



# **Chapter V**

## ***Financial Infrastructure***

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In 2007, China's financial infrastructure construction made progress in many aspects: the payment system progressed steadily, the building of the legal framework made great headway, the new enterprise accounting standards system was implemented smoothly, the credit environment was noticeably improved, and anti-money laundering made new breakthroughs, all playing a positive role in promoting healthy and stable performance of the financial sector and safeguarding financial security.

## Payment System

In 2007, China's payment system progressed steadily, witnessing new developments in institutional building, broader usage of non-cash payment instruments, better supervision and good progress in the Olympics-friendly payment environment.

### *The Payment System Building Made Steady Headway*

**The LVPS and BEPS performed well.** In 2007, as the “artery” for inter-bank fund transfer in China, the LVPS run by PBC operated well, handling 171.883 million inter-bank payment and clearing transactions totaling RMB 504.2 trillion yuan, hence providing safe and efficient payment services for banking financial institutions and the financial market. The BEPS, as a public platform for bulk cost-effective inter-bank payment and clearing business, operated well and launched

new operations closely related to people's daily life, thus providing all-climate, safe and efficient payment services for inter-bank deposits and withdrawals.

**Functions of the payment system were enhanced.** In May 2007, PBC completed and put into operation the payment management information system used for collecting data from the CNAPS and monitoring its operations, providing a new way for PBC to oversee in real time the liquidity in the banking system and a new channel for banking financial institutions to strengthen their liquidity management. In the first half of 2007, the National Check Image Exchange System was completed and put into operation, making checks cashable nationwide and facilitating inter-city fund transfer and settlement. In addition, PBC started the building of a central bank accounting data centralization system and inter-bank foreign currency settlement system in China.

**The building of intra-bank payment systems was pushed ahead continuously.** In order to improve financial services and survive market competition, major banking financial institutions built and operated centralized and efficient intra-bank payment systems of their own, to improve their capacity of processing payment transactions, and create conditions for improving customer-oriented payment services, product parameters management and business innovation. At the same time, under the coordination and support of PBC, provincial rural credit associations stepped up efforts in connecting urban and ru-

ral credit cooperatives and in upgrading their internal integrated business systems, hence bringing the payment system of urban and rural credit cooperatives up to a new level.

**Non-cash payment instruments were used in more areas.** In 2007, in order to promote non-cash payment instruments, PBC promulgated and implemented the *Notice on Improving Individual Payment and Settlement Services*, worked with the Ministry of Finance to promote the use of corporate cards, improved bank card services tailored for migrant workers and the negotiable instruments businesses. In 2007, a total of 15.45 billion non-cash payment transactions were processed, worth RMB 593 trillion yuan, up 19.7% and 26.3% respectively y-o-y. The negotiable instruments business was innovated and grew in volume, playing a positive role in reducing transaction cost, raising fund and nurturing credit; the environment for bank card acceptance continued to improve, and the coverage of small and medium-sized designated merchants and bank card-based consumption rose continuously; with the growing demand for

convenient and fast payment services, online payment, telephone payment, mobile payment and other new payment instruments also developed rapidly.

**Payment system oversight was further strengthened.** The payment system oversight targeting “safety and efficiency” was further institutionalized. First, payment and settlement-related regulations were promulgated and improved, the revision of *Regulations on Bank Card*, *Administrative Rules on Payment and Clearing Organizations* and *Electronic Payment Guidelines (No. 2)* made new progress. Second, PBC updated the RMB bank settlement account management system, providing a new approach for improving the management of bank settlement accounts. Third, in collaboration with MPS, PBC completed the promotional campaign of networked identification verification system across China, providing a convenient technology for banking financial institutions to verify clients’ identification, hence conducive to rooting out corruption, bribery, tax evasion, money laundering and other illegal activities.

### Box 8 Building an Olympics-friendly Payment Environment

China will host the XXIX Olympic Games in 2008, so the building of an Olympics-friendly payment environment becomes an important part of Olympics infrastructure construction. In March 2007, PBC and other concerning authorities established the Leading Group for Olympics Payment Environment (hereinafter referred to as “Leading

Group”) to coordinate related policy measures and resources. The Leading Group set the overall objective of building a convenient, satisfied, safe and efficient Olympics-friendly environment, and identified the following priorities: first, to provide convenient account services for the International Olympics Committee, national or regional

Olympics committees, foreign media, sponsors, sports organizations and other foreign entities on the list of BOCOG and individuals who will be in China during the Games; second, to improve the bank card acceptance environment, satisfy the payment demand of Chinese and foreign cardholders when they are in China in the duration of the Games, reinforce bank card risk management to ensure security; third, to expand non-cash payment functions such as foreign currency exchange, bank card, traveler's checks and electronic transfer; fourth, to guarantee the safe and stable operation of various payment systems and make

sure that the payment environment in the host cities can meet actual demand. After that, six cities hosting Olympics events including Beijing, Shanghai, Tianjin, Qingdao, Shenyang and Qinhuangdao organized their own coordinating agencies responsible for the building of Olympics-friendly payment environment, clarified objectives and measures, and drafted plans concerning bank card, accounts, foreign currency exchange and cash services to coordinate and carry forward the building of Olympics-friendly payment environment in their respective regions. At present, various undertakings proceed smoothly with noticeable results.

### *Speed Up the Building of a Safe and Efficient Modern Payment System*

In recent years, China's economy has been developing rapidly. Ever increasing economic strength and comprehensive national strength raise higher requirements for the development of the payment system. Efforts of building a safe and efficient modern payment system should aim to promote sustained economic growth, achieve efficient transmission of monetary policies and maintain financial stability, improve payment efficiency and service quality, broaden the scope of payment services and satisfy diverse requirements for payment services.

**Further improve the payment system infrastructure construction.** More economic transactions and the rapid development of the financial market need better payment

system infrastructure. As such, PBC will embark on the construction of a central bank accounting data centralization system to adapt to the shift from the accounting style to the management style and meet the requirements of the central bank for accounting management, accounting services, accounting information and risk control. At the same time, a foreign currency payment system will be established in China to ensure the efficiency and safety of inter-bank foreign currency payment and settlement.

**Continue to improve intra-bank payment systems run by banking financial institutions.** Payment service quality varies greatly among banking financial institutions. Small and medium-sized financial institutions are less capable to provide payment services and therefore susceptible to the intense competition with foreign financial institutions and

payment and clearing organizations when China opens up to the outside world. Banking financial institutions should continue to improve their intra-bank payment systems, establish effective internal control and risk control mechanisms, guarantee safe and stable operation, improve payment services and strengthen their own core competitiveness.

**Promote the development of non-cash payment instruments.** Non-cash payment instruments only account for a relatively small share in the payment instruments system, and their penetration ratio in small and medium-sized cities is low. Besides, there are such problems as non-standardized operations. Going forward, efforts should be made to promote the development of the negotiable instruments business by intensifying technological innovation, improving issuance and transaction, and nurturing the development of entities specialized in negotiable instruments businesses; to forcefully develop bank card services by improving bank card acceptance environment, increasing acquisition of small and medium-sized merchants and bank card consumption, and strengthening risk management; to encourage innovations in e-payment, improve relevant processing systems and operations standards so as to ensure the healthy development of electronic payment.

**Improve the oversight of payment and settlement.** The legal framework concerning payment and settlement needs to be improved. Payment and settlement oversight needs to be strengthened. The prevention of payment risks remains an arduous task. PBC will actively

push forward the institutional building, speed up the revision of the *Negotiable Instruments Law*, and the establishment of the *Regulations on Bank Card* and the *Administrative Rules on Payment and Clearing Organizations*, innovate supervisory methods, urge banking financial institutions to improve risk management, and effectively supervise and evaluate payment risks aided by the analysis of payment information.

## Legal System

The legal system building made great progress in 2007, with a number of important laws and regulations instituted or amended, the capacity of governmental governance by law strengthened, the judicial environment improved. All of these provide a more solid legal foundation for the creation of a safe and orderly financial eco-environment.

### *Great Progress Made in the Legal System Building*

**The *Property Law* provides a legal basis for the improvement of property system.** The *Property Law* was passed on March 16, 2007 and became effective on October 1, 2007. It is a basic law regulating property relations in the civil domain, and the regulations on ownership, usufruct rights and security interests are fundamental for the socialist market economy, and conducive to the improvement of China's property rights framework and the socialist market economic system.

**The *Enterprise Income Tax Law* reflects the principles of tax-burden fairness and fair market competition.** The *Enterprise Income Tax Law* came into force on January 1, 2008 after its passage on March 16, 2007. It treats Chinese enterprises and foreign-invested enterprises equally in terms of tax burden, improves policies concerning tax deduction and preferential tax rate, and standardizes administration of enterprise income tax collection, hence conducive to nurturing fair competition among enterprises and optimizing the industrial structure.

**The *Contingency Law to Emergencies* is the first law in China on contingencies.**

The *Contingency Law to Emergencies* was passed on August 30, 2007 and took effect on November 1, 2007. It defines the classification of emergent events, classification standards, responsibilities of governments at various levels when emergencies occur, obligations of citizens, legal persons and other organizations for emergent events, emergency prevention, monitoring, early-warning, response plans and post-emergence relief, etc. The promulgation of the *Law* can help effectively control, mitigate and eliminate serious social hazards, regulate responses to contingencies and safeguard the state safety, public security, environmental security as well as social and economic order of the state.

**The *Anti-Monopoly Law* is conducive to the improvement and development of market economy.** The *Anti-Monopoly Law* was passed on August 30, 2007 and will enter into effect on August 1, 2008. It prescribes in

separate chapters stipulations on forbidding signing agreements on monopoly, forbidding abusing the monopolizing position, constraining the centralization of market players and forbidding the abuse of administrative power to exclude or restrict competition. The *Law* also has stipulations governing anti-monopoly law enforcement agencies, anti-monopoly investigation and legal obligations. As a basic law safeguarding the market economic order, the *Law* can help eliminate the damage of monopoly to market economy, enhance enterprises' competitiveness, promote the concept and culture of competition and safeguard the legitimate rights and interests of market players and consumers, thus conducive to the further improvement of the market economy.

**Other related laws and regulations were improved.** The passage and implementation of the draft amendment of *Civil Procedure Law* can help protect the litigation right of civil subjects. The *Labor Contract Law* provides a legal basis for improving labor and social security, establishing and developing harmonious industrial relations. The *Administrative Regulations on Futures Trading* regulates futures trading activities, and strengthens supervision over futures trading. In addition, concerning authorities have established a series of rules and measures in accordance with relevant laws and regulations to make the latter more operable and authoritative. Such rules include the *Administrative Measures for Financial Institutions' Report of Transactions Suspected of Financing for Terrorist Purposes*, *Measures on the Administration of Client Identity Identification and Materials and Transaction Re-*

*cording of Financial Institutions, Measures for the Registration of Pledge Receivables, Measures for the Administration of Futures Exchange and Administrative Measures for Futures Companies, etc.*

**Administrative law enforcement capacity was further enhanced.** First, the *Decree of Government Information Openness* was issued to improve information transparency of government agencies. Second, all the prevailing but outdated administration rules and regulations were scrapped, and a second round of cleaning-up was conducted to items subject to administrative approval by the State Council, in order to forcefully push ahead the reform of the administrative approval system. Third, the administrative review system was improved to put in play the system's role in solving administrative disputes, making governments law-minded and building a socialist harmonious society. Fourth, the cooperation among various government agencies was strengthened, with a joint ministerial conference mechanism established to handle illegal fund-raising, and a so-

cial credit system created to safeguard the normal social and economic order and protect the legitimate rights and interests of general public. Fifth, the *Regulations on the Punishment of Civil Servants of Administrative Organs* was established to regulate behaviors of civil servants and ensure that administrative organs and their civil servants perform duties in accordance with laws.

**The judicial environment became better.** First, judicial interpretation was made to the *Criminal Law*, the *Enterprise Bankruptcy Law* and other laws to improve the integrity and operability of laws and regulations. Second, judicial regulations governing judiciary organs were standardized, the open trial principle was implemented more forcefully and the open trial system was further improved. Third, judicial enforcement efforts were intensified to investigate and punish criminal activities such as refusal to honor court verdicts and arbitration awards and perverting of course of justice so as to maintain judicial authoritative-ness.

### **Box 9 The Property Law and Its Significance for the Development of Financial Sector**

The drafting of the *Property Law* was commenced in 1993, and the Law was finally passed on the fifth session of the 10<sup>th</sup> National People's Congress in March 2007 after several rounds of review before taking effect on October 1 in the same year. The *Property Law* is an important part of the civil law, and part of

the socialist legal system with Chinese characteristics. It thus bears great significance for improving basic economic system of China and socialist market economy, materializing and safeguarding the fundamental interests of the vast majority of people and invigorating the creativity of society.

The main content of the *Law* includes: equal protection of state ownership, collective ownership and private ownership; creation, change, transfer and elimination of property rights; definition of state, collective and private ownership; stipulations of usufruct rights (including the right to contractual operation of land, the right to use construction land, the right to use house foundation and easement); stipulations of the security interests and amendments to the *Guarantee Law*; and provisions of ownership acquisition.

The most direct impact of the *Property Law* on the financial sector development is that it can improve the institutions of security interests in the following areas: it allows borrowers to use chattels or claims to properties such as existing or future manufacturing equipment, raw materials, semi-finished

products, finished products, accounts receivable, and subscribed fund as security to apply for loans, so that the scope of eligible guarantee is expanded; at the same time, the *Law* clearly defines the registration department of chattels and claims to properties. The expansion of properties that can be used as guarantee, on the one hand, helps financial institutions to make innovations, expand their business scope, and reduce to some extent financial risks accumulated due to the over-reliance on realities so as to reduce the NPL ratio; on the other hand, it can help solve the difficulties of small and medium-sized enterprises to get loans, expand the coverage of credit market so as to promote its development. In addition, the clarification of registry makes operable the guarantee with non-transferable chattels and claims to properties, thus conducive to the realization of security interests.

### *Efforts Needed to Improve the Financial Legal System*

The building of financial legal system should reflect the requirements of socialist market economy development, and focus on outstanding problems impacting the healthy development of financial sector. In the future, in order to safeguard the healthy and stable performance of financial sector, great endeavors should be made to strengthen the building of financial legal system and promote the continuous improvement of financial legal environment. First, the *Anti-money Laundering Law*

should be enforced in an all-round manner, and the legal framework governing anti-money laundering should be improved so as to earnestly push forward the anti-money laundering work in the financial sector. At the same time, efforts should be made to revise or adjust the stipulations in the *Criminal Law* about the anti-money laundering crime and the terrorist financing crime by making the provisions more operable, improving the efficiency of investigation, litigation and ruling of the two crimes. Second, *Regulations on Deposit Insurance* should be speedily drafted to regulate behaviors of stakeholders in the deposit in-

insurance system through legal means, promote the establishment of insurance deposit system so as to stimulate small and medium-sized banking financial institutions to strengthen risk prevention and maintain the equity and stability of financial market. Third, efforts should be made to accelerate the building of social credit system by issuing *Regulations on Credit Information Management*, which will provide a legal basis for the improvement of credit environment. Fourth, efforts should also be made to create a sound market exit mechanism, to define the rights and obligations of financial operators, creditors, supervisors, the central bank, local governments and other players involved, to clarify specific methods, standards, procedures, debt servicing principles related to market exit mechanism in accordance with the *Enterprise Bankruptcy Law*, so as to strengthen market discipline over financial institutions and maximally protect the rights and interests of depositors and investors. Fifth, continuous endeavors should be made to improve the legal system guaranteeing the coordination mechanism among different financial regulators, enhance information sharing and provide a benign supervisory and regulatory environment for financial development and innovation.

## Accounting Standards

The new enterprise accounting standards issued in 2006 brought China's accounting system in line with IFRS, marking a milestone in

China's accounting reform, and conducive to further improvement of China's socialist market economy. It also helps China to open up wider and further to the outside world and accelerates Chinese enterprises' integration into the world economy.

### *The New Enterprise Accounting Standards System and its Influence on Financial Institutions*

All listed companies, together with 24 large central enterprises, adopted the new accounting system on January 1, 2007, and all the other central enterprises will fully adopt the system by the end of 2008. In a breakdown by financial institutions, securities companies, fund management companies and futures brokerage companies commenced the new accounting system on January 1, 2007, securities investment funds on July 1, 2007, insurance financial institutions on January 1, 2007, while banking financial institutions, as required by supervisory authority, adopted the new system according to their business characteristics and financial status in a layered manner, but the entire banking industry is expected to use the new standards in financial reports no later than 2009. Therefore, all of Chinese financial institutions will have adopted the new enterprise accounting system no later than 2009. Judged from how the new system is implemented since 2007, the transition from the old system to the new one was smooth.

**The quality and transparency of accounting information is improved.** Pursuant to the new accounting system, financial institutions should disclose more risk manage-

ment policies, quantitative and qualitative information about their risk profiles. The disclosure can fully reveal risks and provide useful data for operating and decision-making. First, financial institutions no longer presented financial assets and liabilities in terms of liquidity, but re-categorized all the financial assets and liabilities according to the intent of ownership in accordance with the new system. The new categorization is more scientific and directly reflects risk management objectives of senior management. Second, the inclusion of financial derivatives business into balance sheet can disclose risks, profits and losses of derivatives trading more comprehensively. Third, the new requirements of accounting and information disclosure related to hedging, transfer of financial assets and etc. fill the absence of standardized rules in these areas, providing a basis for accurate handling of the relevant businesses. Fourth, the introduction of the concept of fair value improves the relevance and timeliness of financial enterprises' accounting information, disclosing quantitative information about their operational performance, financial standing and risk management. Therefore, the new system is in line with risk management practice of international financial institutions, and will improve market disciplines and information transparency.

**The internal management mechanism of financial institutions starts to change fundamentally.** The new accounting system prompts financial institutions to comprehensively review the prevailing accounting standards, bookkeeping and reporting systems, intensify personnel training, and overhaul or re-

vamp the basic accounting policies, risk management procedure, business process flow and information support system. For example, ICBC upgraded the RMB and foreign currency bond system alongside the introduction of fair value calculation model, and developed a management system for loan impairment provisioning to adapt to the changes of provisioning methods. CCB revised stipulations on the accounting of equity investment, debt assets, and updated relevant systems. BOCOM introduced a back-office system of capital, which is used to process bond transactions, inter-bank borrowing, foreign exchange purchase and sale and derivatives trading.

### *Efforts Needed to Carry Forward the Effective Implementation of the New Enterprise Accounting System*

The implementation of new enterprise accounting system covers various areas such as institutional arrangements, technical preparation, personnel qualifications, coordination between supervisory and taxation policies, and should be improved step by step so as to enhance the effectiveness.

**Improve the quality of accounting information disclosure.** The new accounting system has more demanding requirements of information disclosure. Though supervisory authorities have also proposed arrangements for information disclosure of listed companies, the continuous supervision mechanism and follow-up system of information disclosure should be improved, and the information collection, analysis, correction and punishment systems should also be further improved so as

to enhance the quality of information disclosure in line with concerning requirements of the new accounting system.

**Prudently use the fair value.** In most cases, fair value cannot be acquired directly, but has to be estimated and validated through valuation techniques. The selection of models and parameter hypothesis is sometimes subjective, and sometimes inconsistent among different institutions. At the same time, fair value is susceptible to economic cycles and market changes. The reliability of fair value needs to be improved because China's financial market still lags behind that of developed countries. Therefore, financial institutions should use fair value prudently, and establish a stable and more reliable model of their own to value relevant financial instruments and ensure the accuracy and reliability of fair value calculation.

**Promote the upgrading of internal systems and improve staff's professionalism.** The implementation of new accounting system touches upon the re-programming of management functions, risk management policies and procedures, and the establishment and improvement of financial instrument valuation techniques, all exerting relatively high pressure on the upgrading of existing systems. In addition, the new accounting system is more rules-based, and requires higher professionalism. As such, it is critical for the implementation of new accounting system to establish a corresponding internal management system and improve staff's professionalism.

**Strengthen the coordination between**

**supervisory policies and taxation policies.** The new accounting system enhances the effectiveness of risk supervision and tax management, but it also requires concerning supervisory and taxation policies to be adjusted accordingly. For example, banks' capital adequacy ratio, securities companies' net capital, insurance companies' solvency and other supervisory indicators are calculated according to adjusted accounting data, therefore, the changes in the new accounting system about categorization, confirmation and calculation methods of financial assets and liabilities make it necessary to change relevant supervisory policies on accounting data in order to prevent volatility of supervisory indicators. In addition, the new system also relates to the calculation of enterprise income tax and business tax. Clarification might be needed in relevant tax laws.

## Credit Environment

In 2007, China's credit environment improved noticeably, characterized by a more sound legal framework, a greater role of the credit information system and stronger awareness of credit in society, hence conducive to the improvement of financial eco-system and the healthy development of economy.

### *The Credit Environment Improved Noticeably*

**The relevant legal framework was improved.** The passage and enforcement of *Property Law* further improved the system of

security interests, expanded the scope of properties that can be used as security, providing an institutional foundation for small and medium-sized enterprises to overcome the difficulty of getting loans and financial institutions to make innovations. On October 1, 2007 when the *Property Law* came into force, PBC launched its registration system of pledge receivables registration designed on basis of modern chattel guarantee registration system, creating favorable conditions for commercial banks and other financial institutions to conduct financing business with pledge receivables. At the same time, the *Enterprise Bankruptcy Law* that entered into force on June 1, 2007 makes it clear that secured creditors have priority claim. The provision, while protecting the rights of creditors, also protects the financing right of borrowers.

**The credit information system played an important role.** PBC organized commercial banks to establish a credit information database for enterprises and individuals, which has become an important infrastructure of economic and financial system, and has been playing an increasingly important role in preventing credit risks, expanding credit scope, improving social credit environment and maintaining economic and financial stability. As of the end of 2007, credit records were created for more than 13 million enterprises and nearly 600 million natural persons. The credit information database provided 30 million and 140 million credit reports of enterprises and individuals respectively in cumulative terms to government agencies, financial institutions, enterprises and individuals.

**Social credit awareness gradually improved.** The building of credit information system can help commercial banks to access clients' credit information more comprehensively and improve their management of lending business. Some commercial banks have included inquiry into the database an indispensable step in the electronic loan management process, to achieve quantitative management of credit risks concerning individuals and small and medium-sized enterprises as well as automatic online collection of default loans. A survey of information supervisors in 500 financial institutions showed that in the first half of 2007, commercial banks rejected 2.2% of loan applications from enterprises and 2.5% loan applications from individuals after making inquiries into the database. Credit risks were prevented effectively. At the same time, enterprises and individuals paid greater attention to their credit records. As of the end of 2007, nearly 1.03 million people took the initiative to check their personal credit reports. After checking credit records, some enterprises and individuals repaid bank loans and were more aware of social credit.

#### *Further Improve Social Credit Environment*

The building of credit environment in China has made substantive progress, but strenuous efforts should be made in legal framework, institutional building and public education to further improve social credit environment.

**Strengthen the legal framework.** Credit information activities may involve state secrets, business secrets and private secrets of individual citizens. Therefore, well-defined

laws and rules are needed to regulate such activities. But at present, there are no state-level laws on credit information activities, but only rules issued by central government departments and by-laws issued by local governments. This situation is not conducive to the sustained and healthy development of credit information activities. In the next step, urgent efforts should be made to promulgate laws and regulations governing information collection, storage, compilation, processing and usage, to strengthen protection of rights and interests of information subjects and to prevent illicit collection and misuse of credit information.

#### **Speed up the building of a credit information system by pooling resources.**

The improvement of credit environment is a systematic project, and involves various aspects of economic life. So it is difficult for any individual government department to promote it. Moreover, it is quite common that enterprises operate and individuals move across provinces, so regional credit information database cannot fully cover their credit status, and cannot display its due role in preventing credit risks and improving social credit. Therefore, coordination and cooperation among different government authorities are needed to establish a nationwide and centralized credit information system, maximally save social resources and improve credit environment.

**Establish and improve a punishment mechanism on discredit.** The nationwide and centralized credit information system for enterprises and individuals should be used to

promote the use of enterprises and individuals' credit reports in bank loan application, commercial transactions and job hunting, to urge enterprises and individuals to pay attention to their credit records in various economic activities, to build an efficient punishment mechanism on discredit so as to lay down a micro-economic foundation for the improvement of social credit environment. At the same time, credit education should be strengthened to improve public's awareness of credit, create benign environment for the building of social credit system and cultivate modern credit culture.

## **Anti-money Laundering**

In 2007, the anti-money laundering work made groundbreaking progress, which was demonstrated in the promulgation of a series of anti-money laundering laws and regulations, China's membership of the FATF, the discovery and hand-over of a large volume of clues to suspicious transactions, and good results in anti-money laundering investigation and assisted investigation of related crimes.

### *Anti-money Laundering Made Breakthrough Progress*

**The legal framework governing anti-money laundering was improved.** The year 2007 marked the first year since the promulgation of the *Anti-money Laundering Law*. In order to make the Law more oper-

able, PBC, after revising and releasing the *Provisions on Anti-money Laundering through Financial Institutions* and the *Administrative Rules for the Reporting by Financial Institutions of Large-Value and Suspicious Transactions* in November 2006, promulgated the *Administrative Measures for Financial Institutions' Report of Transactions Suspected of Financing for Terrorist Purposes*, worked with concerning supervisory authorities to jointly issue the *Measures on the Administration of Client Identity Identification and Materials and Transaction Recording of Financial Institutions*, and released the *Detailed Rules for Anti-money Laundering Investigations (for Trial Implementation)*, the *Administrative Measures for the On-site Inspections for Anti-money Laundering (for Trial Implementation)* and the *Off-site Anti-money Laundering Supervision Measures (for Trial Implementation)* in 2007. These documents specify the anti-

money laundering obligations of financial institutions, clarify PBC's supervisory obligations for anti-money laundering and related operational procedure, and further improve the legal framework governing anti-money laundering.

### **International cooperation in anti-money laundering and counter terrorist financing was actively pursued.**

In June 2007, the third meeting of the 18<sup>th</sup> plenum reviewed and passed the assessment report of the AML/CTF measures in place in China, and agreed to admit China as a full member. In addition, China actively engaged itself in the work of the Euro-Asia Group (EAG) on AML and CTF, and deepened the cooperation and intelligence exchange with EAG members. At the same time, China sought to resume its membership of the Asia-Pacific Group (APG) on AML and CTF.

### **Box 10 China's FATF Membership**

FATF is an international organization specialized in containing money-laundering activities. It has 34 members (including 32 countries and regions and 2 international organizations) and over 20 observers (including 8 FATF-like regional anti-money laundering agencies and over 10 other international organizations and institutions). FATF is mainly responsible for promulgating standards on AML/CTF, promoting and supervising AML/CTF policy measures in place in individual countries on the national

and international levels, and cooperating with other international organizations to combat money laundering and terrorist financing activities. The 40 recommendations on AML and 9 special recommendations on CTF revised by FATF in June 2003, having been recognized by the UN Security Council, the IMF, the WB and other international organizations and national governments, have become guiding documents on AML/CTF, and the core standards in these two areas.

In the precondition of safeguarding China's sovereignty, China actively applied for FATF membership. In 2004, China expressed its willingness to join FATF, and became FATF observer in January 2005. On June 28, 2007, on the third meeting of the 18<sup>th</sup> plenum, China was accepted as a full member. A new chapter of China's international cooperation in anti-money laundering was opened.

China's FATF membership is very important for China to deepen international cooperation in AML/CTF, effectively combat money laundering, corruption and other criminal activities and maintain financial stability. First, the membership can help China to erect its image as a responsible big country in AML/CTF, to participate in the promulgation of and voting on international

standards and rules in this area, and to safeguard national interests in a more constructive manner. Second, the membership can promote international cooperation in AML/CTF, improving the efficiency in cracking down on illicit fund transfer across borders and chasing flight capital. Third, it signals that China's AML/CTF system has been basically in line with international criteria, thus beneficial for Chinese financial institutions to "go out" and to get equal treatment as their counterparts in other FATF member countries in global market. Fourth, it is conducive to improving China's AML/CTF system, and promoting financial institutions to strengthen risk control, operate in a sound manner, and improve the professionalism in preventing and combating money-laundering and terrorist financing activities.

**The anti-money laundering coordination mechanism was continuously improved.** In accordance with the *Anti-money Laundering Law* and relevant regulations on the work division of joint ministerial conference on anti-money laundering, PBC revised the System of the Joint Ministerial Conference on Anti-money Laundering, adjusted and increased the membership of joint ministerial conference, clarified the responsibilities of concerning departments in anti-money laundering, and improved the coordination mechanism. PBC also connected its network with the identity information inquiry system run by MPS, and handed over a large number of clues to suspicious transactions to MPS.

**Anti-money laundering investigation and assisted case investigation achieved good results.** The China Anti-money Laundering Monitoring and Analysis Center expanded the scope of fund to be monitored. On the basis of fund monitoring network covering banking sector, securities and futures sector as well as insurance sector were connected to the Center in October 2007 and began to report large-value and suspicious transactions. With the deepening of anti-money laundering regulation and fund monitoring, anti-money laundering investigation and assisted investigation achieved good results. In the process of fund monitoring, PBC reported 554 cases to investigative authority based on discovered clues to

suspicious transactions, worth RMB 229.5 billion yuan.

### *Promoting Anti-money Laundering Work*

China made rapid progress in anti-money laundering and achieved good results in some important areas, but in comparison with international standards, there is still room for improvement in the working mechanism, supervisory capacity and international cooperation.

**The anti-money laundering working mechanism needs to be improved.** The *Anti-money Laundering Law* only has general provisions on the administrative system, the responsibilities of supervisory authority, obligations of financial institutions, and criminal investigation into anti-money laundering. When the *Law* is enforced, it is necessary to improve the anti-money laundering working mechanism, establish a standardized and effective investigative system, adjust and regulate the relationship between PBC and public security authority, financial regulators and other related authorities, so as to create synergy to improve work efficiency and intensify the efforts to crack down on money laundering crimes.

**The supervisory capacity of anti-money laundering should be improved.** PBC needs to standardize its anti-money laundering inspection methods, and the system of off-site inspection indicators and off-site supervisory system should be improved. The anti-money laundering work of banking financial institu-

tions focus on modul compliances, and only a small number of suspicious transactions are reported based on subjective judgment further. Therefore, the analysis and monitoring capacity of banking financial institutions should be strengthened and the value of their monitoring intelligence should be increased. At the same time, the anti-money laundering inspection of securities, futures and insurance sector should be improved. Efforts should be made to expand the scope of anti-money laundering regulation, and study and launch the AML/CTF in such sectors as lawyers, real estate and lottery.

**The international cooperation in anti-money laundering should be broadened.** When expanding business and establishing branch offices in overseas market, Chinese financial institutions should establish an AML/CTF system in line with the relevant regulations of host countries. Moreover, with more and more foreign financial institutions setting up branches in China, it is necessary to closely watch and supervise their legal compliance. In addition, international cooperation should be strengthened. Efforts should be made to improve the AML/CTF framework according to FATF requirements, so as to reach the criteria in the FATF 40 + 9 recommendations; to strengthen exchange with foreign anti-money laundering authorities, to broaden cooperation with foreign FIU, and to establish and improve a mechanism that prevents and combats cross-border transfer of illicit fund.

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