



Chapter VI

Financial Safety Net and Financial Infrastructure

Prudential financial supervision, the central bank's function as the lender of last resort, and deposit insurance system constitute the main institutional arrangements of the financial safety net in most countries. In China, political guarantee is the strongest pillar of financial safety net and the natural barrier and advantage to maintain financial stability with Chinese characteristics. Financial infrastructure building in payment and settlement system, legal system, accounting standards, credit system, anti-money laundering system and others are also important aspects to maintain financial stability and security.

Financial Safety Net

Political guarantee

The most important political guarantee of maintaining financial stability and security in China includes followings: The CPC Central Committee and the State Council attach great importance to and provide leadership on financial stability. Local governments at all levels pay a great attention and actively respond to the situations related to financial stability. Relevant authorities work in collaboration for implementation. In recent years, local governments at all levels conduct the Scientific Concept of Development, overcome the difficulties and earnestly take the responsibility of maintaining local financial stability and have done a lot of effective work in line with the require-

ments of building a harmonious society.

Effectively prevent and mitigate financial risks, earnestly maintain financial stability.

Local governments at all levels earnestly take the responsibility for safeguarding local financial and social stability and make an active effort to raise funds for proper disposal of financial risks. In 2006, breakthroughs in disposal of financial risks have been made. First, the disposal of banking sector's risks went on smoothly. Efforts were made to improve the effectiveness of emergency plans. Continue to promote classified disposal of UCCs, properly solve the historical legacy issues in high risk RCCs. Continue to complete the rectification and risk mitigation of the trust business, closing down Jinxin Trust and Investment Corp. and Jilin Pan Asia Trust and Investment Company for rectification according to the law. The *Supplementary Provisions on the Policy of Purchasing Individual Claims of Financial Institutions* was released for the smooth and orderly conduct of individual claims acquisition. Second, the disposal of securities financial institutions' risks pushed forward smoothly. Efforts were made to continue to push forward the comprehensive restructure of securities companies and urge them to resolve outstanding issues. The relevant authorities and local governments worked together to restructure Tiantong Securities, Southwest Securities, Xinjiang Securities, etc. . Some other companies were restructured in accordance with market principles. During the period of comprehensive restructure, a total of 31 high-risk securities companies were disposed. Meanwhile, the government accel-

erated the implementation of the third-party custodian system for clients' securities transaction and settlement funds, new treasury bonds repurchase system and other basic systems.

Active endeavors were made to guide the reform of RCCs.

In line with the requirements of the *Pilot Plan on Further Reform of RCCs* issued by the State Council in 2003, the historical burden of rural credit cooperatives should be digested by the central government, local governments and RCCs together in order to mitigate the risks of RCCs. Central government's support policies include fiscal policy, tax policy and the central bank's financial support. Local governments' major support policies include direct fund support, high-quality assets replacement and assistance in clearing and collection of NPLs. Moreover, according to the State Council requirement on "local governments responsible for the management of credit cooperatives", the provincial governments take the management responsibilities for RCCs through the formation of provincial-level joint cooperatives. Thanks to the joint efforts of the central and local governments and relevant authorities, the historical burden of the rural credit cooperatives had been initially shaken off, with financial risks under control, rapid development of various businesses, noticeable improvement of business conditions, and intensified support to agriculture development.

The financial ecosystem has been improved. To create a favorable financial environment and to maintain financial stability and social stability are the requirements of the CPC

Central Committee and State Council for local governments at all levels. Local governments at all levels gave classified guidance suited to local specific conditions and extended pilot programs to comprehensively promote financial ecosystem, mainly reflecting in the following three aspects: First, a government-led working mechanism for the construction of the local financial ecosystem began to take shape. Local governments issued special guidance to financial ecological environment construction, and developed plans for building social credit system. Financial ecosystem construction as a working target was included in government performance appraisal. In some areas, a local government-led endeavor to build financial security zone with close cooperation of relevant authorities and participation of the financial sector and community, made significant progress and created a good environment for the economic and financial operations. Second, efforts were intensified to build model communities of sound financial ecological environment to stimulate and improve community financial services. In rural areas, the financial ecological environment construction and the promotion of farmer micro-credit and mutually guaranteed loans were closely integrated; the establishment of trustworthy county and trustworthy town went on deeply. In urban areas, active endeavors were made to develop micro-credit business for community residents, the self-employed, laid-off employees and unemployed workers and students, which having combined the construction of financial ecological environment with the improvement of the community residents' access to loans. Third,

Local financial legal environment further improved. Efforts were increased to strengthen judicial and law enforcement to overcome local protectionism. Communication and contacts gradually deepened between local courts and the financial sector. The law enforcement had been strengthened in the lawsuits case involving financial institutions. Enforcement ra-

tio of financial lawsuits was improved by a large margin, and financial debt evasion activities had been effectively curbed. Efforts were made to crack down on all kinds of illegal financial institutions and illegal financial activities and other financial crimes in order to protect the legitimate rights and interests of investors and financial institutions.

Box 15 Management of a City Commercial Bank Payment Risk and Its Implication

On June 6, 2006, a newspaper published false reports that a city commercial bank was warned by regulatory authority due to its poor risk management and that the bank would be asked to exit market. The news spread quickly and caused panic among many citizens who were misinformed, and triggered off a bank run. On June 14, the bank deposits dropped RMB 241 million yuan in net value, and excess required reserve was only RMB 21 million yuan. The bank run turned into a real payment risk.

Local government and relevant authorities attached great importance to the incident, launching the financial emergency plans in time, setting up a leading group for risk disposal, putting forth disposal measures, and endeavored to promote the efficiency of organization and coordination to ensure timely information disclosure. First, they gave play to the media through television and other forms and carried out policy propagation and positive guidance which quickly stabilized the situation. Second, the commercial bank

was allowed to use its required reserve to meet payment needs, which was vital to restore public confidence and played an important role. After the storm subsided, the relevant parties actively studied the fundamental risk prevention measures and urged the commercial banks to adjust asset structure, enhanced liquidity and improved its capability for risk prevention and mitigation.

There're some implications emerging from the occurrence of this incident and the rapid and effective disposal. First, full play should be given to local government in dealing with the financial risks. During the disposal, the local government played a core role in organizing, coordinating and upholding the correct guidance over public opinion which effectively controlled the incident from spreading and provided strong support for the rapid and steady disposal of the risks. Second, it is necessary to strengthen the coordination of emergency mechanism and improve the financial emergency response plan. The parties concerned should perform their

duties respectively and work together closely, and make positive response to guarantee the proper settlement of financial risks. Third, early disposal measures for failed financial institutions should be adopted by the relevant authorities. Financial institutions should also have accurate market positioning,

adjust and optimize the credit structure, improve liquidity ratio and enhance payment ability under emergent situation. Fourth, it is necessary to expedite the establishment of a deposit insurance system so as to improve the assistance mechanism in the crisis and prevent the spread of the banking crisis.

Financial regulation

In 2006, there were marked improvement and enhancement in financial regulation and supervision related to the institution building, regulatory ways and means.

Banking regulatory authorities focused on developing effective supervision and continually improving the regulatory system, ways and means. First, further improved the legal system and related regulatory policies. The amendment to *the Banking Regulation and Supervision Law* gave relevant regulatory authorities the extension of the inspective power. There had been a big breakthrough in banking regulatory means. The promulgation and implementation of the *Commercial Banks Compliance Risk Management Guidelines* and the revised *Regulations on Administration of Foreign-funded Banks* further improved the banking regulatory framework. Second, implementation of the *New Basel Capital Accord* enhanced the level of banking risk management. For large commercial banks operating with overseas agencies and whose international business accounted for a considerable proportion, the regulatory authorities clearly demanded the implementation of the

new Basel Capital Accord from the end of 2010 in order to apply strict capital control system and improve risk prevention capacity. Third, active endeavors were made to improve the commercial banks' corporate governance and strengthen information disclosure. In accordance with the requirements of a modern enterprise system, the major commercial banks made the initial construction of the corporate governance framework, and market discipline and transparency for the banking sector were further strengthened. Fourth, regulatory ways and means were improved, and the regulatory capacity was strengthened. Off-site supervision had been reinforced. Particularly, the monitoring information system started to operate, which further improved the regulatory infrastructure. On-site inspections focused on fields, businesses and agencies with potential risks, and highlighted the concept of sustained risk control. There was a more transparent and standardized market access regulatory framework. In particular, while regulatory authority relaxed rural financial institutions access policy, supplemented measures were enhanced to strengthen supervision of the various risks.

Securities regulatory authorities took it

a central task to protect the legitimate rights and interests of medium and small investors, improved the fundamental system, further intensified supervision, and improved the efficiency of law enforcement. First, further improved the securities regulatory system of laws and regulations. According to the *Company Law* and the *Securities Law*, efforts were made to review, revise and perfect the existing laws and regulations. *Rules on Supervision and Regulation of Listed Companies* and *Rules on Supervision and Regulation of Securities Firms* and other administrative statutes regulations were drafted, *Administrative Measures for the Listed Companies Securities Issuance* and other regulations and standardized documents were enacted or amended, which basically formed the regulatory system of laws and regulations in support of the *Company Law* and the *Securities Law*. Second, actively built consolidated supervision system over listed companies in which various authorities and local governments jointly participated. Enhanced mechanism building for information sharing and emergency risk management regarding listed companies. Preliminary results were achieved in cleaning up the illegal use of listed company funds. Third, strengthened risk control over securities companies with net capital monitoring as the core. By the end of 2006, 92% of securities firms in the country had met overall indicator requirement in risk control and the industry had improved its standardized level of operation. Fourth, further enhanced the level of regulation and enforcement efficiency, and conducted enforce-

ment power on securities supervision given by the *Securities Law*, improving auditing efficiency in the lawsuits. There were concentrated efforts to prosecute a number of major cases including the Kelong Electronics and Guangdong Securities and the effectiveness of law enforcement had taken effect. Fifth, further enhanced the role of Securities Investor Protection Fund in dealing with the risks of securities firm. In 2006, the Securities Investment Protection Fund made an active effort to raise funds to compensate and acquire the shortfall of the customer transaction and settlement funds, and individual claims for 9 disposed securities firms.

Insurance regulatory authorities strengthened infrastructure construction, improved regulation, and enhanced risk prevention capacity continuously. First, strengthened institution construction, and introduced the *Administrative Provisions on the Post-holding Qualifications of Directors and Senior Managers of Insurance Companies*, *Regulations on Administration of Insurance Salespersons*, *Trial Guidelines on Regulating Corporate Governance of Insurance Companies*, *Provisions on Investment-linked Actuarial Systems* and *Universal Insurance Actuarial Requirements* and others to regulate the development of the insurance industry. Second, actively guided the insurance industry to strengthen self-discipline, and guided the insurance industry associations to formulate guidelines for development of large commercial insurance, accident insurance, regular life insurance and other types of insurance. Third, strengthened the regulation over

the market behavior, payment capacities and corporate governance. To address the prominent problems concerning the development of the insurance industry, a nationwide specific on-site inspection was carried out and efforts were made to actively promote the insurance company to increase capital and equity and issue subsidiary bonds to improve the solvency. Thorough inspection was made on management structure of 44 Chinese-funded insurance companies and relevant training was provided on corporate governance structure for company senior management.

The function of the lender of last resort and deposit insurance system construction

In dealing with the financial risks, PBC carries out the function as the lender of last resort according to the law, provides emergency help to financial institutions with temporary liquidity difficulties, and meanwhile upon approval by the State Council, provides risk disposal funding to high-risk financial institutions in times of business suspension for rectification, closure, and bankruptcy liquidation. To some extent, it assumes the implicit deposit insurance responsibility, which is vital to protect depositor's interests and maintain the social stability. With the development of the socialist market economy, the drawbacks for PBC to take implicit deposit insurance responsibility have become increasingly obvious. Particularly it is prone to result in moral hazard and is not conducive to long-term financial stability. So the implicit way should be turned into the explicit deposit insurance system as soon as possible.

In 2006, the deposit insurance system construction entered into the legislative stage. A working group was set up, and the comprehensive deposit insurance system design was launched.

Deposit insurance legislation is an important component of the deposit insurance system and is of great significance to China as it speeds up the deposit insurance system-building process and improves the soundness of market exit mechanism for financial institutions. First, regulating behavior of the stakeholders of deposit insurance system through the legislation is conducive to clarifying the rights and obligations of all interested parties. Second, mandatory and fair nature of legislation will contribute to better protection of the interests of the majority of depositors, promote small and medium-sized banks to strengthen risk prevention and maintain financial market stability and fairness. Third, legislation will give the deposit insurance system more authorities and transparency, and increase public trust in the deposit insurance system and banking sector. It will contribute to enabling the deposit insurance agencies to perform duties effectively and improve the deposit insurance system efficiency. Fourth, legislation will help standardize the laws on the market exit of China's financial institutions, better regulate market exit behavior of financial institutions and change the administrative-led financial institutions risk disposal modes.

On the basis of international experience, China's deposit insurance legislation should pay attention to the followings: First, protect

as much as possible the rights and interests of the small and medium-sized depositors and ensure depositors' confidence in the banking sector. Second, give the deposit insurance agencies necessary power and means to perform their mandates so as to ensure effective implementation of the deposit system. Third, clearly define the relations between deposit insurance institutions, regulatory authorities and other relevant institutions, and link up with other relevant legal system to ensure that the deposit insurance system runs smoothly.

After many years' study, to speed up the establishment of the deposit insurance system with Chinese characteristics has become a consensus. Deposit insurance system should cover all deposit-taking financial institutions and implement differential rates, limited coverage and timely disposal of risk. It is necessary to establish deposit insurance agencies with sound functions, rights and corresponding responsibilities, and effective operation in order to enhance risk awareness of financial institutions and depositors, and protect the legitimate rights and interests of depositors.

Investor education

Investor education means enhancing investor's understanding of financial products, financial services and financial institutions through a series of education and training, information services and other ways, guiding investors to establish a correct concept of investment and risk awareness and to enhance self-protection capabilities, and strengthening the market discipline over financial institutions through

investors' screening of financial products and financial institutions. To develop and strengthen investor education, establishing a "caveat emptor" investment philosophy is not only the basis for financial stability, but also necessary conditions to promote the healthy development of the financial industry and build a harmonious society.

China has always attached importance to investor education. In recent years, the financial authorities and local governments have adopted a variety of ways to popularize financial knowledge, reveal financial risks and improve the public's financial literacy. Since 2005, PBC has joined with local governments in major cities and organized large nonprofit financial knowledge exhibition, opened up financial knowledge columns on the news media and websites, held lectures on financial knowledge, conducted financial knowledge contests and other financial literacy education activities. In 2006, PBC published the *Financial Knowledge Book for Citizens* to popularize financial knowledge and donated more than 100 000 copies to rural areas, schools and communities. CBRC focused on the development of public education services network and public education services zones, edited and compiled professional brochure for financial products and sent professionals to provide consultation services on financial knowledge for the public. CSRC took investor education as its routine work, endeavors were made by securities companies and fund management firms and other securities intermediaries service agencies to reveal risk of stock, funds, stock index futures and other securities products.

SAC issued a *Notice on Deepening the Investor Education Work* to help investors to grasp the basic knowledge of the securities market and establish correct investment concepts. CIRC focused on insurances propagation and education, and together with the Ministry of Education jointly issued the *Guidelines on Strengthening Insurance Education in Schools* and made it clear to include insurance education in the national education system. Three Entries activities were held in Anhui Province, Dalian City and other regions to make insurance enter schools, communities and rural areas. Nearly one million people participated in the contests on insurance integrity education and other activities.

Along with China's steady and rapid economic development, social productive forces, overall national strength and people's living standards improve comprehensively and individual financial assets increased significantly. Investor education has become an urgent task. As systemic and long-term task, the investor education should be pushed ahead by all levels of governmental bodies, financial institutions and communities together.

Financial Infrastructure Construction

Payment system

In 2006, significant progress was made in the building of China's payment system. The payment and settlement network continuously improved, with CNAPS as the core, internal

payment system of banking financial institutions as the foundation and bills payment systems and bank card payment system as important components. The payment system played an important role in preventing payment risks and maintaining financial stability.

The LVPS system of PBC operated well and RPS was completed. After the completion of the LVPS system of PBC, it was linked to the internal payment system within the banking financial institutions, the central bonds integrated business systems, the bank card payment system, RMB inter-bank operating system, foreign exchange trading system and other systems, as well as linked to Hong Kong and Macao RMB clearing banks, which provided safe and efficient payment and settlement services to banking financial institutions and financial markets. In 2006, there were 140 million payment and clearing transactions with the amount reaching RMB 257.5 trillion yuan. In June 2006, PBC established RPS, which provided a low-cost and common payment platform for the banking financial institutions in the small amount, bulk-volume and inter-bank settlement business and provided clients with all-weather, safe and efficient payment and settlement services.

Functions of the payment system were upgraded. To effectively prevent liquidity risk and credit risk in payment system, in 2006, PBC opened automatic impawn financing functions in the LVPS system and the impawn management functions in RPS, which upgraded and improved CNAPS functions and provided more facilitation to commercial banks

for more flexible management of funds. It was of major significance to prevent liquidity risk and credit risk of payment system and maintain financial stability. Meanwhile, the pilot operation of nationwide check image exchange system succeeded in December 2006 in six

provinces (municipalities) of Beijing, Tianjin, Shanghai, Guangdong, Hebei and Shenzhen, provided facilitation for the nationwide use of checks and gave full play to the role of check in promoting the economic and social development.

Box 16 Payment System Automatic Pledge Financing Mechanism

The liquidity management has a major impact on the payment system. Low liquidity results in insufficient clearing account balances, which will affect the timely processing of payment business and social capital turnover; over high liquidity results in a large balance reserve in the settlement accounts which will increase the cost of funds for participants, affecting the profitability of commercial banks and the use of social capital. Therefore, many countries in the world have emphasized the responsibilities and obligations of the central bank in payment systems. Providing day financing facilities for participants is the main duty the central bank should implement and normally composed of impawn financing and day overdraft. Pledge financing, which is secured by the assets, is generally used by the central banks of various countries.

CNAPS automatic pledge financing refers to the mechanism that in the case of the banking financial institutions' settlement accounts in payment system is insufficient in daylight position, they can pledge bonds to PBC to finance the shortfall through the au-

tomatic pledge financing, the pledged bonds will be automatically returned as soon as the commercial banks pay back the money. Before the launching of automatic pledge financing, CNAPS adopted a liquidity risk control mechanism of daylight queuing or end-of-day rejection towards business having settlement account shortfall. However, this mechanism has the following weakness: On the one hand, when the liquidity of participants is insufficient, it is often resolved by fund transfer from upper-level bank, inter-bank offering or application to PBC for temporary loan, which likely to cause low financing efficiency and the payment system settlement efficiency will be affected as well. On the other hand, in order to deal with insufficient liquidity, banking institutions have to deposit a large amount of excess reserve in PBC and the cost of funds is therefore increased. Under such circumstance, PBC should improve management system of payment system liquidity to provide daylight financing facility to participants.

In recent years, all nationwide banking financial institutions and the majority of local

banking financial institutions have already had the settlement qualification in the inter-bank bond market with the development of bond markets. Meanwhile, in November 2004, the central bonds integrated business system was connected to LVPS, realizing DVP. All above composed the necessary conditions to launching automatic pledge fi-

nancing mechanism. China's automatic pledge financing business has achieved automatic bond pledge, financing, repayment and release of pledged assets by relying on modern payment system, centralized accounting system of Central Bank and the centralized securities integrated business system.

Internal payment systems of banking institutions work well. To comply with the needs of market competition, some large banks increased technical and financial input in order to improve financial services and to raise the overall strength, built centralized and efficient internal payment system orderly, and further improved the business processing capacity. In 2006, inter-bank payment system of banking institutions handled a total of 1.53 billion payment transactions with the value of RMB 225.6 trillion yuan. The number and the value of businesses accounted for 40% and 40.8% of the total payment systems businesses respectively.

Payment system construction has been continuously strengthened. To establish a sound system of laws and regulations is an important factor to prevent payment risk and strengthen the supervision. In 2006, PBC actively promoted the development of payment system, and pushed forward the amendment to *Negotiable Instruments Law*, made effort to introduce the *Regulations on Bank Cards* and the *Administrative Rules on Payment and Settlement Institutions*. PBC formulated and released *Opinions on Promoting the Develop-*

ment of Commercial Acceptance Bill Business, Administrative Rules on Hong Kong RMB Check Business and a series of guidelines and rules in order to further regulate the payment services market.

Legal environment

In 2006, the socialist legal system with Chinese characteristics achieved significant progress. The *Enterprise Bankruptcy Law*, *Amendment to the Criminal Law (VI)*, *Anti-Money Laundering Law*, *Company Law*, *Securities Law* and a number of other dominant laws were enacted and implemented orderly. Operating rules and the basic system building of the financial industry had been further enhanced. The legal environment maintaining financial stability and financial security has improved significantly.

The *Enterprise Bankruptcy Law* laid the legal foundation for the disposal of risks and market exit of financial institutions. The *Enterprise Bankruptcy Law* set provisions on market players for market exit and reentry, thus improving the market economy rules. Its scope of application was expanded to all corporate entities, including commer-

cial banks, securities companies, insurance companies and other financial institutions. It stipulates that the regulatory and administrative departments under the State Council has the authority to file application to the courts for reorganization or bankruptcy liquidation of failed financial institutions and authorize the State Council to formulate the regulations on bankruptcy of financial institutions. These provisions changed the administration-led risk disposal mode of financial institutions and provided powerful legal support for the prevention of financial risks and maintenance of financial stability.

Amendment to the Criminal Law (VI) supplemented and improved legal measures combating the economic and financial crimes. On the one hand, the following crimes were added to the *Criminal Law*: crimes of hollowing listed companies, crimes of fraudulent obtaining of loans from financial institutions, credit crimes, bankruptcy fraud crimes and financial institutions violation of fiduciary obligations, unauthorized use of client funds. The amendment stipulated more severe penalties on crimes of manipulation of securities and futures market. On the other hand, adjustment was made on what constituted certain financial and economic crimes, which made enforcement more operational. The SCNPC also amended the *Banking Regulation and Supervision Law*, which authorizes banking regulatory authorities to investigate related institutions and individuals in addition to the banking financial institutions. These adjustments contribute to investigate and punish financial law-breaking cases more effi-

ciently, and intensify the crackdown on financial crimes. They play an important role in strengthening market discipline, maintaining the market order, improving market environment and strengthening public confidence.

Anti-Money Laundering Act further defined the administration system of China's anti-money laundering. It clearly laid down the responsibilities of anti-money laundering authorities and relevant departments, and stipulated the anti-money laundering obligations of financial institutions and other high-risk industries prone to money laundering activities. It also laid down principles of international cooperation in anti-money laundering. The law has an important role in effectively preventing and combating money laundering crimes and in safeguarding the normal financial and economic order.

The rules of operation of the financial industry were further refined and administration according to the law was enhanced. To fulfill China's WTO access commitments, the State Council promulgated the *Regulations on Administration of Foreign-funded Banks* and removed all non-prudential market access restrictions on foreign banks. The Central Bank and financial regulation authorities strengthened basic system construction, formulated and drafted over a hundred regulations and regulatory documents on macro-control, financial market, financial services and financial supervision to improve the efficiency of administrative law enforcement, and to strengthen law enforcement. The *Company Law* and the *Securities Law* came

into force in 2006 played an active role in promoting the development of the financial industry and the financial market.

In 2006, the 10th SCNPC also considered the drafted *Property Law* and *Enterprise Income Tax Law*. Introduction of the two laws will strengthen the legal protection of basic civil rights, and it is of great significance to further improve the market economy legal system in China and to promote sound development of the financial ecosystem.

Accounting and auditing standards

In February 2006, MOF issued 39 enterprise accounting standards and 48 certified accountants auditing standards. The listed companies started to conduct the new enterprise accounting standards from January 1, 2007, and CPA auditing standards system's implementation started since January 1, 2007 for accounting firms in China. The publication and implementation of the two standards marked the establishment of enterprise accounting standards system and certified accountants auditing standards system in China, which meet the requirements of the development of China market economy and are in line with the international practices.

The new enterprise accounting standards consist of one basic standard, 38 specific standards and relevant application guidelines. Compared with the original standards, the new enterprise accounting standards were improved in the following areas: First, they adopted mixed computing mode of fair value and historical cost in order to better reflect the various

risks and the time value of money, and to improve the relevance of asset and liability information. Second, the classification of financial assets and liabilities is based on the intention to hold, which requires that enterprises should have a clear investment strategy in the initial transaction and strengthen the link between accounting policy and investment decisions. Third, original off-balance sheet items such as derivative financial instruments, options, futures and options are included in the sheet, which contribute to timely and fully reflect their intrinsic value at risk and their impact on financial conditions and business results of the enterprises. Fourth, the estimated present value of future cash flow is used to determine the value of financial assets impairment, which can provide more accurate information and reflect the true value of the loan. Fifth, certain accounting standards are applied to some important and special sectors and hedge accounting is used increasingly. Sixth, some accounting policies were changed, such as the provision that non-financial assets impairment may not be reconverted, the abolition the LIFO inventory valuation and tax payable method, permission of debts restructuring revenue to be included in the non-operating income, and so on. Seventh, more and higher requirements for the information disclosure were exerted concerning the earnings per share, presentation of financial instruments, etc., adopting a series of reporting standards for improving the chain of the information disclosure. All of these will further protect the legitimate rights and interests of investors and strengthen the market discipline.

The new CPA auditing standards system draws upon the latest results of the international auditing system theories and practices, putting more stringent requirements upon business quality control, auditing procedures and working papers. It reflected requirements of convergence with the international auditing standards and met the CPA's professional needs arising from the new situation. The new system will enable the CPA to work harder, endeavor to prevent auditing risks, and continuously improve the service qualities to provide better system guarantee to safeguard the public interests.

Credit environment

Continuous improvement of the credit environment plays a critical role in the maintenance of normal social and economic order, and prevention and mitigation financial risks. Credit rating and credit system development are important aspects of credit environment building. Through the provision of credit information products, credit lending party or buyer of financial products will obtain knowledge of the financial status of applicant or sellers of the product, which will help solve the problem of asymmetric information in financial transactions, prevent credit risks and maintain financial stability.

Credit rating industry continued to develop in a healthy manner. Credit ratings provides independent, objective and impartial evaluation and judgment of credit records, management, financial status and other elements of economic players, financial instruments and other social organizations,

and therefore, provides an evidence for decision-making of investors and plays an important role in strengthening the market discipline and safeguarding financial security. China's credit rating industry started in the 1980s with bond rating, and was growing in strength with the development of the capital market. In March 2006, PBC promulgated the *Credit Rating Administration Guidelines*, which brought uniformity and standardization to credit rating agencies' practices and guided rating agencies to establish a sound and scientific credit rating system. After that, the credit rating standards for the credit market and the inter-bank bond market were issued, and the rating industry continued to develop in a solid manner.

Credit system building made significant progress. A uniform and integrated national enterprises and individuals credit information database started nationwide network operation in January and July 2006 respectively, and established a credit file of more than 500 million individuals and more than 10 million enterprises accordingly. The database network spans the country, achieving real-time sharing of credit information among all financial institutions in the country. It played an important role in preventing credit risk in financial institutions and protecting lawful rights and interests of enterprises and individuals.

Anti-money laundering

In 2006, the legal system against money laundering in China has made significant progress. Noticeable progress was made in international cooperation against money laundering. Coordination

dination and cooperation mechanism were continuously improved and banking institutions also significantly strengthened anti-money laundering efforts.

The legal system and international cooperation against money laundering made significant progress. In October 2006, the *Anti-Money Laundering Law* was enacted which further improved anti-money laundering legal system. According to the *Anti-Money Laundering Law*, *Rules for Anti-Money Laundering by Financial Institutions* and *Administrative Rules for the Reporting by Financial Institutions of Large-value and Suspicious Transactions* were published. Important changes were made to prior relevant rules and regulations. The targets of monitoring and subject of obligations for anti-money laundering were extended from banking institutions to securities, futures, insurance and others, and anti-money laundering management in the local and foreign currency was unified. In November 2006, FATF conducted on-site assessment of China and China's accession to FATF made significant progress.

Improve coordination mechanism in anti-money laundering work to achieve unified management of anti-money laundering in the local and foreign currency. Efforts were made to further strengthen the communication and cooperation in anti-money laundering. Most provinces (municipalities and autonomous regions) and separately listed cities established coordination mechanism between relevant governmental departments regarding anti-money laundering. In

the first half of 2006, PBC and SAFE launched and completed the transfer of the work of SAFE to PBC concerning anti-money laundering functions, agencies, staff and information systems to achieve unified management in the anti-money laundering in local and foreign currencies.

Banking institutions strengthened anti-money laundering efforts significantly.

First, they established and perfected the organization system of anti-money laundering to coordinate the implementation of concrete tasks in anti-money laundering. Second, following the principles of compliance and prudence, an anti-money laundering internal control system was basically established and the accountability for anti-money laundering were clearly defined. Third, customer due diligence investigation was launched and examination of customer accounts data authenticity and integrity was strengthened. Fourth, the implementation of reporting system of large and suspicious transactions was basically implemented, and the mechanisms of reporting to the next higher level were completed with development and application of computer systems. Fifth, anti-money laundering legislation, advocacy and skills training were launched in most institutions.

Supervisory measures of anti-money laundering were further improved and supervisory capabilities were enhanced. In 2006, according to the requirements of institutionalizing and standardizing, supervision and management was strengthened on financial institutions regarding anti-money

laundering and active efforts were made to explore the establishment of effective anti-money laundering regulatory framework suited to

China's national conditions and to achieve integration of off-site monitoring and on-site inspection.

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