilitate QFII expansion this year.

We believed that this proposal will help inject more liquidity into China A share market, as well as expedite China's progresses in capital account liberalization in a boarder sense, including a) further relaxing the foreign investment management like holding period and remittance; b) implementing and expanding the Stock Connect scheme (see our Apr 11 note "A leap in China's efforts to liberalize capital accounts"); c) establishing capital account convertibility in SHFTZ and developing a domestic RMB offshore market; d) permitting cross-border RMB remittances by individuals and broadening channels for offshore banks to borrow/lend RMB in domestic market.

Promoting direct-financing

To develop a multi-layer capital market with proper structure, complete function and effective regulation by 2020, the Guideline highlighted the development of direct financing, which includes three major areas of bond market, equity market and private equity.

- On bond market, the Guideline aimed to a) develop a scheme of local government bond issuance; 2) enrich bond products suitable for various investors; 3) develop bond types for SMEs; 4) connect different bond exchanges and 5) improve issuance procedure, rating mechanism as well as 6) promote asset securitization. To develop a multi-layered equity market and cultivate a healthy private equity market are other two major areas in promoting the direct-financing.
- In A share stock market, the approval-based stock issuance system will be replaced by a registration-based one, and such move will be accompanied by the new IPOs governing rules published by the Securities Association of China the same day of the Guideline. Regulators will crackdown insider trading, enhance information disclosure, improve delisting regime, and support pension funds investments into capital markets by preferential tax policies.
- The State Council also said it will foster the market for private equity funds and venture capital funds. Going forward, the placement of private equity won't be subjected to administrative approval and funds of private equity and venture capital will be encouraged to support SMEs and newly-emerging industries.

We believe that such reforms will substantially help to improve financial stability and capital allocation in China. According to CSRC, 42.3% of financing in China belonged to the direct-financing category by end of 2012, lower than that of developed economies like the US (87.2%), Japan (74.4%), Germany (69.2%) and emerging markets like India (66.7%) and Indonesia (66.3%). As a result, risks are highly concentrated in banking system. And financing is expensive and hard to access for small borrowers. We expect that the reforms of promoting direct-financing will help enrich the investment channels for individuals and corporate, disperse risk in financial system, meet financing needs of SMEs and lower the funding cost for them.

Under such endeavor, China capital markets will be much more diverse, structured and transparent in the future, and will a) mobilize massive private savings; b) encourage inward portfolio flows; and c) lift market sentiment and valuation.

Promoting mixed ownership reform

Echoing the on-going SOE reform, the statement said to "actively" develop a mixed ownership economy, to improve the modern enterprise system and corporate governance structure, and to promote equity transfer. Specifically, it encouraged the employee stock ownership as well as M&A among companies of different ownership. Entry barrier and acquisition restriction on private companies will be further removed.

In our view, the mixed ownership reform is the key for China reform package on corporate level, which will help enhance SOEs' performance, unleash potential of private companies, better allocate resources as well as boost economic potential growth. According to our calculation, by Feb 2014, 62% of all Chinese listcos' market cap was SOEs either central or local ones, while private-owned only accounted for 38%. Among listed SOEs, 54% operated in monopolized sectors like oil & gas, banking, telecom and transportation, 42% operated in competitive sectors like food & beverage, auto, equipment, etc. Going forward, we expect 1) more monopolized central SOEs, in oil & gas, telecom and transportation, to open up for private capital investment with minority shares; 2) large chunk of local SOE shares in competitive sectors like F&B, apparel, electrics and healthcare will be taken over by private capitals; 3) more local SOEs assets to be listed or injected into listcos. More details of this reform will be elaborated in the upcoming SOE reform plan.

Managing a balance between innovation, development and financial risk prevention

While encouraging the innovation and modernization in China capital market, the authorities still keep the financial stability as paramount. Risk control, monitoring, reporting and disposal will go side by side with financial market evolvement. And most importantly, the bottom line of "no systemic or regional risk" will be firmly held, as per the Guideline. The policy also requires good management on the relationships of market vs. government, and investors at their own risk vs. investor protection. Investors should have a rational investment principle, awareness of risks, responsible for their actions and self-protection ability. Regulators will provide investors, especially small investors, the rights to know, to participate, to appeal and to supervise.

The statement is in line with the "orderly default" concept proposed by regulators in regard of trust market and other shadow banking market risk.

Appendix 1

Important Disclosures

Additional information available upon request

For disclosures pertaining to recommendations or estimates made on securities other than the primary subject of this research, please see the most recently published company report or visit our global disclosure look-up page on our website at http://gm.db.com/ger/disclosure/DisclosureDirectory.eqsr

Analyst Certification

The views expressed in this report accurately reflect the personal views of the undersigned lead analyst(s). In addition, the undersigned lead analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report. Lin Li/Audrey Shi

Regulatory Disclosures

1. Important Additional Conflict Disclosures

Aside from within this report, important conflict disclosures can also be found at https://gm.db.com/equities under the "Disclosures Lookup" and "Legal" tabs. Investors are strongly encouraged to review this information before investing.

2. Short-Term Trade Ideas

Deutsche Bank equity research analysts sometimes have shorter-term trade ideas (known as SOLAR ideas) that are consistent or inconsistent with Deutsche Bank's existing longer term ratings. These trade ideas can be found at the SOLAR link at http://gm.db.com.

3. Country-Specific Disclosures

Australia and New Zealand: This research, and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act and New Zealand Financial Advisors Act respectively.
Brazil: The views expressed above accurately reflect personal views of the authors about the subject company(ies) and its(their) securities, including in relation to Deutsche Bank. The compensation of the equity research analyst(s) is indirectly affected by revenues deriving from the business and financial transactions of Deutsche Bank. In cases where at least one Brazil based analyst (identified by a phone number starting with +55 country code) has taken part in the preparation of this research report, the Brazil based analyst whose name appears first assumes primary responsibility for its content from a Brazilian regulatory perspective and for its compliance with CVM Instruction # 483.
EU countries: Disclosures relating to our obligations under MiFiD can be found at http://www.globalmarkets.db.com/riskdisclosures.
Japan: Disclosures under the Financial Instruments and Exchange Law: Company name - Deutsche Securities Inc. Registration number - Registered as a financial instruments dealer by the Head of the Kanto Local Finance Bureau (Kinsho) No. 117. Member of associations: JSDA, Type II Financial Instruments Firms Association, The Financial Futures Association of Japan, Japan Investment Advisers Association. This report is not meant to solicit the purchase of specific financial instruments or related services. We may charge commissions and fees for certain categories of investment advice, products and services. Recommended investment strategies, products and services carry the risk of losses to principal and other losses as a result of changes in market and/or economic trends, and/or fluctuations in market value. Before deciding on the purchase of financial products and/or services, customers should carefully read the relevant disclosures, prospectuses and other documentation. "Moody's", "Standard & Poor's", and "Fitch" mentioned in this report are not registered credit rating agencies in Japan unless "Japan" or "Nippon" is specifically designated in the name of the entity.
Malaysia: Deutsche Bank AG and/or its affiliate(s) may maintain positions in the securities referred to herein and may from time to time offer those securities for purchase or may have an interest to purchase such securities. Deutsche Bank may engage in transactions in a manner inconsistent with the views discussed herein.
Qatar: Deutsche Bank AG in the Qatar Financial Centre (registered no. 00032) is regulated by the Qatar Financial Centre Regulatory Authority. Deutsche Bank AG - QFC Branch may only undertake the financial services activities that fall within the scope of its existing QFCRA license. Principal place of business in the QFC: Qatar Financial Centre, Tower, West Bay, Level 5, PO Box 14928, Doha, Qatar. This information has been distributed by Deutsche Bank AG. Related financial products or services are only available to Business Customers, as defined by the Qatar Financial Centre Regulatory Authority.
Russia: This information, interpretation and opinions submitted herein are not in the context of, and do not constitute, any appraisal or evaluation activity requiring a license in the Russian Federation.
Kingdom of Saudi Arabia: Deutsche Securities Saudi Arabia LLC Company, (registered no. 07073-37) is regulated by the Capital Market Authority. Deutsche Securities Saudi Arabia may only undertake the financial services activities that fall within the scope of its existing CMA license. Principal place of business in Saudi Arabia: King Fahad Road, Al Olaya District, P.O. Box 301809, Faisaliah Tower - 17th Floor, 11372 Riyadh, Saudi Arabia.
United Arab Emirates: Deutsche Bank AG in the Dubai International Financial Centre (registered no. 00045) is regulated by the Dubai Financial Services Authority. Deutsche Bank AG - DIFC Branch may only undertake the financial services activities that fall within the scope of its existing DFSA license. Principal place of business in the DIFC: Dubai International Financial Centre, The Gate Village, Building 5, PO Box 504902, Dubai, U.A.E. This information has been distributed by Deutsche Bank AG. Related financial products or services are only available to Professional Clients, as defined by the Dubai Financial Services Authority.

Risks to Fixed Income Positions

Macroeconomic fluctuations often account for most of the risks associated with exposures to instruments that promise to pay fixed or variable interest rates. For an investor that is long fixed rate instruments (thus receiving these cash flows), increases in interest rates naturally lift the discount factors applied to the expected cash flows and thus cause a

loss. The longer the maturity of a certain cash flow and the higher the move in the discount factor, the higher will be the loss. Upside surprises in inflation, fiscal funding needs, and FX depreciation rates are among the most common adverse macroeconomic shocks to receivers. But counterparty exposure, issuer creditworthiness, client segmentation, regulation (including changes in assets holding limits for different types of investors), changes in tax policies, currency convertibility (which may constrain currency conversion, repatriation of profits and/or the liquidation of positions), and settlement issues related to local clearing houses are also important risk factors to be considered. The sensitivity of fixed income instruments to macroeconomic shocks may be mitigated by indexing the contracted cash flows to inflation, to FX depreciation, or to specified interest rates - these are common in emerging markets. It is important to note that the index fixings may -- by construction -- lag or mis-measure the actual move in the underlying variables they are intended to track. The choice of the proper fixing (or metric) is particularly important in swaps markets, where floating coupon rates (i.e., coupons indexed to a typically short-dated interest rate reference index) are exchanged for fixed coupons. It is also important to acknowledge that funding in a currency that differs from the currency in which the coupons to be received are denominated carries FX risk. Naturally, options on swaps (swaptions) also bear the risks typical to options in addition to the risks related to rates movements.

David Folkerts-Landau
Group Chief Economist
Member of the Group Executive Committee

Guy Ashton
Global Chief Operating Officer
Research

Marcel Cassard
Global Head
FICC Research & Global Macro Economics

Richard Smith and Steve Pollard
Co-Global Heads
Equity Research

Michael Spencer
Regional Head
Asia Pacific Research

Ralf Hoffmann
Regional Head
Deutsche Bank Research, Germany

Andreas Neubauer
Regional Head
Equity Research, Germany

Steve Pollard
Regional Head
Americas Research

International Locations

Deutsche Bank AG
Deutsche Bank Place
Level 16
Corner of Hunter & Phillip Streets
Sydney, NSW 2000
Australia
Tel: (61) 2 8258 1234

Deutsche Bank AG
Große Gallusstraße 10-14
60272 Frankfurt am Main
Germany
Tel: (49) 69 910 00

Deutsche Bank AG
Filiale Hongkong
International Commerce Centre,
1 Austin Road West,Kowloon,
Hong Kong
Tel: (852) 2203 8888

Deutsche Securities Inc.
2-11-1 Nagatacho
Sanno Park Tower
Chiyoda-ku, Tokyo 100-6171
Japan
Tel: (81) 3 5156 6770

Deutsche Bank AG London
1 Great Winchester Street
London EC2N 2EQ
United Kingdom
Tel: (44) 20 7545 8000

Deutsche Bank Securities Inc.
60 Wall Street
New York, NY 10005
United States of America
Tel: (1) 212 250 2500

Global Disclaimer

The information and opinions in this report were prepared by Deutsche Bank AG or one of its affiliates (collectively "Deutsche Bank"). The information herein is believed to be reliable and has been obtained from public sources believed to be reliable. Deutsche Bank makes no representation as to the accuracy or completeness of such information.

Deutsche Bank may engage in securities transactions, on a proprietary basis or otherwise, in a manner inconsistent with the view taken in this research report. In addition, others within Deutsche Bank, including strategists and sales staff, may take a view that is inconsistent with that taken in this research report.

Opinions, estimates and projections in this report constitute the current judgement of the author as of the date of this report. They do not necessarily reflect the opinions of Deutsche Bank and are subject to change without notice. Deutsche Bank has no obligation to update, modify or amend this report or to otherwise notify a recipient thereof in the event that any opinion, forecast or estimate set forth herein, changes or subsequently becomes inaccurate. Prices and availability of financial instruments are subject to change without notice. This report is provided for informational purposes only. It is not an offer or a solicitation of an offer to buy or sell any financial instruments or to participate in any particular trading strategy. Target prices are inherently imprecise and a product of the analyst judgement. The financial instruments discussed in this report may not be suitable for all investors and investors must make their own informed investment decisions. Stock transactions can lead to losses as a result of price fluctuations and other factors. If a financial instrument is denominated in a currency other than an investor's currency, a change in exchange rates may adversely affect the investment. Past performance is not necessarily indicative of future results. Deutsche Bank may with respect to securities covered by this report, sell to or buy from customers on a principal basis, and consider this report in deciding to trade on a proprietary basis.

Derivative transactions involve numerous risks including, among others, market, counterparty default and illiquidity risk. The appropriateness or otherwise of these products for use by investors is dependent on the investors' own circumstances including their tax position, their regulatory environment and the nature of their other assets and liabilities and as such investors should take expert legal and financial advice before entering into any transaction similar to or inspired by the contents of this publication. Trading in options involves risk and is not suitable for all investors. Prior to buying or selling an option investors must review the "Characteristics and Risks of Standardized Options," at http://www.theocc.com/components/docs/riskstoc.pdf . If you are unable to access the website please contact Deutsche Bank AG at +1 (212) 250-7994, for a copy of this important document.

The risk of loss in futures trading and options, foreign or domestic, can be substantial. As a result of the high degree of leverage obtainable in futures and options trading losses may be incurred that are greater than the amount of funds initially deposited.

Unless governing law provides otherwise, all transactions should be executed through the Deutsche Bank entity in the investor's home jurisdiction. In the U.S. this report is approved and/or distributed by Deutsche Bank Securities Inc., a member of the NYSE, the NASD, NFA and SIPC. In Germany this report is approved and/or communicated by Deutsche Bank AG Frankfurt authorized by the BaFin. In the United Kingdom this report is approved and/or communicated by Deutsche Bank AG London, a member of the London Stock Exchange and regulated by the Financial Conduct Authority for the conduct of investment business in the UK and authorized by the BaFin. This report is distributed in Hong Kong by Deutsche Bank AG, Hong Kong Branch, in Korea by Deutsche Securities Korea Co. This report is distributed in Singapore by Deutsche Bank AG, Singapore Branch or Deutsche Securities Asia Limited, Singapore Branch (One Raffles Quay #18-00 South Tower Singapore 048583, +65 6423 8001), and recipients in Singapore of this report are to contact Deutsche Bank AG, Singapore Branch or Deutsche Securities Asia Limited, Singapore Branch in respect of any matters arising from, or in connection with, this report. Where this report is issued or promulgated in Singapore to a person who is not an accredited investor, expert investor or institutional investor (as defined in the applicable Singapore laws and regulations), Deutsche Bank AG, Singapore Branch or Deutsche Securities Asia Limited, Singapore Branch accepts legal responsibility to such person for the contents of this report. In Japan this report is approved and/or distributed by Deutsche Securities Inc. The information contained in this report does not constitute the provision of investment advice. In Australia, retail clients should obtain a copy of a Product Disclosure Statement (PDS) relating to any financial product referred to in this report and consider the PDS before making any decision about whether to acquire the product. Deutsche Bank AG Johannesburg is incorporated in the Federal Republic of Germany (Branch Register Number in South Africa: 1998/003298/10). Additional information relative to securities, other financial products or issuers discussed in this report is available upon request. This report may not be reproduced, distributed or published by any person for any purpose without Deutsche Bank's prior written consent. Please cite source when quoting.

Copyright © 2014 Deutsche Bank AG