SHANGHAI—China's banking regulator is ending a 12-year ban for banks to invest in bonds listed on the local stock exchanges, said a person familiar with the situation, offering a major boost to this semi-dormant segment of the country's fixed-income market.

The re-entry of cash-rich banks into the market for exchange-traded bonds, which are typically sold by listed companies, including blue chips such as property heavyweight Vanke Co., will improve liquidity in the market and lower companies' financing cost, analysts said. The move will also help Chinese companies reduce their reliance on bank loans at a time when soaring credit growth has stoked concerns over inflation and asset bubbles.

The China Banking Regulatory Commission has approved Bank of Communications Co., Industrial & Commercial Bank of China Ltd., and China Construction Bank Corp. to trade government and corporate bonds listed on both the Shanghai and Shenzhen stock exchanges, the person said Wednesday.

Beijing banned banks from trading exchange-listed bonds in 1997 after it said it found irregularities in the market. Since then, fixed-income trading by lenders has been restricted to the interbank debt market, which is dominated by bonds issued by state-owned enterprises and government agencies.

In addition to regulatory approval, the banks have to be cleared for trading by the exchanges themselves. Bank of Communications and China Construction Bank have received approval from the Shanghai Stock Exchange, while ICBC has yet to apply for the necessary trading qualification to the bourse, said the person.

The China Securities Regulatory Commission and the CBRC in January said they will allow

China's 14 domestically listed banks to invest in such exchange-traded bonds on a trial basis.

The three banks are likely to start trading bonds on the exchanges by the end of this year, the person said.

Officials from the three banks declined to comment on receiving approval from CBRC, and officials from the regulator weren't immediately available for comment.

Zhang Lei, a bond analyst at Shanghai Securities, said the exchange-traded bond market has been marginalized in recent years because of its relatively small size. "The return of the banks could improve the market's liquidity and attract more companies to issue bonds on the exchanges," he said.

Banks are the most active participants in China's broader bond market. Without the presence of banks in the exchange-traded bond market, the volume of bonds traded on the Shanghai and Shenzhen exchanges has been negligible. While bond-trading volume on China's interbank market totaled 40.8 trillion yuan ($5.98 trillion) in the January-October period, the volume on the two stock exchanges was just 393 billion yuan.

Yields on exchange-traded corporate bonds are on average 0.2 to 0.3 percentage point higher than those traded on the interbank market, a premium demanded by investors concerned with the poor liquidity and higher price volatility on the stock exchanges.

"The policy change will also boost exchanged-traded corporate-bond demand and gradually close the yield gap between bonds traded on the bourses and those in the interbank market," said Xu Hong, a bond analyst at Datong Securities.