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Foreign Banks in China

This survey focuses on the strategic and emerging issues surrounding the expanding activities of foreign banks in China.

June 2011

pwc

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Foreword

Welcome to the sixth PwC[1] survey on foreign banks in China. This year, we surveyed and interviewed 42 financial institutions in China.

Our aims in carrying out this survey are to:

- raise awareness of strategic and emerging issues for foreign banks in China
- establish data on certain industry trends
- understand the thinking of chief executive officers in the banking industry
- provoke discussion and debate on the best options for foreign banks to capitalise on trends and developments
- provide insights and perspectives on how banking in China may evolve over the next three years.

The 127 foreign banks operating in China have grown their total assets by 29% during 2010. Their aggregate total assets amounted to RMB 1.7 trillion, which represented 1.83% of the total banking assets in China. Forty foreign banks have now become locally incorporated. Data from China Banking Regulatory Commission (CBRC) indicates that, at the end of 2010, they accounted for 87% of all foreign banking assets. The 42 banks interviewed collectively expect to grow employment by 53% to over 52,000 people by 2014.

The top five major drivers of change cited by the foreign banks are:

- regulatory changes
- funding constraints
- liquidity
- developments in the capital market
- economic cycle.

China will become an increasingly important global banking market. Another recent PwC UK report entitled *Banking in 2050* predicted that China could overtake the US as the world's largest banking market as early as 2023 based on projected growth of banking assets.

I would like to thank the CEOs and senior executives who participated in this survey for their time and effort in making this publication possible. I would also like to thank Dr Brian Metcalfe for his research and analysis.

For further information, please contact the PwC banking partners listed at the back of this survey.

Raymond Yung

PwC China Financial Services Leader
June 2011

[1] *"PwC" refers to PricewaterhouseCoopers Limited which is a member firm of PricewaterhouseCoopers International Limited, each member firm of which is a separate legal entity.*

Executive summary

Background

This survey focuses on the strategic and emerging issues surrounding the expanding activities of foreign banks in China. It builds on five previous surveys undertaken between 2005 and 2010.

The survey attempts to synthesise diverse viewpoints, protect confidentiality and offer insights into this fast-changing financial services environment.

It is based on interviews with CEOs, senior executives and branch managers of 42 foreign banks in China.

The interviews were approximately one hour in length and were conducted in Beijing, Hong Kong, Shanghai and Shenzhen in April and May 2011.

The participants in alphabetical order were:

- Australia and New Zealand Banking Group (ANZ)
- Banco Santander
- Bank of America Merrill Lynch
- Bank of Montreal
- BBVA
- BNP Paribas
- BNY Mellon
- Crédit Agricole
- Citibank
- Commerzbank
- Commonwealth Bank of Australia
- Credit Suisse
- Dah Sing Bank
- DBS Bank
- Deutsche Bank
- First Sino Bank
- Hang Seng Bank
- HSBC
- ING Bank
- Intesa Sanpaolo Bank
- JPMorgan Chase
- KBC Bank
- Mizuho Corporate Bank
- Natixis
- Norddeutsche Landesbank
- OCBC Bank
- Rabobank
- Raiffeisen Bank International
- Royal Bank of Canada
- RBS
- Scotiabank
- Société Générale
- Standard Chartered Bank
- Sumitomo Mitsui Banking Corporation
- The Bank of East Asia
- UBS
- VTB Bank
- Wells Fargo Bank
- WestLB
- Westpac Bank
- Wing Hang Bank
- Wing Lung Bank

Overview

Foreign banks in China continue to fight hard to define their role in the Chinese market and to expand their operations.

The foreign banks' total assets grew steadily between 2003 and 2007, stalled in 2008 and 2009 at the time of the stimulus plan[2], and grew again in 2010. Overall market share increased from 1.7% in 2009 to 1.83% in 2010.

However, the market share figure fails to reflect how the foreign banks continue to redefine the market segments that offer them the opportunity to excel and plot a path of stable, long term expansion.

In 2011, the foreign banks are operating in an environment where liquidity has been progressively tightened. At the time of this report's preparation, the People's Bank of China (PBOC)'s has increased banks' reserve requirement ratio (RRR) six times since the beginning of the year.

Against a more uncertain macro-economic and financial environment, the foreign banks appear to have added focus to their China strategies.

The next three years will be very challenging, but the participants in this report remain determined to push ahead with their organic growth strategies.

In addition to growing organically, the report concludes that the foreign banks are pursuing strategic partnerships and making acquisitions where possible in many different parts of the financial sector.

Indeed, it is the inevitability of this gradual, defined process towards greater internationalisation of the economy that is underpinning the foreign banks' optimism. They believe that the opening up of the economy and the transition towards a convertible currency must lead to increased opportunities for foreign banks.

The report finds that foreign banks continue to believe that China offers rich opportunities. They also continue to believe they will only be able to exploit these opportunities if the playing field is level, and the regulators across the sector facilitate the growing internationalisation of the Chinese economy.

Commitment to China remains resolute

What is clear is the resolute commitment by the parents of the foreign banks to the China market.

Across the various bank groups, on a scale of one to ten, ten being the greatest, commitment remains at eight or greater. For example, the locally incorporated foreign banks score 8.8 out of ten, while the Asian banks rate 9.1 out of ten. By 2014, 25 participants believe their parents' commitment levels will be nine or greater.

Different strategies become more apparent in the post global financial crisis environment

The foreign banks can now be more clearly categorised in terms of their approach to the market, given the various regulatory obstacles and hurdles that need to be negotiated.

On the retail front, six banks are ahead of the competition in terms of customer base and branch networks.

This group includes The Bank of East Asia, Citibank, DBS Bank, Hang Seng Bank, HSBC and Standard Chartered Bank. This group estimates they will collectively operate over 500 branches

[2] In late 2008, the Chinese government announced a RMB 4 trillion stimulus plan to help minimise the effects of the global financial crisis. As a result, domestic bank lending grew dramatically at that time.

and sub-branches by 2014. Members of this group also have a strong presence (relative to other foreign banks) across the financial sector.

A second group of corporate and investment banks has also emerged. This group includes some major European and American players who may have some minor retail activities but remain focused on the investment and corporate banking market.

A third group includes many of the Asian banks who emphasise close trading and business links with China. Some members of this group also have a retail focus.

Sub-groups within this Asian category include the Japanese and Korean banks who have a unique position in serving their home country clients in China.

The Hong Kong banks also serve specific market needs.

An Australian sub-group can also be identified. These banks also seek to capitalise on the special regional relationship with China.

A fourth group contains banks that may be focused on narrow market niches. They may be global players in particular market segments such as wealth management, trade financing or foreign exchange. Depending on their size in China, they may also warrant membership in some of the other groups already mentioned.

A final group includes some of the smaller foreign bank branches. They may have followed their clients to China and continue to play a role in serving their clients' financial needs.

Members of this group are particularly vulnerable to the increasing demands of the regulatory environment. Their small scale of operations makes it difficult to gain traction and to plot a path forward with any degree of certainty.

Some of these banks' parents may also have suffered during the global financial crisis. As a result, the Chinese regulators may have adopted a more cautious relationship towards them.

Within this group of smaller banks today are also banks that may have entered the market late but have ambitious plans for the future.

It is important to emphasise that not all the foreign banks fit into this neat classification. Indeed, quite a few have characteristics that would place them in more than one box.

However, some definable groups are beginning to emerge. Some of these banks will be better positioned to benefit from future market deregulation if, and when, it takes place.

Growing employment and turnover

The foreign banks continue to extend their employment base as they expand their business scope and network.

The 42 banks interviewed collectively expect to grow employment by 53% to 52,312 people by 2014.

Today, the banks employ just over 1,000 non-People's Republic of China (PRC) employees and this will increase only slightly by 2014.

As expected, staff turnover which had dropped in 2009, picked up in 2010. While 12 banks experienced turnover below 10%, a similar number experienced turnover above 20%.

Projecting forward for 2011, 18 banks expect turnover to climb above 15%. As the larger foreign banks expand their networks, they are susceptible to poaching by their smaller counterparts moving into similar markets at a later stage.

Key staff positions such as compliance officers, relationship bankers and financial advisors are often targeted by headhunters.

The staff function in greatest demand from a hiring perspective continues to be relationship bankers on the corporate side.

Salary increases anticipated

Forty respondents unanimously agreed that salaries would increase in 2011. Over half the participants believe wage hikes will climb above 10% in 2011.

The rising level of inflation is influencing salaries escalation but banks also believe it is essential to secure staff. Participants pointed out that for key positions, on an after-tax basis, Shanghai is now comparable to Hong Kong, London and New York.

Corporate credit viewed as stable by foreign banks

Despite concerns about the broader economy, the majority of foreign banks believe that corporate credit is stable.

This is a reversal from 2009 when 20 banks thought it was deteriorating.

Data from China Banking Regulatory Commission (CBRC) confirms this opinion. The non-performing loans (NPL) ratio for large Chinese banks, city commercial banks and foreign banks declined in the five quarters preceding the first quarter in 2011.

At the end of the first quarter of 2011, the NPL ratio for foreign banks was 0.5%.

One concern to the overall marketplace is domestic banks' loans to local governments for municipal infrastructure projects.

A number of participants argued that the broad corporate credit outlook at this stage was sector specific, with uncertainties surrounding the small and medium-sized enterprises (SMEs), real estate, construction and commodities.

Consumer credit stable

Again, over half the respondents (16 out of 29) believe that consumer credit is also stable.

The CEO of one of the larger foreign banks said Chinese consumers were spending more and buying big-ticket items like properties and cars.

Debt capital markets

Debt capital markets continue to be viewed as the area with greatest future opportunity for the foreign banks on the corporate side.

Debt capital markets has been placed in first position for the last three years. In second position in 2011 was currency swaps. And in third place, interest rate swaps.

Internationalisation of the *renminbi* – a major opportunity

In 2009, the authorities initiated a pilot programme for cross-border trade transactions. The programme was further expanded in 2010. It is widely believed that the first steps towards internationalisation of the *renminbi* will create opportunities for all banks servicing exporters, importers and investors in China and other countries selected for cross-border trade settlements.

Initially the main beneficiaries will be Chinese domestic banks and Hong Kong banks, and foreign banks with China and Hong Kong presence. We should also see an increase in *renminbi* deposits and demand for *renminbi*-related services.

The foreign banks will also benefit once the regulatory guidelines become more transparent as channels develop to facilitate cash management and repatriation of *renminbi* back to China.

Locally incorporated foreign banks dominate the market

Forty foreign banks are now locally incorporated. Data from CBRC indicates that at the end of 2010, they accounted for 87% of all foreign banking assets.

Loan-to-deposit ratio

One of the major concerns for the locally incorporated banks is the 75% loan-to-deposit ratio.

The larger locally incorporated foreign banks with a retail presence indicated in this survey that they were satisfied with the growth in retail deposits.

A number of "corporate-oriented" locally incorporated foreign banks also seem to be generating a significant percentage of corporate deposits.

Indeed, corporate deposits contribute 50% or more funding for 15 foreign banks in the survey.

There are, however, a number of foreign banks that remain concerned about their ability to generate local deposits as the five-year grace period for them to comply with China's 75% loan-to-deposit ratio ceiling expires on 31 December 2011.

Although media reports at the beginning of 2011 suggested that a group of four or five banks might miss this deadline, the responses from the 20 locally incorporated foreign banks in this survey suggested that they are satisfied with their deposit generating capabilities.

Buoyant growth in revenues

Despite the constraints of a tight regulatory environment and liquidity constraints, the foreign banks envisage strong growth.

Twenty-two banks expect annual revenue growth in 2011 of between 20% and 50%, and five banks expect growth to equal, or exceed, 100%.

The banks anticipate growth to continue over the next three years.

Indeed, seven banks hope to increase their pace of growth by 2014.

This buoyant growth should be viewed against the earlier comment regarding a decline in market share.

In other words, although market share declined at the time of the stimulus plan and then rose slightly in 2010, growth projections remain very optimistic. The foreign banks are striving to develop and deepen their relationship with existing clients both within, and outside, China.

Around 40 foreign banks have embraced the need to locally incorporate, and it is within this group that one can expect to see the most pronounced multi-faceted growth.

Some of the global corporate and investment banks that have at this stage not chosen to locally incorporate can also be expected to grow rapidly. They may choose over the next few years to change their status and seek local incorporation.

Regulatory change

The foreign banks continue to feel the cumulative weight of new regulations. An important new regulation applied in 2011 is called "Three Measures, One Guideline" ("3M,1G"), which will have an impact on the foreign banks' scope and depth of business. "Three Measures, One Guideline" instructs the banks that working capital loans cannot be used to finance fixed assets, project financing and shareholdings.

While the foreign banks readily understand the principles of such measures and will make every effort to satisfy this requirement, they are uncomfortable that the regulator will hold them responsible for any deviance by their clients from the loans' deemed purpose.

Why China remains critical

The strong commitment and qualified optimism that were expressed by the foreign banks in this report is fuelled by both domestic expansion and the expectation that the market will open up as China takes steps towards greater convertibility of the *renminbi*.

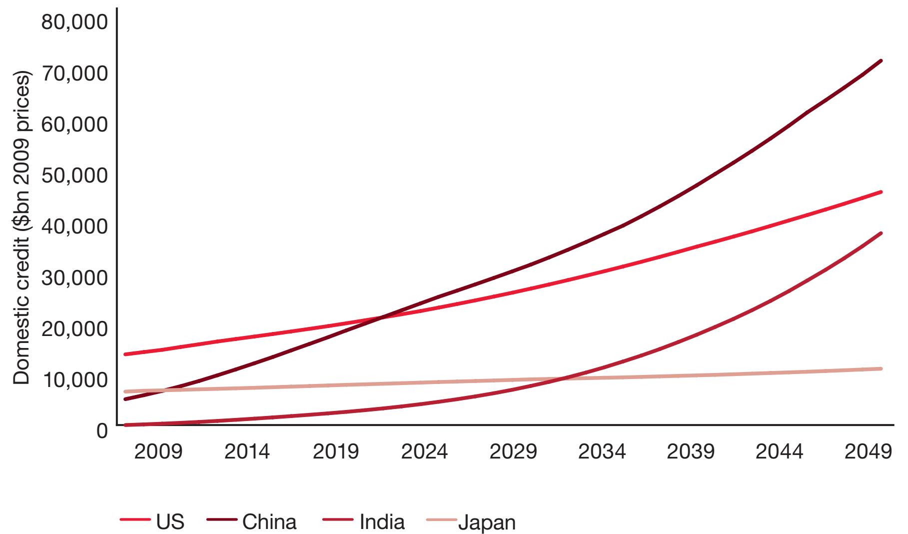
China will become an increasingly important global banking market. A recent PwC UK report entitled *Banking in 2050*, (www.pwc.co.uk/financialservices) predicted that China could overtake the

US as the world's largest banking market by 2023 based on projected growth of domestic banking credit assets (see diagram below).

The global leader board based on domestic banking assets is displayed in the Appendix on page 86. It illustrates China's transition from third position in 2009 to first by 2023.

These predictions further support the reasons why the foreign banking community needs to continue to expand and build a robust presence in China.

Domestic banking assets for the US, China, India and Japan



Source: PwC UK *Banking in 2050* (May 2011)

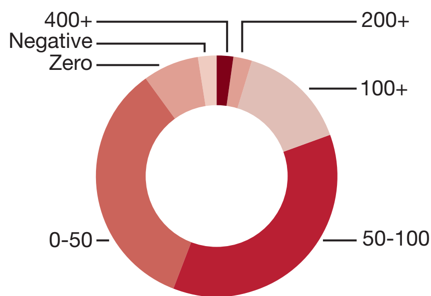
Peer ranking summary

A summary of the peer ranking (top three positions) of the foreign banks/ financial institutions is shown in the table below. Peer rankings are based on the opinions of CEOs, senior executives and branch managers that participated in this survey. Please refer to the Peer Review section on page 72 for full details.

	First	Second	Third
Brand awareness	HSBC	Standard Chartered	Citibank
Cash management	Citibank	HSBC	Standard Chartered
Corporate finance	HSBC	Goldman Sachs	Citibank
Corporate lending	HSBC	Standard Chartered	Citibank
Corporate social responsibilty	HSBC	Citibank	Standard Chartered
Credit cards	Bank of East Asia	HSBC	Standard Chartered/Citibank
Debt capital markets	HSBC	Citibank	Goldman Sachs
Derivatives	HSBC	Citibank	Deutsche Bank
Equity capital markets	Goldman Sachs	JPMorgan Chase	UBS
Foreign exchange and treasury	HSBC	Citibank	Standard Chartered
Investment banking	Goldman Sachs	Morgan Stanley	JPMorgan Chase
Mergers and acquisitions	Goldman Sachs	Morgan Stanley	JPMorgan Chase
Private banking	UBS	HSBC	Citibank
Project financing	HSBC	Standard Chartered	Citibank
Retail banking	HSBC	Standard Chartered	Bank of East Asia
Trade finance	HSBC	Standard Chartered	Citibank

Market environment

Projected employment increases by 2014



Percentage increases in employment by 2014

Based on responses from 41 banks

Future employment growth

In the 2011 survey, the 42 banks interviewed employ 34,166 people. In last year's study, the total was 29,739. The pool of survey participants is marginally different, but this change did not have a significant impact on the overall number of employees.

The group of 42 banks plan to increase employment by 53% to 52,312 by 2014.

The top six banks by employment size all have a retail presence. In alphabetical order they are The Bank of East Asia, Citibank, DBS Bank, Hang Seng Bank, HSBC and Standard Chartered Bank.

This group has a combined total number of 23,900 staff. And it is estimated that that number will reach 36,700 by 2014.

Non-PRC employees

The banks currently employ 1,220 non-PRC employees, and expect only a modest future increase of 64 non-PRC staff by 2014 to 1,284.

Four banks expect to reduce their number of non-PRC employees by 2014.

The average percentage of non-PRC staff is 3.5%. Participants which have higher levels of non-PRC employees include banks with a narrow market focus, and Hong Kong and Japanese banks.

Finding senior qualified and experienced personnel remains a challenge for the entire financial sector.

Retail customers

There was a general reluctance by a number of participants to provide data on their current and future retail customer base.

A clear break exists between the Big Six retail banks – HSBC, Standard Chartered Bank, Citibank, The Bank of East Asia, DBS Bank and Hang Seng Bank. Two of these declined to provide data this year. As a result, figures last year were used to provide a combined Big Six estimate.

The number of retail customers for this group is estimated as approximately 980,000 in 2011, rising to 2.04 million by 2014.

In 2010, 15 foreign banks reported 835,600 customers, predicting that number to rise to 2 million customers by 2014. Other foreign banks that have a retail presence vary in size and scope. Some have small operations with around 1,000 customers, while others have less than 10,000, and at least one bank, 20,000 customers.

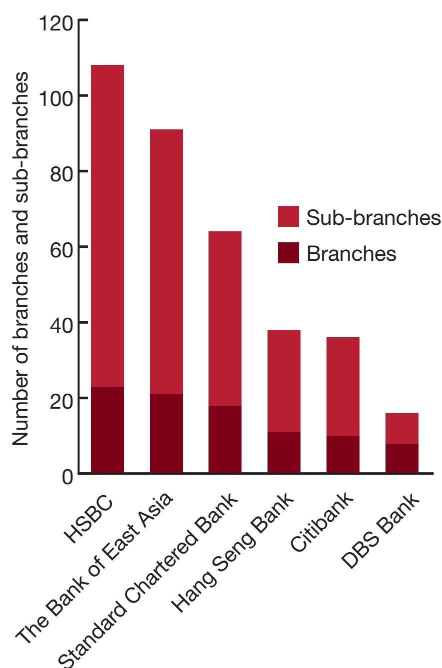
Branch networks

Responses on branch networks by 40 of the banks interviewed, suggested that the anticipated total of 493 branches and sub-branches at the end of 2011, will increase by more than 290 to 783 by 2014. This includes two banks that plan to increase their branches and sub-branches by over 50 by 2014.

It does not include any projections for one foreign bank that was reported in the media to open around 100 branches through its joint venture in rural banking.

These branch expansion plans look ambitious, given the current CBRC policy which requires a foreign bank to match a branch opening in a developed banking market with one in an undeveloped banking market.

Branch networks of the Big Six foreign retail banks



Source: Bank's websites, February 2011

* DBS Bank network will expand with the completion of its takeover of former RBS branches

Currently, the top six foreign banks based on the size of their branch and sub-branch networks are HSBC, The Bank of East Asia, Standard Chartered Bank, Hang Seng Bank, Citibank and DBS Bank.

The adjacent chart displays the size of each bank's network based on information from their website.

The top six banks anticipate that they will operate 545 branches and sub-branches by 2014.

Total number of foreign bank institutions in China in 2010

The 37 locally incorporated foreign banks operated 223 branches.

In addition, there were 90 foreign bank branches established by 74 banks.

At the end of 2010, 44 foreign bank branches and 35 locally incorporated foreign banks were given approval to conduct *renminbi* business while 56 foreign banking institutions were permitted to engage in derivatives trading. *(Source: CBRC Annual Report 2010)*

Foreign banking establishments in China in 2010

	Foreign banks	Wholly foreign-owned banks	Joint-venture banks	Wholly foreign-owned finance companies	Total
Locally incorporated institutions (LII)		37	2	1	40
Foreign bank branches	90				90
Total	90	37	2	1	130

Source: CBRC Annual Report 2010

Foreign bank operations in China (2004 to 2010)

Item/Year	2004	2005	2006	2007	2008	2009	2010
Number of institutions*	188	207	224	274	311	338	360
Assets**	5,823	7,155	9,279	12,525	13,448	13,492	17,423
As % of the total banking assets in China	1.84	1.91	2.11	2.38	2.16	1.71	1.83

*Including headquarters, branches and subsidiaries
**RMB 100 million

Source: CBRC Annual Report 2010

Geographic spread of the foreign banks

According to CBRC, at the end of 2010, foreign banks had outlets in 45 cities in 27 provinces. In 2003, they had outlets in just 20 cities.

Growth in total assets of all foreign banks in China (2003 to 2010)

Several participants were reluctant to provide asset totals and income estimates.

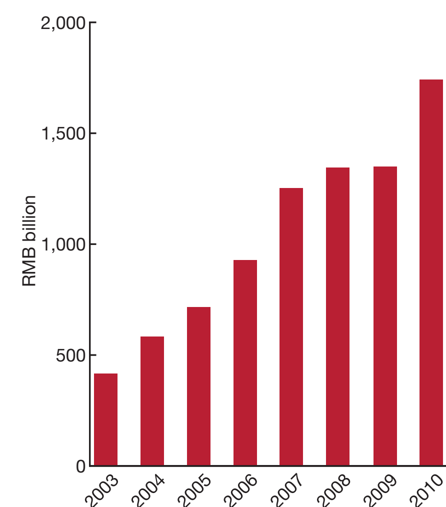
According to CBRC, at the end of 2010, the total assets for all foreign banking institutions increased to RMB 1.74 trillion. Between 2009 and 2010, assets increased by 29.13%.

Foreign bank deposits for 2010 were RMB 1.06 trillion – an increase of 44%.

Loans totalled RMB 913.7 billion, up 26.26%, while the liquidity ratio was calculated at 61.49%.

The NPL ratio at the end of 2010 was 0.53%, the capital adequacy ratio (CAR) 18.98% and core-CAR 18.56%.

Total assets of all foreign banks in China (2003 to 2010)



Source: CBRC

Performance of all foreign banks in China (2007 to 2010)

CBRC reported that the total profit after tax for foreign banks in 2010 was RMB 7.78 billion. This represents an increase over 2009 but is well below 2008.

In March 2011, CBRC issued a statement on the profit outlook for foreign banks in Shanghai for 2011. Shanghai has 20 locally incorporated foreign banks, which together make up 83% of the assets of all locally incorporated foreign banks in China.

Profit after tax (RMB billion)	2007	2008	2009	2010
Banking institutions	446.73	583.36	668.42	899.09
Policy banks & the CDB	48.93	22.98	35.25	41.52
Large commercial banks	246.60	354.22	400.12	515.12
Joint-stock commercial banks	56.44	84.14	92.5	135.80
City commercial banks	24.81	40.79	49.65	76.98
Rural commercial banks	4.28	7.32	14.9	27.99
Rural cooperative banks	5.45	10.36	13.49	17.9
Urban credit cooperatives	0.77	0.62	0.19	0.01
Rural credit cooperatives	19.34	21.91	22.79	23.29
Non-bank financial institutions	33.38	28.45	29.87	40.8
Foreign banks	6.08	11.92	6.45	7.78
New-type rural financial institutions & postal savings banks	0.65	0.65	3.22	11.9

Source: CBRC

Shanghai-Based Foreign Banks Slash 2011 Revenue Growth Target

Shanghai-based foreign banks almost halved their revenue growth target for this year in the face of China's intensifying fight against inflation, the banking regulator in Shanghai said Tuesday. Foreign banks that have incorporated their Chinese business in Shanghai are aiming for revenue growth of 21% in 2011, down 17 percentage points from last year's target, the China Banking Regulatory Commission's Shanghai branch said in a statement.

The move is a reflection of how banks in China are vulnerable to the country's monetary tightening, especially a squeeze in credit supply.

In a significant departure from their home-market operations, foreign banks in China are as highly dependent on issuing loans as their Chinese rivals to make a profit. Foreign banks usually derive a big share of their overall profits from fees from products and services in global markets. China is requiring local units of foreign banks to reduce their ratio of loans to deposits to 75% to cope with rising credit risks, in line with the requirement for local lenders.

"Locally incorporated foreign banks are cautiously optimistic about their business prospects in the context of China's macroeconomic environment," the statement said. To prevent the economy from overheating, China's central bank has raised interest rates four times and increased the proportion of deposits banks must hold in reserve 10 times since the start of 2010.

Economists say more interest rate hikes and reserve ratio increases in the coming months are likely. China's consumer price index rose 5.4% in March from a year earlier, marking the fastest pace in nearly three years.

Despite the reduction in revenue growth target, foreign banks will accelerate their expansion pace in China as they have been recovering from the latest global financial crisis, said the statement.

Vying for their share of China's more than CNY70 trillion (US$11 trillion) of deposits, Shanghai-incorporated foreign banks intend to open 147 outlets across mainland China this year, up 42 units from their target for last year, according to the statement.

In addition, foreign banks will capitalize on Beijing's efforts to internationalize its currency to boost their business in China, the statement said, adding they will develop foreign-exchange businesses such as yuan exchange-rate risk hedging and offshore yuan bond clearing.

As of the end of 2010, there were about 20 locally incorporated foreign banks in Shanghai, accounting for more than half of such foreign banks in China, data from the banking regulator show. The Shanghai-incorporated foreign banks, including HSBC Holdings PLC and Citigroup Inc., had combined assets of CNY1.27 trillion at the end of December, accounting for 83% of total assets held by China-incorporated foreign lenders.

(Source: Dow Jones, 19 April 2011)

Q Have your expectations changed since local incorporation?

In response to whether their expectations have changed since incorporation, 11 banks indicated that they had changed positively, two said negatively and seven responded neutral.

Q How many locally incorporated banks will there be by 2014?

Thirty-three respondents provided estimates on the number of foreign banks that will be locally incorporated by 2014.

Given that there are 40 locally incorporated foreign banks in China today (see Appendices on page 83), 12 respondents believe there would be an additional five, and 13 suggested ten more.

As a result, the total estimates for 2014 are approximately 45 – 50 locally incorporated foreign banks. Four participants believe there will be no further additions.

Taiwanese banks may ultimately seek local incorporation and add to the number

Six Taiwanese banks – Land Bank of Taiwan, Taiwan Cooperative Bank, Chang Hwa Bank, Cathay United Bank, First Bank and Hua Nan Bank – formed the first group of Taiwanese banks to open branches in mainland China. *(Source: CBRC Annual Report 2010)*

A memorandum of understanding on cross-strait banking alongside the Economic Cooperation Framework Agreement (ECFA) means that Taiwanese banks may apply for corporate *renminbi* business license once it has established in China for a year, and being profitable for one full annual accounting period.

Furthermore, they can conduct *renminbi* business after operating a branch for two years and being profitable for one. Normal regulations require three years as a branch with two profitable years.

Although there is no current indication that a number of Taiwanese banks will ultimately seek local incorporation status, it seems highly probable.

The respondents in this survey believe that the Taiwanese banks will, in due course, add to the number of locally incorporated foreign banks.

Q What concerns do you have regarding the Chinese banking market?

The major concerns expressed by participants in the survey are outlined below:

- The tightening of liquidity with increases in interest rates and reserve requirements
- The banking sector is still healthy and the regulator may be overly cautious and precipitate problems
- The loan expansion in the last two years may lead to significant loan losses. It is questionable whether there is a sufficient talent base to manage the rapid growth in loans. One bank expressed reservations about the level of NPLs in the big domestic banks. The bank questioned whether the current estimates were realistic and asked what impact this might have on them
- The dominance of the Big Four domestic banks versus the city commercial banks
- The administrative burden of the regulatory environment for smaller foreign banks
- Currently the banks enjoy fixed margins. As control of interest rates is relaxed over the next five years, the spreads will narrow and this will be a major challenge
- The overlapping responsibilities of regulatory agencies such as CBRC, PBOC, State Administration of Foreign Exchange (SAFE), National Development and Reform Commission (NDRC) and National Association of Financial Market Institutional Investors (NAFMII). Interpretations by PBOC and SAFE differ on cross border *renminbi* transactions
- Regulation differs in different regional markets
- One foreign bank commented that CBRC was attempting to make them fit into a domestic banking mould, which was not possible
- The proliferation of different ratios including short and long-term debt quotas, *renminbi* quota discretionary outbound payment ratios and the loans-to-deposits ratio
- One large foreign bank indicated that they would like to see a level playing field for foreign banks, notably in the area of *renminbi* bond underwriting
- One large foreign investment bank feels that deregulation of the industry was progressing too slowly. They suggested CBRC was more open to change versus China Securities Regulatory Commission (CSRC) which remains very conservative
- An Asian bank expressed a lack of willingness by domestic banks to lend to their foreign counterparts
- A European bank said that prudential ratios imposed by CBRC limits their ability to meet the needs of their core customers.

Q What are the major drivers of change in the Chinese banking industry today? Please rank the top five in order of importance?

The most important drivers of change in 2011 is consistent with both 2010 and 2009, i.e. regulatory changes.

The pro-rated score this year based on 40 respondents increased to 161, more than double the driver in second place - funding constraints. The funding constraints factor has also increased in value by around 10% over 2010. These constraints are an important limiting factor on the ability of the foreign banks to grow.

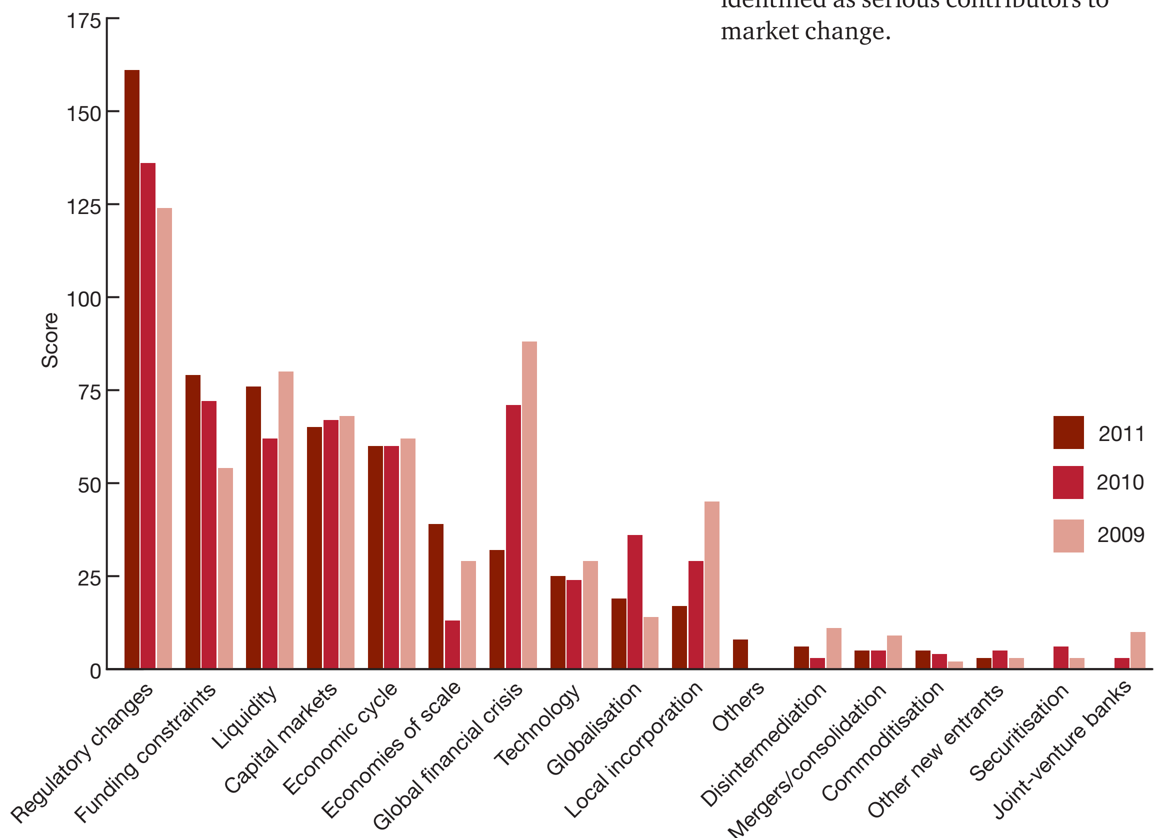
In third place is liquidity which moves up from fifth position in 2010.

Developments in capital markets albeit slow from the foreign banks' perspective, remain an important driver of change. As noted elsewhere in this report, there is cautious optimism that the capital markets will begin to open significantly more, and this will allow many of the foreign banks to begin to leverage their experience and expertise in the Chinese market.

Economies of scale received wider recognition in 2011. It moved into sixth place from tenth last year. This factor score was assisted by a number of locally incorporated banks which recognise the need to grow the scope and scale of their operations.

As one might expect, the global financial crisis appears a less important influence on change. It has declined form third position in 2010 to seventh this year. Local incorporation also dropped from eighth to tenth position.

The remaining seven drivers which include items such as disintermediation, commoditisation and securitisation continue to be identified as serious contributors to market change.



Based on responses from 40 banks each in 2011 and 2010, and scores have been re-adjusted for 38 banks in 2009

Q What does your bank find the most/least difficult aspects of the Chinese banking industry?

The three most difficult aspects of the Chinese banking industry from the foreign banks' perspective were:

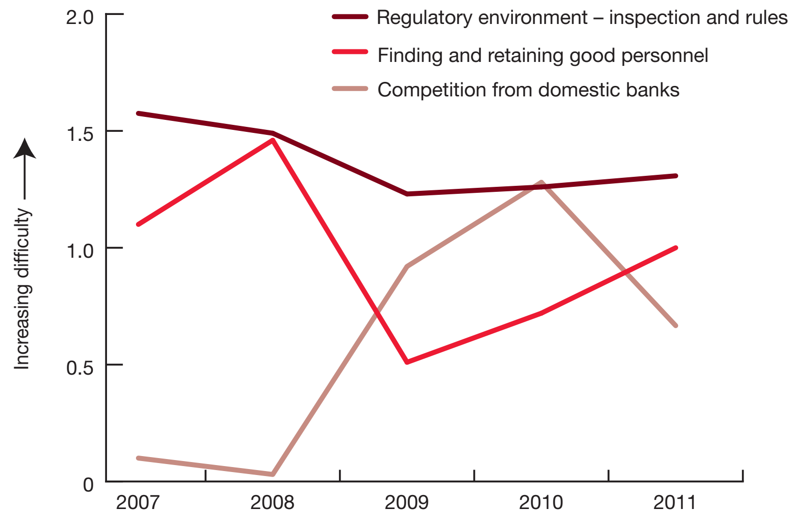
- the regulatory environment
- finding and retaining good personnel
- competition from domestic banks.

As the chart below indicates, the first two of these aspects have remained at the top of the list over the last five years. Competition from domestic banks climbed into the top spot last year following the government's stimulus plan, but it has now fallen to third position because of tightening liquidity. The regulatory environment has been consistently ranked important since 2008, but fell at the time of the global financial crisis. It now appears to be rising again at a rapid pace. In fourth place is innovative product/service offerings. This factor moves up two places in the rankings from 2010. Foreign banks are anxious to flex their expertise in the capital markets and by opportunities associated with the *renminbi*. As many foreign banks plot their way forward in the post-global financial crisis era, ability to introduce new products and the ownership restrictions on market diversification have become more prominent.

Based on responses from 39 banks in 2011

Top three most difficult aspects of Chinese banking (2007 to 2011)

The regulatory environment has consistently been viewed as the most difficult aspect of the Chinese banking market for foreign banks.

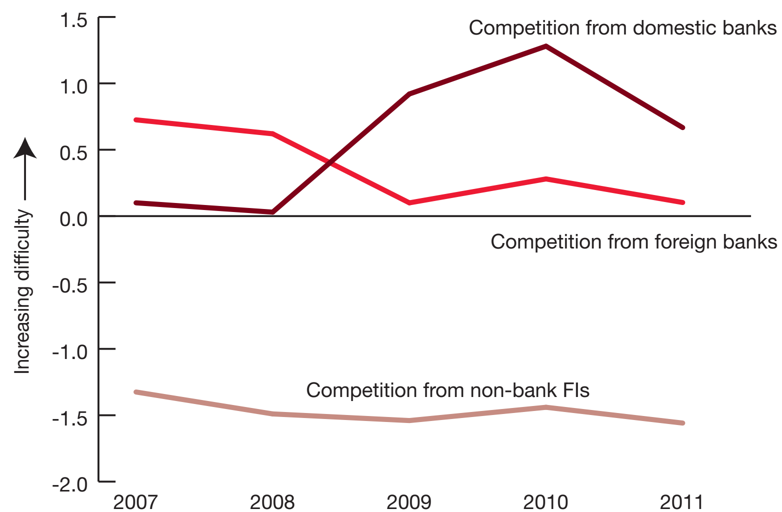


Competition between banks (2007 to 2011)

Foreign banks do not view other foreign banks as a difficult aspect of the Chinese banking market.

On the other hand, competition from domestic banks is, as noted earlier, considered much more significant.

Neither other foreign banks nor non-bank financial institutions (NBFIs) represent much difficulty.



Q What is the level of commitment of your head office to China in 2011 relative to other markets on a scale of one to ten? A score of ten is maximum commitment.

As expected, the level of commitment of the foreign banks to the Chinese market is expected to rise over the next three years. The number of banks scoring the maximum of ten increased from 11 to 12 banks by 2014.

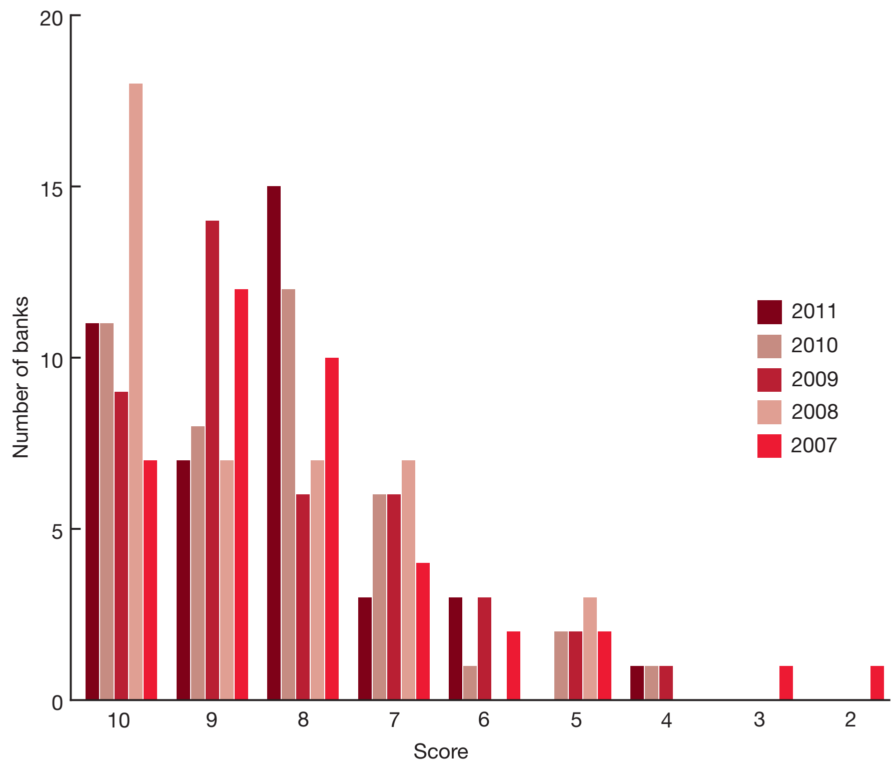
A major increase takes place with the number of banks scoring nine out of ten, rising from seven to 15 banks.

As a result, the overall average moved upwards from 8.4 to 8.6.

Fifteen banks expect their scores to rise by 2013.

Comparison of commitment over the last four years indicates that across the different bank groups, there has been a slight decline in scores when 2011 is compared to 2008.

The overall average has hovered around 8.4 out of ten, which shows a very strong level of head office commitment to the China market.



Based on responses from 40 banks in 2011, 41 banks each in 2010 and 2009, 42 banks in 2008 and 39 banks in 2007

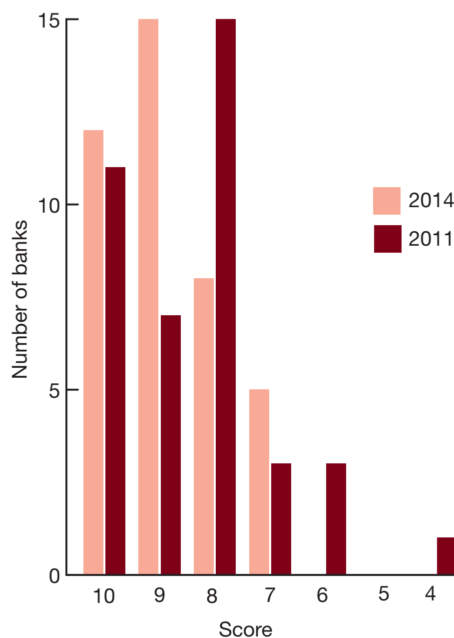
Commitment of parent	2011	2010	2009	2008
Locally incorporated banks	8.8 (19)	9.05 (20)	8.7 (20)	9.47 (16)
European banks	8.2 (21)	7.7 (21)	7.8 (19)	8.3 (20)
North American banks	8.0 (8)	9.0 (8)	8.6 (8)	8.6 (9)
US banks	8.4 (5)	9.2 (5)	9.0 (5)	N/A
Asian banks	9.1 (11)	8.8 (12)	9.0 (13)	9.23 (13)
Average	8.4 (40)	8.3 (41)	8.4 (40)	8.64 (42)

Q How would you characterise the commitment of your parent bank to the Chinese market in 2014 versus 2011?

The level of commitment will continue to increase by 2014. Although the number of banks scoring the maximum score of ten will increase from 11 banks to 12 in 2014 and the number scoring nine out of ten will more than double to 15 banks.

This improvement will result from many banks that scored eight out of ten in 2011, moving their scores up to nine out of ten for 2014.

In the 2010 report, four banks scored six or below. This year, four banks again scored below six, with one in 2010 scoring just four. The chart shows that by 2014, all the participants recorded a commitment level of seven or higher.



Based on responses from 40 banks each for 2011 and 2014

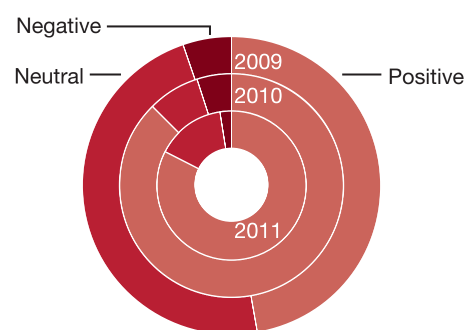
Q From the perspective of your head office, has the agenda for your bank's China operations over the last year changed positively, negatively or neutral?

In 2009, following the financial crisis, 18 banks indicated that there had been a negative impact on the agenda for China.

This changed to just two negative impacts in 2010, and in 2011, only one bank believes its China agenda has been negatively affected.

Many participants expressed extreme commitment to the Chinese market. They portrayed China as an expanding market with substantial growth opportunities from both their own clients and the large Chinese corporates. One European bank noted that there were still many problematic issues but China remained a key strategic market.

Another large European bank indicated that it was going to be a "lot more aggressive" in the future.



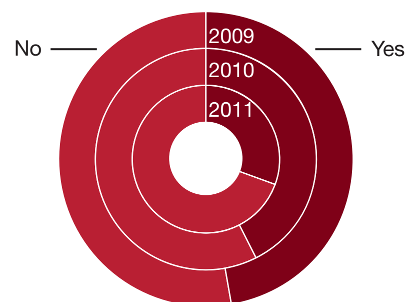
Based on responses from 40 banks each in 2009, 2010 and 2011

Q Has the global financial crisis changed your bank's business model in China?

The impact of the global financial crisis continues to recede. In 2011, only 12 banks indicated the crisis had affected their business model in China.

This group included a number of European banks that continue to be under government ownership and direction.

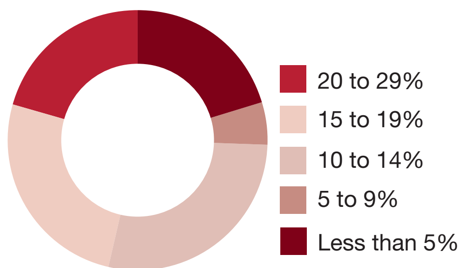
In 2009, 18 banks recorded that their business model had been affected by the financial meltdown.



Based on responses from 39 banks in 2011, 40 banks in 2010 and 38 banks in 2009

Q What was the level of staff turnover in 2010?

Aniticipated staff turnover in 2011



Eight banks recorded 20% or greater

Based on responses from 39 banks

Thirty-nine banks provided estimates of their actual staff turnover in 2010. The result showed that 12 banks experienced less than 10% turnover while 12 banks recorded greater than 20%. One bank indicated that it had more than 30% turnover in 2010.

This contrasts markedly with the results for 2009 when turnover dropped dramatically in the wake of the global financial crisis. At that time, over half of the banks experienced less than 5% staff turnover.

Going forward, 29 of the 39 banks that provided projections believe they will encounter staff turnover above 10% this year. Eighteen banks expect the turnover rate to rise above 15% in 2011.

Interestingly, a number of the larger foreign banks indicated that there might be a slight decline in turnover in 2011 versus 2010. The reasons behind this view were unclear. One reason might be that these banks may be less constrained on salary increases in 2011.

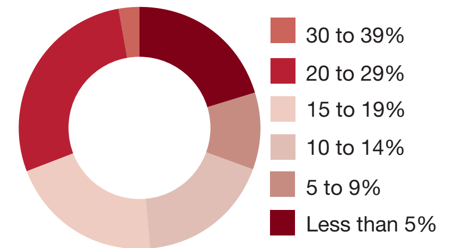
One large foreign bank suggested that a possible slowing down in the domestic economy might lower the staff turnover rate.

However, the larger banks remain vulnerable to staff poaching from other foreign banks in second-tier cities, where some foreign banks may be opening branches for the first time.

One large Asian bank that suggested its turnover rate will drop from 20% in 2010 to 10% in 2011, believes this would be the outcome of a series of personnel initiatives. These include more staff social activities, faster promotions, emerging talent courses and more long service cash awards.

Headhunters are actively targeting key staff. A European bank reflected on the loss of a legal and compliance person who had been earning RMB 360,000 annually, being hired by another European bank with a salary of RMB 1.5 million.

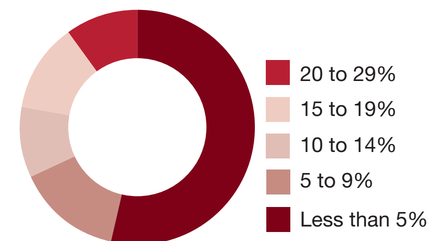
Staff turnover in 2010



12 banks recorded 20% or greater

Based on responses from 38 banks

Staff turnover in 2009



22 banks recorded less than 5%

Based on responses from 41 banks

Q In 2011, will base salaries remain the same, increase or decrease?

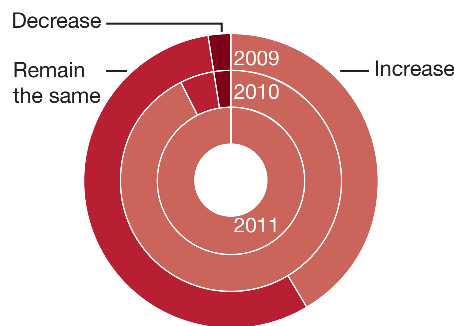
Two years ago, 23 banks said their salary levels would remain static. In 2011, all 40 banks answering this question said salaries would increase.

One European bank said China salaries would increase by 15% in 2011. They noted that salary increases in Europe this year for the bank would be 6%. If this percentage was applied to China they envisaged they would lose two-thirds of their staff.

One factor that is driving salary escalation, in addition to supply shortages, is the rising rate of inflation.

A number of banks said that following the global financial crisis, there was much more differentiation on salary and bonus awards. This now closely matched performance, and while some awards were significant, others were minimal or zero.

A large European bank believes that for comparable positions, salaries in Shanghai (after tax given the high Chinese taxes) matched those of Hong Kong, Singapore, London and New York.



Based on responses from 40 banks in 2011, 41 banks each in 2010 and 2009

Q Do you plan to reduce or contain overall human resource costs in 2011?

Within the group of 40 respondents, only one bank suggested that it would reduce costs. This was the result of a unique situation where it was retreating from one previously important line of business.

Eight banks volunteered that they were attempting to contain costs and seeking improved levels of productivity.

However, the most common response reflected China as a growth market where emphasis was on market expansion and development.

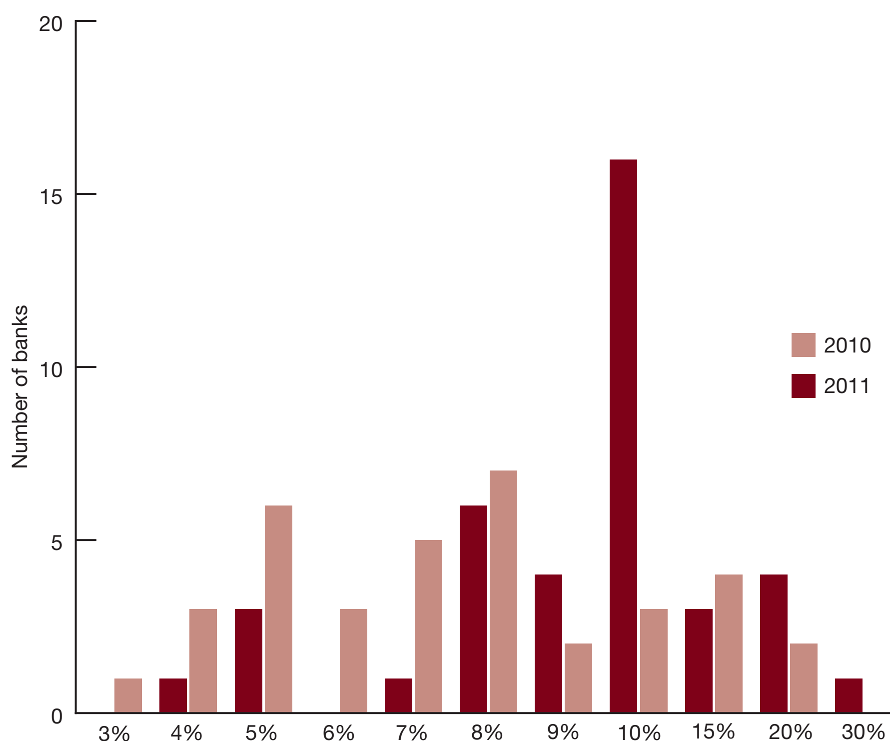
As noted elsewhere in the report, there is also a view that growth will lead to future economies of scale and business scope.

Q Can you give us an indication of the percentage increase in salary in 2011?

Salaries are expected to increase at a higher level in 2011 compared to 2010.

Sixteen banks indicated that salaries would rise by 10%, another eight banks suggested increases would be above 10% and one of them suggested salaries would rise by 30% in 2011.

In 2010, only nine banks indicated salaries would increase by 10% or higher. In 2010, 23 banks were positioned in the 5% to 9% range.



Based on responses from 39 banks in 2011 and 36 banks in 2010

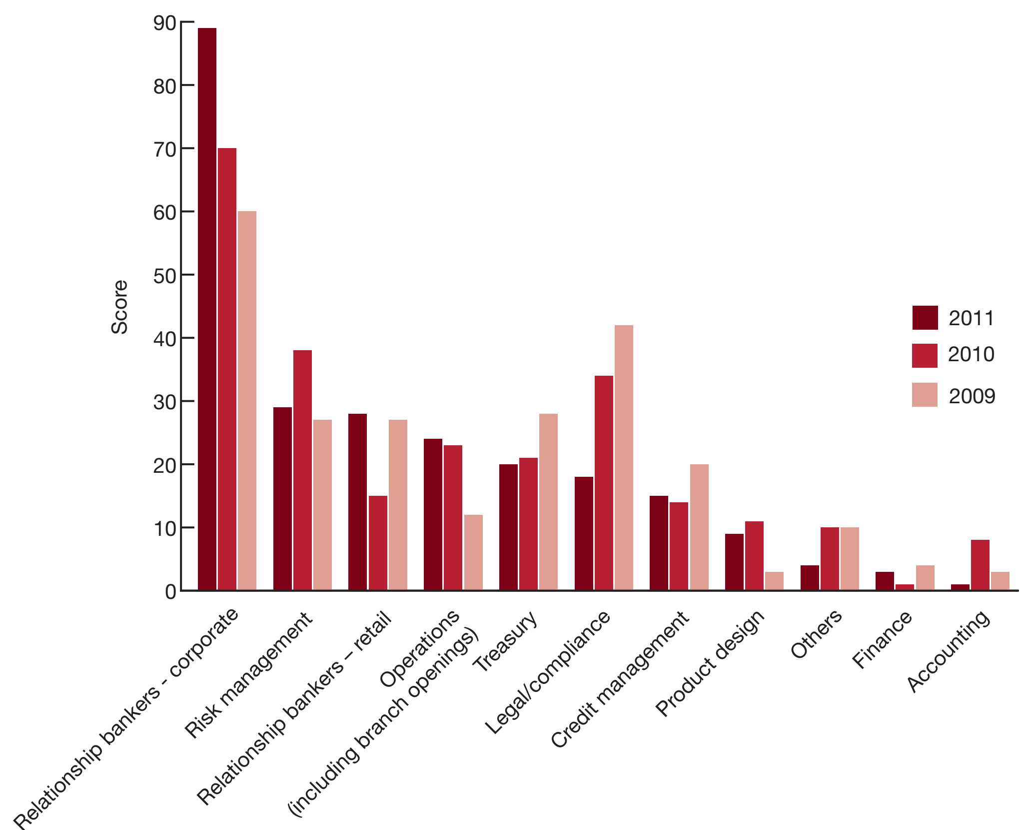
Q Which staff functions have the highest hiring priority in 2011? Can you rank the top three?

The most important hiring position this year continues to be relationship bankers on the corporate side of the business. This is consistent with 2009 and 2010 although the score has increased in 2011. In second place, with a reduced score is staff in the risk management area.

In third position in 2011, is relationship bankers on the retail side. This factor has moved up from sixth place in 2010, and reflects increased importance in the retail segment.

In contrast, legal and compliance which scored 42 in 2009, 34 in 2010, dropped to 18 in 2011.

The other category included product management and global treasury services.



Based on responses from 40 banks in 2011, 41 banks in 2010 and 40 banks in 2009; not all banks provided three rankings

Risk management

Q The Chinese version of Basel III will entail a new set of differentiated requirement. Will such a move be positive or negative?

The foreign banks believe that the move towards adopting Basel III in China is a positive development.

They also believe that ultimately there will be some differentiation of the requirements for China given the special circumstances of the Chinese economy.

One of the requirements of the Chinese version of Basel III will be a 2.5% minimum loan loss reserve. Such a requirement will have an impact on the profitability of the banks.

Bank profitability will also be influenced by the performance of the economy and the level of NPLs.

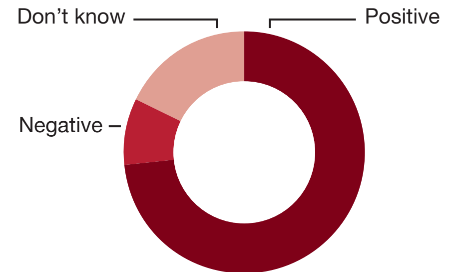
The banks will need to maintain the pace of increases in capital with increases in assets to make sure that their CAR is not diminished.

Profitability will be affected by market conditions, and if there is an increase in NPLs, CAR will come under increased pressure.

CBRC has indicated that systemically important financial institutions (SIFIs) will be required to satisfy Basel III conditions by the end of 2013, while non-SIFIs will be granted a much longer transition period.

SIFIs will be required to have a CAR of 11.5%, while non-SIFIs will be required to meet a CAR of 10.5%.

Chinese banks' adoption of Basel III



Based on responses from 34 banks

CBRC draft proposals on bank capital

China drafts new rules on bank capital requirements

China's banking regulator has drawn up a tough new set of capital requirement rules as part of efforts to implement Basel III guidelines, according to a document obtained by Reuters. The draft by the China Banking Regulatory Commission confirmed reports that appeared in local media this week.

China's big banks, or systemically important financial institutions (SIFIs), will be subject to a minimum capital adequacy ratio (CAR) of 11.5 percent under "normal conditions". But this could rise to 14 percent, with a counter-cyclical additional requirement up to 2.5 percent if CBRC thinks that credit growth is abnormally strong.

Liquidity and leverage ratios will also be introduced in a broader regulatory framework for controlling bank lending and financial risks.

Following are the main highlights:

Capital adequacy ratio

- Minimum 11.5 percent CAR for SIFIs, in addition to a possible counter-cyclical requirement of up to 2.5 percent; new rules start in early 2012 and banks must meet the requirements by end of 2013;
- Minimum 10.5 percent CAR for non-SIFIs, or smaller banks; no counter-cyclical requirement;
- Minimum core tier-1 CAR requirement is set at 5 percent, which is stricter than the 4.5 percent requirement in Basel III

Leverage ratio

- Tier-one capital must be at least 4 percent of total on- and off-balance sheet assets; new rules start in early 2012; SIFIs to meet the requirement by end-2013, non-SIFIs by end-2016;
- The 4 percent requirement is higher than the 3 percent minimum requirement in Basel III

Liquidity ratios

- Liquidity Coverage Ratio (LCR), or the ratio between high-quality liquid assets and net cash outflows for a 30-day period, must be at least 100 percent; all banks to meet the requirements by end-2013;
- Net Stable Funding Ratio (NSFR), or the ratio between usable stable funding sources and needed stable funding sources, is required to be at least 100 percent; all banks to meet the requirement by end-2013

Provisions

- Provisions must be at least 2.5 percent of total outstanding loans;
- Provisions must be at least 150 percent of total non-performing loans;
- SIFIs must meet requirements by end-2013, non-SIFIs by end-2016;

Grace period

In general, China requires its SIFIs to meet the new requirements by end-2013 and its non-SIFIs to meet the new rules by end-2016. Basel III set the deadline at Jan. 1, 2019. Criterion about SIFIs have not finalised, but the biggest five lenders (Industrial & Commercial Bank of China, China Construction Bank, Bank of China, Agricultural Bank of China and Bank of Communications) are likely to be labelled as SIFIs.

(Source: Reuters, 25 February 2011)

Q Did the global financial crisis impact the rollout of certain financial products in China? What type of products were affected, and why?

As reported in the previous two surveys, the foreign banks believed that the global financial crisis has slowed the rollout of some key financial products such as derivatives and securitisation.

In this year's responses, there was reference to the rollout of new products and the possible timeline towards increased convertibility of the *renminbi*.

The increased level of regulation and control over the last three years has made the development and launch of new products much more difficult.

As a result, it is possible to conclude that both directly and indirectly, the global financial crisis has slowed the rollout of products and impacted on the contribution of the foreign banks in terms of creativity and innovation. It has also affected the competitive positioning of the foreign banks.

Based on responses from 38 banks in 2011, 41 banks in 2010 and 40 banks in 2009

Q Has local incorporation had a positive influence on risk management?

Twenty-four of the 36 banks that answered this question contended that the move to local incorporation had a positive influence on risk management.

They argued that local incorporation provides a sharper focus on the local operation and cited requirements such as the loan-to-deposit ratio.

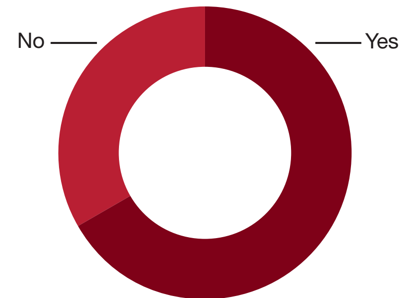
However, many banks including several that have chosen local incorporation, contended that their head office requirements were already far reaching and rigorous.

Some argued that it was wrong to link local incorporation with improved risk management.

A large foreign bank observed that Chinese regulations were often ambiguous and this added confusion and uncertainty.

Another participant believes that setting up a new China platform for risk management would be counterproductive.

Positive influence on risk management?



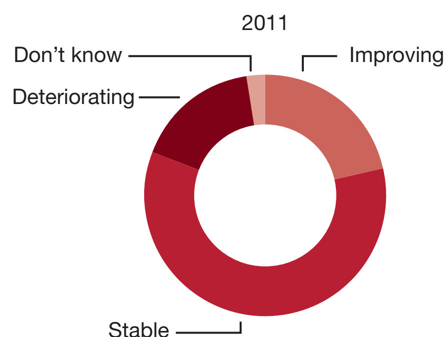
Based on responses from 36 banks

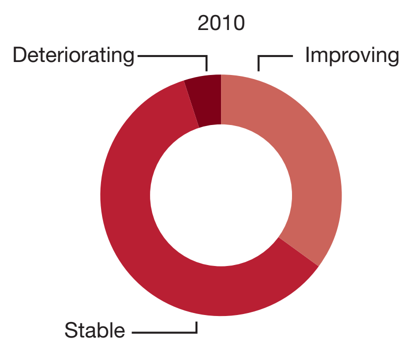
Q How would you describe the current position for corporate credit? Is it improving, stable or deteriorating?

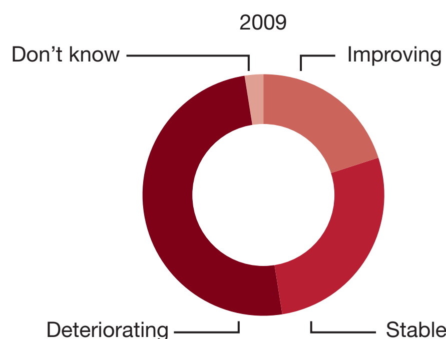
These three charts show how most participants believed corporate credit was deteriorating in 2009. By 2010, approximately one-third believed it was improving and a significant number also viewed it as stable.

In 2011 those believing it was improving has decreased, the stable percentage remains much the same and the deteriorating category has increased.

Corporate credit







Based on responses from 42 banks in 2011 and 40 banks each in 2010 and 2009

NPLs – present and future

As CBRC data below demonstrates, the NPL ratio over the last five quarters has been declining. In the case of the foreign banks, the ratio has declined from 0.74% in Q1 2010 to 0.50% in Q1 2011.

For the Big Five banks, the ratio over the same period fell from 1.59% to 1.20%. Several foreign banks cautioned that the credit outlook was sector specific with uncertainties hanging over SMEs, real estate, construction and commodities.

The future impact of LGFVs on loan performance at China's banks

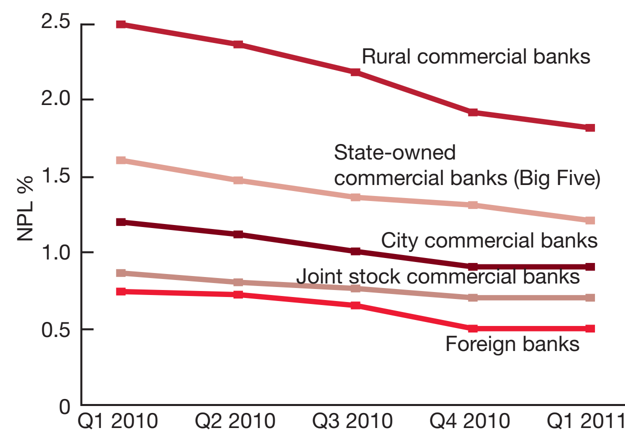
China has more than 10,000 local government financing vehicles (LGFVs), an increase of 25% since the end of 2008. LGFVs allow local governments to finance projects by borrowing from banks and often providing land as collateral.

The PBOC in June 2011 said that 70% of the LGFVs were run by county governments.

Over 50% of the loans carried a tenor longer than five years and over 50% are loans for roads and highways and municipal projects.

(Source: China Regional Financial Operation Report, PBOC, June 2011)

Non-performing loan ratio 2010-2011



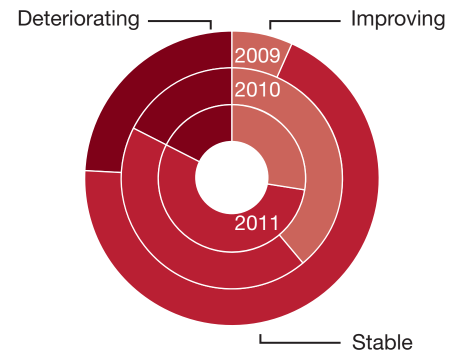
Source: CBRC

Q How would you describe the current position for consumer credit? Is it improving, stable or deteriorating?

Over half the banks, 16 out of 29, believe that consumer credit is stable. Eight banks indicated that it is improving. In 2010, nine banks said it is improving.

One large retail bank said that consumers are spending more and purchasing homes and cars.

Consumer credit



Based on responses from 29 banks in 2011, 23 banks in 2010 and 29 banks in 2009

Consumer demand

Continuing levels of consumer demand

Car sales in April 2011 were 1.14 million vehicles, a modest increase from a year earlier. In 2010, sales jumped 32% to 18 million vehicles. There is an expectation that the rate of growth will slow as a result of higher gas prices, traffic restrictions and the removal of government incentives.

(Associated Press, 10 May 2011)

Bloomberg reported that housing sales rose 26% in the first quarter of 2011 despite government measures to curb speculation.

Premier Wen Jiabao said in a 13 April 2011 cabinet meeting that the country faces challenges including rising property prices in many cities.

(Bloomberg News, 15 April 2011)

In a March 2011 report *Understanding China's Love for Luxury*, McKinsey & Company found that increasing wealth and conspicuous consumption is driving demand for luxury goods down the economic ladder.

McKinsey concluded that the 13 million households making up China's upper middle class households (incomes between RMB 100,000 and RMB 200,000) offer the growth opportunity.

McKinsey's research also found that pools of luxury goods' consumers were growing rapidly. They believe that the number of cities that can support luxury consumption will grow from 30 cities to 60 cities over the next five years.

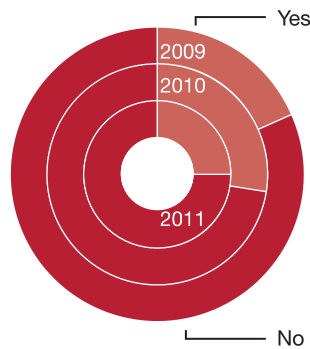
These trends are reflected in the healthy demand for consumer credit. They also add credence to the move by some of the foreign banks with a retail presence to emphasise the importance of the growing affluent market rather than addressing high net worth individuals (HNWI) at the top end of the market with a private banking offering.

Q Do you believe the Chinese banks' risk management systems are sufficiently robust?

The foreign banks continue to be skeptical of the risk management systems at the Chinese banks.

While most participants continue to frame their responses by commenting on continual improvements, their reservations have been elevated by the stimulus plan.

Many participants refer to external influences on lending decisions. They also refer to corruption, internet fraud and identity fraud.



Based on responses from 36 banks in 2011, 40 banks in 2010 and 38 banks in 2009

China's Record Bank Lending May Spur Fitch Rating Downgrade

Fitch Ratings lowered its outlook on China's AA- long-term local-currency rating to "negative" from "stable," citing a "high likelihood of a significant deterioration" in banks' asset quality within three years. The outlook on China's A+ foreign-currency rating remains stable, London-based Fitch said in a statement yesterday.

Bad loans could rise to 15 percent to 30 percent of the total, with concern at the quality of lending compounded by growth in off-balance-sheet credit, Fitch said. Chinese banks extended 7.95 trillion yuan ($1.2 trillion) of new loans last year, helping drive the economy's rebound from the global financial crisis and fueling a surge in property prices.

"Fitch has documented a proliferation of off-balance sheet and other more or less informal channels through which credit is being extended to the economy," Andrew Colquhoun, head of Fitch's Asia-Pacific sovereign unit, told a conference call today. "This gives rise to concerns that the effectiveness of monetary policy may be decreasing."

A downgrade by Fitch would be the first on China's debt since Standard & Poor's cut its foreign and local currency long- term ranking one level in July 1999 to BBB. Fitch has never cut China's credit rating, according to data compiled by Bloomberg. Bank of America-Merrill Lynch economists led by Lu Ting said a systemic banking crisis in China is a "remote possibility" in the next couple of years.

Being "cautious is one thing, exaggerating risks is quite another," the economists wrote in an e-mailed note today. Some rating firms "might need to be more careful in using models" to predict the probability of a bank crisis in China, they wrote.

China, the world's second-largest economy with about $2.8 trillion in foreign-exchange reserves, has raised interest rates four times since October to fight inflation. Premier Wen Jiabao said last month that "exorbitant" home-price increases are a key concern as China seeks to rely more on domestic than foreign demand to power economic growth.

Loans to companies and households in China rose to about 140 percent of gross domestic product last year, from 111 percent in 2008, Fitch said. The increase is linked to property lending and local-government financing, it said.

"The lack of disclosure on a local government level and how much debt they have taken on is somewhat of a concern," Colquhoun said on the call. He said it was "not inconceivable" that support to cover bad loans could rise to as much as 30 percent of gross domestic product, should the non-performing loan ratio reach 30 percent. The non-performing loan ratio of 1.1 percent at the end of 2010 could rise to 6 percent if local-government financing was classified in a "more conservative" manner, the company said in yesterday's statement. "Fitch expects some sovereign support for the banking system will be required."

(Source: Bloomberg News, 13 April 2011)

Products and market segments

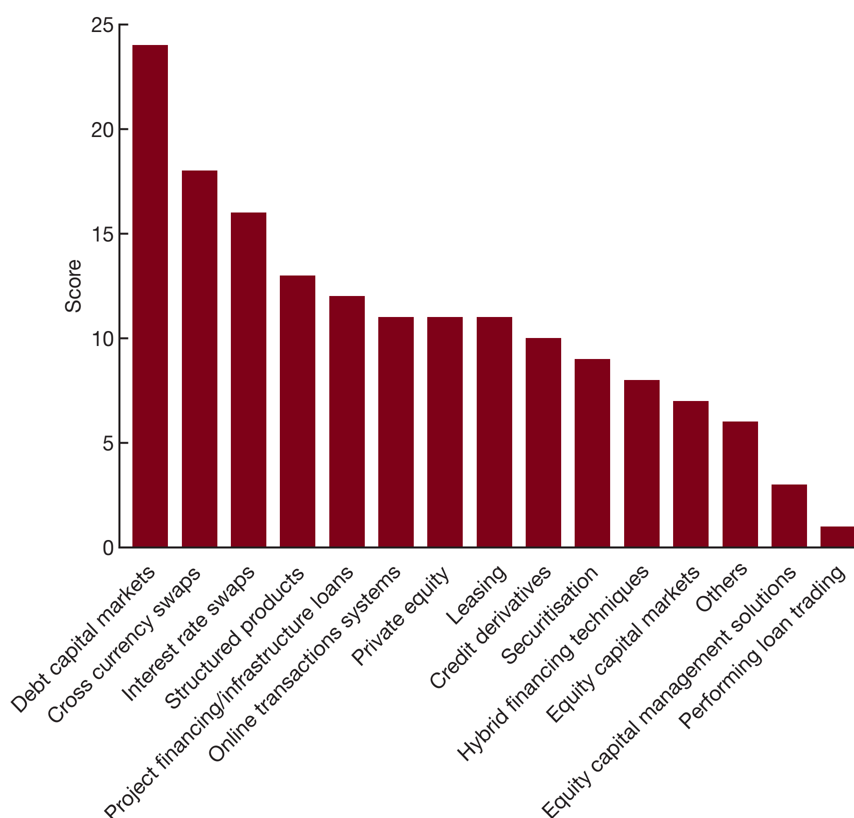
Q What wholesale products do you see becoming increasingly important in the Chinese banking industry in the next three years?

Debt capital markets continue to be identified as the area of greatest future opportunity for foreign banks engaged in wholesale banking. Debt capital markets have secured top place over the last three years.

The bond market continues to grow in China. It is now the second largest in Asia and the sixth biggest in the world. In the first ten months of 2010, bond issuance grew by 25% to RMB 8.2 trillion.

Cross currency swaps were positioned in second place. China Foreign Exchange Trading System (CFETS) continues to introduce reforms as China makes progress on its path towards increased internationalisation of the *renminbi*. The foreign banks anticipate significant growth in a number of product areas associated with the internationalisation of the currency.

	2011 Rank	2010 Rank	2009 Rank
Debt capital markets	1	1	1
Cross currency swaps	2	5	5
Interest rate swaps	3	4	3
Structured products	4	2	5
Project financing/infrastructure loans	5	9	2
Online transactions systems	6	11	10
Private equity	7	3	4
Leasing	8	6	8
Credit derivatives	9	12	12
Securitisation	10	10	14



Based on responses from 40 banks in 2011

Q Can you expand upon how structured products are currently being used in the Chinese market, and how this might develop by 2013?

There was a widely held view that structured products would continue to grow in importance.

Some of the suggestions on areas of opportunity were as follows:

- on the liability side – where structured deposits provide increased yields
- structured asset products, e.g. ship financing or leasing
- asset wealth management products including high yield deposits, currencies and commodities
- interest rate swaps, foreign exchange swaps
- hedging of fuel costs by airlines.

Several banks anticipated that the transition from vanilla structured products towards more sophisticated products will be accompanied by a series of new CBRC rules and regulations.

There was a feeling that any innovation by the foreign banks would be managed by CBRC to ensure that the domestic banks can keep pace.

Q Which product areas do you see becoming increasingly important in the Chinese retail banking industry in the next three years?

This response is identical to the findings in last year's report.

The three most important retail products going forward continue to be:

- High net worth individuals (HNWI)/ private banking
- Investment products
- Mortgages.

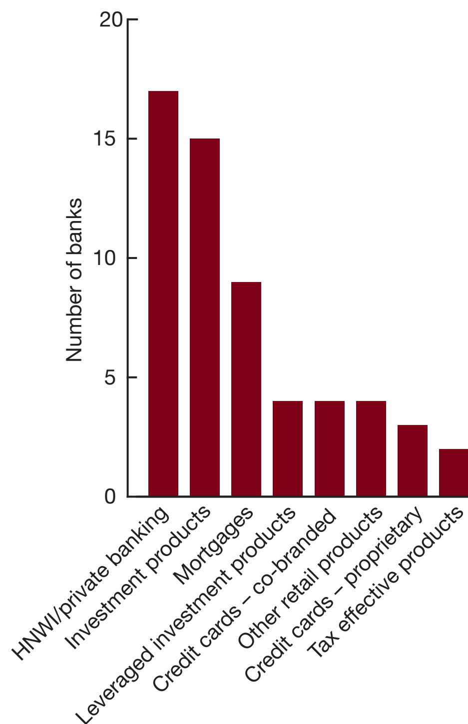
Less important products included leveraged investment products and credit cards.

The Bank of East Asia is the only foreign bank to issue credit cards in its own name. Other large foreign banks continue to service the credit card market through co-branded cards issued with large domestic banks.

Up to end-2010, banking institutions issued a total of 2.41 billion cards, up 18.6 percent year-on-year, and the transaction volume amounted to RMB 283.6 trillion, up 74.2 percent year-on-year.

Newly issued credit cards numbered 211 million, achieving an aggregate transaction volume of RMB 5.1 trillion, including RMB 2.7 trillion in consumption volume. The percentage of credit card consumption in the total retail sales increased from 3.1 percent in 2006 to 17.7 percent in 2010, and its percentage in GDP increased from 1.1 percent in 2006 to 6.9 percent in 2010.

(Source: CBRC Annual Report 2010)



Based on responses from 22 banks in 2011

Q In your opinion at the retail bank branch level, how serious a problem are the following issues on a scale of one to ten? A score of ten represents the maximum.

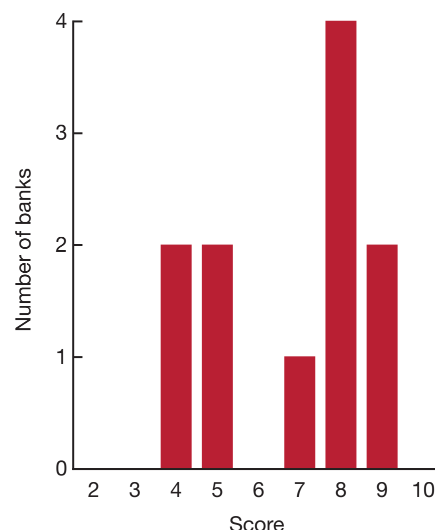
The foreign banks were again asked to comment on three problematic areas of operation for the domestic banks; a lack of expertise of staff in selling products, the mis-selling of some products and controls in the distribution channels.

Eleven banks answered this question in 2011.

Responses suggest that the foreign banks continue to believe their domestic counterparts still have problems in each area.

In the case of a lack of expertise, seven banks scored seven or greater.

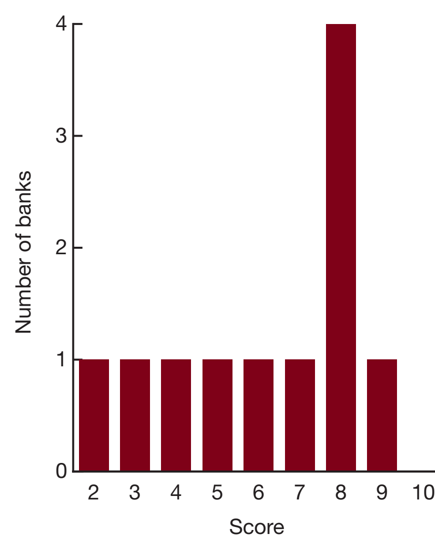
Lack of expertise of staff in selling particular products



Based on responses from 11 banks

While several banks believed mis-selling was not a problem, seven banks still attributed a score above six out of ten, and five of these scored eight or higher.

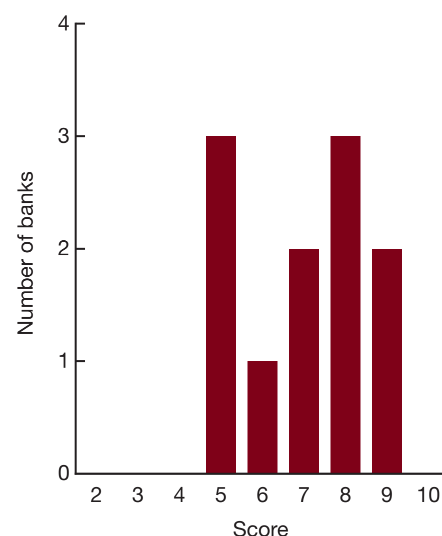
Mis-selling of certain products



Based on responses from 11 banks

Finally, seven banks also scored seven out of ten or above regarding the nature of controls in the banks' distribution channels.

Controls in the distribution channel



Based on responses from 19 banks in 2010 and 20 banks in 2009

Average scores over three years show a modest improvement for both a lack of expertise and mis-selling of products. However, the foreign bankers' perception of controls at the branch level suggests that this area remains a challenge.

Average scores 2009-2011

	2011	2010	2009
Lack of expertise	6.8	7.2	7.5
Mis-selling of products	6.18	6.2	7.2
Controls in distribution	7.0	6.1	7.0

Q Will the aggregate market share of foreign banks in China (vs local banks) stay the same, increase or decrease?

In both 2009 and 2010, 16 foreign banks believed that as a group they would be able to increase market share.

This figure declined to 12 banks in 2010 when for the first time, the majority of banks indicated that their market share would stay the same.

As the adjacent chart shows, market share peaked in 2007 at 2.36% and in 2010 was 1.83%.

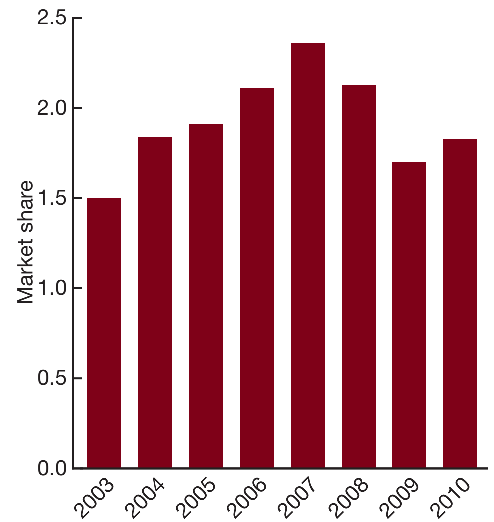
A large foreign bank suggested that it was unlikely that market share would increase unless it was accompanied by deregulation.

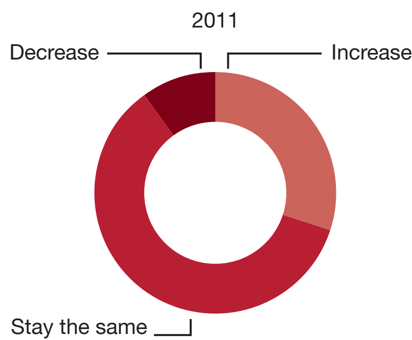
Another suggested that the foreign banks possessed superior technology and networks, but this was being eroded as the domestic banks worked to further narrow the gap.

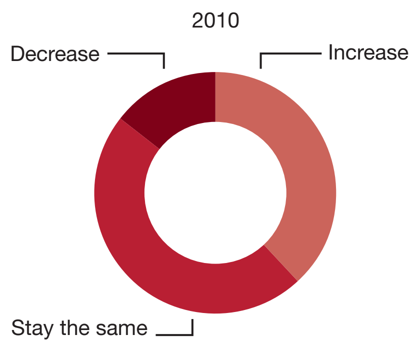
A European bank contended that if interest rates were deregulated, then foreign banks would capture market share, if not, then there would be no change.

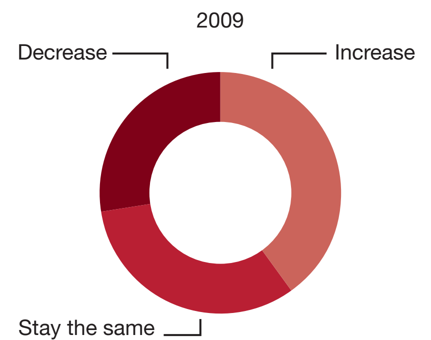
While one respondent argued that the government would like to see some increase, another suggested they would only allow a market share of 2%.

Market share for all foreign banks 2003-2010









Based on responses from 40 banks in 2011, 42 banks in 2010 and 40 banks in 2009

Q What is your bank's primary method of expansion in China?

The primary method of expansion for foreign banks remains organic growth.

In 2011, 30 banks chose this method. There was only one exception — a European bank that contended it was not in an expansion mode.

Although the question restricted participants to just one choice, two banks suggested that they were actively pursuing joint ventures and three banks said they planned acquisitions.

One bank indicted that a venture into rural banking represented its most important form of market expansion.

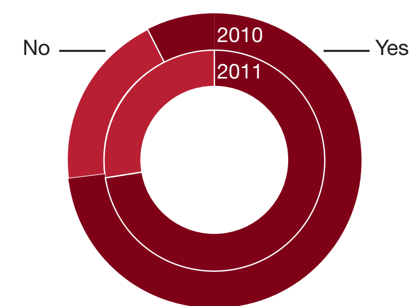
This year's findings come close to those of 2010 and 2009 when 37 banks and 38 banks, respectively, also cited organic growth as the most important expansion option.

Q Does your bank plan to be involved in partnership relationships over the next three years?

Partnerships will continue to be important for foreign banks. The banks have developed and will seek to further relationships in areas such as the following:

- consumer finance
- private banking
- insurance
- trust services
- asset management
- leasing
- securities
- rural banking
- correspondent banking.

Plans to seek future partnerships?



Based on responses from 40 banks in 2011 and 41 banks in 2010

A good example of a foreign bank partnership is exhibited by the cooperation agreement between ANZ Bank and China Exim Bank.

The agreement covers the development of trade and energy, infrastructure and engineering projects in Australia as well as the Asia-Pacific region. It focuses on the provision of structured export finance and project finance.

Partnerships between foreign banks and securites firms are growing as the foreign banks increase their involvement across the financial sector

Examples of recent partnerships between foreign banks and securities firms include agreements between Citibank and Orient Securities and RBS and Guolian Securities.

Foreign banks are permitted to own up to one-third of the shares in these entities.

Other joint venture securities firms include:

- JPMorgan and First Capital Securities (FC JPM Securities)
- Deutsche Bank and Shanxi Securities (Zhongde Securities)
- Credit Suisse and Founder Securities (Credit Suisse Founder Securities)
- Goldman Sachs and Beijing Gaohua Securities (Goldman Sachs Gaohua Securities)
- UBS Securities (restructured from former Beijing Securities)
- Daiwa SMBC and Shanghai Securities (Daiwa SSC Securities)
- CLSA (Crédit Agricole) and Fortune Securities (Fortune CLSA Securities)
- Morgan Stanley with Huaxin Securities (Morgan Stanley Huaxin Securities).

Morgan Stanley had previously received government approval to sell its 34.3% stake in China International Capital Corporation (CICC) to Kohlberg Kravis Roberts, TPG Capital, Government of Singapore Investment Corporation (GIC), which is the country's sovereign wealth fund, and Great Eastern Holdings, an insurance company controlled by Oversea-Chinese Banking Corporation (OCBC).

In 1995, Morgan Stanley in partnership with various Chinese investors formed CICC, the first Sino-foreign investment bank which became the top-ranked underwriter of share sales in China.

Commenting on the RBS and Guolian Securities joint venture – Huaying Securities – Guolian's Chairman Lei Jianhui said "the joint venture will focus more on expanding its bond business in China's less developed bond market by using RBS's expertise in this area".

(Source: Wall Street Journal, 20 May 2011)

The joint ventures in China also hope to tap the country's growing IPO market.

In 2010, China was the world's largest IPO market, with 346 companies raising US$83.7 billion. *(Source: Financial Times, 30 May 2011)*

Q What are the top three drivers of success in private banking?

By the end of 2010, a total of 124 commercial banks offered 7,049 types of personal wealth management products, with a total book balance of RMB 1 .7 trillion.

The diversified wealth management products have enabled flexible options for businesses and individuals in managing their assets and liquidity. Third, the development of e-banking business was in full swing.

In 2010, the total number of e-transactions reached 35.73 billion, amounting to RMB 628.52 trillion. The number of online banking customers exceeded 279 million, and the number of e-banking transactions reached 10.9 billion with a total volume of RMB 520.77 trillion

(Source: CBRC Annual Report 2010)

The following are the different drivers of success for private banking that the participants indicated.

Quality of people

This includes highly skilled and resourceful individuals with good connections who are able to identify and satisfy their clients' needs. Several world class private banking participants said that retaining these individuals was particularly difficult, given their limited supply.

Branding

The brand and reputation of the foreign banks are critically important.

Quality of products

The participants believe local regulations limit their ability to leverage their product portfolios and international expertise. This allows domestic banks to offer real competition. Limitations on the types of instruments that can be offered by foreign banks reduce their effectiveness. For example, QDII rules limit the potential growth of foreign banks.

A global leader in private banking said it was difficult to design solid products and create product differentiation.

Willingness to educate clients

One bank suggested foreign banks need to understand their clients better and avoid promoting a western-based model of wealth management.

It was emphasised that the Chinese wealth management client was likely to be younger, to have recently acquired his or her wealth and to possess a "trading" mentality.

Clients are unlikely to understand their own needs and therefore need educational support on wealth management.

Strategic clarity

Foreign banks need to have a clearly defined, narrow and targeted focus.

Multiple legal platforms

If a client needs both banking and securities services, it may be necessary for the foreign bank to offer legal entity platforms that support a range of products.

Investments

Q Do you envisage foreign banks making further acquisitions in China over the next three years?

The foreign banks anticipate that they will make acquisitions in complementary areas where permitted by local regulations.

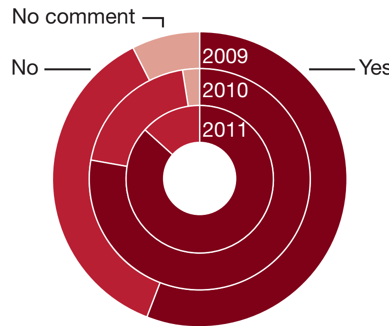
A number of foreign banks have already made their permitted equity investment of up to 19.9% each in two domestic banks.

Participants from foreign banks which have yet to reach this investment limit suggested that many likely targets had already been acquired and those remaining commanded a high premium.

Some of the areas of future acquisition included the following:

- insurance
- trust companies
- consumer credit
- securities firms
- leasing
- asset management
- non-bank financial institutions.

Plans to make further acquisitions?



Based on responses from 38 banks in 2011 and 41 banks each in 2010 and 2009

Q In your opinion, which markets are the big Chinese banks likely to expand into? How will they undertake this expansion?

Overseas development of Chinese banking institutions

The year of 2010 witnessed the steady progress made by Chinese banks in the prudent implementation of overseas development strategy.

During the year, the Industrial and Commercial Bank of China (ICBC) was approved to open branches in the cities of Milan, Madrid, Paris, Brussels, Amsterdam and Karachi, the Bank of China (BOC) was approved to branch in Phnom Penh, the China Construction Bank (CCB) was approved to set up a branch in Sydney, and the Bank of Communications (BoCOM) was approved to open a branch in Ho Chi Minh.

In addition, the BOC, the BoCOM and the China Merchants Bank (CMB) obtained approval from Taiwan financial regulatory authority to set up representative offices in Taiwan, making them the first batch of mainland banks allowed to enter Taiwan market.

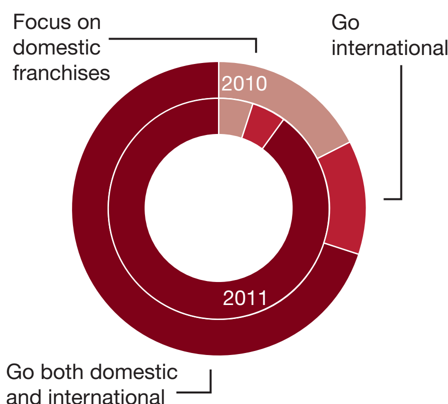
As of end-2010, the five large commercial banks set up 89 branches and subsidiaries outside China, acquired or invested in ten foreign banks; six of the national joint stock commercial banks established five branches and five representative offices overseas; and two city commercial banks opened two representative offices overseas.

(Source: CBRC Annual Report 2010)

In 2010, 28 respondents believed the large Chinese banks would focus both on their domestic franchises and going international. In 2011, this belief was expressed by 36 of the 40 respondents. The foreign banks believe the domestic banks are capturing opportunities both at home and abroad.

There was a widely-expressed view that the domestic banks were following their clients into overseas markets.

The regions frequently cited included Africa and South Africa but European banks have said Chinese banks have opened up branches in their capital cities such as Paris, Frankfurt, Brussels and Luxembourg.



Based on responses from 40 banks in both 2011 and 2010

One large foreign bank contended that ICBC was the most aggressive Chinese bank in international expansion. An American bank suggested that the Chinese banks would not follow the same path as the Japanese banks when they expanded internationally.

An Australian bank indicated that the Big Four were present in Australia. The PBOC also has a representative office in Sydney. The Chinese central bank has representative offices in the Americas, Europe, Tokyo, Frankfurt and Africa.

ICBC Plans Mideast Expansion

Industrial & Commercial Bank of China Ltd., the country's largest bank by assets, plans to open more branches in the Middle East and would consider acquisitions there to capitalize on China's booming investment in the region.

ICBC has accelerated its overseas expansion since it raised $21.9 billion in the world's biggest initial public offering in 2006, but its total assets outside mainland China still account for only 3% of its assets of $1.8 trillion.

The bank has three outlets in the Middle East: a wholly owned unit in Dubai, a branch in Doha and a branch in Abu Dhabi, said Tian Zhiping, ICBC's chief executive for the Middle East. Mr. Tian said he expects the bank's Middle East operations to post a net profit of more than $10 million this year, up from $2.8 million in 2009.

"We will start a study about the feasibility of opening branches in Kuwait and Saudi Arabia later this year," he told reporters on the sidelines of a financial forum Monday. Mr. Tian said once ICBC sets up branches in the two countries, its network in the Gulf Cooperation Council will be complete. "For the rest of the Middle East and North Africa, the bank will consider buying local banks for further expansion if there are the right opportunities," he said.

(Source: Wall Street Journal, 1 June 2010)

ICBC completes $550 mln deal to buy Thailand's ACL

Industrial and Commercial Bank of China (ICBC), the world's largest bank by market value, said it had acquired 97.24 percent of Thailand's smallest lender, ACL Bank ACL.BK, for about $550 million after a tender.

ICBC had bought 1.55 billion ACL shares, including preferred shares, after the tender closed last week, it said in a filing to the Securities and Exchange Commission.

Based on an offer price at 11.50 baht, ICBC is expected to spend 17.7 billion baht for the stake, according to Reuters calculation.

It includes 30.6 percent stake sold by the Finance Ministry.

The deal is ICBC's first acquisition in Thailand and one of a handful of overseas purchases by it in recent years.

ICBC announced its bid for ACL in September, after agreeing to buy 19.26 percent from Bangkok Bank BBL.BK for $106 million at 11.50 baht a share.

(Source: Reuters, 21 April 2010)

ICBC to buy stake in US retail bank – WSJ

Industrial and Commercial Bank of China agreed to acquire a majority stake in the Bank of East Asia's U.S. unit, making it the first Chinese lender to buy into a U.S. retail bank, The Wall Street Journal reported on its website on Friday.

The bid by China's largest lender is likely to be closely scrutinized by U.S. regulators and could draw some political backlash, given the spotty relationship between the two countries and the history of attempts by Chinese companies to enter the U.S. market.

But if approved it could pave the way for other Chinese banks to buy into the U.S. market and bring fresh capital to the banking industry which recovering from the financial crisis.

To approve a deal, the Fed will need to determine that ICBC is subject to comprehensive supervision or regulation on a consolidated basis in its home country. In other words, the Fed would have to recognize the adequacy of the supervision by Chinese banking regulators -- something they have not been able to do as late as 2008.

Bank of East Asia's U.S. subsidiary reported net income of $1.9 million in the quarter ending Sept. 30, according to regulatory data. It had total assets of $717 million and deposits of $425.2 million.

Hong Kong-based-Bank of East Asia formed its U.S. subsidiary in August 2001 through the acquisition of Alhambra, California-based Grand National Bank.

The U.S. subsidiary has 13 branches in New York and California, according to its website.

(Source: Reuters, 21 January 2011)

Liquidity and funding

Q Has there been a negative impact on lending as a result of liquidity pressures?

The tightening of liquidity has had a negative impact on lending among foreign banks.

Twenty-nine of the participants, or almost 75% of the sample size, said that liquidity tightening had affected their banks' lending. The number of participants who gave an affirmative answer to the question rose to 37 when asked if the tightening of liquidity had impacted foreign banks. The same number of respondents said there had been an impact on domestic banks.

The foreign banks that responded 'No' typically were not those that were focused on lending, had excess capital or a sound deposit base.

At the time of this survey, a few banks suggested that the various increases in reserve requirements had not been directly felt in the marketplace.

On the application of the *renminbi* loan quota for 2011, foreign banks had varying comments. Some participants indicated that CBRC had granted increases over 2010, while others said the amount had remained the same. There were some who suggested it had decreased. A large European bank said that "no one understands the 'quota system" '. One bank suggested that renminbi quotas were "dynamic" and being granted on a quarterly basis. Another bank believed "quotas" will tighten this year because of rising inflation levels.

In addition to *renminbi* quotas the participants also mentioned short- and long-term foreign currency quotas. Discussion of these quotas and their future application lead the participants to comment on the transition to a convertible currency. While some participants believe this will occur in five years – by 2016, others believe full convertibility may be ten years away. Some participants referred to the central government's stated goal of Shanghai becoming a global financial centre by 2020 and questioned how this would be possible without a fully convertible currency.

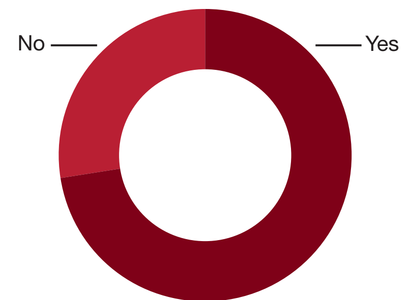
China's central bank said Thursday it will raise banks' reserve requirement ratio by 0.50 percentage point from May 18, in a move to address inflation concerns by locking up liquidity in the banking system.

So far this year, the People's Bank of China has raised the reserve requirement ratio once every month for a total of five hikes, making it almost a routine event in the eyes of many market participants.

The reserve requirement increase will require banks to hold a higher proportion of deposits in reserve at the central bank rather than lending them out. Once the move takes effect, the official reserve requirement ratio for most large banks will rise to 21.0%.

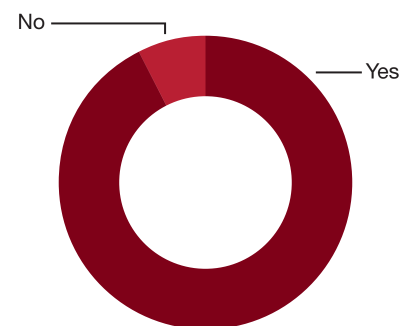
The move will drain around CNY370 billion ($57 billion) from the financial system based on the level of deposits in March, according to a Dow Jones Newswires calculation. *(Source: Dow Jones Newswires, 12 May 2011)*

Impact on your bank



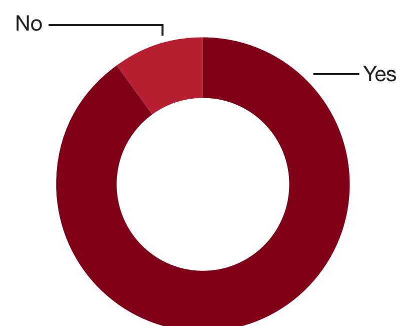
Based on responses from 40 banks

Impact on all foreign banks



Based on responses from 40 banks

Impact on domestic banks



Based on responses from 40 banks

Q Can you describe your funding sources in 2011 and in 2014 in very approximate percentages?

The participants provided rough estimates of their funding sources for both 2011 and 2014.

As the table below indicates, the three most important sources are corporate deposits, domestic banks and foreign banks' parent institutions.

Corporate deposits contribute to 50% or more of the funding for 15 banks.

Domestic banks contribute 25% or more to 11 banks and parental funding contributes 25% or more to 18 banks. Fifteen banks benefitted from retail deposits. In 2010, ten banks said they benefitted from retail deposits.

2011

	Parent	Corporate deposits	Domestic banks	Foreign banks	Retail deposits – HNWI/Premier clients>RMB 250K	Retail deposits – Others<RMB 250K	Others	
Bank 1		100%						100%
Bank 2	10%	80%			10%			100%
Bank 3	100%							100%
Bank 4	25%	60%				15%		100%
Bank 5	20%	40%	20%	20%				100%
Bank 6	100%							100%
Bank 7	30%	70%						100%
Bank 8	70%		30%					100%
Bank 9		80%			20%			100%
Bank 10	50%	35%	10%		5%			100%
Bank 11	20%	60%	5%	5%	10%			100%
Bank 12	15%	40%	30%	10%			5%	100%
Bank 13	10%	60%	10%	10%	10%			100%
Bank 14	15%	35%	30%	10%	10%			100%
Bank 15	40%	40%	20%					100%
Bank 16		70%			30%			100%
Bank 17	15%	20%	10%	5%	25%	25%		100%
Bank 18	10%	55%	5%		30%			100%
Bank 19	60%	30%	10%					100%
Bank 20	20%	10%	25%	45%				100%
Bank 21	20%	50%	20%	10%				100%
Bank 22	35%	15%	40%	10%				100%
Bank 23		100%						100%
Bank 24		20%	60%	20%				100%
Bank 25	50%		30%	20%				100%
Bank 26	25%	70%			5%			100%
Bank 27	40%	30%	10%	20%				100%
Bank 28	100%							100%
Bank 29	45%	25%	15%	15%				100%
Bank 30		50%	50%					100%
Bank 31	100%							100%
Bank 32	10%	20%	70%					100%
Bank 33	10%	60%			15%	15%		100%
Bank 34	50%	30%	20%					100%
Bank 35		25%	75%					100%
Bank 36	90%	5%		5%				100%
Bank 37	58%	2%	20%	20%				100%
Bank 38		40%	40%			20%		100%
Bank 39	15%	75%	1%				9%	100%
Number of banks	31	33	25	15	11	4	2	

Q Can you describe your funding sources in 2011 and in 2014 in very approximate percentages?

Sixteen banks indicated 50% or more of their funding will originate with corporate depositors in 2014. Twelve banks will again source 25% or more from domestic banks.

Fourteen banks will benefit from retail deposits in 2014.

2014

	Parent	Corporate deposits	Domestic banks	Foreign banks	Retail deposits – HNWI/Premier clients>RMB 250K	Retail deposits – Others<RMB 250K	Others	
Bank 1		100%						100%
Bank 2		80%			20%			100%
Bank 3	70%	30%						100%
Bank 4	15%	60%				25%		100%
Bank 5	20%	40%	20%	20%				100%
Bank 6	100%							100%
Bank 7	30%	70%						100%
Bank 8	30%	20%	50%					100%
Bank 9		60%			40%			100%
Bank 10	30%	30%	10%		30%			100%
Bank 11	20%	60%	5%	5%	10%			100%
Bank 12	15%	50%	25%	5%			5%	100%
Bank 13	10%	60%	10%	10%	10%			100%
Bank 14	15%	35%	30%	10%	10%			100%
Bank 15	30%	40%	30%					100%
Bank 16		50%			50%			100%
Bank 17	5%	20%	10%	5%	60%			100%
Bank 18	10%	55%	5%		30%			100%
Bank 19	50%	40%	10%					100%
Bank 20	20%	30%	20%	30%				100%
Bank 21	15%	70%	8%	7%				100%
Bank 22	35%	15%	40%	10%				100%
Bank 23		100%						100%
Bank 24		20%	60%	20%				100%
Bank 25	15%	60%			25%			100%
Bank 26	40%	30%	10%	20%				100%
Bank 27	70%	30%						100%
Bank 28	30%	25%	25%	20%				100%
Bank 29		50%	50%					100%
Bank 30	50%	20%	30%					100%
Bank 31	10%	20%	70%					100%
Bank 32	10%	44%			23%	23%		100%
Bank 33	40%	30%	30%					100%
Bank 34		50%	50%					100%
Bank 35	50%	20%	15%	15%				100%
Bank 36	40%	20%	20%	20%				100%
Bank 37		50%	20%			30%		100%
Number of banks	28	36	25	14	11	3	1	

Q Can you provide details on your loan portfolio?

Thirty-eight banks provided data on the competition of their loan portfolios. This showed that 31 banks have lending relationships with the large Chinese corporates, 25 with home country corporates and 22 with global corporates.

Seven banks have 50% or more of their portfolios with the large Chinese corporates and a further five banks have more than 50% with home country corporates.

Three of these banks have 80% or more of their loans with home country corporates, suggesting that their China presence is strongly oriented to their important home country-based clients.

Seven banks recorded loans to Chinese SMEs. In 2010, ten banks said they had loans to SMEs.

	To Chinese based large listed corporates	To Chinese based private corporates	To Chinese based SME corporates	To global corporates	To home country corporates	To Chinese banks	To foreign banks	Others	Total
Bank 1	10%			20%	60%	10%			100%
Bank 2	25%		25%	50%					100%
Bank 3				100%					100%
Bank 4	40%	20%	10%	10%	20%				100%
Bank 5	50%			50%					100%
Bank 6	45%	15%		20%	20%				100%
Bank 7				50%	20%	30%			100%
Bank 8	80%			20%					100%
Bank 9	10%	60%	20%		10%				100%
Bank 10	30%	40%	20%		10%				100%
Bank 11	5%			20%	40%	25%	5%	5%	100%
Bank 12	50%			20%	15%	15%			100%
Bank 13	25%			25%	10%	30%	10%		100%
Bank 14	30%			10%	40%	20%			100%
Bank 15	30%	5%	10%	30%	25%				100%
Bank 16	25%	25%		30%		10%	10%		100%
Bank 17				70%	10%	20%			100%
Bank 18	10%			35%	55%				100%
Bank 19	50%	10%		40%					100%
Bank 20	10%	50%		15%	25%				100%
Bank 21					90%			10%	100%
Bank 22	20%	10%		30%	20%	20%			100%
Bank 23	25%				15%	60%			100%
Bank 24	25%	10%			35%	30%			100%
Bank 25	30%	15%		30%	25%				100%
Bank 26	15%	10%		20%	5%	35%	15%		100%
Bank 27		100%							100%
Bank 28	60%					30%	10%		100%
Bank 29	10%			90%					100%
Bank 30	10%				50%	20%	20%		100%
Bank 31							100%		100%
Bank 32	20%				80%				100%
Bank 33	60%	20%				20%			100%
Bank 34	20%	30%	10%		40%				100%
Bank 35							100%		100%
Bank 36	20%				80%				100%
Bank 37	60%	20%				20%			100%
Bank 38	20%	30%	10%		40%				100%
Number of banks	31	17	7	22	25	16	8	2	

Regulation

Q How significant will the change, in terms of regulation of foreign banks in China, be in the aftermath of the global financial crisis?

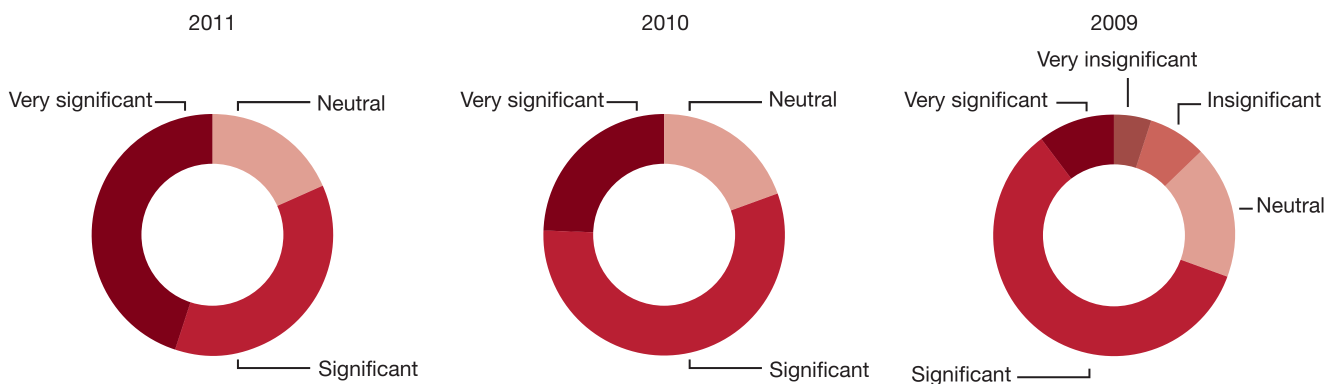
In 2010 the participants predicted tighter regulation. This trend continued in 2011. Seventeen banks believe there will be very significant increases and 14 banks significant increases. Several participants pointed out the paradox that while on the one hand the market will be liberalised and opened up, on the other hand this transition will be accompanied by increased regulation. In last year's report there was widespread comment and criticism by the participants surrounding the Know Your Customer (KYC) rules and new account opening procedures. This criticism has faded and the banks have appeared conditioned to these new regulations.

Criticism this year centred on the "Three Measures, One Guideline" directive referred to by some banks as "3M, 1G". One European bank observed that this regulation held the banks liable for something that was beyond their control.

A North American bank described "regulation" as a layering process where each year CBRC and PBOC introduced new layers which were laid down on top of previous regulations.

Many participants again voiced concern on a lack of clarity in interpretation and how regulations were often interpreted and applied differently in different cities.

A large European bank commented that the current emphasis on macroeconomic policy meant that regulation was very much a moving target.



Among the 38 responses, 31 claimed the change will be either significant or very significant

Among the 41 responses, 33 claimed the change will be either significant or very significant

Among the 39 responses, 27 claimed the change will be either significant or very significant

Current regulatory issues — “Three Measures, One Guideline”

In last year’s report many of the foreign banks, while clearly agreeing with the principles associated with Know Your Customer (KYC) rules and Anti-Money Laundering (AML) rules, believed that the methods of implementation were cumbersome and placed them at a disadvantage relative to their domestic counterparts.

For example, the need for a client to be present to complete the documentation at the foreign bank branch, which might be a considerable distance from the clients’ place of business, made completing transactions difficult. They argued that their own internal KYC and AML were very strict and this extra requirement was unnecessary.

The same situation arose this year with the implementation of a new regulation entitled “Three Measures, One Guideline” or “3M, 1G”.

“Three Measures, One Guideline” stipulates that working capital loans cannot be used for investments in fixed assets, project financing and shareholdings.

The regulations require the lender and borrower to state the purpose of the loan before the loan is granted.

Furthermore the regulator has said that banks will be punished if working capital loans are used for the abovementioned purposes. Smaller foreign banks with limited staff resources feel this regulation is particularly burdensome.

Three measures and one guideline

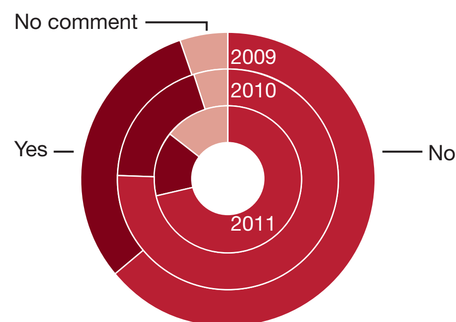
The three measures and one guideline is well intended in trying to discourage misuse of loans and to encourage better lending practices. However, the implementation has caused confusion in the marketplace as the measures are prescriptive rather than principle and needs-based. As every bank has different risk processes and also different risk standards, the policies subsequently adopted by different banks were also different and confusing. The authorities have also required the major banks to increase capital in anticipation of new Non-Performing Loans (NPLs) from the surge in new lending. Foreign banks mainly lend to multinational corporations and large companies and did not experience such a loan surge. Foreign banks’ loan portfolios grew at 14% in 2009 compared to the 35% increase for Chinese banks. *(Source: European Business in China Position Paper 2010/2011: Banking and Securities)*

Q Have there been disagreements between your bank and the tax bureau on business tax, withholding tax or income tax?

Although the foreign banks felt that the business tax was unjust, the level of disagreement declined in 2011. Only six banks said they had disagreements.

As noted in the 2010 report, the foreign banks believed it was unfair to apply business tax to gross interest income and not net interest income.

Business tax

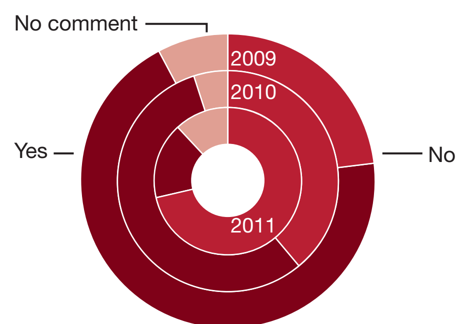


Based on responses from 42 banks in 2011, 41 banks in 2010 and 39 banks in 2009

Several banks continue to disagree with the application of the withholding tax.

This was a major issue in 2009 and 2010 when 27 and 23 banks, respectively, expressed disapproval. In 2011, that number fell to seven banks.

Witholding tax



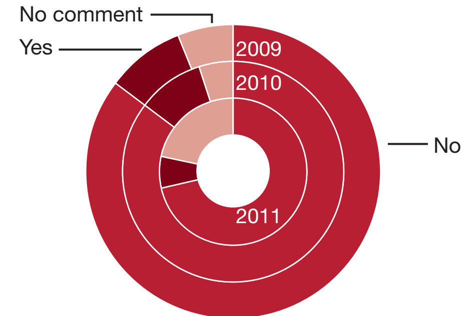
Based on responses from 42 banks in 2011, 41 banks in 2010 and 39 banks in 2009

Q Have there been disagreements between your bank and the tax bureau on business tax, witholding tax or income tax?

Only three banks indicated they had any disagreements regarding income tax.

However, many banks believe that the development of the financial sector, particularly in Shanghai, would benefit from a lower level of income tax.

Income tax



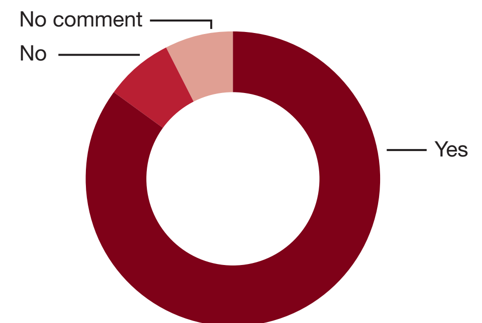
Based on responses from 42 banks in 2011, 41 banks in 2010 and 34 banks in 2009

Q Are there any tax rules you would like to see changed?

Thirty-four banks gave an affirmative answer to this question. Most recommended tax changes on withholding taxes and business taxes.

A large European bank said that tax treatment varies according to locations in China.

One bank specifically mentioned Confirmation of Corporate Loan Interest Revenue (State Administration of Taxation 2010 No. 23).



Based on responses from 40 banks

Regulatory issues highlighted in the European Business in China Position Paper 2010/2011: Banking and Securities

Q Can you score the relevancy of each of the following regulatory issues on a scale of one to ten? A score of ten represents the maximum importance.

The issues are:

- Branch expansion
- Access to the *renminbi* derivatives market
- Approval for bond underwriting
- Membership of China's National Advanced Payment System (CNAPS)

Branch expansion

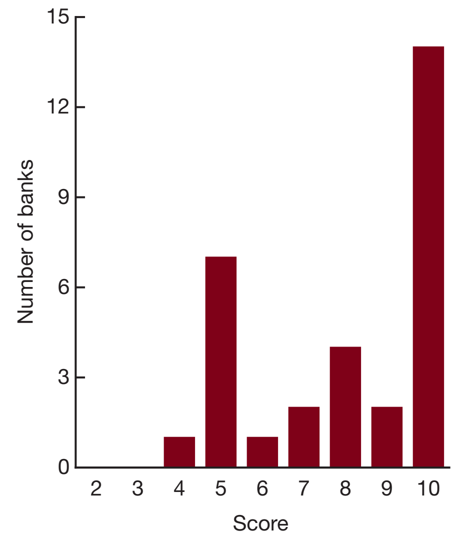
Foreign banks are currently prevented from making simultaneous applications to open branches and sub-branches.

In addition, locally incorporated banks are subjected to a complex and time-consuming submission process in order to expand their branch and sub-branch networks.

Almost half of the 32 respondents to this question scored the branch expansion process ten out of ten. Only eight banks scored it at five or below.

The foreign banks are anxious to expand their networks and move towards greater economies of scale. Some banks have also chosen to engage in rural banking as a futher means of expanding their geographic footprint.

Branch expansion



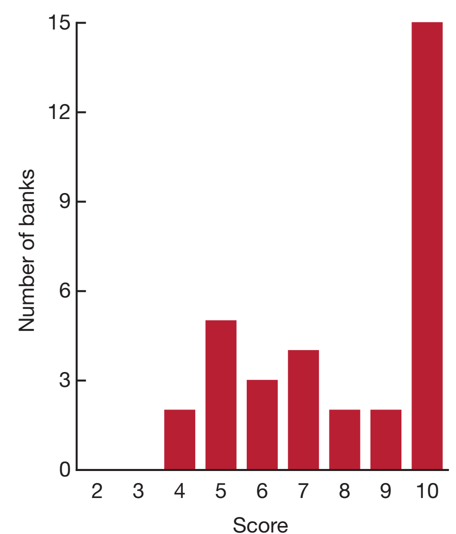
Based on responses from 32 banks

Access to *renminbi* derivatives market

The European Chamber has argued that foreign banks should be allowed equal access to the *renminbi* derivatives market and that the standards and approval process for permission should be more transparent.

Fifteen of the 33 respondents to this question attributed the maximum score of 10. Seven banks scored it at five or below.

Access to *renminbi* derivatives market



Based on responses from 33 banks

The 2011 U.S.-China Strategic and Economic Dialogue U.S. Fact Sheet – Economic Track

China is now moving to allow foreign banks to underwrite corporate bonds in the interbank bond market.

In April, China's corporate bond market oversight body released criteria for underwriters and opened up a one-week period for new applicants, during which time many U.S. and other foreign institutions applied.

Source: US Department of the Treasury, 10 May 2011

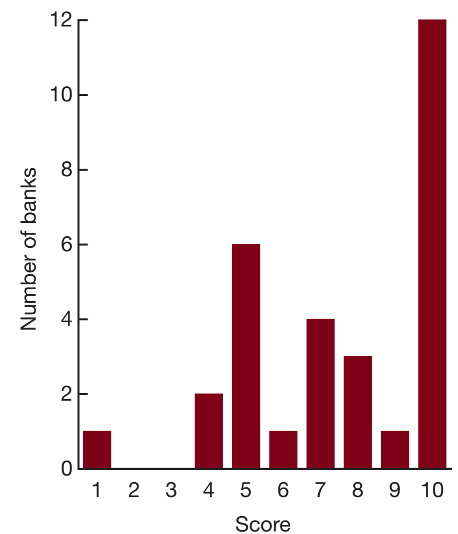
Foreign banks approval for bond underwriting

In 2009 foreign banks were granted the right to trade corporate bonds. They expected that having created a track record of trading bonds, they would be given the right to underwrite corporate bonds. The foreign banks as a group had hoped they would have been able to leverage their expertise and technology in this area.

When asked to assess the difficulty of receiving approval for bond underwriting, 12 banks gave it the maximum score of ten where ten represents the maximum importance.

In 2010 only three foreign banks, namely HSBC, JPMorgan and Standard Chartered had been approved underwriter status.

Foreign bank approval for bond underwriting



Based on responses from 30 banks

Excerpts from keynote speech by Governor of People's Bank of China, Zhou Xiaochuan, at China Global Debt Capital Markets Congress (November 16 2010)

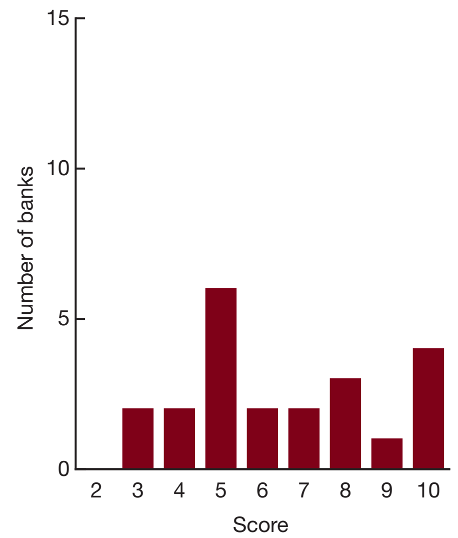
The Chinese bond market has realized the fruitful development in recent years. However, compared to the developed ones, the bond market has failed to play its fundamental role in resource allocation to a satisfactory extent, and remained unable to satisfy the need created by sustainable development of the Chinese economy. This is mainly evidenced by: (1) the lack of risk management instruments, the unsound market mechanism for risk sharing and the underdeveloped financial derivatives market; (2) market liquidity still needs to be improved, market price still fails to reflect the true market supply and demand, and yield curve still needs further perfection; (3) institutional investor types are concentrated, and serious homogeneity still exists; (4) the public creditability of credit rating agency still needs to be enhanced; (5) legal and policy issues that hinder the market development still need solutions, and adjustments in accounting standards, taxation and other associated systems are needed in order to meet the need of product innovation. In one word, compared to the matured financial markets, underdevelopment is still the biggest problem faced by the Chinese bond market.

China's National Advanced Payment System (CNAPS)

Although some foreign banks were readily admitted to CNAPS, others were prevented from inclusion. Furthermore, the PBOC recommended that some foreign bank branches should consider using Chinese banks as CNAPS agents.

Clearly this is not an issue for the foreign banks that have been admitted to CNAPS. Four banks gave the maximum score of ten to CNAPS membership.

CNAPS membership



Based on responses from 22 banks

Beijing tells firms to use bonds, not loans

Mainland companies are being encouraged to sell bonds and cut reliance on loans, as Beijing limits bank credit in its fight against inflation.

In a recent trip to Guangdong, Lu Wenshan, a deputy director with the public offering department of the China Securities Regulatory Commission(CSRC), told local company executives bonds could help them withstand risk in an environment of rising interest rates, the official Securities Times reported yesterday.

"When China targets M2 money supply to tighten liquidity, bank loans will be reined in," said Guo Tianyong, professor at Central University of Finance and Economics in Beijing. "It is natural that companies will want to seek other financing channels. The underdeveloped corporate bond market has room to grow."

Outstanding corporate bonds on the mainland, including debt issued by non-policy banks, stood at 4.3 trillion yuan (HK$5.1 trillion) at the end of last year - about 10.9 per cent of the gross domestic product and 21 per cent of the total outstanding bonds.

The securities watchdog this year vowed to approve bond sale applications within one month for companies with more than 10 billion yuan in net assets or with an AAA domestic credit rating.

Listed state-owned enterprises and other blue-chip companies are ideal candidates to sell bonds, the CSRC said this month. Shanghai International Port (Group), the first to sell bonds since approval was fast-tracked, raised five billion yuan last month by issuing five-year bonds at an annual interest rate of 4.69 per cent. The coupon was 0.2 percentage points lower than the guidance interest rate set for intermediate bonds in the inter-bank market.

Lu said: "Corporate bonds face an unprecedented development opportunity ... Compared with the stock market, the bond market is lagging behind. The imbalance between direct financing and indirect financing, and stock offerings and bond financing could impact the security and stability of the financial system."

Last year, regulators approved the issuance of 25 corporate bonds to raise a total of 60 billion yuan, while companies raised nearly 100 billion yuan through initial public offerings and share placements. Bank loans were at about eight trillion yuan. Bank lending has been restrained by new regulatory requirements. The China Banking Regulatory Commission yesterday said it had asked the biggest lenders to raise the minimum capital adequacy ratio from an existing 11.5 per cent to better cushion themselves against economic risks.

Analysts are optimistic about the prospects of the corporate bond market on the mainland because of rising interest rates for bank loans.

However, the American Chamber of Commerce said in a report released yesterday that the mainland's secondary bond market is "moribund" because interest rates are set by the central bank.

(Source: South China Morning Post, 27 April 2011)

8 Foreign Banks Get OK To Enter China's Interbank Bond Market

China's central bank has granted its approval to eight more foreign banks, including the Hong Kong units of Citigroup Inc. (C) and Bank of Tokyo-Mitsubishi UFJ Ltd., to trade in the domestic interbank bond market as part of a trial program under which offshore yuan can be invested in onshore yuan bonds.

The six other banks are the Hong Kong units of Agricultural Bank of China Ltd. (1288.HK) and China Construction Bank Corp. (0939.HK), as well as Nanyang Commercial Bank Ltd., Wing Lung Bank Ltd., Wing Hang Bank Ltd. (0302.HK), and Chiyu Banking Corp.

The People's Bank of China previously approved 11 foreign banks, including Standard Chartered PLC (STAN.LN) and HSBC Holdings PLC (HBC), to trade in the interbank bond market after it allowed foreign financial institutions participating in the cross-border yuan-settlement program to reinvest their yuan proceeds in the mainland China bond market in August.

The trial program includes Hong Kong, Macau and foreign banks that participate in the yuan-settlement program, as well as overseas central banks. China's interbank bond market includes over 10 types of bonds, such as government bonds and policy-bank bonds.

(Source: Dow Jones, 21 March 2011)

Q How significant is the application of the Know Your Customer rules and Anti-money laundering rules?

In 2010, there was major criticism by the foreign banks surrounding the application of CBRC's Know Your Customer (KYC) and Anti-money laundering (AML) rules.

The foreign banks portrayed these regulations as a "collective punishment" or "barrier of entry". The foreign banks, because of their restrictive branch networks, believed that the requirement for clients to appear in person to complete account documentation made the process unduly onerous. They were unsure that the same rules were being followed by their domestic counterparts.

While in the past, the foreign banks portrayed the new regulations as burdensome and tedious, the response this year has mellowed.

Respondents have accepted that this is now a normal part of doing business and although they have their own internal KYC and AML requirements, they now also adhere to the additional CBRC rules.

Performance

Q What is your business' estimated annual revenue growth in 2011 and over the next three years?

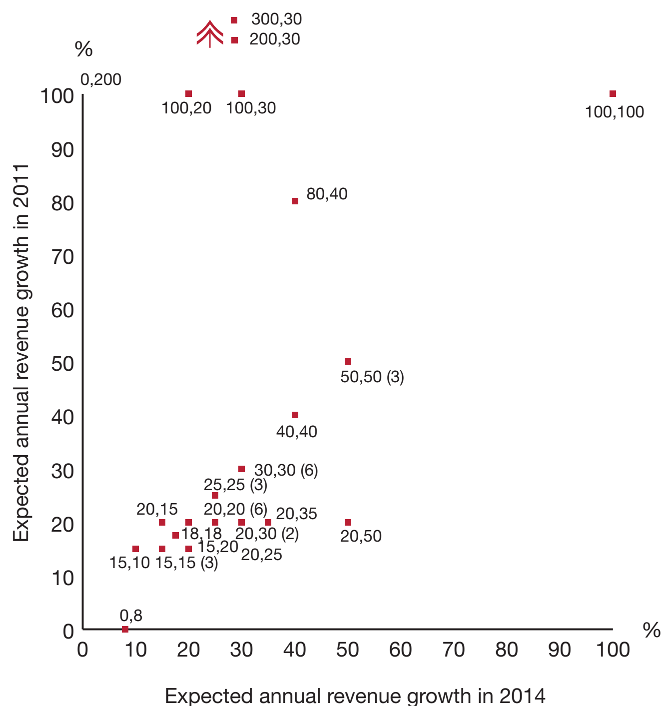
Thirty-nine banks provided data on their projected revenue for 2011.

Two banks anticipated zero growth and a further six banks anticipated revenue growth of below 20%.

Twenty-two banks projected revenue growth between 20% and 50%. Three banks projected growth between 50% and 100% and three more expected 100% growth. Finally, one bank anticipated 200% growth while another 300%.

Looking forward to 2014, seven banks expect slower growth. This includes all five banks that projected rates of 100% or higher in 2011.

Seven banks hope to grow at a faster pace in 2014 as compared to 2011.



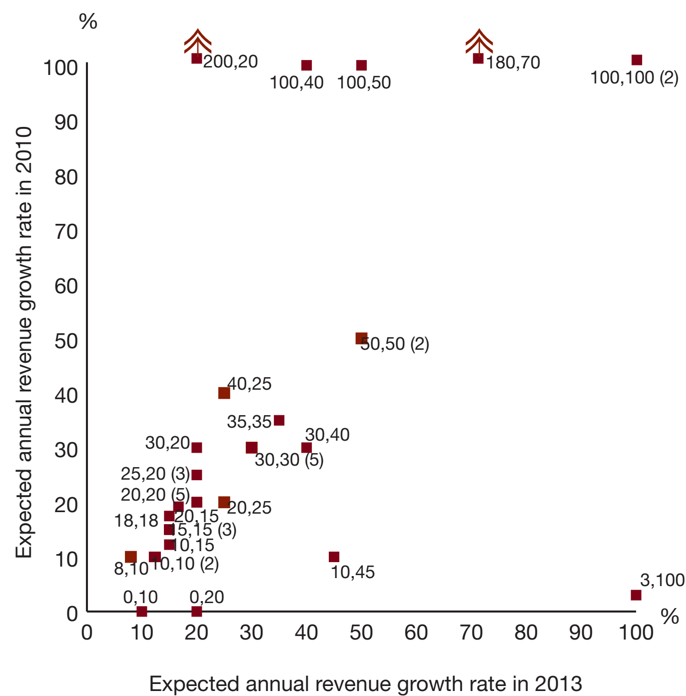
Based on responses from 39 banks

Annual revenue growth projections made in 2010 for 2010 and 2013

In comparison to projections made in 2010, current predictions reveal some interesting similarities and differences.

In 2010, five banks predicted growth of 100% or higher (similar to 2011). Sixteen banks fell in the 20% to 100% range in 2010. In 2011, six banks were in this range.

In 2010, 12 banks were in the 20% to 40% range. In 2011, 21 banks were in this higher range.



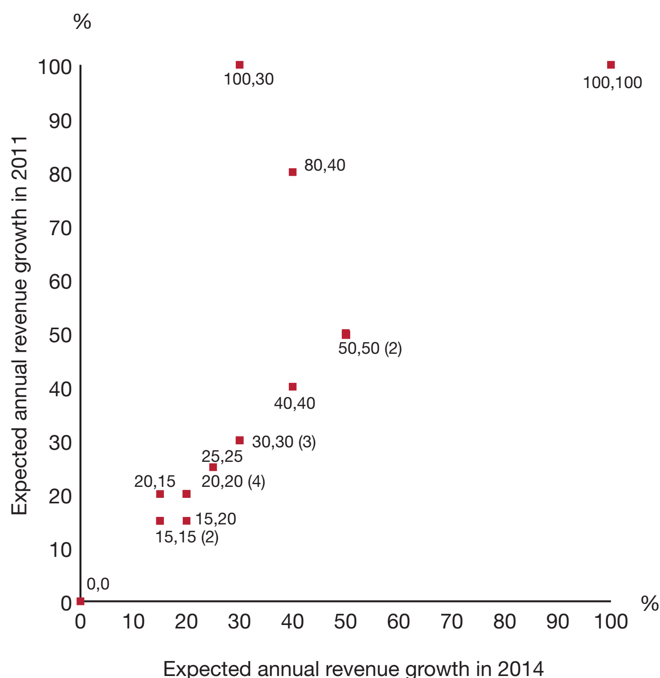
Based on responses from 39 banks

Annual revenue growth projections made in 2011 for 2011 and 2014 for locally incorporated foreign banks

Locally incorporated banks

Four locally incorporated foreign banks projected revenue growth of 20% in 2011 and 2014, three predicted 30% in 2011 and 2014 and two banks expected 50% in 2011 and 2014 and two banks 15% in 2011 and 2014.

In addition, there were several significant "outliers" including 100% in 2011 and 30% in 2014, 100% in 2011 and the same again in 2014 and one 80% in 2011 and 40% in 2014.



Based on responses from 19 locally incorporated banks

Peer review

Q Can you name the top three banks in terms of success (performance, presence, momentum) across a variety of different markets?

A simple scoring method awarded three points to first place, two points to second and one point to third place. This allowed the banks to be ranked based on a total score.

Banks were asked not to record an opinion unless they were active in that segment and were comfortable in providing an accurate ranking in terms of success (performance, presence and momentum) as opposed to mere size.

They were not permitted to rank their own institution. Often banks would choose just to indicate first or second places.

The "Change" column indicates whether the ranking has moved up, down or remains unchanged from that recorded in the 2010 survey.

Foreign exchange and treasury

	First	Second	Third	Score	Change
HSBC	14	9	4	64	→
Citibank	10	5	10	50	→
Standard Chartered	3	8	4	29	↗
Deutsche Bank	4	3	4	22	↘
JPMorgan Chase	1	2	1	8	→
Bank of East Asia		1		2	↗
Bank of America Merrill Lynch		1		2	↗
Bank of Montreal			2	2	↘
DBS Bank			1	1	↗
Société Générale			1	1	↗

Based on 32 banks

Derivatives

	First	Second	Third	Score	Change
HSBC	7	5	5	36	↗
Citibank	5	5	7	32	↘
Deutsche Bank	8	1	3	29	→
Standard Chartered	5	5	2	27	↗
JPMorgan Chase		3		6	↘
Bank of America Merrill Lynch		2	1	5	↗
Goldman Sachs	1	1		5	↗
Société Générale		1	1	3	↘
BNP Paribas		1	1	3	↘
Royal Bank of Scotland		1		2	↗

Based on 26 banks

Corporate lending

	First	Second	Third	Score	Change
HSBC	19	4	3	68	→
Standard Chartered	6	11	5	45	→
Citibank	2	6	6	24	→
Bank of East Asia	3	3	6	21	→
DBS Bank		2	3	7	→
Mizuho Coporate Bank	1	1		5	↗
Deutsche Bank		1	1	3	↘
Bank of Tokyo-Mitsubishi UFJ	1			3	↗
BNP Paribas		1		2	↘
Hang Seng Bank			1	1	↘
Bank of America Merrill Lynch			1	1	↗

Based on 32 banks

Project financing

	First	Second	Third	Score	Change
HSBC	5	1	1	18	↗
Standard Chartered	2	3	3	15	↘
Citibank	1	2	1	8	→
BNP Paribas	1	2		7	→
Bank of East Asia	1		1	4	↗
Société Générale	1			3	↘
Bank of Tokyo-Mitsubishi UFJ		1		2	↗
DBS Bank			1	1	↗
Natixis			1	1	↗

Based on 11 banks

Investment banking

	First	Second	Third	Score	Change
Goldman Sachs	14	1	1	45	→
Morgan Stanley	1	8	3	22	→
JPMorgan Chase	2	4	6	20	→
UBS	3	3	4	19	↗
Deutsche Bank	2	3	1	13	↘
HSBC	1	2	1	8	→
Citibank	2			6	→
Bank of America Merrill Lynch		1	2	4	↗
Standard Chartered			1	1	→

Based on 25 banks

Private banking

	First	Second	Third	Score	Change
UBS	11	2		37	↗
HSBC	7	2	1	26	→
Citibank	1	3	6	15	↗
Standard Chartered		5	2	12	↘
Credit Suisse		2	2	6	→
Deutsche Bank		2		4	→
Royal Bank of Scotland	1			3	↗
ANZ	1			3	↗

Based on 21 banks

Corporate finance

	First	Second	Third	Score	Change
HSBC	7	2	1	26	→
Goldman Sachs	4		1	13	↗
Citibank	1	3	1	10	↗
Standard Chartered		2	3	7	↗
UBS	2		1	7	↗
Deutsche Bank	1	1		5	↗
Morgan Stanley		2	1	5	↘
JPMorgan Chase		1	1	3	↘
Bank of East Asia		1		2	↘
Credit Suisse		1		2	↗
DBS Bank			1	1	↗
ANZ			1	1	↗

Based on 15 banks

Mergers and acquisitions

	First	Second	Third	Score	Change
Goldman Sachs	13			39	→
Morgan Stanley	1	7	2	19	→
JPMorgan Chase	2	3	1	13	↗
UBS	2	1	3	11	↗
Deutsche Bank		4	2	10	↗
HSBC	1	1	1	6	↘
Citibank	1		2	5	↘
Bank of East Asia		1		2	↗
Macquarie		1		2	↗
Bank of America Merrill Lynch			1	1	↗
Royal Bank of Scotland			1	1	↗

Based on 20 banks

Trade finance

	First	Second	Third	Score	Change
HSBC	20	6		72	→
Standard Chartered	9	15	5	62	→
Citibank	2	5	5	21	→
BNP Paribas	2		2	8	→
Bank of East Asia		2	3	7	→
Deutsche Bank	1		3	6	↘
Société Générale		2	1	5	↗
Bank of America Merrill Lynch		1	1	3	↗
ANZ	1			3	↗
BNY Mellon	1			3	↘
ING Bank		1		2	↗
Norddeutsche Landesbank		1		2	↘
Royal Bank of Scotland			2	2	↗
Wells Fargo			1	1	↗
DBS Bank			1	1	↗
Scotiabank			1	1	↗

Based on 36 banks

Cash management

	First	Second	Third	Score	Change
Citibank	17	3	4	61	→
HSBC	10	12	4	58	→
Standard Chartered	2	8	9	31	→
Deutsche Bank		1	2	4	→
Bank of East Asia		1	1	3	→
Bank of America Merrill Lynch		1		2	↗
Royal Bank of Scotland		1		2	↗
Bank of Tokyo-Mitsubishi UFJ			1	1	↗

Based on 29 banks

Equity capital markets

	First	Second	Third	Score	Change
Goldman Sachs	3	1		11	→
JPMorgan Chase	2	2		10	↗
UBS	2	2		10	→
Morgan Stanley	1	1	4	9	↘
Deutsche Bank	1	2		7	↘
HSBC		1	1	3	→
Citibank	1			3	↘
Standard Chartered			1	1	↘
Royal Bank of Scotland			1	1	↗

Based on 10 banks

Debt capital markets

	First	Second	Third	Score	Change
HSBC	3	1		11	→
Citibank	1	2	1	8	→
Goldman Sachs	1	2		7	↗
UBS	2			6	↗
Morgan Stanley	1	1	1	6	→
Standard Chartered		1	3	5	↘
JPMorgan Chase	1	1		5	↗
Royal Bank of Scotland	1		2	5	↗
Deutsche Bank		1	2	4	↘
Bank of America Merrill Lynch	1			3	↗
Société Générale		1		2	↗
Bank of Tokyo-Mitsubishi UFJ			1	1	↗

Based on 11 banks

Retail banking

	First	Second	Third	Score	Change
HSBC	25	3	1	82	→
Standard Chartered	3	18	3	48	→
Bank of East Asia	3	2	15	28	↗
Citibank		4	7	15	↘
Hang Seng Bank			1	1	→

Based on 31 banks

Credit cards

	First	Second	Third	Score	Change
Bank of East Asia	21	1	2	67	→
HSBC	5	1		17	→
Standard Chartered		2	2	6	↗
Citibank		2	2	6	→
Hang Seng Bank			1	1	→

Based on 26 banks

Brand awareness

	First	Second	Third	Score	Change
HSBC	34	2		106	→
Standard Chartered	1	23	7	56	→
Citibank	2	11	12	40	→
Bank of East Asia			12	12	→
DBS Bank			2	2	↗
JPMorgan Chase			1	1	↗
ANZ			1	1	↗
Goldman Sachs			1	1	↗

Based on 37 banks

Corporate social responsibility

	First	Second	Third	Score	Change
HSBC	10	2		34	→
Citibank	2	4	2	16	→
Standard Chartered	1		2	5	→
Bank of East Asia		1	3	5	→

Based on 13 banks

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Methodology

Previous experience has shown that personal interviews with senior bankers using a standard questionnaire offers the best research approach. The questionnaire contained 47 questions and was completed during interviews of approximately one hour. The author conducted all interviews in April and May 2011 in Beijing, Hong Kong, Shanghai and Shenzhen.

Responses have not been attributed to individual banks but rather collectively within three groups: Asian banks (13), European banks (21) and North American banks (8). A group of locally incorporated banks is also used.

At times, individual banks declined to answer particular questions or were unable to provide sufficiently accurate data. This is noted where applicable.

The time commitment and support by all banks in this survey was outstanding.

About the author

Dr Brian Metcalfe is an Associate Professor in the Business School at Brock University, Ontario, Canada. He has a doctorate in financial services marketing and has researched for and produced many reports, such as this one, on behalf of PwC firms in 14 different countries including Australia, Canada, China, India, Japan and South Africa.

Previous reports have examined strategic and emerging issues in corporate, investment and private banking, life and property and casualty insurance, insurance broking, and wealth management.

In 2010, he authored the reports on Foreign Banks in China and Foreign Insurance Companies in China.

He has consulted for a wide range of organisations, including Royal Bank of Canada, Scotiabank, Barclays Bank, Sun Life Insurance Company, Equitable Life of Canada and several major consulting firms.

He has also taught an executive management course entitled “Financial Services Marketing” in the Graduate School of Business at the University of Cape Town.

Bank groups

The information provided has been considered proprietary and remains confidential. Results are therefore presented in a “disguised” group format, in the form of regional groups of banks. The members of the bank groups are as follows:

Asian banks

- ANZ†
- Commonwealth Bank of Australia†
- Dah Sing Bank
- DBS Bank
- First Sino Bank
- Hang Seng Bank
- Mizuho Corporate Bank
- OCBC Bank
- SMBC
- The Bank of East Asia
- Westpac Bank†
- Wing Hang Bank
- Wing Lung Bank

European banks

- Banco Santander
- BBVA
- BNP Paribas
- Crédit Agricole
- Commerzbank
- Credit Suisse
- Deutsche Bank
- HSBC
- ING Bank
- Intesa Sanpaolo Bank
- KBC Bank
- Natixis
- Norddeutsche Landesbank
- Rabobank
- Raiffeisen Bank International
- RBS
- Société Générale
- Standard Chartered Bank
- UBS
- VTB Bank*
- WestLB

North American banks

- Bank of America Merrill Lynch
- Bank of Montreal
- Bank of New York Mellon
- Citibank
- JPMorgan Chase Bank
- Royal Bank of Canada
- Scotiabank
- Wells Fargo Bank

† ANZ Banking Group, Commonwealth Bank of Australia and Westpac Bank are Australian banks and for convenience have been grouped with the Asian banks.

* VTB Bank is based in St Petersburg, Russia and has been included in the European banks.

List of locally incorporated foreign banks

	Bank
1	Allied Commercial Bank
2	Australia and New Zealand Banking Group
3	Bangkok Bank (China) Company Limited
4	Bank International Ningbo
5	Bank of East Asia (China) Limited
6	Bank of Montreal (China) Company Limited
7	Bank of Tokyo-Mitsubishi UFJ (China) Limited
8	BNP Paribas (China) Limited
9	Chinese Mercantile Bank
10	Citibank (China) Company Limited
11	CITIC Ka Wah Bank (China) Limited
12	Concord Bank
13	Crédit Agricole CIB (China) Limited
14	Dah Sing Bank (China) Limited
15	DBS Bank (China) Limited
16	Deutsche Bank (China) Company Limited
17	East West Bank (China) Limited
18	First Sino Bank
19	GE Capital Finance (China) Company Limited
20	Hana Bank (China) Company Limited
21	Hang Seng Bank (China) Limited
22	HSBC Bank (China) Company Limited
23	Industrial Bank of Korea (China) Limited
24	JPMorgan Chase Bank (China) Company Limited
25	KEB Bank (China) Company Limited
26	Metrobank (China) Limited
27	Mizuho Corporate Bank (China) Limited
28	Morgan Stanley Bank International (China) Limited
29	Nanyang Commercial Bank (China) Limited
30	OCBC Bank (China) Limited
31	Royal Bank of Scotland (China) Company Limited
32	Shinhan Bank (China) Limited
33	Societe Generale (China) Limited
34	Standard Chartered Bank (China) Limited
35	Sumitomo Mitsui Banking Corporation (China) Limited
36	United Overseas Bank (China) Limited
37	Wing Hang Bank (China) Limited
38	Woori Bank (China) Limited
39	Xiamen International Bank
40	Zhengxin Bank Company Limited

Participants by country/territory of origin

Name of bank	Country/Territory	City
ANZ	Australia	Shanghai
Commonwealth Bank of Australia	Australia	Shanghai
Westpac Bank	Australia	Beijing
Raiffeisen Bank International	Austria	Beijing
KBC Bank	Belgium	Shanghai
HSBC	Britain	Shanghai
RBS	Britain	Shanghai
Standard Chartered Bank	Britain	Shanghai
Bank of Montreal	Canada	Beijing
Scotiabank	Canada	Hong Kong
Royal Bank of Canada	Canada	Beijing
BNP Paribas	France	Shanghai
Crédit Agricole	France	Shanghai
Natixis	France	Shanghai
Société Générale	France	Shanghai
Commerzbank	Germany	Shanghai
WestLB	Germany	Shanghai
Norddeutsche Landesbank	Germany	Shanghai
Deutsche Bank	Germany	Shanghai
Bank of East Asia	Hong Kong	Shanghai
Dah Sing Bank	Hong Kong	Shenzhen
Hang Seng Bank	Hong Kong	Shenzhen
Wing Hang Bank	Hong Kong	Shenzhen
Wing Lung Bank	Hong Kong	Shenzhen
Intesa Sanpaolo Bank	Italy	Shanghai
Mizuho Corporate Bank	Japan	Shanghai
Sumitomo Mitsui Banking Corporation	Japan	Shanghai
ING Bank	Netherlands	Shanghai
Rabobank	Netherlands	Shanghai
VTB Bank	Russia	Shanghai
DBS Bank	Singapore	Shanghai
OCBC Bank	Singapore	Shanghai
Banco Santander	Spain	Shanghai
BBVA	Spain	Beijing
Credit Suisse	Switzerland	Beijing
UBS	Switzerland	Beijing
First Sino Bank	Taiwan	Shanghai
Bank of New York Mellon	USA	Shanghai
Citibank	USA	Shanghai
Bank of America Merrill Lynch	USA	Shanghai
JPMorgan Chase Bank	USA	Beijing
Wells Fargo Bank	USA	Shanghai

Top 50 Chinese banks ranked by Tier 1 capital and assets

Rank China	Rank World		Tier 1 Capital $m	% change	Assets $m	Rank
1	7	ICBC	91,111	14.54	1,725,938	1
2	14	Bank of China	73,667	13.4	1,281,183	3
3	15	China Construction Bank	71,974	14.04	1,409,356	2
4	28	Agricultural Bank of China	39,786	0.00	1,026,021	4
5	49	Bank of Communications	22,625	17.01	484,628	5
6	67	China CITIC Bank	14,526	7.86	259,956	7
7	80	China Minsheng Banking Corp	12,998	7315	208,897	9
8	81	China Merchants Bank	12,928	23.63	302,853	6
9	97	Industrial Bank	11,279	33.55	195,097	10
10	108	Shanghai Pudong Development Bank	9,546	72.40	237,649	8
11	136	China Everbright Bank	6,799	61.88	175,397	11
12	155	Bank of Beijing	5,372	14.91	78,127	15
13	178	Huaxia Bank	4,328	11.98	123,818	12
14	218	Guangdong Development Bank	3,147	16.95	97,608	13
15	226	Bank of Shanghai	3,000	1924	68,252	16
16	231	Shenzhen Development Bank	2,955	34.32	86,086	14
17	292	Bank of Jiangsu	2,196	43.25	48,425	17
18	299	Ping An Bank	2,096	70.96	32,319	19
19	339	Shanghai Rural Commercial Bank	1,810	15.36	31,035	21
20	349	Bank of Nanjing	1,754	15.93	21,838	29
21	356	Huishang Bank	1,719	921	23,784	26
22	377	Guangzhou Rural Commercial Bank	1,574	190.41	27,195	23
23	391	Evergrowing Bank	1,483	147.17	31,306	20
24	395	Bank of Hangzhou	1,465	125.04	21,966	27
25	419	Bank of Ningbo	1,362	10.82	23,923	25
26	427	Chongqing Rural Commercial Bank	1,303	23.74	29,414	22
27	431	Chengdu Rural Commercial Bank	1,291	208.11	18,481	32
28	434	China Zheshang Bank	1,275	111.79	23,933	24
29	450	Bank of Guangzhou	1,217	8.86	18,656	30
30	463	Bank of Tianjin	1,173	23.47	21,870	28
31	472	Beijing Rural Commercial Bank	1,152	5.88	41,612	18
32	474	Bank of Jilin	1,139	12.88	15,837	35
33	476	Shunde Rural Commercial Bank	1,138	147.93	14,873	37
34	478	Bank of Chengdu	1,135	16.29	15,282	36
35	515	Dongguan Rural Commercial Bank	998	20.97	16,160	34
36	549	Bank of Dalian	901	22.42	18,574	31
37	568	Jiangnan Rural Commercial Bank	847	N/A	10,664	43
38	599	Shenzhen Rural Commercial Bank	776	15.82	11,148	42
39	603	Bohai Bank	767	5.65	17,210	33
40	611	Bank of Jinzhou	740	138.71	7,964	50
41	673	Bank of Nanchang	618	15.08	6,483	53
42	681	Bank of Qingdao	603	616	6,390	54
43	687	Fujian Haixia Bank	594	135.71	6,082	57
44	690	Bank of Chongqing	591	23.13	11,843	40
45	709	Wuhan Rural Commercial Bank	572	N/A	7,990	49
46	710	Bank of Dongguan	572	2516	11,600	41
47	715	Harbin Bank	569	21.06	12,380	38
48	717	Xi'an City Commercial Bank	566	112.78	9,175	45
49	726	Hankou Bank	553	9.72	9,165	46
50	740	Baoshang Bank	533	39.16	11,957	39

Source: The Banker, July 2010

Global leader board of domestic banking assets in 2009, 2030 and 2050

Country rankings in 2009	Domestic assets 2009 (US$bn, constant 2009 prices)	Country rankings in 2030	Domestic assets 2030 (US$bn, constant 2009 prices)	Country rankings in 2050	Domestic assets 2050 (US$bn, constant 2009 prices)
1. US	14,772	1. China	31,018	1. China	72,228
2. Japan	7,486	2. US	26,841	2. US	46,544
3. China	6,006	3. Japan	9,774	3. India	38,484
4. UK	4,989	4. India	7,848	4. Japan	11,959
5. Germany	4,416	5. UK	6,082	5. Brazil	10,624
6. France	3,401	6. Germany	6,047	6. UK	9,112
7. Spain	3,271	7. France	5,136	7. Germany	8,477
8. Italy	2,993	8. Italy	4,053	8. France	7,909
9. Canada	1,618	9. Brazil	3,799	9. Russia	6,811
10. Australia	1,324	10. Spain	3,756	10. Mexico	5,965
11. Brazil	1,019	11. Russia	2,922	11. Italy	5,601
12. India	945	12. Canada	2,810	12. Turkey	5,502
13. Republic of Korea	935	13. Republic of Korea	2,515	13. Indonesia	5,129
14. Russia	413	14. Australia	2,286	14. Spain	4,992
15. Turkey	352	15. Mexico	1,804	15. Canada	4,761
16. South Africa	250	16. Turkey	1,738	16. Vietnam	4,426
17. Saudi Arabia	244	17. Indonesia	1,394	17. Republic of Korea	4,191
18. Mexico	241	18. Saudi Arabia	1,088	18. Australia	3,812
19. Indonesia	187	19. Vietnam	933	19. Nigeria	3,514
20. Vietnam	113	20. South Africa	843	20. Saudi Arabia	3,303
21. Argentina	86	21. Argentina	637	21. South Africa	2,722
22. Nigeria	47	22. Nigeria	524	22. Argentina	2,205

Source: PwC UK: *Banking in 2050* (May 2011)

Background comments on participants Asian bank group

Asian banks	World ranking The Banker, July 2010		Home country ranking	Background comments†
	Tier 1	Assets	Tier 1	
ANZ Bank 500 employees www.anz.com	47	50	3	Headquartered in Melbourne, ANZ operates in more than 30 countries. With assets of A$532 billion, ANZ has around eight million personal, private banking, small business, corporate, institutional, and asset finance customers worldwide. ANZ has had a continuous presence in mainland China since 1986 when a representative office was established in Beijing. Locally incorporated in 2010, it is the only Australasian-based bank with both local and foreign currency commercial banking capabilities in mainland China. ANZ also has long-term strategic partnerships with Bank of Tianjin (20% stake) and Shanghai Rural Commercial Bank (19.9% stake).
Commonwealth Bank of Australia 100 employees www.commbank.com.au	58	44	4	The Commonwealth Bank was founded in 1911 and now headquartered in Sydney, Australia. Between 1920s and the end of 1950s, it functioned as both a commercial bank and a central bank. At the end of 2010, the Group has A$650 billion assets. Its first Chinese representative office was established in Beijing in 1994. It opened its first Chinese branch in Shanghai in March 2010.
Dah Sing Bank 200 employees www.dahsing.com	645	487	12	Dah Sing Banking Group Limited has been listed on the Hong Kong Stock Exchange since 2004. Majority owned by Dah Sing Financial Holdings Limited, it has four banking subsidiaries (Dah Sing Bank, MEVAS Bank and Banco Comercial de Macau and Dah Sing Bank (China) Limited), and a securities trading company, as well as an offshore joint venture private banking business with SG Hambros Bank. Dah Sing Bank is the strategic investor holding a 20% interest in Bank of Chongqing, which is a leading city commercial bank in Chongqing, the largest city in Western China. Bank of Chongqing is operating mainly in Chongqing with a branch network of 80 branches.

† The background comments were taken from the respective banks' websites in May 2011

Asian bank group

Asian banks	World ranking The Banker, July 2009		Home country ranking	Background comments†
	Tier 1	Assets	Tier 1	
DBS Bank 1,800 employees www.dbs.com	62	97	1	Singapore-based DBS Bank is a leading financial services group in Asia that operates in 15 markets including China. It first entered the Chinese market with a representative office in Beijing in 1993. In May 2007, DBS Bank became the first Singapore bank to incorporate in China. In less than three years, DBS Bank (China) has increased its number of customers by four times and doubled its employees hired. Other than the head office in Shanghai, DBS Bank now has ten branches and nine sub-branches in mainland China. See acquisition of RBS branches under RBS background.
First Sino Bank 620 employees www.fsbankonline.com	N/A	N/A	N/A	Established in 1997 as the first joint venture bank between Taiwanese investors and a Chinese bank, First Sino Bank is headquartered in Shanghai. Its shareholders include Hong Kong-registered Lotus Worldwide Limited, Shanghai Pudong Development Bank and Wing Hang Bank. The major shareholders of Lotus Worldwide are Taiwanese investors. First Sino Bank also has branches in Tianjin, Shenzhen and Shanghai, plus ten sub-branches across the country.
Hang Seng Bank 1,500 employees www.hangseng.com	N/A	N/A	N/A	Hang Seng Bank is a principal member of HSBC Group, which holds a 62.14% equity stake in the bank. It offers personal, commercial and corporate banking services. Hang Seng (China) Limited. was established on 28 May 2007 as a wholly-owned subsidiary of Hang Seng Bank, and operates a network of 11 branches and 27 sub-branches in mainland China.
Mizuho Corporate Bank 1,115 employees www.mizuhocbk.co.jp * Mizuho Financial Group	26*	15	3	Headquartered in Tokyo, Mizuho Bank was established on April 1, 2002 by Mizuho Financial Group Inc. Mizuho Bank has branches in Asia, Europe, the Americas and the Middle East. About 25 million individual customers have accounts with Mizuho Bank, and it has loans outstanding to roughly 100,000 SMEs and middle-market corporations. It is locally-incorporated in China with 12 outlets.

† The background comments were taken from the respective banks' websites in May 2011

Asian bank group

Asian banks	World ranking The Banker, July 2010		Home country ranking	Background comments†
	Tier 1	Assets	Tier 1	
OCBC Bank 800 employees www.ocbc.com.sg	96	115	3	Singapore-based OCBC Bank offers both consumer and business banking services through 500 branches and representative offices in 15 countries. It has total assets of S$244 billion. OCBC Bank has maintained a continuous presence in China since 1925, with the opening of its first branch in Xiamen. On 1 August 2007, OCBC Bank opened its locally-incorporated, wholly-owned subsidiary in Shanghai.
Sumitomo Mitsui Banking Corporation 1,100 employees www.smbc.co.jp	23	23	2	Based in Tokyo, Japan, Sumitomo Mitsui Banking Corporation (SMBC) was established in April 2001 through the merger of two leading banks, Sakura Bank Limited and Sumitomo Bank Limited. In December 2002, Sumitomo Mitsui Financial Group Inc. was established through a stock transfer as a holding company, under which SMBC became a wholly-owned subsidiary. SMBC China is locally incorporated in Shanghai, and now has 12 branches and sub-branches.
The Bank of East Asia 3,800 employees www.hkbea.com	206	206	5	Founded in Hong Kong in 1918 and locally incorporated in mainland China in 2007, The Bank of East Asia (BEA) is the largest independent bank in Hong Kong, with consolidated assets of HK$534.2 billion at the end of 2010. BEA operates over 140 outlets in Hong Kong and over 100 outlets within China, offering both retail and commercial services. BEA has an international network of more than 210 outlets and over 11,000 employees with a presence in US, UK, Canada, and Southeast Asia. Headquartered in Shanghai, BEA China set up its first branch in China in 1920 and has been operating continuously in the country ever since.
Westpac Bank 45 employees www.westpac.com.au	34	41	2	Westpac Bank began trading in 1817 in Sydney. Westpac Bank employs approximately 40,000 people worldwide and has global assets of $618 billion. It has been represented in Hong Kong since 1971 and mainland China since 1982. Its first branch in China opened in 2008 in Shanghai. It offers services including Corporate and institutional banking, foreign exchange and treasury. In 2008 Westpac Bank merged with St. George Bank to become Australia's leading provider of home lending, with a market share of 25 per cent, Australia's largest wealth manager with funds under administration of $108 billion and the largest bank by market capitalisation at approximately A$66 billion.

† The background comments were taken from the respective banks' websites in May 2011

Asian bank group

Asian banks	World ranking The Banker, July 2010		Home country ranking	Background comments†
	Tier 1	Assets	Tier 1	
Wing Hang Bank 780 employees www.whbhk.com	485	432	10	Wing Hang Bank (WHB) was founded in Guangzhou as a money changing business in 1937 and has operated in Hong Kong for the past 70 years. WHB now has over 70 branches and representative offices throughout Hong Kong, Macau and Mainland China. The principal activities of the bank are retail banking, corporate banking and foreign exchange and treasury services. In June 2007 WHB established its local incorporation in mainland China, and it is the first foreign bank headquartered in Shenzhen.
Wing Lung Bank 80 employees www.winglungbank.com	566	494	11	Wing Lung opened in 1933 in Hong Kong. The Bank has altogether 48 banking offices. Wing Lung Bank provides comprehensive banking services, such as deposits, loans, corporate financing, securities, credit cards, wealth management, etc. The Bank also provides hire-purchase and leasing, trustee, insurance agency and underwriting, through its wholly-owned subsidiaries. In 2008, China Merchants Bank started buying Wing Lung Bank's equity and became the largest shareholder of the bank. In January 2009, China Merchants Bank acquired all of the shares and now fully owns Wing Lung Bank.

† The background comments were taken from the respective banks' websites in May 2011

European bank group

European banks	World ranking The Banker, July 2010		Home country ranking	Background comments†
	Tier 1	Assets	Tier 1	
Banco Santander 35 employees www.santander.com * Santander Central Hispano	10	15	1	Headquartered in Spain, Banco Santander is the fourth largest bank in terms of profit in 2009. Santander operates mainly in Continental Europe, the United Kingdom and Latin America. It opened the first Chinese representative office in Beijing in 1993.
BBVA 15 employees www.bbva.com	30	33	2	BBVA is a global group that offers individual and corporate customers a range of financial and non-financial products and services. It employs 104,000 people in over 30 countries around the world, has more than 47 million customers and 900,000 shareholders. BBVA has a solid position in the Spanish market, where it first began its activities over 150 years ago. It also has a leading franchise in South America and it is the largest financial institution in Mexico.BBVA owned 4.93% stakes of China Citic Bank, which is the seventh largest financial entity in China by assets. In 2009 BBVA raised its stake to 15%.
BNP Paribas 370 employees www.bnpparibas.com	8	1	1	BNP Paribas is a global banking and financial services group that is present in over 81 countries. The group operates in three major segments: Corporate and Investment Banking, Investment Solutions and Retail Banking. In October 2005, BNP Paribas signed an agreement to buy 19.2 percent of Bank of Nanjing (BON) and now holds 12.6 percent. In June 2008, it converted the branches of BNP Paribas in Beijing, Tianjin and Guangzhou into branches of its existing local subsidiary, BNP Paribas (China) Limited, which is now headquartered in Shanghai.
Crédit Agricole 180 employees www.ca-cib.com * Crédit Agricole Group	13*	3	2	With a network of more than 54 million customers globally, 160,000 staff in 70 countries, Crédit Agricole specialises in capital markets, investment banking and financing. It earned 3.6 billion EUROs net income in 2010. Building on over a century of activity in China, Crédit Agricole has five fully operational branches in Shanghai, Beijing, Guangzhou, Tianjin, Xiamen and a representative office in Shenzhen. Crédit Agricole China was among the first foreign banks to be licensed for Chinese currency (*renminbi*) operations.
Commerzbank 130 employees www.commerzbank.com	27	24	2	Commerzbank is the second largest credit institution in Germany, With the merging of Dresdner Bank into Commerzbank in May 2009. It has a total of around 14million private and corporate customers worldwide and assets of 754 billion EURO. In China, Commerzbank now has three branches in Shanghai, Beijing and Tianjin.

† The background comments were taken from the respective banks' websites in May 2011

European bank group

European banks	World ranking The Banker, July 2010		Home country ranking	Background comments†
	Tier 1	Assets	Tier 1	
Credit Suisse 80 employees www.csfb.com	31	26	1	Credit Suisse Group is a global financial services company headquartered in Zurich. Founded in 1856, Credit Suisse serves companies, institutional clients and high-net-worth private clients worldwide. Credit Suisse is active in over 55 countries and employs more than 50,100 people from approximately 100 different nations. The Company provides its clients with a range of products and services that include Investment Banking, Private Banking and Asset Management.
Deutsche Bank 500 employees www.deutsche-bank.de	20	7	1	Founded in Berlin in 1870, Deutsche Bank is a global investment bank, employing over 100,000 people in 73 countries. Deutsche Bank first established its presence in 1872 in Shanghai. Deutsche Bank in China and Hong Kong now has business interests in corporate advisory and capital markets, transaction banking, private and retail banking, as well as asset management. Deutsche Bank also has a retail presence in China, acquiring a 19.99 percent stake in Hua Xia Bank. Deutsche Bank has locally incorporated and headquartered in Beijing in January 2008.
HSBC 5,300 employees www.hsbc.com	5	4	2	Established in Hong Kong and Shanghai in 1865, HSBC operates around 7,500 offices in 87 countries and territories. HSBC Bank (China) Company Limited began operations on April 2, 2007 as a wholly-owned subsidiary of The Hong Kong and Shanghai Banking Corporation Limited. HSBC has had a continuous presence in mainland China for 146 years. It has invested over US$5 billion in select mainland financial services entities, including the acquisitions of a 19% stake in Bank of Communications, a 15.57% stake in Ping An Insurance, and an 8% stake in Bank of Shanghai. Its current network in mainland China comprises of 108 outlets. It was the first foreign bank in China to engage in gold-exchange business. HSBC China also offers debit cards that can link a *renminbi* account and up to two foreign currency accounts.
ING Bank 65 employees www.ing.com	21	12	1	ING is a global financial institution providing banking, investments, life insurance and retirement services for its customers. ING Group serves more than 85 million customers in Europe, the US, Canada, Latin America, Asia and Australia. ING expanded into retail banking through its acquisition of a 16.07% stake in the Bank of Beijing. ING is active in lending, financial markets and corporate finance in China. It also operates its private banking services out of Hong Kong.

† The background comments were taken from the respective banks' websites in May 2011

European bank group

European banks	World ranking The Banker, July 2010		Home country ranking	Background comments†
	Tier 1	Assets	Tier 1	
Intesa Sanpaolo Bank 25 employees www.intesasanpaolo.com	25	27	2	Intesa Sanpaolo is an Italian banking group resulting from the merger of Banca Intesa and Sanpaolo IMI. In addition to its operations in the Italian market it has an international presence focused on Central-Eastern Europe and the Mediterranean basin. With total assets of 645 billion euros, it serves 19.3 million customers and has more than 7,400 branches worldwide. In 2007, Intesa Sanpaolo acquired a 19.9% stake in Bank of Qingdao, a local commercial bank in Shandong Province.
KBC Bank 55 employees www.kbc.com	52	47	3	Established in 1935, KBC is a bank and insurance company in Belgium. It operates in some 30 countries with over 2,200 branches, with corporate banking subsidiaries in Germany, the Netherlands, Ireland, the UK, the US, France, China, Hong Kong and Singapore. KBC's Shanghai branch operation was established in May 1997.
Natixis 47 employees www.natixis.fr * Groupe Banques Populaire	18*	16	3	Natixis is the listed subsidiary of the Banque Populaire Group and Caisse d'Epargne Group. Natixis is a French-based financing, investment banking and services bank with over 22,000 employees and 116 offices in 68 countries. Natixis' network specialises in these areas: corporate and investment banking, asset management, private equity and private banking, services as well as receivables management. It has a branch in Shanghai and a representative office in Beijing.
Norddeutsche Landesbank 26 employees www.nordlb.de	92	57	8	Norddeutsche Landesbank (NORD/LB) has representations and service offices worldwide and a network of more than 1,500 correspondent banks, a staff of 6,463 employees and a consolidated balance sheet of 238.7 billion euros as at the end of 2009. It offers a wide range of financial services to its private, corporate and institutional clients and to the public sector. The main areas of specialisation of NORD/LB are investment, agricultural and real estate banking, corporate finance, ship and aircraft financing as well as private banking. It has a branch in Shanghai and a representative office in Beijing.

† The background comments were taken from the respective banks' websites in May 2011

European bank group

European banks	World ranking The Banker, July 2010		Home country ranking	Background comments†
	Tier 1	Assets	Tier 1	
Rabobank 65 employees www.rabobank.com	24	28	2	Rabobank is a full-range financial services provider founded on cooperative principles. Rabobank Group is comprised of 152 independent local Dutch Rabobanks plus Rabobank Nederland, their central organisation, and a number of subsidiaries. Food and agribusiness is the main focus of Rabobank. It actively expanded its Chinese business into agriculture, food processing, communications and environmental sectors through its offices in Shanghai and Beijing. It also has a rural banking presence. In 2006, Rabobank acquired a 10% stake in United Rural Cooperative Bank of Hangzhou, which became Hangzhou United Bank in January 2011, with 136 outlets and ten million customers.
RBS 600 employees www.rbs.com	4	2	1	RBS opened its Shanghai branch in 2004 and its Beijing branch in 2007. RBS China formed a strategic partnership with Bank of China after buying a stake in the Chinese bank in 2005. RBS China sold the stake in January 2009. RBS has branches in Shanghai and Beijing, as well as those ABN AMRO China acquired in 2007. In December 2010, RBS entered into an agreement with DBS Bank to transfer its retail and commercial banking portfolios and related employees in Shanghai, Beijing and Shenzhen to DBS Bank (China).
Raiffeisen Bank International 103 employees www.rzb.at	83	87	3	With a balance sheet of 131.2 billion euros as at 31 December 2010, Raiffeisen Zentralbank Österreich AG (RZB) is the third-largest bank in Austria. RZB was founded in 1927 and is headquartered in Vienna. In addition to operations in Austria and Central and Eastern Europe, RZB is also active in a number of international centres. Raiffeisen Bank International AG (RBI) originated from the merger of Raiffeisen Zentralbank Österreich AG's (RZB) principal business areas and Raiffeisen International Bank. Within China, RBI offers services to retail and corporate customers, as well as financial institutions and sovereigns. It has branches in Beijing and Xiamen, and representative offices in Zhuhai, Harbin and Hong Kong. It also has a finance company in Hong Kong.

† The background comments were taken from the respective banks' websites in May 2011

European bank group

European banks	World ranking The Banker, July 2010		Home country ranking	Background comments†
	Tier 1	Assets	Tier 1	
Société Générale 700 employees www.societegenerale.com	19	17	4	Société Générale dates back to 4 May, 1864, the date of the authorisation decree signed by Napoleon III. Société Générale Group serves some 30 million customers in France and worldwide. Its international retail banking division is present in 37 countries. The corporate and investment banking division of the Société Générale Group operates in over 41 countries across Europe, the Americas and Asia Pacific, and employs around 12,000 staff worldwide. Société Générale opened a representative office in Beijing in 1981. Société Générale China received final regulatory approval for local incorporation to set up a wholly foreign owned bank in China in August 2008. Societe Generale (China) Limited began operations in September 2008. In China, its services include corporate and investment banking, commercial and personal banking as well as private banking.
Standard Chartered Bank 5,000 employees www.standardchartered.com	42	49	5	Standard Chartered has an extensive global reach. It has a network of over 1,700 branches and outlets in more than 70 countries across the Asia, the Middle East, Africa, Europe and the Americas. Standard Chartered employs 75,000 people, representing 125 nationalities and derives over 90 per cent of its profits from the emerging trade corridors of Asia, Africa and the Middle East. In China, the Bank set up its first branch in Shanghai in 1858 and has remained in operation throughout the past 150 years. Standard Chartered Bank (China) Limited is one of the first foreign banks to locally incorporate in China in April 2007. Standard Chartered has one of the largest foreign bank networks – with 18 branches, 50 sub-branches, one representative office and a Village Bank in China.
UBS 600 employees www.ubs.com	35	20	2	With headquarters in Zurich and Basel, Switzerland, UBS operates in over 50 countries and is present in all major international centres. UBS employs more than 65,000 people globally. It offers global wealth management and business banking, global asset management and investment banking services.

† The background comments were taken from the respective banks' websites in May 2011

European bank group

European banks	World ranking The Banker, July 2010		Home country ranking	Background comments†
	Tier 1	Assets	Tier 1	
VTB Bank 15 employees www.vtb.com	65	128	2	VTB Group is the first international financial group of Russian origin representing Russia in global markets and providing professional financial services. As of 1 October 2009, its shareholders equity totalled more than US$19 billion and assets more than $90 billion. Presently, the Government of the Russian Federation is the major shareholder of VTB, with its share accounting for 75.5%. VTB works with foreign export insurance agencies and the Export-Import banks, including Export-Import Bank of China and the Industrial and Commercial Bank of China.
WestLB 23 employees www.westlb.de	104	56	10	WestLB AG is a European commercial bank with German roots. With total assets of Euro 191.5 billion as of 31 December 2010, it is an internationally operating commercial bank with links to the global financial markets. WestLB offers a range of products and services, focusing on lending, structured finance, capital market business, asset management, transaction services and real estate finance.

† The background comments were taken from the respective banks' websites in May 2011

North American bank group

North American banks	World ranking The Banker, July 2010		Home country ranking	Background comments†
	Tier 1	Assets	Tier 1	
Bank of America Merrill Lynch 600 employees www.bankofamerica.com	1	6	1	Bank of America Merrill Lynch serves individual consumers, small and middle market businesses and large corporations with a range of banking, investing, asset management and other financial and risk-management products and services. Within the United States, it serves approximately 57 million consumer and small business relationships with 5900 retail banking offices, approximately 18,000 ATMs.
Bank of Montreal 350 employees www.bmo.com	57	54	4	Bank of Montreal, Canada's first chartered bank, opened for business on 3 November 1817. With total assets of C$412 billion in 2010 and almost 38,000 employees, BMO provides a broad range of retail banking, wealth management and investment banking products and solutions. It is currently active in Europe, Latin America, and East Asia as well as in the United States. BMO's history in China dates back to the early 1800s. BMO currently has branches in mainland China and Hong Kong, as well as a representative office in Taiwan and an investment banking representative office in Beijing.
BNY Mellon 120 employees www.bnymellon.com	82	88	15	Headquartered in New York and established in 2007 from the merger of Mellon Financial Corporation and The Bank of New York Company, Inc., BNY Mellon has US$1.2 trillion assets under management and 49,000 employees in 36 countries worldwide. The company has had a physical presence in China since 1994 when it opened our first office in Shanghai, and later another in Beijing.
Citibank 6,500 employees www.citi.com	3	10	3	Citi is a US-based financial services company with some 200 million customer accounts in more than 140 countries. Citi's history in China dates back to 1902 when it became the first American bank to establish operations, and now offers corporate and investment banking, consumer banking and private banking services. On 2 April 2007, Citi locally incorporated as Citibank (China) Company Limited. As of May 2011, Citi operates ten corporate bank branches and 33 consumer bank outlets in China.

† The background comments were taken from the respective banks' websites in May 2011

North American bank group

North American banks	World ranking The Banker, July 2010		Home country ranking	Background comments†
	Tier 1	Assets	Tier 1	
JPMorgan Chase Bank 360 employees www.jpmorganchase.com	2	8	2	JPMorgan Chase & Co. is a US-based global financial services firm with assets of US$2 trillion and operates in more than 60 countries with over 200,000 employees. JPMorgan's history in China dates back to the 1920s. It offers wholesale and commercial banking products. In July 2007 JPMorgan Chase Bank (China) locally incorporated, which was the first locally incorporated foreign bank in Beijing.
Royal Bank of Canada 22 employees www.rbc.com	36	36	1	RBC provides personal and commercial banking, wealth management services, insurance, corporate and investment banking services on a global basis. RBC employs more than 79,000 full and part-time employees who serve close to 18 million clients in Canada, the US and 56 other countries. RBC currently has operations in the mainland and Hong Kong.
Scotiabank 60 employees www.scotiabank.com	38	48	2	With approximately 70,000 employees, Scotiabank Group and its affiliates serve more than 18.6 million customers in more than 50 countries around the world. Scotiabank has been in China for more than 20 years. Its Chinese business includes loans, deposits, trade finance, cash management and treasury services. Scotiabank purchased a minority stake in Xi'an City Commercial Bank, an investment initiative undertaken jointly with the International Financial Corporation.
Wells Fargo Bank 70 employees www.wellsfargo.com	6	22	4	Wells Fargo opened for business in the gold rush era in San Francisco. It is now a diversified financial services company providing banking, insurance, investments, mortgage, and consumer and commercial finance through more than 9,000 stores and 12,000 ATMs and the Internet across North America and internationally. Wells Fargo has US$1.2 trillion in assets and approximately 280,000 team members. It is ranked fourth in assets and second in market value of its stock among other US peers as of March 31, 2011.

† The background comments were taken from the respective banks' websites in May 2011

American Chamber of Commerce White Paper — Banking Section April 2011

Introduction

Over the past year, despite continued global economic weakness due to the 2008 financial crisis, China's banking sector has continued to demonstrate strong growth in both assets and earnings. Indeed, China's listed banks are among the most valuable in the world by market capitalization and appear poised to begin to actively expand into the international markets. China's government, central bankers and regulators have succeeded in maintaining a banking sector that has served as an engine of economic growth in spite of the significant turbulence elsewhere in the world.

AmCham-China has long been a strong supporter of the shared commitment of the US and Chinese governments to work together on a broad range of financial services issues. Over the past several years both governments have worked together effectively to address issues of mutual interest. AmCham-China renews its pledge to support these efforts wherever possible.

Nonetheless, there are growing concerns relating to the unprecedented expansion of credit by China's banks over the past two years. In particular, in 2010 efforts by banks to lend off-balance-sheet new loans through cooperation with the trust sector raises worries about future levels of nonperforming loans, the medium-term strength of the banking system and, ultimately, China's model for sustained economic growth.

Currently, China has a system in which foreign banks continue to play an insignificant role. Although there are now some 338 foreign banks operating in China, together they hold less than two percent of the country's total financial assets. The reality is that even though four years have passed since China fully acceded to the World Trade Organization (WTO), the domestic banking sector remains in practice closed to meaningful foreign bank participation. Similarly, the electronic payment market is equally closed to foreign participation, with China UnionPay holding a monopoly.

As the world enters into its recovery phase from the global financial crisis, Chinese policymakers now face the problem of how to drive financial reform forward toward the development of a full market economy. Robust participation by foreign players in all of China's financial markets would over time reduce the risk burden now fully carried by Chinese institutions, improve the quality of financial services to clients and reduce waste by allocating capital to China's enterprises and projects more efficiently.

Specific Issues

Foreign banks continue to face challenges in realizing their full business potential in China. There are many contributing factors to this, including an overly complex regulatory environment, the need to meet the requirements of multiple regulators and a regulatory approach that is rule-based rather than principle-based. AmCham-China urges all relevant Chinese authorities to consider how best to address the issues noted below.

Improved Coordination Among Chinese Policy and Regulatory Authorities

China currently has a large number of regulatory bodies with authority over various aspects of the banking sector. In addition to the Chinese Banking Regulatory Commission (CBRC) there are, among others, the Ministry of Finance, the People's Bank of China (PBOC), the State Administration for Foreign Exchange (SAFE), the National Development and Reform Commission (NDRC) and the National Association for Financial Market Institutional Investors. There is inevitably overlap between these entities and instances where there are conflicting requirements. It is left to the foreign banks to seek to coordinate and resolve any conflicts arising from this complex operating environment.

In particular, foreign banks are required to seek approval for all new products and services they plan to offer in the China market. Increasingly complex products and services require review and approval from multiple regulators. This involves significant amounts of effort and time to complete the process.

AmCham-China advocates for more effective coordination among financial market regulatory bodies. We would support the formation of either a comprehensive financial market coordinating body that would serve as the infrastructure overseeing China's developing banking and capital markets, or a super-regulatory body with responsibility for these increasingly complex markets.

Uniform Regulatory Standards and Interpretation

In addition to the coordination problem between different regulatory bodies, foreign banks are frequently confronted with inconsistent interpretations of the same regulation by local entities within the CBRC system. For example, in some locations, specific banking products are not allowed. In other places, actions are required which result in the

increase of both business and operational risk. The goal of local regulators is to reduce risk or prevent the recurrence of problems. However, at times the opposite is achieved or solutions are at best superficial, while simultaneously creating significant costs for foreign banks.

AmCham-China recognizes the difficulty CBRC faces in adapting national regulations to local situations in a country as diverse as China. We strongly recommend, however, that CBRC make enhancing consistency among its branch offices a priority to help resolve this perennial problem.

Capitalization and Liquidity

When foreign banks initially incorporate their branches into wholly-owned subsidiaries, they are permitted to bring in initial amounts of capital consistent with the scale and needs of their business operations at the time. Thereafter, new capital increases are subject to the regulatory approval of CBRC and, indirectly, SAFE. Approvals are often based on the administrative judgment of these bodies and not on the business cases and needs as put forth by the foreign banks.

As the experience of foreign banks in China in the latter part of 2008 demonstrated, the business environment can be subject to rapid and unexpected change. To adjust to such situations, foreign banks must maintain a rather higher level of capital than would be required elsewhere. This is particularly the case when foreign banks are unable to avail themselves of the funding possibilities offered by their offshore parents. SAFE and NDRC each year approve offshore short-term and long-term foreign debt quotas for locally incorporated foreign banks in China. From the beginning, these quotas have been inadequate and over the past few years have been reduced to even smaller amounts. Finally, the Central Bank Law of 1994 describes the availability of a liquidity window at the PBOC which banks can make use of in the event of exceptional liquidity needs. In 2008 this window was not made available for locally incorporated foreign banks.

In sum, access to sufficient liquidity, whether through adequate foreign debt quotas or the Central Bank borrowing window, is of absolute importance for proper and prudential asset and liability management in the event of extraordinary circumstances. Foreign banks recognize the government's efforts to encourage foreign banks to increase onshore funding while at the same time preventing unwanted foreign currency flows. At the same time, however, regulators should be aware that conflicting regulations can lead to the creation of liquidity problems in the banking sector.

AmCham-China urges regulators to base their review of foreign bank capital increase applications on business and not on purely administrative factors. If foreign banks believe they require additional capital, regulators should welcome the safety it provides. We also believe that adequate regulations exist to address the possibility of unwanted foreign currency flows into and out of China's domestic markets. We strongly recommend that the foreign debt quotas be increased and ultimately be removed. In addition, AmCham-China would willingly cooperate with the relevant regulatory bodies to develop a clear and transparent contingency plan to provide sufficient liquidity to foreign banks in the event of extraordinary market circumstances once again arising.

Branch Expansion

Under the terms of regulatory guidelines, locally incorporated foreign banks are allowed to expand their branch and sub-branch network. This is in line with China's objective of increasing foreign participation in the domestic financial markets as described in the WTO agreement. At present, however, the CBRC will only entertain applications to establish single branches. The submissions for such branch applications are complex, and the review and approval process is time consuming for both applicants and regulators.

In addition, unwritten policy guidelines exist that require foreign banks to open one branch in undeveloped banking markets for each branch opened in developed markets. This requirement is applied across all foreign banks regardless of a bank's business model or customer base. By requiring foreign banks to open businesses in support of domestic social policy, regulators make it more difficult for banks to maintain strong, healthy and profitable growth, while at the same time meeting other regulatory requirements.

AmCham-China understands the practical approach adopted by the regulators with regard to branch expansion, and also appreciates the Chinese government's goals to ensure the equitable distribution of financial services across greater China. However, AmCham-China urges the CBRC to work with foreign banks to develop network expansion plans that would allow for multiple branch and sub-branch approvals. In addition, we urge the CBRC to open up an interactive process with foreign banks regarding the requirement to locate branches in less economically attractive areas.

Electronic Payment Services

Many foreign banks and electronic payment companies have significant experience and expertise in foreign markets with regard to payment services and the required infrastructure to support them. However, current regulations preclude foreign companies from participating in electronic payment services in the *renminbi*-denominated payment card transaction market in China. China UnionPay continues to enjoy a monopoly in the market and this has slowed the market's development in nationally prioritized areas such as e-commerce.

In turn, this has impacted attempts to boost consumer spending and hindered market innovation. For example, in January 2011, China's domestic electronic payment system suffered a network failure that caused the system to go offline for approximately 30 minutes. This was not the first instance that such a breakdown has occurred.

An open and competitive Chinese electronic payment market would further benefit domestic banks, which gain greatly from cooperation with electronic payment companies. For example, an open market would advance the interoperabiity of China's electronic payment system, promoting both inbound and outbound tourism. This would benefit both consumers and domestic banks involved in international transactions. Beyond bank cards, electronic payment companies can help domestic banks remain relevant and competitive in developing areas like chip payment, mobile payment and new forms of online payment. These growth areas will help China's goal of moving toward a more consumption-oriented economy.

A competitive electronic payment market with multiple participants including both Chinese and foreign firms is critical for the strong development of China's electronic payment market. It would provide diversification against future network failures, promote the development of financial markets, spur financial innovation, improve customer service standards and ensure customers enjoy lower competitive fees. Experience elsewhere in the world has shown that no single payment network can achieve these goals in any market, particularly one as vast as China.

AmCham-China urges the CBRC and PBOC to open the electronic payment services industry to greater competition. Liberalization of this industry would have an immediate and tangible benefit for Chinese consumers and the overall domestic economy.

Conclusion

China has continued to make significant progress in its banking industry in the years since full accession to the WTO. However, foreign banks face a considerable burden in operating within China's complex financial regulatory landscape. In the interest of clarifying banking rules,

AmCham-China urges Chinese authorities to consider ways to improve coordination among and within China's many banking regulatory agencies.

Though foreign banks have made some inroads into the Chinese market, even now they hold only 1.77 percent of total Chinese financial assets. In practice, the Chinese banking industry remains largely off-limits to outside competition. AmCham-China believes that as Chinese financial institutions expand their products and services to support customer needs both domestically and abroad, they will need to strengthen their infrastructure, risk practices and talent management. Allowing foreign banks to take a more active role in the Chinese financial sector would raise the bar industry-wide in terms of financial product innovation, risk management and customer service. This would prompt state-owned banks to become more competitive, benefiting Chinese banking customers at both the corporate and individual level.

Recommendations

- Improve coordination among and within financial regulators, and as the complexity of China's financial landscape increases, consider creating a super-regulatory body to oversee banking and capital markets.
- Support requests by foreign banks for necessary increases in capital.
- Ensure more consistent regulatory implementation among the many branch offices of the CBRC.
- CBRC and foreign banks should develop network expansion plans that allow multiple branch and sub-branch approvals.
- Create a market-oriented electronic payment services sector with greater competition.

American Chamber of Commerce White Paper — Bond Markets Section April 2011

Introduction

China has made great progress toward establishing more open and transparent financial services markets; yet, clearly more needs to be done. Capital allocation in China is not market-driven, resulting in inefficiencies in financial intermediation and low returns on investment. An important step in improving efficiency of capital allocation is supporting the development of bond markets both government and corporate.

Although China has made some strides in this area, national treatment for participants in China's nascent bond market remains a significant concern to AmCham-China, especially with respect to underwriting, capital requirements for derivatives, derivatives trading with corporate clients and bond settlement agent licensing. China appears well positioned to use its positive momentum to address these issues and raise domestic bond markets to globally recognized standards of practice. By bringing its domestic bond market up to international standards, China will be better able to harmonize its market with other Asian cross-border bond markets when the capital account is opened in the future.

The primary bond markets in China are the largest in Asia, but the secondary markets are moribund. Interest rates are administratively set by the People's Bank of China (PBOC) and bonds are issued with coupons at negative real interest rates, leading to this result. AmCham-China suggests the gradual liberalization of interest rates so that active trading can develop in true secondary markets based on a robust yield curve. The controlled interest rate regime also distorts underwriting in the primary markets because risk cannot be properly priced and issues are little more than bought deals. Most of this chapter is devoted to technical infrastructure crucial to government bond market functioning, but the underlying prerequisite of a sound market remains interest rate deregulation.

Fully functioning and open financial markets and efficient capital allocation must be built upon the strong foundation of a liquid and transparent government bond market. The benefits of such a government bond market include: risk-free benchmark sovereign rates, necessary for pricing other instruments in a healthy financial system, including corporate bonds and bank loans; sound money markets; lower overall systemic risk within the financial system; cost-effective risk management; and lower long-term funding costs for the government.

The development of an open, transparent and effectively regulated government bond market is in turn a precondition to a healthy and dynamic corporate bond market. Enhanced debt capital markets allow banks to move away from a system driven by government-directed rates toward a modern, market-driven loan and deposit rates regime. They also allow banks to establish a market culture capable of better addressing credit risk and better positioned to allocate capital efficiently.

In order to establish a strong government bond market, China should institute eight fundamental elements: (1) deregulated interest rates; (2) a disciplined issuance and reissuance program to support large benchmark issuances; (3) a liquid "classic" bond repurchase (repo) market; (4) a liquid and active government bond futures market; (5) a broad range of liquid over-the-counter (OTC) derivatives contracts and exchange-traded derivatives contracts; (6) high quality, efficient and cost effective electronic price discovery, trading and settlement platforms; (7) market-friendly regulations and taxes; and (8) a broad and active domestic and foreign investor base.

AmCham-China commends China's accomplishments in financial services and encourages Chinese regulators to initiate concrete bond market reforms to continue this positive momentum going forward.

Significant Developments

China's efforts to develop well functioning debt capital markets have had good results in recent years. Bond market activity in China surged 60 percent in each of the past two years and corporate bonds increased 77.5 percent year-on-year. Although China has become the largest corporate bond market in Asia, excluding Japan, corporate bonds accounted for only a small portion of the total of the sector's funding. At the end of 2010, China's interbank market bonds outstanding totalled approximately RMB 20.72 trillion (US$ 3.15 trillion), comprised of 32.69 percent in government bonds, 19.75 percent in central bank bills, 28.63 percent in financial institutional bonds, and 18.82 percent in non-financial corporate debt financing instruments.

China's recent major accomplishments toward bond market development follow.

"Classic" Bond Repurchase Market

A "classic" bond repurchase (repo) market refers to a system within which margining of exposures is standard and the bond title is actually transferred as part of the agreement, allowing repo institutions to use these bonds that they hold for additional purposes, such as further repos, covering short positions, securities lending, or collateral. As a result, bonds in classic repo agreements continue to generate market liquidity. The National Association of Financial Markets Institutional Investors (NAFMII), a PBOC-sponsored quasi-regulatory, self-regulatory organiza¬tion and trade association, took an important step toward development of a classic repo market in 2010 by producing an updated draft Chinese master repo agreement (CMRA). Once approved, the CMRA will support the further devel¬opment of a classic repo market, including term repos, and also significantly facilitate repo negotiations. AmCham-China applauds NAFMII's efforts and eagerly awaits final implementation of the new CMRA.

Underwriting

NAFMII is also at an advanced stage of designing a market-orientated bond underwriting entry-and-exit mechanism through a consultative process with committees of its members. It is developing criteria that in principle should allow both local and foreign banks to underwrite bonds in China. This will establish clear and simple criteria for foreign banks to participate initially as sub-underwriters and later as lead underwriters for commercial paper (CP) and medium-term note (MTN) bond markets. However, this is only a first step toward an issuer-driven underwriter selection and appointment process that is more consistent with the approach taken in more advanced financial markets.

Electronic Price Discovery, Trading and Settlement

Market participants seem generally satisfied with the services provided by the China Foreign Exchange Trade System (CFETS) and China Central Depository & Clearing Company Limited (CCDC), which have been operating for many years. The November 2009 launch of the Shanghai Clearing House (SCH), as authorized by PBOC and the China Ministry of Finance (MOF), is a significant step. Over the course of 2010, SCH worked closely with international organizations and international clearing house counterparts to establish its infrastructure and prepare other operational elements, such as details on criteria for membership and margining mechanics, including close-out netting. A well capitalized and formally credit-enhanced SCH, with low cost systems for the user, could function as a Central Counterparty (CCP) for financial transactions and provide expanded liquidity to both government and corporate bond markets in China, especially when it includes repo and bond futures transactions.

Broadened Investor Base

The existence of a broad and active investor base that includes foreign investors generates market activity and liquidity. China's effort to develop the offshore *renminbi* market is a good step toward expansion of the foreign investor base and longer term should create additional channels through which these investors could participate more meaningfully in the domestic bond market. China should continue this momentum by expanding and increasing the number of existing investment channels and increasing or eliminating investment quotas.

Corporate Bond Markets

The introduction of the China Bond Insurance Corporation in 2010 encourages a culture more aware of and capable of addressing credit risk in corporate bond issuances and facilitates the issuance of collective small and medium-sized enterprise (SME) corporate bonds. Additionally, NAFMII's publication in October 2010 of Guidelines for a Pilot Credit Risk Mitigation Business in the interbank market launched credit derivatives transactions in China, the aggregate notional amount of which already exceeds RMB 1.99 billion (US $300 million) according to most experts. Credit derivatives are internationally recognized risk management tools and considered essential to the development of corporate bond markets.

Specific Issues

AmCham-China encourages China to use its current momentum to remove cumbersome impediments and raise domestic bond markets to a new level of liquidity and effi¬ciency.

National Treatment for Foreign-Owned Banks

First and foremost, China should treat foreign banks no differently than domestic banks with regard to licensing, corporate form, regulation and permitted products and services, allowing them to compete fully in domestic markets.

Without providing such consistent and equal access to the marketplace, China remains vulnerable to increased criticism that its financial industry policies are protectionist and aimed at excluding foreign banks from its financial markets. The expertise and technology transfers that inevitably occur with a broader participation of foreign banks will also accelerate the further development of China's financial services industry, allowing China an earlier integration into the global financial market.

AmCham-China believes strongly that continued reform and modernization of China's underdeveloped financial sector is critical to China achieving its own economic goals of maintaining high rates of growth and job creation and promoting greater internal demand by cultivating a more services-based, consumer-driven economy.

Capital Requirements for Swaps and Derivatives

Though a number of impediments to the growth of derivatives trading exist (as discussed below), the market now must grapple with a new constraint contained within derivatives regulations issued by China Banking Regulatory Commission (CBRC) in January 2011. Called the Interim Measures on the Administration of Derivatives Business of Banking Financial Institutions (New Derivatives Measures), these new measures present a particular cause of concern in the form of the "Three Percent Rule."

Under the Three Percent Rule, market risk capital allocated for non-hedging derivatives transactions cannot exceed three percent of an institution's core capital. As a result of being structured as subsidiaries, foreign-invested institutions based in China generally are much more thinly capitalized than their comparable domestic Chinese bank counterparts. Therefore, the Three Percent Rule has a disproportionate and discriminatory impact on foreign-invested institutions. AmCham-China encourages CBRC to adjust the New Derivatives Measures to consider the capital base of and support from the parent companies of foreign-invested institutions so they can contribute fully to China's market development.

Underwriting

Although foreign banks can trade commercial paper and MTN on the OTC interbank market in China, they are still not permitted to underwrite these issues. AmCham China commends NAFMII's attempt to resolve this issue. However, under the current proposal published by NAFMII, it will take years of service as a sub-underwriter in China and the meeting of additional criteria before a foreign bank could be considered for full underwriter status. In addition, while the draft qualitative and quantitative criteria are written in a way to appear neutral, in practice these requirements will exclude many foreign banks. Implementation of the draft rules would establish a system whereby the regulator sets criteria for underwriter selection, an approach that is in stark contrast to standard best practices for issuers employed in well developed financial markets around the world. In these mature markets issuers select lead underwriters, and lead underwriters select sub-underwriters with issuer approval, based on commercial criteria and regardless of a bank's national origin. Foreign banks, including Chinese banks, are eligible to underwrite issues in developed economies across the world, notably the case in the US, UK and EU. In such jurisdictions, when commercially selected, banks need only have the required general banking licenses, retain qualified staff and have appropriate risk management systems in order to act as an underwriter.

Global banks possess extensive and internationally recognized knowledge and experience in underwriting debt securities and many have operated businesses in China for a number of years. Allowing experienced foreign banks into China's underwriting market will offer domestic issuers more choice and will lead to more cost effective options, lower funding costs and expanded distribution channels. The broader competition and cooperation among underwriters typical of leading global markets will improve the functioning of the Chinese market and raise the quality of service to clients.

Retiring and Reissuance Process

In leading government bond markets, there are typically multiple issues of similar maturities, of which the most actively traded issue in a given maturity is called the "on-the-run" issue. China's government bond issuance program lacks deep and liquid on-the-run benchmark government bonds across the maturities spectrum, contributing to an uneven yield curve. A government bond market that maintains on-the-run issues can meet the fluctuating demands of buyers and sellers by maintaining liquidity through a consistent strategy of regularly reissuing targeted existing issues and retiring illiquid existing issues. This approach to bond market management creates deep on-the-run benchmark issues of maturities across the yield curve. China's adoption of this approach would build market confidence in the consistent availability of such reference benchmarks, which would enhance market liquidity overall.

"Classic" Government Bond Repo Market

Although some progress has been made, a fully liquid and active "classic" repo market remains elusive. Transactions in the current repo market are relatively short term, with as much as 85 percent being pledged as security and involving no title transfer meaning they do not function as true repos. The absence of the ability to manage collateral margins inhibits the development of term repos (i.e., those longer than overnight). China's bond market would be better served by a repo market that more closely mirrors the global best practices found in the classic approach. AmCham China urges Chinese regulators to finalize the CMRA, as NAFMII's document incorporates the classic repo approach and will dramatically enhance repo market development. Such a move would lay the foundation for a good term repo market, extend liquidity across the government bond yield curve and make more precise risk management hedging transactions possible.

Government Bond Futures Market

An active, liquid and closely supervised bond futures market would allow participants to hedge positions quickly and reduce risk more effectively, while at the same time deepening the cash equity and fixed-income markets in China. Bond futures markets are essential for market makers and primary dealers to function efficiently and are a key component of developed markets in general.

Creditor's Rights and Bankruptcy Procedures

Overall, the rules governing creditor's rights in bankruptcy must be strengthened and improved in order to ensure market participant confidence in the enforceability of transactions, particularly related to repos, futures and other derivatives typically traded under master agreements.

Under current Chinese bankruptcy law, an insolvency administrator has the right to decide whether to put aside or uphold any executory contract and whether to disregard any termination right provided by contract. The practice of this discretion is often referred to as "cherry picking."

Another example has to do with the enforceability of close out netting for repo and derivatives transactions between counterparties, which is addressed with legal certainty in most other financial markets. Generally, such transactions are traded under internationally recognized master agreements such as the Global Master Repurchase Agreement and the International Swaps and Derivatives Association master agreements. If one party to a repo or derivatives transaction goes bankrupt, these international master agreements provide for all transactions with the bankrupt party documented under the relevant master agreement to be closed by netting all transactions under which funds are owed to the counterparty or due from the counterparty. Through this approach, the amounts owed by and due to each of the parties under each and every relevant transaction is calculated and reduced to one net amount of exposure. Under the current system, Chinese banks seem to rely on implicit government guarantees as their primary form of risk management when dealing with each other, leaving the derivatives market dangerously exposed in the event a Chinese bank defaults and the government does not step in to cover the obligation. Foreign banks cannot rely on this implicit guarantee, and as a result must reduce their credit lines for Chinese banks.

Although recent regulator-sanctioned documents recognize and utilize close-out netting concepts, the delay by regulators in addressing the legal regime for close-out netting and the cherry-picking issue in a clear and concise manner undermines such efforts.

For example in 2008, when a draft Banking Financial Institutions Bankruptcy Regulation was prepared by CBRC, the industry hoped that CBRC would clarify the enforceability of close-out netting in the regulation. This regulation has since stalled. Restarting and finalizing it would likely require involvement of not just CBRC but several other key regulators, including PBOC, MOF and CSRC. A regulation of this type could potentially go a long way toward clarifying the enforceability of close-out netting in China. AmCham-China encourages regulators to reinvigorate consideration and development of this or other stand-alone regulations that would address the netting and cherry-picking issues.

Clarification through unambiguous legislation, judicial interpretations or administrative regulations on enforceability of close-out netting, and the disapplication of cherry-picking powers in the context of qualified financial contracts would strengthen the credibility of Chinese domestic agreements, such as those drafted by NAFMII.

Business Taxes on Financial Transactions

As China's financial markets mature and transactions across the spectrum of repos, futures, interest rate derivatives and bond trading become more interdependent, the failure of tax rules to keep pace with the industry creates concerns for domestic and foreign banks. The Business Tax rules, which segregate transactions into separate categories, were developed long before financial markets reached their current level of sophistication. Since the profit margins on the overall transactions are generally quite thin, the resulting gross tax on a transaction as whole may be close to or even exceed the net profit, which discourages hedged transactions and relative-value trading. Administration of these Business Tax rules should therefore be amended as soon as possible to eliminate the four transaction categories and allow net gains and net losses to be carried forward. This approach would reflect modern business practices and promote market liquidity.

Direct Access for Foreign Market Participants and Foreign Investors

Rapid development of options for 100 percent foreign-ownership in the financial services is urgently required. Significant restrictions exist with respect to setting up wholly foreign-owned subsidiaries in China. Many financial sector businesses are required by regulation to enter into joint ventures with local partners and are subject to a limited scope of activity. In addition, foreign-owned firms hoping to expand their activity and branch networks and offer new products face a complex, slow, opaque and often futile approval process. AmCham-China urges China to grant foreign-owned firms full national treatment and market access, and to maintain this level playing field for all businesses through efficient and transparent administrative processes.

Introduction of specific and larger quotas for direct investment in the OTC interbank bond market, starting initially with quotas of US $30-50 billion (RMB 197-328 billion) converted into *renminbi* for approved foreign investors, would be a step in the right direction.

Securitization Market

At present, China has a significant informal securitization market, through which trust companies act as intermediaries between fund providers and borrowers, though this market currently functions in an unregulated manner. Well regulated and effective securitization markets are internationally recognized as efficient financing mechanisms. The establishment of a formal securitization market with clear, consistent and enforceable rules and sound documentation and disclosure requirements would better address the concerns of banks, regulators and investors.

Regulatory Process and Notification

Fair and transparent regulation plays an integral role in the development of deep and liquid capital markets that attract market participants, increase efficiency, and spur economic growth and job creation. Transparency generally means that the public and industry participants have the opportunity to participate in the rule-making process, access information about proposed rules, question and understand the rationale behind draft rules, and have sufficient opportunity to review and comment on proposed rules. Final rules and regulations should be clearly articulated and easily understood and should reflect the input of all stakeholders.

A large number of regulatory and quasi-regulatory bodies govern the financial services sector in China (e.g., PBOC, SAFE, MOF, SAT, NDRC, CSRC, CBRC, CIRC and NAFMII). Each regulator has its own priorities and processes, and the entire system is extremely difficult and complicated for foreign financial institutions to navigate. Notification of regulatory change is inconsistent, and the complex approval process for new products and licenses continues to suffer from the absence of a coordinated regulatory approach.

Furthermore, since required approvals can be granted sequentially with various regulatory bodies requiring different sets of criteria, approval by one authority does not guarantee similar treatment by another. At times it is not even clear which regulator's approval is required, and sometimes the regulators themselves hold conflicting views as to whose approval is or is not required.

Redundancy and conflicting requirements also exist between different geographic regions and even between "competing" regulators, leading to unnecessary delays, inefficiencies and confusion. Rules are often unclear, reasons for denial or approval are not widely disclosed, and in some cases the rules themselves are not public. In addition, market participants are not consistently consulted or notified publicly regarding changes to rules, regulations

or laws, and new regulations are sometimes imposed without allowing for an adequate transition period.

China's regulatory and jurisdictional uncertainty is a serious impediment for foreign-owned financial institutions and effectively serves as a non-tariff trade barrier. Regulatory transparency and consistency, market consultation processes, sufficient notification of new rules and time for public comment are vital to well functioning financial markets. If China's convoluted regulatory system is not reformed, it will seriously impede future development of Chinese bond markets.

International Standard Commercial Practices

Additional limitations are imposed on the market by unusual incentive programs or other approaches to licensing that are not international standard practice in the industry. Two examples include Chinese market-maker status and bond settlement agent licensing in derivatives trading.

Chinese Market-Maker Status and Derivatives Trading

Derivatives trading with corporate clients requires multiple regulator licenses and approvals. This privilege is available on a very limited basis. One of the requirements to qualify is to serve as a PBOC approved market maker.

In the world's leading financial centers, market makers are financial institutions that offer two-way pricing quotes for various products, currencies or commodities to buyers and sellers. There is simply no rationale to link derivatives trading with corporate clients to market-maker status. In fact, this linkage impedes the growth and liquidity of the derivatives market. Neither US, UK nor EU regulators require market makers to be licensed; however, in China the PBOC grants such status, and the ability to trade derivatives with corporations is offered to offset the burdens of market making.

Bond Settlement Agent Licensing and Derivatives Trading

The only other way to trade derivatives with corporate clients is to acquire a Level "A" Bond Settlement Agent License, which is also granted by PBOC. As of this writing, no foreign bank has succeeded in obtaining a Level "A" Bond Settlement Agent License from PBOC. Clearer criteria and explanations of the basis for disqualification would promote a better understanding of this process. Ultimately, AmCham-China urges PBOC to allow participation by foreign banks.

Conclusion

AmCham-China supports China as it strives to expand domestic bond markets to match financial market leaders. Great strides and significant progress have already been made, though advancement continues to be hindered by discriminatory rules and policies that disadvantage foreign banks, especially with respect to bond underwriting and derivatives trading. Treating foreign banks and service providers unequally inhibits the growth of China's bond markets and works against China's own commitments to equal national treatment.

Recommendations

- Implement policies to support national treatment for all banks and allow foreign banks to compete fully in domestic markets, particularly in the areas of underwriting and derivatives trading.[PBOC, NAFMIL, CBRC and CSRC]
- Remove the limits on foreign ownership in all financial services sectors. [State Council]
- Gradually deregulate interest rates.
- Clarify creditor's rights through unambiguous regulations, legislation or judicial pronounce-ments regarding enforceability of close-out netting and elimination of cherry picking by insolvency administrators. [MOF, PBOC, CBRC and CSRC]
- Amend existing business tax and accounting rules that inhibit market development. [MOF, CSRC and SAT]
- Take measures to develop a classic term repo market. [NAFMII and PBOC]
- Allow significant direct investment by foreigners in the government bond market. [PBOC and SAFE]
- Re-launch a bond futures market with regulatory, supervisory and technological infrastructure. [PBOC, MOF and CSRC]

Key Recommendations

I. Market Access Issues

1. Branch/Sub Branch Network and Business Expansion

Concern

After obtaining a foreign currency license, a branch of a foreign bank needs to conduct business for three years, and show profitability for the last two years, before being able to apply for an *renminbi* license. Furthermore, the licensing process is unclear because of regional variations in implementation and a lack of transparency. Newly-incorporated banks face a similarly time-consuming and complex submission process when seeking approval for business licences.

Locally-incorporated banks face difficulties in business planning and resource management due to a complex system of submissions to expand foreign bank's branch and sub branch network, as well as to deploy activities in a timely manner in the retail segment.

Assessment

The three-year waiting period for the *renminbi* license is a considerable barrier to market entry and contravenes the basic idea of equal treatment for domestic and foreign banks. In addition to delaying investment in new branches, it also obstructs the development of the Chinese banking sector in an unnecessary way.

The lack of transparency is clearly illustrated by CBRC Head Office's decision not to approve a number of foreign bank *renminbi* branch applications, arguing that applicants had accumulated losses in their balance sheets. However, the rules governing branch licensing do not mention accumulated losses, and only state that a branch must have been profitable for the last two years. Basing rejections on criteria that are not part of the written rules makes it very difficult for banks to predict the success of applications.

Furthermore, the official wording of the regulations does not always lead to clear interpretation, or of the implementation rules and guidelines being 'classified'. Banks often lack a thorough understanding of how many branches they can apply for each year, and how concurrent applications will be treated. This uncertainty goes against China's objective of increasing foreign participation and developing the banking sector in western and north eastern provinces.

European banks have an interest in expanding into western China, however, many may be reluctant to apply for branches if this risks causing unplanned delays to their expansion strategies in the eastern provinces.

Once the incorporation licence has been obtained, a newly incorporated bank must then apply for corporate and retail *renminbi* licences separately. This unnecessarily lengthens the timeframe before being able to offer services to Chinese customers.

There are a number of complex submissions that need to be made in order to expand a locally-incorporated bank's branch and sub branch network. These submissions are time consuming for both the bank and the regulator and do not provide sufficient information on the future strategic direction of the locally-incorporated bank. Whilst the Working Group understands the need for detailed submissions, the Working Group would like to recommend a planned strategic approach whereby multiple branch and sub branch applications will be allowed on an annual basis, in order to facilitate the locally-incorporated bank's branch network expansion strategies in a more transparent and planned manner. Consequently, this will allow locally-incorporated banks to strategically expand their branch and sub branch network in a more timely and efficient manner.

Recommendation

- Abolish the waiting period for *renminbi* licenses.
- Enable a unique and bundled *renminbi* retail and corporate process after incorporation, to allow the newly incorporated banks to start operations immediately.
- Enable locally-incorporated banks to provide annual master plans to be pre-agreed in principle.
- Allow multiple branch and sub branch simultaneous expansion submissions.

2. Renminbi Derivatives Market

Concern

The *renminbi* derivatives market is only open to market players with bond market maker-status, but it is not clear why this is the case. It also appears that only three foreign banks have been granted this status (an improvement from a year ago), while others that applied have been turned down without any rationale given for the refusal.

Assessment

With the recent change in legislation, a bank must have bond market maker-status in order to be able to trade *renminbi* Interest Rate Swaps (IRS) with corporate companies. Foreign banks in the past were able to use the PBOC as a benchmark index or a proxy

benchmark like seven-day repo or PBOC deposit rate to quote *renminbi* IRS to corporate companies. This ability no longer applies.

There has been an example of a major foreign player receiving bond market maker-status although its trading volumes were relatively low. Other foreign banks with higher volumes, at that time, were turned down with very little reasoning behind the refusal.

The Working Group would like to suggest that the authorities clarify the application procedure, set standards to better enable transparency in how decisions are made, and to authorise a variety of market players to enter this market.

Recommendation

- Allow equal access to the *renminbi* derivatives market and provide clear/transparent application rules on qualifications for approval.

3. Bond Underwriting

Concern

Foreign banks are delighted that in early 2009 they were granted the right to trade corporate bonds. This was followed by the announcement that foreign banks were also given the right to underwrite financial bonds. After establishing a track record of trading corporate bonds, foreign banks also expected that they would have the right to underwrite corporate bonds for the accounts of their customers. Unfortunately, no foreign bank has yet been approved for corporate bond underwriting, while only one foreign bank underwrote a financial bond that was issued by its invested bank. Also in 2009, selected securities companies were allowed to enter the PBOC bond market, and selected domestic banks were allowed to enter the CSRC bond market. No foreign bank or securities company has received the same treatment.

Assessment

Working Group members welcome the efforts made so far by financial authorities to establish a strong liquid domestic bond market. The importance of succeeding in this objective cannot be underestimated, and reforms must continue on the same path.

The Working Group understands and supports the government in its step by step approach, but at the same time, would like to encourage the authorities to proceed more quickly and in a more transparent manner with the reform once it has gained confidence with the initial steps taken.

Foreign banks can bring their expertise and technology to this market. Allowing foreign banks to fully participate in both the PBOC and CSRC bond market will encourage them to accelerate the required transfer of know-how.

Recommendation

- Accelerate the approval of foreign banks and securities companies to underwrite financial and corporate bonds in the PBOC market.
- Grant foreign banks the right to underwrite bonds traded on the securities stock exchange on the same terms as local banks.

4. CNAPS Membership

Concern

Some foreign bank branches have been excluded from CNAPS membership. It is recommended that they instead use Chinese domestic banks with CNAPS membership as an agent.

Assessment

A number of foreign banks have recently received approval for CNAPS membership after a protracted approval process. There are a lot of advantages to participating in CNAPS for all banks, such as speed, security and significantly reduced sources of operational errors. Although membership approvals have been granted to a number of foreign banks and their branches, it is not clear to the Working Group members why the PBOC does not provide access to all market players in a speedy manner.

The PBOC has recommended to non-CNAPS members that they should use as agents, Chinese banks with CNAPS membership, however, they face mounting difficulties in doing this as, firstly, using an agent bank increases the complexity of meeting the deposit reserve requirements with PBOC (currently at 15%*). It also does not ensure efficient cash management. When incoming funds arrive at the agent bank close to cut-off time, very little time then exists to technically transfer the funds to the PBOC *renminbi* nostro account to fill up the deposit reserve.

*PBOC, May 4th 2010, Notice on Increasing Deposit Reserves Ratio by 0.5% from 10th May 2010 (Yin Fa [2010] No. 137)

Not meeting deposit reserve requirements is a severe fault. Providing direct membership to all market players would therefore reduce the risk of failing to meet the requirements.

Secondly, the CNAPS payment format is not yet adapted for agency functionality. Indeed, no specifically allocated field exists to identify the ultimate beneficiary of the payment.

Therefore, the identification of the beneficiary can only be done in the “payment reference field”. This adds to the complexity, increases the processing time and adds unnecessary risks inherent in manual input to processing the payment.

Thirdly, the CNAPS membership is of vital importance to foreign branches seeking a deeper involvement in the domestic *renminbi* market. PBOC, as an example, regulates that only banks with direct access to the CNAPS-High Value Payment System (HVPS) system can apply to the *renminbi* cross-border settlement scheme. Hence, foreign branches without the CNAPS membership are exempt from this new business opportunity.

The above-mentioned issues limit the operational capacity of foreign branches seeking to expand their business activities in China. In order to ensure a level playing field and to improve the industry’s efficiency and security (which will benefit customers), the Working Group members suggest that nationwide CNAPS membership should be granted to all market participants holding an *renminbi* license.

Recommendation

- Allow CNAPS membership to all market participants who have been granted an *renminbi* license.
- Improve CNAPS payment formats to allow the identification of the final beneficiary in a specifically allocated field to increase efficiency, cut manual intervention and reduce risks. Note that this recommendation is applicable for all CNAPS members, including locally-incorporated foreign banks.

5. Capital Requirements

Concern

Branches of foreign banks are required to deposit 30% of their working capital with domestic banks.

a) This limits the use of the capital for branches of foreign banks, as it could otherwise be lent out to clients.

b) Foreign, locally-incorporated banks today are not allowed to take up these deposits.

Assessment

Regulations mandate that 30% of a branch’s working capital has to be deposited at a local bank. This imposes extra costs on foreign banks as capital could otherwise be deployed in ways yielding higher returns. Chinese regulators gain little assurance from instituting the mandatory deposit because the liabilities of foreign banks are fully guaranteed by their respective head offices. Furthermore, Chinese banks do not face such mandatory deposits.

Branches of foreign banks also face major difficulties in complying with the *renminbi* capital adequacy ratio for branches. Foreign banks, in accordance with international standards, have to hold a ratio of capital to risk-weighted assets of 8% minimum as required by the supervisory authority in their respective country of domicile. However, in addition to this, the Chinese regulations require them to fulfil the *renminbi* capital adequacy ratio of 8% individually for each branch in China for their *renminbi* business.

Therefore, foreign banks with a bigger branch network in China will have to have a much higher minimum capital adequacy ratio than 8%, since some branches will always have higher actual ratios than the 8% minimum for their *renminbi* business.

Locally-incorporated banks operating under the same law and regulators as their Chinese-funded competitors are not allowed to take up the mandatory 30% deposits that branches of foreign banks have to deposit at a designated local bank. The Working Group considers this as a market access restriction and would like to recommend to the regulator to lift this restriction.

Recommendation

- Eliminate the mandatory 30% deposit of working capital, or at least incorporate the 30% into the liquidity ratio calculations.
- Reduce the *renminbi* capital adequacy ratio for branches, or at least allow calculation on a consolidated basis for all Chinese branches of the same foreign legal entity, similar to locally-incorporated banks.
- Allow foreign locally-incorporated banks to take 30% of working capital deposits from other branches of foreign banks, on an equal basis with local banks.

6. Local Fund Agency

Concern

The business scope of foreign banks has gradually expanded under the entitlement of “national treatment” since the local incorporation of foreign banks in China. The Measures of Security Investment Fund Sales which was issued by CSRC in 2004 allow all commercial banks, security companies etc... to be the agent for local fund distribution, thus, locally-incorporated foreign funded banks are qualified to

be the local fund distribution agent. CBRC, in principle, agrees that locally-incorporated banks are qualified to be the agent of local fund distribution, but to date no specific rules, nor approval by CSRC has been granted.

Assessment

Foreign banks in overseas markets have a wealth of experience in fund agency sales. Overseas funds usually have a wider scope of fund investment objectives and goals compared with local funds. Therefore, foreign banks have already developed a mature system for fund selection and allocation, portfolio analysis and investor education. If this experience can be transferred into local fund agency sales, it will not only be a good reference for local banks to sell the funds and conduct wealth management business, but will also encourage financial innovation by local fund managers. Secondly, fund investment is an important wealth management tool for investors, playing a significant role in the financial planning process. To open local fund agency sales to foreign banks could better assist local investors to achieve their investment goals and to build upon their wealth management philosophy. Last but not least, from a risk control perspective, fund agency sales have developed into mature intermediary businesses for local banks, with a comprehensive regulatory and risk control system in place. To open local fund agency sales to foreign banks will not generate additional regulatory risks, but instead would represent a positive and significant move in the development of China's financial industry.

Recommendation

- Open local fund agency sales to foreign banks on an equal footing with Chinese banks.

7. Custody Business

Concern

Foreign bank Qualified Foreign Institutional Investors (QFII) custodians need to re-apply for QDII custodians' approval, whereas local bank QFII automatically qualify for QDII. Despite indications that existing custody licences will be grandfathered to banks that locally-incorporate, the Working Group is not aware of this rule having been formalised through regulation. This uncertainty raises the risk that a foreign banks' local entity is subject to the custody rule requiring RMB 8 billion (approximately EUR 862 million) capital in place for conducting custodian business.

Assessment

Setting up a QFII or a QDII custodian requires two steps: qualifying as a custodian and applying for a business licence. Under current legislation, domestic banks that have obtained QFII, or any other custodian approval, automatically qualify as QDII custodians. However, this rule does not apply to foreign QFII custodians, who have to apply for QDII custodian qualification before being eligible to apply for a business licence.

The RMB 8 billion paid-up capital is only required when the business licence is authorised. It is not applicable for the custody business of a China incorporated entity to conduct business, assuming that they are in possession of the related business licence. In this regard, the parent company's capital base should be allowed to apply for new custody business licences under the local incorporation model, unless the custody business of the Chinese incorporated entity is applying for a change of business permission to add new business licences. In this case, the RMB 8 billion capital requirement would be applied.

A number of custodian businesses that refer to the local market (e.g., insurance funds, trustee products, private equity funds, social security and pension funds) have been limited to local banks. So far no foreign bank has obtained a licence to manage such funds.

Recommendation

- Grant equal treatment to foreign banks and domestic banks with regards to QDII authorisation.
- Allow the parent company's capital base to apply for new custody business licenses under the local incorporation model. Licenses given before incorporation should be grandfathered.
- Allow locally-incorporated banks to obtain custody licenses to manage insurance funds, trustee products, private equity funds, social security and pension funds.

II. Operational Issues

1. Loan-to-Deposit Ratio (locally-incorporated banks)

Concern

The ratio level of 75% between balance of loans and balance of deposits will come into effect at the end of 2011. This will adversely affect the operations of small and medium-sized locally-incorporated banks, as well as discriminate against newly incorporated banks, as they have a small branch network and will have limited ability to gather deposits from the broader public.

Assessment

Article 39(2) of the Commercial Banking Law sets the loan to deposit ratio at 75%. This rule does not yet apply to locally-incorporated banks. They currently enjoy a grandfathering period until the end of 2011.

This ratio is uncommon in international practice as other ratios are considered more adequate and sufficient for controlling banks' operations, for example, 8% capital adequacy ratio and 25% liquidity ratio.

The Working Group would like to suggest broadening the definition of deposits to include other types, such as offshore *renminbi* and institutional deposits, rather than just the current consumer and corporate deposits.

In addition, the Working Group would like to see the grandfathering period applied as per date of incorporation instead of having a fixed deadline giving a comparative disadvantage to those banks that entered the market only recently. Not only do they face the difficulty of building a network to gather the deposits, they face the additional restriction of complying with this loan to deposit ratio. Therefore, the Working Group would like to see a transition period of five years from the date the *renminbi* retail licence is obtained.

Recommendation

- Broaden the definition of deposits used to compute the loan to deposit ratio.
- Foresee a transition period of five years for newly incorporated banks, starting from the day of incorporation, to comply with the loan to deposit ratio.

2. Account Opening Procedures

Concern

The addition of account opening procedures which were announced in late 2009 by CBRC Shanghai (and affecting foreign banks locally-incorporated in Shanghai nationally) may negatively impact business growth.

Assessment

Due to the *renminbi* fraud in the market in 2009, the CBRC Shanghai conducted a series of detailed measures relating to *renminbi* account opening procedures and rules. The high attention given to risk mitigation measures enforced by the CBRC Shanghai is greatly respected by the Working Group, however, Working Group members would like to make the following recommendations so as to ensure risk mitigation does not impact negatively on business growth.

Recommendation

- Allow Banks to enhance their own account opening risk control mechanism to prevent fraud. Banks will be ultimately liable, e.g. paying back the loss to the victim caused by the bank. This will prevent any negative impact on the clients and therefore avoid social instability.
- Allow a certain flexibility with regards to the detailed procedures based on the CBRC guidelines, as long as the ultimate goal of fraud-prevention can be achieved

3. Market-Driven and Principle-Based Lending Policies

Concern

The financial industry is still very much dependent on the government's macro-economic policies. This top-down approach on lending practices does not foster the development of risk management practices, nor does it educate the young credit culture to learn from its mistakes. As new lending assets more than doubled from a total of RMB 4.2 trillion in 2008 to RMB 9.6 trillion in 2009, and with first quarter loan growth reaching just under 35% of 2010 targets2, the government instituted three measures and one guidance policy to further strengthen risk lending practices.

The intent of the policy is indeed the basis of excellent prudent lending practices. However, as the policies are prescriptive rather than principle-based, the implementation has been inconsistent, thereby causing confusion for customers.

2 1st quarter lending in 2010 was RMB 2.6 trillion. PBOC's annual target for 2010 is RMB 7.5 trillion. All statistics retrieved from PBOC website (www.pbc.gov.cn), May 30, 2010

Assessment

In late November 2007, in order to ease over-heating in the economy and to control rising inflation, the PBOC orally requested that all banks with *renminbi* licences curb their *renminbi* lending for an indefinite period. Subsequently, with the financial crisis weighing on China's development and social stability, the authorities took massive and unprecedented steps to stimulate the economy – ahead of all other major economies. A much acclaimed RMB 4 trillion stimulus package was announced in November 2008 along with the removal of lending quotas, a reduction in reserve requirements and lower interest rates. All banks were urged to lend in order to keep China on its current development track. During the first four months of 2009, more money was lent than during the whole of 2008.

In previous Position Papers, the Working Group has questioned the oral communication method used and the lack of transparency that this process entailed. More fundamentally, however, the Working Group believes China should rely more on market driven lending practices. Indeed, the current practices could lead to moral hazard. Due to the relatively underdeveloped financial market, banks do not have a wide range of investment opportunities. They can lend to corporations or households and buy securities (the PBOC and the Ministry of Finance (MOF) issued instruments representing 90% of all securities on banks' balance sheets). In a competitive environment with low interest rates, the only option left for banks to meet their profit targets is to increase lending. At the same time, banks tend to use the time without quotas to lend as much as possible, in order to grow their assets base before new quotas are introduced.

The 2009 loan surge mainly reflects loans provided by the five State Owned Commercial Banks financing the big infrastructure projects of the stimulus package. However, a significant boom in property markets in most major

cities suggests that part of the added liquidity was diverted to asset markets. The PRC authorities have repeatedly voiced concern about this trend and have introduced new regulations to discourage misuse of loans. The three measures and one guidance is well intended in trying to discourage misuse of loans and to encourage better lending practices. However, the implementation has caused confusion in the marketplace as the measures are prescriptive rather than principle and needs-based. As every bank has different risk processes and also different risk standards, the policies subsequently adopted by different banks were also different and confusing. The authorities have also required the major banks to increase capital in anticipation of new Non-Performing Loans (NPLs) from the surge in new lending. Foreign banks mainly lend to multinational corporations and large companies and did not experience such a loan surge. Foreign banks' loan portfolios grew at 14% in 2009 compared to the 35% increase for Chinese banks.

Recommendation

- Adopt market driven lending practices to regulate loans portfolio growth and enhance transparency so as to reduce moral hazard risk.
- Adopt principle-driven measures and incentivise each bank to design and implement their own version of fixed asset and working capital loans on a risk-based analysis.

4. Foreign Debt Quota

Concern

In recent years the SAFE (and the National Development and Reform Commission (NDRC) for the medium/ long term quota) has significantly cut short-term foreign debt quota limits and stabilised (or slightly reduced) them for the current year. The trend for quota reduction goes against a trend of increasing foreign direct investment (FDI) that is the core activity of foreign banks. The access to liquidity given by foreign currency inter-bank international markets is of paramount importance for proper and prudent asset/ liabilities management. Foreign banks are concerned about funding genuine trade-related financing as the onshore foreign currency market is at a comparative disadvantage to the offshore market due to a lack of liquidity for tenor above the week.

Assessment

The Working Group recognises the government's priority to balance China's short-term and long-term foreign debt. The Working Group also recognises the value of several regulations in stemming the potential speculation on *renminbi* appreciation. The Working Group commends the new regulations that have been promulgated to remove lending for less than 90 days from the quota for trade-related uses. In addition, the Working Group understands SAFE's objective of moving away from offshore funding and towards onshore funding. Banks are also willing to move towards onshore funding (the introduction by the tax bureau of the withholding tax and the thin capitalization rule provide an "incentive" for this). However, until the onshore market presents a competitive and liquid position at tenor, up to at least one year, the possibility to access the international market will be done in a prudent manner. Clients that have genuine foreign currency funding needs see their related costs significantly increasing because foreign banks are unable to support their foreign currency funding requirements from inter-group sources. Not only are the small quotas a burden, the additional liquidity ratio requirement limits the available funding for clients. Removing the foreign currency quotas would certainly also support the development of Shanghai as an international financial centre.

Recommendation

- Increase (and ultimately remove) the short-term debt quota for genuine trade-related uses which are not affecting the money supply in China.
- Deepen onshore liquidity by putting in place market-based means of funding, with PBOC acting as lender of last resort, using international rates as a benchmark.

5. Prudential Ratios (branch)

Concern

The net of long-term borrowings financed from overseas branches are treated as current liabilities. This unnecessarily reduces the liquidity ratio as the current assets only cover short term lending.

Assessment

The purpose of liquidity ratios is to ensure a bank's ability to pay short-term obligations. To achieve this in an efficient manner, it is essential that the ratio captures actual solvency. It is international practice to compare assets and liabilities with the same tenor. In the absence of large retail customer deposits, foreign banks rely on overseas intra¬group funding, including long-term borrowings.

However, in China, the net of long-term borrowings from overseas branches are treated as current liability, thus reducing the liquidity ratio, although no immediate demand for repayment is given.

Recommendation

- Remove the net of long-term borrowings from overseas branches from the current liabilities, to compare assets and liabilities with the same tenor.

6. Taxation Issues

Concern

The levying of a 5% Business Tax (BT) on onshore and offshore lending, and a 10% Withholding tax on offshore funding, increases the costs of lending. The levying of a 5% withholding BT on all fees payable to overseas service providers impacts the competitiveness of the banking sector in China.

Assessment

No other country levies indirect taxes on funding and lending activities by domestically-registered banks. This impacts the competitiveness of the banking sector in China, and ultimately leads to increased costs which then need to be passed on to the customer receiving the loan.

The levying of a 5% withholding BT on all fees payable to overseas service providers (services rendered by head office or external vendors such as SWIFT, IT system services providers, etc...) was introduced in 2009. This also leads to increased operational costs which, ultimately, also need to be passed on to clients.

Recommendation

- Waive the 5% Business Tax on onshore and offshore lending.
- Waive the 10% Withholding Tax on offshore funding.
- Waive the 5% Withholding BT levied on service payments to overseas service providers.

7. Data Processing System Location (locally-incorporated banks)

Concern

Foreign banks are required to relocate their data processing systems onshore before receiving the bank card licence. This requirement causes concern not only from the point of view of bank cards, but also for other banking products and services.

Assessment

The members of the Working Group are concerned about Section 13(3) of the Draft Bank Card Policy shared by the PBOC with individual banks in April 2007. It states that one of the necessary conditions required is "to build within China data processing systems which can meet the technical standards asked for by the business and possess the technology to protect information security." This requirement seems to be slightly different from the existing regulation. According to Section 13(5) of the enforced bank card regulation, data processing systems should be safe and efficient, without specifying where they should be located. The Working Group understands the regulators' concern in mitigating security and infrastructure risks. The importance of business continuity cannot be underestimated and is viewed very seriously by all our members. The recent dramatic earthquakes in Sichuan, or in Taiwan some years back, are sad reminders of the utmost importance of contingency planning and business continuity. The Working Group therefore understands the regulators' request to protect domestic customers by locating data processing systems onshore.

However, the Working Group believes that the location of the data centre is neither the most critical, nor the sole condition to mitigating infrastructure risks, and that the focus should be on the building of an entire business continuity plan.

Most financial institutions, especially those with a global presence, have all set up large scale regional processing centres to centrally handle transaction data around the world. At the same time, they have set up back-up data centres in other locations that manage the activities should a major disaster occur. This set-up is using today's state of the art technology, and avoids the huge costs of having to set up data centres in every country in which the financial company is operating. Setting up a specific China platform would represent considerable extra costs for international banks. Not only does this increase investment costs, it also affects the overall operations of a financial institution, as running different systems is operationally less efficient. Working with different local databases and systems in a global IT architecture increases operational risk and costs, as systems will tend to be administered separately. It is important to find a right balance between operational efficiency, data security, infrastructure costs and business continuity.

In addition, if banks are only allowed to provide bank cards when they have onshore systems, this puts foreign bank at a competitive disadvantage compared to domestic banks whose headquarters and main business operations are in China. This is not beneficial to the market development and enhancement of consumer services, as foreign banks are in a position to bring over new products and expertise to push the market forward in China.

Recommendation

- Maintain section 13.5 of the current existing bank card policy stating data processing systems should be "safe and efficient" without specifying where they should be located.
- Apply the principles of "safe and efficient" rather than location-specific rules for databases relating to all banking products and services.

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Providing organisations with the advice they need, wherever they may be located, our highly qualified, experienced professionals listen to different points of view to help organisations solve their business issues and identify and maximise the opportunities they seek. Our industry specialisation allows us to help co-create solutions with our clients for their sector of interest.

We are located in these cities: Beijing, Hong Kong, Shanghai, Singapore, Taipei, Chongqing, Chungli, Dalian, Guangzhou, Hangzhou, Hsinchu, Kaohsiung, Macau, Nanjing, Ningbo, Qingdao, Shenzhen, Suzhou, Taichung, Tainan, Tianjin, Xiamen and Xi'an.

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The on-going transformation of the financial services industry, through the key drivers of technology and capital markets, is dramatic and complex. As legal barriers fall between the various components in the industry, the financial services sector is being shaped by megatrends such as convergence, consolidation and globalisation. Each of these megatrends has a significant impact on the way our clients manage and think about their businesses.

We have the largest specialist financial services practice in mainland China and Hong Kong. Our strategy is to bring significant business advantage to our clients through combining our global multidisciplinary teams, integrated across industry sectors, geographies and functional skills to bring our global best practices and creative problem-solving skills to bear.

PwC China has been at the forefront in working with banks in mainland China to reform their governance standards and systems, whether as auditor or advisor. To guide these and other banks through the challenging process of restructuring, we developed the China Bank Reform Roadmap, which outlines the operational restructuring, financial re-engineering and financial reporting changes needed to prepare banks for the new environment, including policies and procedures that will create true transparency.

Following the CBRC's announced intention to apply the Basel II principles within its supervision framework for domestic banks, PwC China successfully integrated its collective global experience into tailored services for the local market. PwC is regarded as the leading advisory firm in assisting banks in planning for, implementing and obtaining benefits from the significant changes that will be required to give effect to Basel II readiness.

Some relevant PwC thought leadership and other publications include:

- Global private banking and wealth management survey (Jun 2011)
- Banking in 2050 (May 2011)
- 6th Banking newsletter for the China banking community – Analysis of major banks' results for 2010 (May 2011)
- Asia's outlook for non-core and non-performing loan portfolios (May 2011)
- A closer look: The Dodd-Frank Wall Street reform and consumer protection act (May 2011)
- The Journal – Breaking the Ice: Using transparency and accountability to thaw the securitisation markets (Apr 2011)
- FS Viewpoint – Getting to know you: Building a customer centric business model for retail banks (Apr 2011)
- FS Viewpoint – When the growing gets tough: How retail banks can thrive in a disruptive, mobile, regulated world (Mar 2011)
- Too good to fail: Defining the new gold standard for risk management in financial services (March 2011)
- Digital transformation – Engaging customers through social media (Feb 2011)
- 14th Annual Global CEO Survey – Banking and Capital Markets summary (Feb 2011)
- Insight – Surviving to thriving: Improving revenues and profits in the new banking environment 2011
- CBI/PwC Financial Services Survey (Dec 2010)
- The Journal – Capital management in banking: The way forward (Dec 2010)
- Banking & capital markets tax issues in Asia Pacific (volume 3) (Nov 2010)
- Chinese bankers survey (Oct 2010)

Services we offer

Audit and Assurance

- Actuarial services
- Assistance on capital market transactions
- Corporate reporting improvement
- Financial reporting
- Financial statement audit
- IFRS reporting
- Regulatory compliance and reporting

Risk & Controls Solutions

- IT risk & governance
- ERP controls & project assurance
- Information security
- Data assurance
- C-SOX and s404 advisory
- Internal controls consulting
- XBRL
- Business resilience and risk management
- Fraud risk & controls
- Sustainability & climate change
- Integrated reporting
- Third party assurance
- Internal audit & corporate governance

Crisis Management

- Business recovery services (for services primarily outside the US)
- Dispute analysis & investigations
- Forensics

Finance Consulting

- Finance function visioning, design, implementation & transformation

Human Resources Consulting

- International assignments
- Incentives & rewards
- HR function strategy, design & transformation
- Corporate culture & change management

Operations Consulting

- Shared services & outsourcing
- Strategic procurement
- Revenue growth
- Supply chain management

Risk Consulting

- Design, implementation & transformation of risk, governance & compliance functions & capabilities

Strategy Consulting

- Corporate & business unit strategy
- Portfolio management
- Financial & business economics
- Market entry advice
- Modelling & business planning
- Regulation, competition & merger economics

Tax

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- Corporate tax compliance
- International assignments
- Mergers & acquisitions
- Transfer pricing
- Tax dispute resolution
- Tax incentive application/planning
- Tax function effectiveness
- Indirect tax planning and compliance

Technology Consulting

- IT transformation
- Enterprise architecture
- Application support
- Data management
- IT sourcing

Transactions

- Accounting valuations
- Advice on fundraising
- Bid support and bid defence services
- Commercial and market due diligence
- Financial due diligence
- Independent expert opinions
- Mergers & acquisitions advisory (buy and sell)
- Post deal services
- Private equity advice
- Project finance
- Privatisation advice
- Tax valuations

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