



Chapter VI

Management of Systemic Financial Risks

International experiences have shown that it is not unusual to have difficulties or crises, either big or small, in the economic field especially in the financial field. Financial risks may either be generated from the financial sector itself or a mirror image of various problems of the whole social and economic system reflected in the financial system. In order to avoid devastating impact of systemic financial risks on the financial sector, economy and society, it is imperative to improve the ex-ante prevention and ex-post response mechanism. Since the reform and opening-up, China has accumulated experiences in managing financial risks, but is still in need of improving its ability of managing systemic financial risks to fend off and dissolve major risks threatening financial stability.

Systemic Financial Risks and Their Generation Channels

Systemic financial risks refer to financial risks that pass from one institution onto others, or from one market onto many others and therefore make the whole financial system extremely vulnerable. Systemic financial risks are abrupt, contagious and have externalities. Occurrence of systemic financial risks might disable financial institutions, financial markets and financial infrastructure from performing such key functions as risk management, resources allocation, payment and settlement. In extreme cases, systemic financial risks may trig-

ger financial crises and rock the entire national economy.

In general, there are two channels where systemic financial risks are generated: the first is endogenous, mainly from accumulated risks of financial institutions, financial market turbulence and poor financial infrastructure; the second is exogenous, from unstable factors in the macro economy and the impact of emergent events.

Endogenous Channels for Systemic Financial Risks

Accumulation of risks of financial institutions. Risks here mainly refer to various financial risks facing financial institutions, such as credit risks, market risks, liquidity risks, operational risks and legal risks. Their accumulation might lead to failure of individual financial institutions. Due to the contagious nature of bankruptcy of financial institutions especially banks, the failure of individual banking institution might induce the “Domino Effect” and paralyze a large number of banks and even the whole financial system.

Financial market turbulence. A financial market plays an important role in macroeconomic adjustment and microeconomic management. Any turbulence in the financial market might endanger the stable performance of the entire financial system. Financial market turbulence is characterized by liquidity squeeze, reversal of market expectations and asset bubble burst.

Liquidity squeeze. Outbreak of various events bearing financial risks such as closedo-

wn of large financial institutions and asset price tumble might erode market confidence and drain market liquidity to an extent that systemic risks are triggered and the whole financial system is endangered.

Reversal of market expectations. In the process of persistent asset price spike, market confidence is likely to inflate, resulting in irrational behaviors of enterprises, households and financial institutions. As a result, the asset price bubble exacerbates and the risks of market correction intensify. Once the correction starts and market expectations reverse, the asset price bubble burst will accelerate or even the market will collapse.

Asset bubble burst. In general, whether asset price bubble burst will lead to systemic risks depends on how closely banks, the stock market and the real estate market are interconnected. If investors do not heavily rely on bank loans for financing, the major influence of a bubble burst is to reduce the wealth of enterprises and households, and its impact on the banking system will be relatively small, so the probability of systemic risks is low. On the contrary, if the capital that keeps on pushing up asset prices mainly comes from bank loans, a burst will severely exacerbate the quality of bank credit assets and lead to a credit crunch.

Poor financial infrastructure. This category of risks includes risks brought about by problems in the payment system, financial legal system, accounting standards, credit environment, and so on. Among these factors, the payment system is the core infrastructure

of the financial system, and its safety and efficiency directly relates to the effective operation of the whole financial system. Any disruption in the payment system might impact the entire financial system and trigger systemic financial risks.

With science and technology advancing and information technologies developing, financial products and instruments are improved rapidly, the trading volume in the financial market increases exponentially, international capital flows in ever-larger volume at faster speed, and financial activities are to a large extent segregated from activities in the real economy including production, trade and other activities. While helping individual institution to spread risks, financial innovation increases instability risks of the financial system, expands sources of systemic financial risks, and speeds up the transmission of financial risks across industry segments markets and borders.

Exogenous Channels for Systemic Financial Risks

Unstable factors in the macro-economy.

Factors such as inappropriate macroeconomic policies, structural imbalances and high inflation might severely rock the financial system. If there are no effective macroeconomic policies to address the problem in the balance of payments caused by an irrational economic structure, a currency crisis or a banking crisis is likely to occur when combined with certain situations such as hot money inflows. Inflation is one of the symptoms of macro-economic instability. When inflation is high, the interest

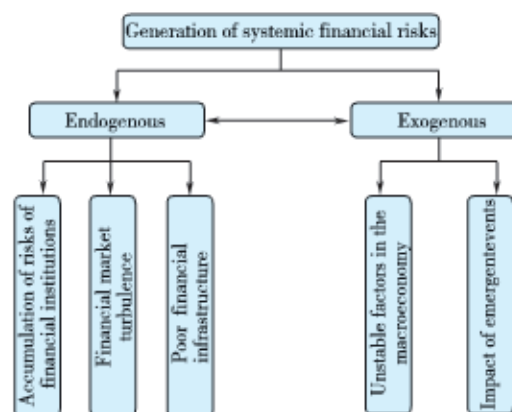
rate is usually negative. As a result, depositors withdraw money from banks, tightening banks' liquidity and worsening their profitability. Likewise, insurance companies face similar downside risks. High inflation also disturbs production and investment activities of enterprises, influences household consumption and living standards, or even endanger people's livelihood.

Impact of emergent events. All kinds of contingent political events (such as terrorist attacks and wars), natural disasters (earthquakes, floods and tsunamis) and bankruptcy of large-scale industrial companies are all likely to shatter market confidence and influence the normal operation of the whole financial system.

In practice, with increasing globalization and financial integration, domestic and foreign

financial institutions are more closely connected with one another, so endogenous and exogenous channels for systemic financial risks are increasingly intertwined and complex.

Figure 6.1 Channels for the Generation of Systemic Financial Risks



Box 11 The US Sub-prime Crisis and Its Impact

The US sub-prime crisis broke out in 2007 and spread to other markets in the world. During the crisis, sub-prime mortgage originating banks or specialized mortgage finance companies went bankrupt, and hedge funds, investment banks, commercial banks, insurance companies and other institutions that had purchased sub-prime mortgage derivatives suffered huge losses; the crisis spread to other debt products, putting pressure on balance sheets of large financial institutions, increasing write-downs and losses, shoring

up credit cost, substantially reducing commercial bills and resulting in a credit crunch; the crisis influenced household consumption and corporate investment in the US, weakening the housing market and slowing down the economic growth; the crisis even crept to the financial market, causing drastic fluctuations of interest rate in the international financial market and fluctuations of major stock indices; the growing spillover effect of the crisis aggregated increased downside risks in the global economy.

The causes of the sub-prime mortgage crisis are complicated, while one of which is slack risk management in the process of financial innovation. First, when originating mortgage loans, banks or specialized mortgage companies did not conduct rigorous examination, so there were potential risks that borrowers would default. Second, existing accounting methodology, information disclosure and pricing models of calculating fair value of sub-prime derivatives are flawed and cannot reflect the complexity and various risks of the derivative products. Third, some financial institutions do not have a sound corporate governance structure and good risk management, and pay inadequate attention to off-balance-sheet risks and liquidity risks, hence unable to fully predict the impact of losses stemming from sub-prime derivatives on their balance sheets. Fourth, credit rating methods employed by credit rating agencies did not fully reflect the full range of risks of sub-prime derivatives, and potential moral hazards and conflicts of interest were involved. Fifth, investors in the tail end of the derivative product chain were lack of relevant information and risk monitoring methods, so they relied heavily on ratings by credit rating agencies.

In order to deal with the financial turmoil and downside risks brought about by the sub-prime crisis, countries concerned took quick actions. First, liquidity injection.

From August 2007, the US Federal Reserve, the European Central Bank, the Bank of England, the Bank of Japan, the Reserve Bank of Australia and etc injected hundreds of billions of dollars into the market. Second, consecutive interest cuts. The Federal Reserve cut the Federal Fund rate by 225 basis points cumulatively on five occasions between September 18, 2007 and the end of the year. Third, government intervention. In a televised speech, the US president promised a package of government stimulus incentives to stop the crisis. Fourth, oversight and early warning on the housing credit market was tightened. Even though the above combined measures eased the negative impact of the sub-prime crisis on the financial market, the crisis' impact on the global economic and financial stability could not be underestimated.

The US sub-prime crisis shows that equal importance should be attached to innovation and risk prevention. We should draw on lessons from the crisis, but we should not suspend financial innovation because of its risky nature. Instead, a comprehensive understanding of the positive role of financial innovation including credit derivatives in spreading risks is needed, and financial innovation should be carried forward. At the same time, risk management should be reinforced to avoid institutional loopholes that might lead to systemic risks.

Management Framework of Systemic Financial Risks

Market failure and lack of efficiency caused by systemic financial risks will in the end harm the interests of all parties concerned. Therefore, it is necessary for the government to strengthen the management of systemic financial risks, which in general refers to government policies and measures on forestalling and dissolving systemic risks, including preventive management and response management.

Preventive Management

Deepen the institutional reform. To deal with weak links in the financial system, it is imperative to push forward reforms of the economic system, financial institutions, financial market, financial infrastructure and financial eco-environment. The combined reform programs can inject vitality into the financial industry and promote financial stability.

Consolidate the microeconomic foundation. Sound financial institutions are cornerstones for the prevention of systemic risks. Financial institutions need to improve their corporate governance and asset quality, strengthen risk management and the internal control mechanism, and enhance risk-proof capacity so as to become modern financial enterprises characterized by adequate capital, strict internal control, safe operation, satisfactory services and good profitability and international

competitiveness. In this way, a solid micro-economic foundation is built up.

Strengthen prudential supervision. Financial supervision can help to rectify financial market failure, reduce financial vulnerability, and promote financial institutions to improve corporate governance and protect the legitimate rights and interests of depositors, investors and the insured. Financial supervision includes oversight on financial institutions along the functional line and oversight on financial markets, and also systemic supervision of financial institutions and financial markets. Sound supervision over financial institutions along the functional line is the foundation for systemic supervision, while the latter supports the former.

The supervision over financial institutions along the functional line and oversight on the financial market is to oversee market entry, business operation and market exit of financial institutions, and the openness, equity and fairness of the financial market, and to promote financial institutions' soundness and efficiency of financial markets. Banking, securities and insurance regulatory authorities are the major agencies that perform these duties.

Systemic supervision covers the entire financial system in order to prevent systemic risks caused by problems of individual financial institutions and markets. Usually, central banks are the systemic risk regulators and exercise their role by using a combination of instruments including interest rate, exchange rate, open market operations, capital account management, central bank lending, payment sys-

tem support, guidance of public opinion or persuasion, and etc.

Tighten market discipline. Strict information disclosure, external auditing and rating systems as well as other market disciplinary systems can assist regulators, clients and investors in making accurate judgment of the capital position, profit margin and risk profiles. It can also serve as a stimulus for sound operation and effective risk management.

Response Management

Response management is also known as crisis management. When contingent systemic financial risks occur, the emergence response mechanism should be put into operation expediently to coordinate all the parties concerned closely. Crisis management measures should be taken to liquidate, close down or restructure insolvent financial institutions based on market principles in order to prevent potential systemic financial risks. Concrete measures include an inter-departmental coordination and emergency response mechanism, the role of central bank as the lender of the last resort, an investor protection system and a relief mechanism using the public finance.

An inter-departmental coordination and emergence response mechanism. Systemic financial risks are eruptive, wide-ranging and harmful, and therefore difficult to be dealt with by one single authority in a timely, efficient and cost-effective manner. The central bank, financial regulatory authorities and other governmental departments should put in place and improve a coordination and emer-

gence response mechanism among them to strengthen cooperation in crisis management and dissolve financial risks in a fast and prudent way.

The role of the central bank as the lender of the last resort. The role of the central bank as the lender of the last resort can be achieved in many ways, and two of them are the most commonly used. The first is direct assistance, where a central bank injects liquidity directly through open market operations, or renders liquidity support to temporarily distressed financial institutions that could influence the entire financial system but have basically sound financial standing and normal operation. This is the most frequently used method for the role of the lender of the last resort. The second is to send explicit signals that the central bank is ready to prop the market, so the market confidence can be restored. The function of the central bank as the lender of the last resort is very important in maintaining financial stability. This method can usually prevent temporarily distressed financial institutions from triggering systemic risks, and in crisis times can ease market liquidity squeeze, stabilize market confidence and prevent panic.

An investor protection system. An investor protection system includes a deposit insurance system, a securities investor protection system and an insurance security system, with the deposit insurance system as the most important one. The core of the deposit insurance system is to establish a market-oriented risk compensation mechanism to reasonably amor-

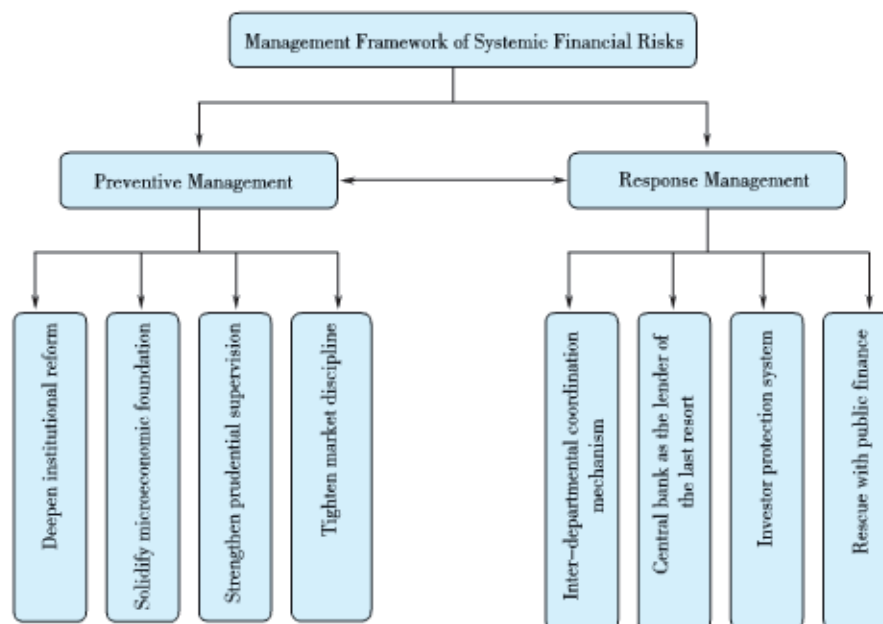
tize financial losses incurred from closedown of financial institutions to the government, financial institutions' shareholders and depositors, so as to protect the interests of the majority small depositors, prevent the crisis from spreading, reinforce the public's confidence in the financial system and maintain financial stability. Normally, the deposit insurance agencies can dispose of risks through direct compensation to depositors, acquisition of problematic financial institutions, receivership and assistance to maintain business continuity.

Financial rescue. In the process of handling systemic financial risks, another interna-

tional best practice apart from central bank's role as the lender of the last resort is that the state finance pays for the rescue cost with public fund.

In addition, in the backdrop of increasing economic and financial globalization, systemic financial risks often go beyond borders, and financial turmoil in one country usually spills over onto other countries, and become a regional or even global financial crisis. These crises are difficult to be solved by one country alone; instead, international cooperation is needed to strengthen management of systemic financial risks.

Figure 6.2 Management Framework of Systemic Financial Risks



Box 12 The Case of Northern Rock

On September 13, 2007, influenced by the US sub-prime mortgage crisis, Northern Rock, the fifth largest mortgage lender in the UK, suffered liquidity crisis due to over-reliance on credit market financing. The Bank's depositors queued to withdraw money, and this caused the first bank run in the UK since 1866.

After Northern Rock's corporate reform in 1977, its assets grew rapidly. At the end of 2006, its consolidated assets amounted to 101 billion pounds, and 89.2% of which were housing mortgage loans. As the fifth largest housing mortgage lender in the UK, Northern Rock had only a small portion of deposit-taking business, and 43% of its capital was from securitization in the financial market, much higher than the average securitization ratio of 7% in the banking sector. The capital structure featuring over-reliance on the market financing led to liquidity problems in times of market turmoil. With the spread of the US sub-prime crisis, the global liquidity crunch made the Bank unable to access financing until the problems culminated in a bank run.

After that, the Exchequer, the Bank of

England and the British Financial Services Authority issued a joint declaration on providing liquidity support facility to Northern Rock. On September 17, 2007, in order to pacify the 3-day bank run, the Chancellor of the Exchequer Mr. Darling said that the British government would provide guarantee for Northern Rock to protect savings of the depositors in the Bank. The Bank of England announced later to provide two-day special capital injection of 4.4 billion pounds to the market. The above measures eased the fear of the public and the turbulence was curbed.

The Northern Rock anecdote fully demonstrated that financial risks could spread across industries, markets and borders. The sub-prime mortgage crisis transferred risks from the US housing market to bond and derivatives markets, and then spread to the British financial market through capital liquidity risks, causing a liquidity squeeze and finally rocking Northern Rock that was highly dependent upon the financial market. It is an important issue facing many financial administrations to effectively prevent systemic financial risks and maintain financial stability.

China's Successful Experiences in Managing Financial Risks

Since the reform and opening-up, China's financial industry has undergone historical changes, making remarkable achievements and playing a more important role in promoting economic and social development. In this process, in order to avoid sectoral risks from evolving into systemic financial risks, the Chinese government has taken active measures to rectify financial order, dissolve risks of small- and medium-sized financial institutions, and actively promote financial reform so as to maintain stable and healthy operation of the financial system.

Rectifying Financial Order

In 1993, some deep-rooted problems in economic performance emerged, including an overheated macro-economy, serious inflation, accumulating financial risks and financial disorder. State-owned commercial banks had such problems as poor asset quality, disorder in inter-bank borrowing, credit lending and investment, setting up economic entities, soliciting deposits with high interest rate and off-balance-sheet operations. There were also occasional problems such as bank credit capital flow into the securities market and the real estate market, establishment of financial institutions in violation of laws and illegal financial businesses.

Facing such a situation, the state took a series of measures to strengthen macro-adjustment by preventing the general price level from rising too rapidly, strictly controlling currency issuance and the aggregate credit, reinforcing macro-management of the real estate market, forbidding financial institutions from raising deposit and lending interest rates on their own or in disguised manner, and containing illegal fund-raising; adopted the segregated operation of the banking, securities and insurance sectors, and forbid commercial banks from investing in credit trust companies, securities companies and other non-banking financial institutions. At the same time, efforts were made to speed up and deepen the financial system reform, strengthen the central bank's functions, establish a financial organizational system with the state-owned commercial banks as the main body in coexistence with various other financial institutions, and push forward the reforms of the money market, capital market and foreign exchange market. Through three years' efforts, China's economy achieved a soft landing with the financial order rectified and potential systemic financial risks eliminated.

Handling Risks of Small- and Medium-sized Financial Institutions

With the breakout of the Asian Financial Crisis in 1997, risk factors increased in the Chinese financial sector shown in the following areas: NPL ratio in banking financial institutions kept rising, the profitability was low, accompanied with liquidity difficulties in some urban commercial banks and many urban and rural credit cooperatives; non-banking financial institu-

tions had no appropriate corporate governance structures, with weak risk management and internal control, and usually running an operational loss; problems such as illegally incorporated financial institutions and illegal financial activities were rampant; some financial institutions and practitioners violated laws and regulations and conducted off-balance-sheet operations.

To ease the shock of the Asian Financial Crisis, the National Financial Work Conference that was convened in December 1997 issued the *Notice of the Central Committee of the Communist Party of China on Deepening Financial Reform, Rectifying Financial Order and Preventing Financial Risks* to forestall and dissolve financial risks with various measures, including: strengthening financial regulation by improving regulatory rules and means; handling problematic financial institutions through receivership, M&A, debt reorganization, re-capitalization, closedown by administrative means and bankruptcy; overhauling the credit trust industry by only granting market access to a few number of large-scale, strictly managed trust investment companies that were truly engaged in trust asset management businesses; releasing *Measures for the Banning of Illegal Financial Institutions and Illegal Financial Business Operations* to crack down on illegal fund raising, disguised deposit taking and other illegal financial business operations.

Through concerted efforts, the historical burden and risk potentials of most financial institutions were dissolved in a timely manner,

with various illegal financial activities punished, risk awareness of financial institutions and investors improved, and the financial ecosystem initially enhanced. As a result, a benign external environment for the financial reform and development in the next step was created.

Deepening the Reform of SOCBs

For many years, SOCBs, as the main body of the banking sector, made an important contribution to promoting the socialist market reform and development. However, influenced by systematic, institutional and external factors, SOCBs had high NPL ratios, inadequate capital, backward mechanisms, poor profitability, unsound corporate governance, and weak risk management and internal control.

The Chinese government has paid great attention to the reform of the SOCBs and taken a series of measures to comprehensively push forward the integrated reform of the SOCBs in a resolute manner since the Asian Financial Crisis in 1997. In 1998, the government issued RMB 270 billion yuan special-purpose treasury bonds to replenish capital of the four solely state-owned commercial banks; in 1999, the four financial asset management companies were set up to dispose of nearly RMB 1.4 trillion yuan bad assets of the four SOCBs; in 2002, prudent financial accounting standards were implemented after the adoption of the five-category loan classification. In 2003, a shareholding reform of the SOCBs was conducted with the objectives of “establishing a standard corporate governance struc-

ture, shifting operational mechanism, becoming internationally competitive modern commercial banks characterized by clearly-defined ownership, adequate capital, stringent internal control, safe operations and good services and earnings". The state injected capital through Huijin Company into CCB, BOC and ICBC successively, and all the recipient banks were successfully listed in overseas markets after completing share-holding reforms. At present, ABC and other financial institutions are speeding up the shareholding reform.

After the reform, NPL ratio of the state-owned commercial banks was considerably slashed, and bad loan provision ratio increased rapidly. The capital adequacy ratio reached international standards, a modern corporate governance structure and internal control mechanism initially took shape, risk management substantially improved, the international competitiveness of the SOCBs became stronger and financial stability was significantly improved.

Implementing Capital Market Reform and Comprehensive Restructure of Securities Companies

Influenced by limitations in the reform scheme design and mismatch between reform measures, problems in the capital market began to emerge in 2002, including: more acute adverse impact of the non-tradable shares, rampant phenomena where securities companies embezzled clients' securities transaction settlement fund and clients' securities assets, unsound corporate governance structure of listed companies, lack of market disciplines, flawed

information disclosure system, and illegal activities such as insider trading and market manipulation. In addition, problems such as lack of institutional investors, limited investment products, poor supervisory and legal framework on the securities industry and insufficient supervision also constrained the further development of the securities market.

To promote the healthy development of the capital market, the State Council issued *Opinions on Promoting the Reform, Opening-up and Stable Development of the Capital Market*, which made overall arrangements for the capital market reform and development: to actively carry forward the reform of non-tradable shares, and overhaul securities companies; to push ahead restructuring of securities companies, establish a securities investor protection fund system, and build up a long-term mechanism for risk disposal; to intensify the efforts in building fundamental systems, reinforce regulation and improve the risk monitoring and early-warning system with net capital as the core indicator; to further improve the legal framework governing the securities sector and improve the operational mechanism of the capital market.

Through the series of reform measures mentioned above, the accumulated risks in the securities sector were initially dissolved, with illegal activities contained, supervisory approaches and methods further improved, and great advance made in the building of industrial fundamental systems, thus laying a solid foundation for the healthy development of the capital market and the securities sector.

In retrospect, China has accumulated abundant experiences in preventing and dissolving financial risks. From handling risks of individual institution and individual industry to comprehensively reforming the financial system, and from handling historical problems in a passive manner to actively reforming the existing system, from response measures to flexible preemptive measures, a systemic financial risk management framework has taken shape. In recent years, China's economy has been developing steadily and rapidly, with remarkable achievements made in the financial reform, accumulated risks in the financial sector prudently handled and financial stability remarkably strengthened. However, some acute problems still persist, and new situations and new problems emerge. Therefore, efforts should be made to improve the financial risks management capacity and prevent and handle major risks influencing financial stability in the process of opening up to the outside world. First, improve macroeconomic adjustment to maintain stable economic performance. At the current juncture, a prudent fiscal policy and a tight monetary policy should be pursued to strengthen liquidity management, prevent rapid economic growth from becoming overheating, prevent structural price increase from becoming generalized inflation, intensify economic restructuring and ease the disequilibria in balance of payments. Second, deepen the financial reform and opening-up to improve the risk management ability of financial institutions. Efforts should be made to improve corporate governance, strengthen internal control, establish a modern financial enterprise

system, and speed up innovation in the process of opening up wider to the outside world so as to improve the efficiency and competitiveness of the financial system. Third, cultivate rational market expectations to promote long-term healthy development of the market. Endeavors should be made to strengthen market supervision, crack down on insider trading and market manipulation, intensify investor education, and continue to deepen the reform and innovation of the capital market so as to promote the healthy development of the market in the long run. Fourth, intensify the building of financial infrastructure to improve the financial eco-system. Measures should be taken to modernize the payment and settlement system, set higher accounting standards and information disclosure standards, establish and improve the credit information system, reinforce anti-money laundering efforts and improve the financial legal system. Fifth, speed up the building of a financial safety net and establish a long-term risk handling mechanism. Endeavors should be made to improve financial regulation, establish and improve a regulatory coordination mechanism, step up the creation of a deposit insurance system and establish and maintain an emergence response mechanism for the purpose of maintaining financial stability. Sixth, arouse the awareness of financial institutions' social responsibility to promote sustainable development of the financial sector. Various measures should be taken to cultivate financial institutions' sense of corporate social responsibility and combine their business operations with social responsibilities.

Box 13 Corporate Social Responsibility and Sustainable Development

Due to its unique role in resources allocation, the financial sector has become the hub of a modern economy, and plays an important role in practicing and promoting social responsibility. The social responsibility of financial enterprises refers to financial enterprises' efforts to promote the harmonious interaction between stakeholders through financial levers so as to protect the environment, promote social development and earn economic returns, and achieve the sustainable development of society, environment, economy and finance. Major international financial institutions pay great attention to social responsibility, and have shifted from a passive stance to a positive one. At present, the Equator Principles¹ initiated and abided by major international financial institutions voluntarily have become a norm for international project financing.

In recent years, Chinese financial institutions started to perform their corporate social responsibilities due to the advocate by concerned government authorities and issued reports thereon. For example, Shanghai Pudong Development Bank issued its report on corporate social responsibility in 2005,

CCB in 2006, BOCOM and China Merchants Bank in 2007. Shenzhen Stock Exchange released *Guidelines on Social Responsibility of Listed Companies* in September 2006, which defined social responsibilities that should be taken by all listed companies including financial institutions. In April 2006, Shanghai Banking Regulatory Bureau issued the *Guidelines on Corporate Social Responsibilities of Banking Financial Institutions in Shanghai*, which encouraged and called on banking financial institutions to actively perform their due social responsibilities, and protect the legitimate rights and interests of shareholders, employees, consumers and other stakeholders. In June 2007, PBC released the *Guiding Opinions on Improving Financial Services in Energy Saving and Environmental Protection*, which guided banking institutions to consciously utilize credit levers to perform their corporate social responsibilities. In July 2007, PBC, the State Environmental Protection Administration and CBRC jointly issued *Opinions on Implementing Environmental Protection Policies and Rules and Preventing Credit Risks*, which asked banking financial institutions to adjust and down-

1 In October 2002, a group of major financial institutions formulated a set of guidelines for the judgment, assessment and management of environmental and social risks in the project finance sector—the Equator Principles, in accordance with policies and guidelines of the International Finance Company. The principles require that financial institutions should actively perform due diligence on environmental and social issues of financing projects to combine corporate social responsibility with the responsibility of gaining economic returns. As of September 2007, 54 financial institutions adopted the Equator Principles, including those from both developed and developing countries, with financing projects in over 100 countries in the world, accounting for 85% of the total project financing.

size loans to “highly energy-consuming and highly polluting” industries and emphasized that “commercial banks should regard supporting environmental protection, controlling credit lending to polluting enterprises as an important part of their corporate social responsibility”.

At present, environment and resources issues constrain the sustainable economic growth. Therefore, financial institutions

should strengthen their awareness of corporate social responsibility, become socially responsible enterprises by drawing on experiences of international big financial institutions and mastering advanced concepts and technologies concerning investment and credit environment and social risk evaluation, speed up the building of a green credit system and promote the sustainable development of finance.

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