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1 The English edition is an unofficial translation of the *China Financial Stability Report 2009*, which was published in June 2009. In case of any discrepancies, the Chinese version shall govern.

Preface

In 2008, the Chinese economy overcame the difficulties posed by severe natural disasters and the complex international economic and financial environment, and maintained the momentum of stable and fairly rapid growth. The management of financial sector and service functions continued to improve, financial reform and innovation made further progress, financial infrastructure further strengthened and the financial system remained stable as a whole. Meanwhile, as the Chinese economy began to feel the pinch of the international financial crisis, and the long-standing structural imbalances in the Chinese economy were yet to be resolved, the task of maintaining financial stability became even more arduous. Therefore, the *China Financial Stability Report 2009* aims to present the latest developments in the reform and opening up of financial sector in China, and assess the stability of financial system and the risks in the system in a thorough and objective manner.

This Report, while basically adopting the structure of the *China Financial Stability Report 2008*, adjusts the chapter structure and offers more quantitative analysis based on last year's experiment. Chapter I presents an overview of the overall state of financial stability in China and an analysis of the impact of macroeconomic performance on financial stability. The next three chapters assess reform and development of the banking sector, the securities sector and capital market, and the insurance sector respectively as well as their impact on financial stability. Chapter V focuses on the progress of financial infrastructure. Chapter VI analyzes the impact of the ongoing international financial crisis, the problems exposed by this crisis, and the measures taken at home and abroad to tackle the crisis, and discusses how to improve the international financial system so as to lay a solid foundation for international financial stability. The Report also includes 14 boxes that analyze and explore important issues that bear on China's financial stability.

In addition, the Report contains two appendices titled The *Reform of*

Financial Institutions in China Since 2003 and The *Development of Wealth Management Products in China.* The first appendix reviews and sums up the progress and achievements of reforming financial institutions, and offers from a policy perspective some thinking on further deepening financial system reform; the second appendix gives a brief overview of the wealth management products in the Chinese market, brings to readers' attention issues in the development of these products, and puts forward policy proposals on promoting sound development of wealth management products.

As is always the case, the Report has room for further improvement due to the theoretical and empirical limit of the authors. We welcome comments and suggestions from all quarters, including the public sector, relevant authorities, academia and other parties. We will further improve the methodology and quality of financial stability analysis and assessment.

Financial Stability Analysis Group of PBC
31 May 2009

Abbreviations and Acronyms

ABC	Agricultural Bank of China
ACS	Accounting-data Centralized System
ADBC	Agricultural Development Bank of China
AIG	American Insurance Group
APEC	Asia-Pacific Economic Cooperation
AUD	Australian Dollar
BCBS	Basel Committee on Banking Supervision
BEPS	Bulk Electronic Payment System
BOC	Bank of China
BOCOM	Bank of Communications
BOP	Balance of Payments
CAR	Capital Adequacy Ratio
CBRC	China Banking Regulatory Commission
CCAR	Core Capital Adequacy Ratio
CCB	China Construction Bank
CCPC	City-level Clearing and Processing Center
CDB	China Development Bank
CDO	Collateralized Debt Obligation
CDS	Credit Default Swap
CEB	China Everbright Bank
CECIC	China Export & Credit Insurance Corporation
CIES	Check Image Exchange System
CIRC	China Insurance Regulatory Commission
CITIC	China International Trust and Investment Corporation
CMBC	China Minsheng Banking Corp. Ltd.
CPC	Communist Party of China

CPI	Consumer Price Index
CPIG	China Pacific Insurance Group
CRA	Credit Rating Agency
CSI	China Securities Index
CSRC	China Securities Regulatory Commission
ECB	European Central Bank
EIBC	Export-Import Bank of China
EUR	Euro
FASB	Financial Accounting Standards Board
FATF	Financial Action Task Force on Money Laundering
FDIC	Federal Deposit Insurance Corporation
FIU	Financial Intelligence Unit
FSAP	Financial Sector Assessment Program
FSF	Financial Stability Forum
G10	Group of Ten
G20	Group of Twenty
C30	Group of Thirty
GBP	Great Britain Pound
GDB	Guangdong Development Bank
GDP	Gross Domestic Product
GEM	Growth Enterprise Market
ICBC	Industrial and Commercial Bank of China
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
IPO	Initial Public Offering
JPY	Japanese Yen
JSCB	Joint-Stock Commercial Bank
LVPS	Large Value Payment System
M&A	Merger and Acquisition
MMIFF	Money Market Investor Funding Facility

NPL	Non-Performing Loan
OTC	Over the Counter
PBC	The People's Bank of China
PDCF	Primary Dealer Credit Facility
PICC	People's Insurance Company (Group) of China
PPI	Producer Price Index
PSBC	Postal Savings Bank of China
QDII	Qualified Domestic Institutional Investor
QFII	Qualified Foreign Institutional Investor
RCC	Rural Credit Cooperative
RMB	Renminbi
RMBS	Residential Mortgage-Backed Securities
ROA	Return on Assets
ROE	Return on Equity
SAR	Special Administrative Region
SDR	Special Drawing Right
SEC	Securities and Exchange Commission
SGD	Singapore Dollar
SME	Small-and Medium-sized Enterprise
SOCB	State-Owned Commercial Bank
SOE	State-owned Enterprise
SPV	Special Purpose Vehicle
TAF	Term Auction Facility
TIC	Trust and Investment Company
TSLF	Term Securities Lending Facility
UCC	Urban Credit Cooperative
UN	United Nations
USD	US Dollar
WB	World Bank
WTO	World Trade Organization
y-o-y	year-on-year

CONTENTS

Boxes

Overview

In 2008, the Chinese economy overcame the difficulties posed by severe natural disasters and the complex international economic and financial environment, and maintained the momentum of stable and relatively rapid growth. The management of financial sector and service functions continued to improve, financial reform and innovation made further progress, financial infrastructure further strengthened and the financial system remained stable as a whole. China took an active part in international cooperation to preserve financial stability together.

The Chinese Financial System Was Stable, Healthy and Safe

In 2008, China adopted various measures to respond to the impact of the international financial crisis. As a result of good domestic economic environment, the financial sector became stronger and more resilient.

The Chinese Economy Grew in a Steady and Relatively Rapid Manner, Offering a Good Macro Environment for the Financial System

In 2008, despite many difficulties, the Chinese economy continued to grow in a steady and relatively rapid manner. The GDP grew 9.0% y-o-y to RMB 30.07 trillion yuan; prices of consumer goods were basically stable. CPI was up 5.9%, an acceleration of 1.1 percentage points from the previous year. For five years in a row, grain harvest was bump and the grain output hit a record high in 2008. Facing the drastic changes in the world economy, the Chinese government adopted a proactive fiscal policy and a moderately loose monetary policy in a decisive manner. A mix of multiple instruments was adopted front in order to give signals that would promote growth and boost market confidence. Benchmark lending and deposit rates were cut five times, and reserve requirement ratio was cut four times to provide stronger financial support to economic growth. The macro-economic management became more forward-looking, targeted and effective in promoting steady and relatively rapid economic growth.

Efforts Were Made to Deal With the Impact of the International Financial Crisis and Maintain Financial Stability

The international financial crisis exacerbated rapidly in 2008, especially after September as many financial institutions went into distress or were forced to declare bankruptcy, or restructure, and international financial markets were in turmoil. The crisis spread to Europe and emerging market economies, and affected the global economic and financial systems. The Chinese government attached great importance to handling the financial crisis, took concrete measures to prevent systemic financial crisis, and adjusted the stance of macroeconomic policy timely. Focusing on boosting effective domestic demand, the Chinese government adopted ten measures promptly, and implemented a series of policies that later became a stimulus package to promote stable and relatively rapid economic growth. In order to maintain financial stability, the relevant government departments enhanced information sharing and policy coordination, stepped up financial risk monitoring, closely watched the international and domestic markets, carefully studied the interactions between the financial sector and real economy, made emergency response plans in advance, and properly handled events related to financial risks. While focusing on managing its own economy, China actively participated in regional and international financial cooperation, and played a positive role in mitigating the impact of the financial crisis and safeguarding regional and international financial stability.

Financial Reforms Produced Significant Results; the Financial Sector Made Further Progress in Opening-up and Financial Innovation Was Enhanced

In 2008, against the backdrop of international financial crisis, China launched the reform program of CDB and ABC to promote their switch to commercial operation and joint-stock reform. At this stage, the joint-stock reform of large state-owned banks was by and large completed. As a result, their asset quality, financial indicators and corporate governance improved, laying a solid foundation for these banks to respond to the international financial crisis. EIBC, ADBC, PSBC, rural credit cooperatives and other banking institutions continued to deepen their reforms, and enhanced their functions in providing financial services to the real economy. Financial asset management companies became even more market-oriented, and functioned fairly well in disposing of non-performing assets. The various reform measures began to produce effects in the capital market, and institutional arrangements made new progress. The range of service was expanded further in the insurance market, easing the lopsided development in the sector. The financial sector made new headway in introducing overseas capital and know-how on the one hand and going global on the other. In 2008, altogether 23 banks, insurance companies and fund management companies were set up as joint ventures, while the financial industry utilized a total of foreign fund with USD 15.917 billion, up 68.4% y-o-y. Chinese financial institutions also actively competed in international market and made innovations in product design and business model to provide diversified financial services.

Foreign Exchange Reserves Continued to Build Up, Indicating Stronger Resilience against External Shocks

At the end of 2008, the official foreign exchange reserves totaled USD 1.95 trillion, up 27.3% y-o-y, representing stronger capability of payment. At end-2008, the outstanding balance of external debt reached USD 374.661 billion, up USD 1.043 billion or 0.28% y-o-y. Among the total, outstanding balance of medium- and long-term external debt posted USD 163.876 billion, and short-term external debt USD 210.785 billion. The External debt service ratio, external debt/export ratio, external debt/GDP ratio, and the ratio of short-term external debt to foreign exchange reserves were 1.78%, 23.69%, 8.65% and 10.83% respectively, all within the internationally accepted safety range. Reform of foreign exchange reserve management advanced and realized the general objective of maintaining asset safety, receiving proper return and preserving liquidity.

Fiscal Revenue, Corporate Profits and Household Income Continued to Grow, and Led to Greater Solvency

In 2008, fiscal revenue totaled RMB 6.13 trillion yuan, an increase of 19.5% y-o-y. Fiscal expenditure grew 25.4% y-o-y to 6.24 trillion yuan. Supported by a good balance in revenue and expenditure, the debt service ability of the government improved. Profitability of enterprises continued to grow, albeit at a moderated rate. The per capita disposable income of urban residents and per capita net income of rural residents were RMB 15 781 yuan and 4 760 yuan respectively, representing a growth of 8.4% and 8.0%. People's livelihood improved and their solvency strengthened.

The Financial Sector Became Stronger as a Whole and Provided Better Service to Economic and Social Development

In 2008, the overall strength and resilience of the financial institutions steadily improved. At end-2008, total assets of banking institutions increased 18.6% y-o-y to RMB 62.4 trillion yuan; outstanding balance of domestic and foreign currency denominated deposits posted RMB 47.84 trillion yuan, an increase of 19.30% y-o-y; outstanding loans denominated in domestic and foreign currencies reached RMB 32.01 trillion yuan, an increase of 17.9%. Altogether 204 banks reached the required level of capital adequacy ratio of 8%, accounting for 99.9% of total banking assets. Securities and futures institutions managed their business on a sound footing, and institutional building aimed at promoting steady and sound development of capital market made steady progress. The insurance sector became stronger based on improved assets, and served as an important force in optimizing financial structure and improving efficiency of the financial market in resource allocation. In order to promote balanced growth of the financial sector and real economy, financial institutions implemented various measures designed to support economic development, and endeavored to strengthen internal control and prevent financial risks.

The Financial Market Continued Its Healthy Development and Operated Smoothly

In 2008, the financial market functioned in a stable manner. Offering a larger variety of bond products, with brisk trading and ample liquidity, the inter-bank market continued the momentum of growth, while interest rates on the money market moved downward and institutional investors were even more diversified. Against the backdrop of reduced access to equity market financing and stricter measures adopted by commercial banks in risk management, bond-type direct financing instruments played a more significant role in supporting economic development. Financing through corporate bond (including enterprise bond, listed company bond, short-term financing bill and medium-term note) increased 68% y-o-y to RMB 872.3 billion yuan. Trading volume and value of the futures market both hit a record high and the market continued its momentum of rapid development. Supply and demand played a larger role on the foreign exchange market, and the RMB exchange rate was generally stable at an adaptive and equilibrium level.

Efforts to Enhance Financial Safety Net Continued and Financial Infrastructure Was Improved

In 2008, measures were taken to make stronger institutional arrangements, intensify risk control, and promote the efficiency of market participants. All these contributed to effective handling of the financial crisis. The securities investor protection fund operated effectively, the scheme of insurance guarantee fund was further improved, and the feasibility study of the deposit insurance system was basically completed. The financial legal system building registered major progress. The application of IT technology by financial sector reached a new stage. The work of modern payment system advanced further. The regulation on credit information system and the anti-money laundering system were improved further. Infrastructure including network, disaster recovery and information security withstood the test of natural disasters, emergency and major events including the Olympic Games.

Implement the Scientific Development Outlook, Take Concrete Measures to Prevent Financial Risks and Safeguard Financial Stability

In 2009, the Chinese financial sector faces new circumstances in its development and reform and new challenges in maintaining financial stability. The sector will implement the scientific development outlook, improve its understanding of the general law in economic and financial development, strengthen monitoring and analysis of the economic and financial risks at home and abroad, continue to closely watch the developments of the international financial crisis, sum up and analyze the lessons of this crisis, properly handle the impacts of the crisis, promote the transformation of economic growth pattern, prevent systemic financial risks and sustain the steady, sound and safe performance of the financial system.

Implement Various Measures Designed for the Financial Sector to Promote Economic Development and Create a Macroeconomic Environment Conducive to Financial Stability

To adopt the scientific outlook on development, an objective requirement is to support steady and relatively rapid economic growth, and this would enable the financial system to effectively handle the negative changes in international environment. Against the backdrop of more uncertainties in the world economy and slowdown of domestic economic growth, the structural and institutional problems in the Chinese economy remain yet to be resolved. Meanwhile, the long-term trend in the economic and social development in China and advantages in the Chinese system are still present. A socialist market economic system is by and large established, and the sustained and rapid economic growth of 30 years has laid a solid material foundation to respond to various risks and challenges. Industrialization and urbanization will generate enormous demand and growth potential. In addition, global economic adjustment will provide new opportunities for the Chinese economy.

These advantages and positive factors in the Chinese economy, if well tapped, will effectively promote sustained and relatively rapid development. Therefore, it is necessary to continue to implement a proactive fiscal policy and a moderately loose monetary policy, as well as the *Thirty Opinions* of the State Council on financial sector supporting economic development, intensify financial support to the real economy, and encourage the financial sector to play a positive role in economic growth, domestic demand expansion and structural adjustment. It is also necessary to make macro-economic management more forward-looking, proactive and innovative, and enhance the ability to handle complex situations, in order to create a favorable condition for steady and relatively rapid economic growth.

Further Deepen Financial Reform to Build a More Resilient and Internationally Competitive Financial Sector

The joint-stock reform of large state-owned banks has made major progress, as indicated by higher profitability and risk control ability, but corporate governance still has room for improvement. As for the securities sector, after the measures designed to overhaul the sector were taken, the risks were effectively dissolved; however, corporate governance of securities firms and their ability to achieve sustainable development are yet to be improved. In the insurance sector, insurance companies have advanced their reform, but they have not yet transformed their extensive growth pattern nor built stronger innovation ability.

As such, it is necessary to continue to advance financial reform, improve corporate governance, and strengthen management and risk control; deepen the reform of the joint-stock banks, strengthen capital requirements, prevent asset quality and profitability from declining; promote reform and development of policy financial institutions and asset management companies, so that they will move faster in internal reform, transform operational mechanism, and provide service to economic and social development more effectively; deepen reform of securities firms, encourage securities companies to expand their operation and become stronger, and establish a sustainable profit making pattern; take concrete measures to transform the operational mechanism of insurance companies to improve their resilience to shocks, enhance risk management and product innovation, increase insurance coverage, and enhance the function of insurance sector.

The Crisis Response Mechanism Will Continue to Play Its Role in Preventing Systemic Financial Risks

With the deepening and spreading of the international financial crisis, China began to feel the crisis' impact on its economic and financial performance, and the financial sector faced severe challenges in terms of asset quality, profitability and risk management. China's financial system also had to respond to the shocks of abnormal cross-border capital flow and exchange rate fluctuations of major currencies triggered by the financial crisis. The experience in responding to the current crisis has also shown that a well-designed financial safety net is of significance in resisting the spreading of crisis and dissolving financial risks.

It is necessary to continue to monitor the development of the international financial crisis, make in-depth analysis of the reason, mechanism and trend of the international financial crisis, sum up the experience of various countries in handling the crisis, and give further play to the crisis response mechanism as well as the crisis contingency plan; improve the systemic risk assessment system and methodology, build stronger risk monitoring, analysis and early warning capability, and prevent systemic risks; closely watch the latest development in the economic performance and financial markets at home and abroad, launch the deposit insurance scheme at a proper time, let the securities investor protection fund play its role, improve the insurance guarantee fund scheme, and build a financial safety net that covers the entire financial industry.

Improve Financing Structure and Enable the Financial Sector to Provide Better Services to the National Economy

Despite relatively rapid development of direct financing as indicated by the growing volume in recent years, the corporate sector still relies heavily on bank loans. In 2008, financing by domestic non-financial sector totaled RMB 6 trillion yuan, in which RMB 5 trillion yuan were bank loans, accounting for 83.1% in the total, and 4.4 percentage points higher than that in 2007. The volume of direct financing declined as a result of the negative impacts of the international financial crisis on domestic capital market.

It is necessary to intensify efforts to build a multi-layered capital market so as to optimize financing structure and provide better financial services to economic development. Effective measures will be taken to promote stable performance of the stock market, and enhance its direct financing function. Efforts will also be made to expand the scale of bond financing by developing instruments such as enterprise bond, corporate bond, short-term financing bill and medium-term note. In addition, measures will also be taken to encourage innovation in the securities market and securities instruments, and to regulate and guide the healthy development of private financing.

Improve the Institutional Arrangements and Methodology of Financial Regulation

A lesson of the current financial crisis is that quantitative regulatory measures including CAR requirements, ratings, and model-based pricing were not sufficient to prevent systemic risks. With the development and innovation in business model, traditional regulatory arrangements and philosophy were not able to achieve the goal of systemic risk management. There were not adequate regulation and supervision over cross-sector, cross-market and cross-border financial activities, and regulatory rules and standards were pro-cyclical.

Therefore, we need learn the lessons of the international financial crisis and improve the institutional arrangements and methodology of financial regulation. Counter-cyclical factors will be included in the regulatory system, and a "circuit-breaker" mechanism shall be designed, in order to address the pro-cyclical behaviors of the financial markets and institutions. Measures will be taken to strengthen supervision over the innovative and off-balance sheet businesses, improve cross-sector and cross-border regulation, establish a risk assessment and early warning mechanism for cross-sector businesses, intensify regulatory coordination and cooperation, and effectively combine institution regulation with functional regulation.

Advance Financial Innovation and Make the Financial Sector More Competitive

A stable and vigorous financial system is an important condition for the financial institutions, financial markets and infrastrcutre to perform their functions of risk management, resource allocation and payment and settlement. Innovation is the key in improving the service quality and competitiveness of the financial sector in China. At present, financial products tended to be homogeneous and could not meet the diversified demands of clients. In addition, with the progress of integrated financial services by financial institutions, it is necessary to strengthen risk management, develop financial market and improve regulation.

At present, we need to further improve the financial regulation system, and create a regulatory environment that is conducive to financial innovation. Also, it is necessary to promote innovation in financial institutions, financial markets and financial products, develop a multi-layered capital market, diversify investment products, increase market liquidity, and create a good market environment for integrated financial services. Efforts will be made to establish good corporate governance and risk management mechanism, and prevent cross-sector, cross-market risks arising from integrated financial services. Measures will be adopted to develop bond market and promote innovation in bond market instruments and related financial products. Financial services to the rural areas will be improved, and the pilot project of new-type rural financial institutions be expanded to build a rural financial system combining commercial finance, cooperative finance and policy finance.

Reform of International Financial System Will Be Promoted to Lay a Good Foundation for International Financial Stability

Another lesson of the international financial crisis is that there are flaws in the current international financial system and its governance. Reliance of the current international monetary system on the sovereign currencies of a small number of countries exacerbated the spread of risks and the crisis; in the international financial system, surveillance over international reserve currencies was inadequate. And, early warning and early response to the financial crisis was clearly not sufficient.

China will continue to take an active part in international cooperation, promote reform of the international financial system and maintain international financial stability. China will promote flexible and diversified regional financial cooperation, and give full play to regional currency assistance mechanism. China will work towards promoting the reform of international monetary system, reducing the system's over-reliance on a small number of reserve currencies, strengthening surveillance over the countries that issue reserve currencies, improving the adjustment mechanism for issuing the international reserve currencies, promoting a diversified and well-balanced international monetary system, prompting the reform of accounting standards, improving code of conduct for and regulation over rating agencies, as well as the transparency of financial markets and financial products, and establishing an early warning system that covers every jurisdiction, especially major international financial centers. It is also necessary to improve the governance of the international financial organizations including IMF and the World Bank, and enhance the representation and voice of developing countries so that the international financial organizations can play their due role in crisis response.

(By Hong Bo)

Chapter I

Macroeconomic Environment

In 2008, with a complicated and volatile world economic and financial situation, the international financial crisis continually aggregated. As the crisis took a heavy toll on the real economy, the major economies in the west slid into recession. In response to the crisis, governments took unconventional measures, whose pace, intensity and scope were rarely seen in history. The international community strengthened cooperation to tide over the crisis. Having overcome various difficulties, the Chinese economy maintained a stable and rapid development momentum.

Economic and Financial Environment

International Economic and Financial Environment

As the international financial crisis continued to deteriorate, the financial industries of the US, the euro area and other developed economies were severely hit, the international financial market experienced drastic turbulence, prices of primary commodities declined, the global credit squeeze heightened, and unemployment rates soared.

Financial institutions were seriously impacted, and financial markets experienced great volatility. In 2008, the five biggest US investment banks either went bust, or acquired by commercial banks or changed into bank holding companies; home mortgage giants Fannie Mae and Freddie Mac were taken over by the government; the US government injected capital into AIG and took into conservatorship; and 25 banks collapsed. Some financial institutions in Europe and Japan experienced risk events, and were eventually recapitalized or went bust. The financial industry in East European countries and other emerging market economies had no escape. At the same time, the stock markets tumbled across the globe, with major stock indices plummeting by over 30%. Yields on government bonds slid noticeably, some currencies devalued sharply, and foreign exchange markets fluctuated hugely.

Commodity prices plunged, and grain prices dropped from elevated levels. In 2008, oil prices fluctuated greatly, dropping from the peak of USD 147.27 per barrel to below USD 40 per barrel at the cheapest. Other raw materials and primary commodities such as iron ore, non-ferrous metals and steel lost nearly half of the original value. Grain prices in the international market pulled back, with the futures prices of soybean, wheat and so on lowering more than one third of their original prices.

Market liquidity was drained, and the global credit crunch escalated. In October 2008, liquidity in short-term credit markets in the US and Europe almost dried up, inter-bank lending cost rose dramatically, and institutions were reluctant to lend. Funds flew into the US T-bond market in large volume to seek safety. Some countries even experienced massive foreign capital flight. Short-term financing markets were in stagnancy.

Major economies slowed down or slid into recession, and unemployment rates surged. In 2008, the US, the euro area, Japan and other advanced economies slid into recession, with their economies registering negative growth in the second half of the year; emerging market economies and developing economies slowed down across the board, and growth in India and Russia was slower than the level last year. At the same time, businesses in a lot of countries were mired in increasing difficulties, and unemployment rates continued to surge, in particular in the US, euro area, Japan and Canada.

The international community launched unprecedented crisis relief measures in joint efforts. In 2008, affected countries and regions took a series of measures including some unconventional ones to pump liquidity into financial institutions, purchased shares of financial institutions in large sum, provided guarantee for banks' debts, banned short-selling of stocks of some financial institutions, and suspended or relaxed fair value accounting standards. The pace, intensity and scale of the above relief measures were rarely seen in history. At the same time, the international community strengthened cooperation to deal with the crisis. G20 leaders convened a Summit on Financial Markets and the World Economy, and agreed on an action plan about financial and economic issues. APEC leaders made a statement on the slowdown of the global economic growth. Some central banks cut rates unilaterally or collaboratively, or injected substantial liquidity to markets.

Macroeconomic Performance of China

In 2008, despite economic slowdown due to the impact of the devastating natural disasters and the international financial crisis, Chinese economy maintained a stable and relatively fast development momentum.

The economy continued to grow rapidly, but at a decelerating pace quarter on quarter. In 2008, Chinese economy continued to grow rapidly, with the GDP posting RMB 30 067 billion yuan, up 9.0% y-o-y. Agricultural production developed steadily, with the grain output totaling 528.5 million tons, increasing for the fifth year in a row; industrial production growth decelerated, with the added value of statistically large enterprises growing by 12.9%, a deceleration of 5.6 percentage points. The GDP growth in the four quarters stood at 10.6%, 10.1%, 9.0% and 6.8% respectively, representing a declining trend quarter by quarter.

Domestic demand kept growing rapidly, but external demand dropped sharply. In 2008, investments and consumption demand continued to grow rapidly. Fixed asset investment in the whole year registered RMB 17.2 trillion yuan, up 25.5% over the previous year. Retail sales amounted to RMB 10.8 trillion yuan, up 21.6% y-o-y. Affected by the world economic slowdown and adjustments in the domestic property market, investment and consumption slowed down notably in the fourth quarter. Moreover, export growth dropped precipitously. The total exports reached USD 1.4 trillion, up 17.2%. Exports registered y-o-y growth of −2.2% and −2.8% in November and December respectively.

Price hike accelerated in the first half of the year and decelerated in the second half by a large margin. The CPI was 5.9% for the whole year, up 1.1 percentage points from a year earlier. Affected by the snow and sleet disaster, the CPI reached 8.7% in February 2008, a record high since 1996. Except for a rebound in April, CPI later dropped month by month. PPI reached its annual peak of 10.1% in August and slid fast afterwards, averaging 6.9% for the whole year, up 3.8 percentage points over the previous year.

Fiscal revenue growth decelerated, and economic benefits fell notably. In 2008, fiscal revenue growth slowed down, and posted RMB 6.1 trillion yuan, up 19.5% y-o-y, representing a deceleration of 12.9 percentage points. Corporate profit growth fell sharply. Statistically large enterprises realized profits of over RMB 2.4 trillion yuan, up 5% y-o-y, representing a deceleration of 31.8 percentage points. Household income growth moderated, with the disposable income growth per capita in urban areas posting 8.4%, down 3.8 percentage points from a year earlier; cash income of rural residents grew 8.0%, representing a deceleration of 1.5 percentage points.

Stock indices tumbled, and property prices fell month by month. In 2008, stocks on the A-share market fell in value across the board. At the end of the year, the Shanghai Stock Composite Index was closed at 1 820.81 points, down 65.39% y-o-y. The capitalization and the floatation of tradable shares of the A-share market lost 62.99% and 49.12% respectively. The hike of house sale prices in 70 large- and medium-sized cities slowed down, and December even experienced negative growth. The housing price was up 6.5% for the whole year.

The balance of payments remained in a surplus position, and foreign exchange reserves continued to pile up. The BOP position was improved in an overall point of view, and current account remained the main source of the BOP surplus. In the fourth quarter of 2008, import and export trade growth slowed down markedly, with the import and export volume posting USD 2.56 trillion, up 17.8% y-o-y. Among this total, exports grew by 17.2% and imports by 18.5%. The total trade surplus grew by USD 32.8 billion to USD 295.5 billion. Foreign capital inflows continued to increase, foreign debt growth moderated, and the capital and financial account surplus decreased. At the end of 2008, the outstanding foreign reserves registered USD 1.95 trillion, up 27.3% from the previous year.

Weighing the changing situation, the Chinese government determinedly shifted the macroeconomic policy from "preventing rapid economic growth from overheated and preventing price hike from becoming entrenched inflation" to "maintaining stable and relatively rapid growth and containing rapid price increase", and later to "proactive fiscal policy and moderately loose monetary policy". Policy measures that aimed to beef up investment and stimulate consumption were launched intensively to lay a solid foundation for stable and rapid recovery of the economy.

Impacts of Economic and Financial Environment on Financial Stability

With China's economy and finance increasingly interconnected with the world, the current international financial crisis exerted impacts to varying degrees on China's import and export trade, economic growth, employment and price stability, posing a challenge to financial stability.

The world economic recession influenced China's economic growth. The major advanced economies started to recede since the latter half of 2008. In spite of the various forceful measures to stabilize the financial system and deal with the crisis, the effects and pertinence of such policies remained to be seen. This, coupled with rising protectionism in trade, investment and finance, overshadowed the prospect of the world economic recovery. IMF predicted that the world economy would grow by 0.5% in 2009 in terms of purchasing power parity, the lowest level since the Second World War. Developed economies would grow at −2%. At the same time, world trade would post negative growth. According to IMF's forecast, the world trade would drop by 2.8% in 2009, and the figure predicted by WTO was 9%. Slump in world trade would have a large bearing on China's exports, driving some export-oriented enterprises into difficulties, which would in turn aggravate credit risks within the banking system. Moreover, export decline would force export enterprises to cut jobs, bringing about difficulties to job creation.

Economic restructuring faced constraining factors. For a long time, China's economic growth depended excessively on investment and exports, and low consumption ratio, high investment ratio and other structural problems became more acute against the backdrop of the international financial crisis. Therefore, it was an urgent need to shift the economic growth pattern to coordinated development among investments, consumption and exports. It is more important to stimulate consumption given the weakening external demand. At present, there are several factors constraining consumption growth. First, household income would be impacted by economic slowdown, which would in turn affect consumption demand. Second, the low share of household income in the national income distribution structure would have an effect on consumption growth. In recent years, the real growth of urban dwellers' per capita disposable income and rural residents' cash income has remained slower than the economic growth. Third, due to an unsound social security system, households' marginal propensity to consume saw an overall downward trend. In 2008, the marginal propensity to consume of urban and rural residents declined from 0.85 in 2002 to 0.56 and 0.71 respectively.

Deflationary risks in immediate term and inflationary risks over medium and long run co-existed. In 2008, CPI and PPI increased in the first half of the year and declined later, and nosedived at the end of the year. In December, CPI grew 1.2% y-o-y, down 1.2 percentage points in month-on-month terms, hitting the lowest point in 29 months. The decline of PPI was even greater, from 2% in November to −1.1%. In 2009, economic slowdown in China and abroad will result in waning aggregate demand, and weakening external demand will cause export enterprises no other choice but to sell products originally manufactured for exports on the domestic market, hence increasing supply and exerting downward pressures on prices. Price tumble of commodities, oil product tax reform and other factors also heightened inflationary risks. At the same time, it should be heeded that the global monetary supply was generally sufficient, and once market confidence recovers, commodity prices are likely to resume growth momentum. Massive capitalization and economic stimulus plans taken by some economies to deal with the crisis lead to a surge in money supply and fiscal deficit, which would translate into inflationary pressures in the medium and long run.

The ongoing adjustments of the stock market and the property market will influence economic growth. In 2008, affected by the international financial crisis and other factors, the stock indices in China tumbled, market turnover declined, capitalization of listed companies shrank considerably, and the capital-raising capability of the stock market weakened. The property market experienced temporary adjustments, growth of property development investment decelerated, and home sales fell sharply. Due to its long industrial chain, the property market will have some effects on economic growth. At the same time, because a large proportion of the real estate developers' funds are borrowed from banks, the drastic adjustments ongoing in the property market will increase credit risks in the banking system.

Measures to Promote Economic Growth and Financial Stability

Since the third quarter of 2008, the impacts of the international financial crisis on Chinese economy have gradually emerged. The Chinese government launched a series of policy measures that aim to promote growth, expand domestic demand, restructure the economy and improve people's living standards, so as to promote stable and relatively fast economic development.

Policy measures that "maintain economic growth and expand domestic demand" have been implemented. The ten measures that aim to "expand domestic demand and promote economic growth", the 4 trillion yuan economic stimulus package and the adjustment and revitalization plans for key industries have been carried out. Proactive fiscal policy has been put into place to display the active role of public finance in projects with direct bearing on people's livelihood, infrastructure construction, environmental protection, post-disaster reconstruction and in increasing the income of urban and rural residents especially those with low incomes. Moderately loose monetary policy has been firmly pursued to guarantee sufficient liquidity in the banking system, promote rational growth of money and credit, and beef up financial support to economic development. Moreover, forceful measures have been taken to promote foreign trade development, and implement more active employment policies to maintain jobs.

Economic restructuring has continued to be strengthened. While expanding domestic demand, economic restructuring has been sped up so as to address the fundamental causes that have long constrained China's economic development. Efforts have been made to increase the share of household income in national income, beef up investments in education, medical services, social security and other weak links as well as public goods, so as to eliminate the concerns of households and to boost consumption demand. In addition, more is spent on agriculture, rural areas and farmers, and supporting policies for agricultural and grain production have been reinforced so as to expand demand in rural areas. Support for the service sector and high and new-tech sectors has been increased, in a bid to promote industrial upgrading. The resources pricing mechanism is reformed and environmental protection standards have been strengthened with a view to promoting the shift of economic growth pattern.

The ability to fend off systemic financial risks has been further improved. The coordination mechanism among financial regulators is improved in order to put into good play the role of supervision over individual institutions and regulation along functional lines, and strengthen cross-sector and cross-market regulation. The assessment of systemic financial risks is improved so as to enhance the supervisory, analytic and risk-warning capability. Counter-cyclicality is enhanced to make the financial system more capable of dealing with cyclical fluctuations. The building of financial emergency response ability is strengthened, and ex ante and ex post mechanisms for disposing systemic risks have been improved. A deposit insurance scheme will be launched in due course to improve the financial safety net, and protect the safety and stability of the financial system.

The reform of the international financial system has been actively pursued. Efforts have been made to promote the reform of corporate governance structure of major international financial organizations, the establishment of a rational global financial rescue mechanism, and the rescue efforts to developing countries; to increase the voice and representation of developing countries in international financial organizations so as to display their role in maintaining financial stability at international and regional levels; to strengthen international cooperation in financial supervision and regulation so as to prevent the contagion of financial risks across borders; to improve the international financial supervision, accounting standards, code of conduct of rating agencies and capital adequacy requirements, to establish a worldwide early warning mechanism, in particular an early warning mechanism for the major international financial centers; to strengthen surveillance over reserve currency issuing countries, establish a mechanism to regulate the issuance of reserve currencies; to strengthen supervision over financial institutions and intermediary agencies, so as to enhance transparency of financial markets and financial products. The roots and lessons of the crisis have proven that it is necessary to reform the present international financial system, remove irrational elements in the international financial system, and reinforce supervision over financial risks. Only by doing the above can a solid institutional foundation be laid down for the long-term stability of the international financial system.

(By Yang Xiaojun)

Chapter II

Banking Sector

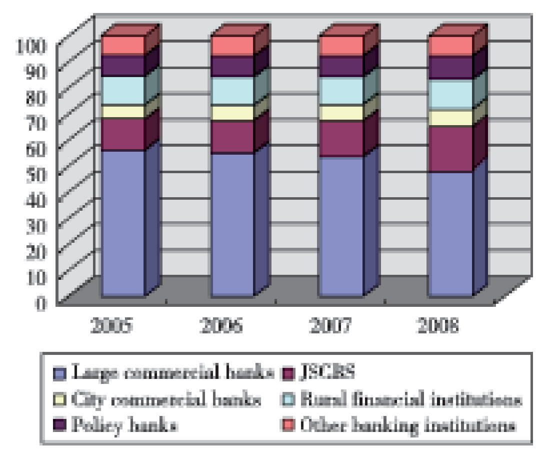
In 2008, China's banking sector carefully implemented macroeconomic management policies, and actively coped with the complex and changeable economic and financial situations both at home and abroad. Banking institutions have taken steps to steadily deepen the reform, strengthen credit management, improve credit structure and intensify risk control, with their overall strength and resilience to risks continuing to enhance.

Recent Developments

Total assets and liabilities continued to increase. As of the end of 2008, total assets of banking institutions increased by 18.62% to RMB 62.39 trillion yuan on a y-o-y basis, and total liabilities grew by 18.22% to RMB 58.61 trillion yuan. The outstanding deposits denominated in both domestic and foreign currencies reached RMB 47.84 trillion yuan, up 19.3% y-o-y; the outstanding loans in both domestic and foreign currencies amounted to RMB 32.01 trillion yuan, up 17.9% .

Competitiveness of the banking sector further enhanced. In 2008, policy banks, JSCBs, city commercial banks and rural financial institutions (including rural commercial banks, rural cooperative banks and RCCs) developed at a fast pace, featuring steadily increased share of assets. Specifically, the assets of policy banks, JSCBs, city commercial banks and rural financial institutions accounted for 9.05%, 14.12%, 6.60% and 11.44% of the total assets of banking institutions respectively, up 0.99, 0.34, 0.25 and 0.8 percentage points. The assets of the big five commercial banks accounted for 51.01%, down 2.24 percentage points over the previous year (Figure 2.1).

Figure 2.1 Proportion of Assets of Banking Institutions



Source: CBRC.

Asset quality improved on an overall basis. In 2008, banking institutions witnessed a decline in both the outstanding NPLs and the NPL ratio. At end-2008, the outstanding NPLs of commercial banks registered RMB 5 602 trillion yuan, RMB 708.2 billion yuan less than previous year; and the NPL ratio recorded 2.4%, down 3.7 percentage points .

Capital adequacy rose evidently. In 2008, the capital base of banking institutions was replenished through various channels. In particular, commercial banks issued a total of RMB 72.4 billion yuan of subordinated bonds and hybrid capital bonds, representing a y-o-y growth of 92.3%. As of the end of 2008, the number of commercial banks meeting the CAR requirement of 8% reached 204, increased by 43 y-o-y. The assets of these banks accounted for 99.9% of the total assets of commercial banks, up 20.9 percentage points from end-2007.

Profits grew by a large margin. In 2008, the net profits of banking institutions after tax rose by 30.6% from the previous year to RMB 583.4 billion yuan, among which net profits of major commercial banks (including the big five commercial banks and 12 JSCBs) after tax totaled RMB 438.36 billion yuan, up 44.7%. The ROE and ROA of banking institutions reached 17.09% and 1.00% respectively.

Effectiveness of supervision steadily intensified. In 2008, banking regulatory authorities closely monitored the domestic and international economic and financial developments, guiding and urging banks to strengthen risk management. Efforts have been made to pay close attention to the changes in asset quality to prevent the rebound of NPLs, accelerate the disposal of financial risks and the control of risks arising from business innovation, guard against financial emergencies, and further strengthen the international communication and cross-sector cooperation on supervisory matters. *The Guidelines on the Risk Management of M&A Loans of Commercial Banks* and the guidelines for banks to establish specialized institutions extending credit to small enterprises were timely issued, and ten measures realigning certain credit regulation policies for sound economic development were raised so as to guide banking institutions to support economic growth.

Reform and Achievements

In 2008, the reform of banking institutions continued to advance, as reflected in improved financial services, enhanced risk management and resilience to crisis. Financial risks were timely mitigated and the stability of banking sector was effectively safeguarded.

Reform of Large Commercial Banks Was Steadily Pushed Forward

In 2008, in accordance with the overall arrangements on China's financial reform, the reform of state-owned commercial banks continued to advance at a steady pace.

The share-holding reform of ABC achieved preliminary results. In 2008, PBC, together with relevant authorities, carried out a careful research on the reform plan for ABC and steadily promoted the reform. On October 21, 2008, the State Council basically approved the *Guidelines for the Shareholding Reform of ABC*. On October 29, the China Investment Corporation, via the Central Huijin Investment Co., injected the USD equivalent of RMB 130 billion yuan into ABC, with the Ministry of Finance and the China Investment Corporation each taking 50% stakes. ABC consecutively completed asset assessment, land property rights verification, and divestiture of non-performing assets. In the meantime, the bank continued to expand the pilot projects of multidivisional structure reform at the county level and ratcheted up credit support for "agriculture, rural areas and farmers". On January 9, 2009, the Agricultural Bank of China Co. Ltd. took shape with the initial establishment of a "shareholders meeting, board of directors, board of supervisors, and senior management" structure, and directors and supervisors were elected according to legal procedures. On January 16, 2009, the Agricultural Bank of China Co., Ltd. was officially inaugurated.

The commercial-based reform of CDB was initially accomplished. In early 2008, the reform plan of CDB was approved by the State Council and the commercial-based reform of the bank advanced steadily. The reform plan specified the management over losses caused by exchange of foreign currency-denominated capital funds in financial restructuring, co-managed funds, and risk provisions; clarified the management plan for state shares, with the Ministry of Finance and the Central Huijin Investment Co. Ltd. as originators holding 51.3% and 48.7% stakes respectively. On December 1, 2008, the China Development Bank Co. Ltd. was established, and a new board of directors, board of supervisors, and senior management team were created according to the procedural requirements of the *Company Law*. On December 16, the China Development Bank Co. Ltd. was officially inaugurated.

In addition, EIBC and ADBC also deepened their internal reforms, strengthened risk management and internal control, and steadily launched new businesses so as to pave the way for the comprehensive reforms. At the beginning of 2009, a working group was established by PBC and other relevant authorities to deliberate issues related to the reform of the two banks.

Box 1 The Reform and Development of Policy Financial Institutions

Policy financial services play a significant role in implementing the government's strategic plans and supporting the coordinated economic and social development. In 1994, three policy banks including CDB, EIBC and ADBC were put in place specializing in policy financial services for infrastructural building, basic industries and pillar industries, the export of electro-mechanical products and equipments, as well as the procurement of grain, cotton and oil, etc. In 2001, CECIC was established engaging in policy export credit insurance business. Since their establishment, the four policy financial institutions actively implemented industrial policies, foreign economic and trade policies as well as macro management policies, and played a positive role in promoting economic restructuring, alleviating the bottle necks in economic development, protecting and reinforcing the fundamental role of agriculture, fostering rural economic development, enhancing the international competitiveness of the Chinese enterprises and export goods, and accelerating the development of an open economy.

With the development of socialist market economy in China, policy financial institutions experienced dramatic changes in market environment, business conditions and operational targets. On the one hand, many of the original policy business has converted into commercial business. On the other hand, under the changing international and domestic economic situations, new policy business was called for in some areas in view of the national interests and strategic development. At the same time, with the expansion of business, problems also emerged in policy financial institutions with regard to function positioning, corporate governance, risk control, incentives and disciplines, and supervision and management. Therefore, the reform of policy financial institutions was brought up on the agenda.

In 2007, the National Financial Work Conference provided guidance for the reform of policy banks, clearly pointed out the principle of applying different reform schemes to different banks according to their unique circumstances, and decided to first reform CDB while requiring EIBC and ADBC to create conditions for the comprehensive reform through conducting internal reform and strengthening capital base. The Conference also called for strengthening the role of policy financial services in serving the national strategies and supporting economic and social development, gradually reforming the operation mechanism of policy financial services, establishing transparent bidding system and making fiscal arrangements to provide necessary interest subsidies and other compensations for policy banks. After the conference, PBC and relevant authorities promoted the reform of CDB, EIBC and ADBC in an active and prudent manner according to the overall arrangements of the State Council. At present, the reform of CDB has made important strides, and the China Development Bank Co. Ltd. was officially inaugurated on December 16, 2008.

In the next phase, PBC will comprehensively follow the decisions made in the National Financial Work Conference, and steadily advance the reform of EIBC, ADB and CECIC taking into account the recent developments of internal and external economic environments. Policy banks should further reinforce their functions of serving the national strategies, dynamically adjust their business scope with classified management, establish and improve corporate governance, optimize the scale control and risk control mechanism, clarify the risk compensation mechanism, and establish standardized external regulation and assessment system, so as to fundamentally tackle the institutional issues that hinder the development of policy financial institutions and further strengthen the role of policy financial institutions in serving the economic and social development.

Banking Institutions' Capability of Promoting Economic Development Further Enhanced

In 2008, in light of the changing economic scenario both at home and abroad, China's monetary policy stance was adjusted in a timely manner from "tight" to "moderately loose". Banking institutions actively implemented macro management policies, and followed the credit policy of differentiated treatment for different sectors to further intensify credit support to key sectors and weak links, which achieved prominent effects.

Credit expansion was timely adjusted. Taking into account the development needs as well as the changes in market demand, banking institutions closely followed macro management policies on credit management and credit restructuring, strongly underpinning the rapid and sound economic development. Banking institutions appropriately managed the aggregate and pace of credit expansion in the first half of 2008 under tight monetary policy, while timely increased credit supply in the second half of the year, in the fourth quarter in particular, to intensify their support to economic development. New loans in 2008 reached RMB 5 trillion yuan, among which RMB 1.43 trillion yuan were issued in the fourth quarter, effectively promoting the implementation of the policy of boosting domestic demand and maintaining economic growth.

Rural financial services continued to improve. First, ABC formulated and carried out the full-fledged plan on serving "agriculture, rural areas and farmers", and conducted pilot programs with a view to exploring the mode of serving the rural economy on the basis of key enterprises in agriculture industrialization and the production base of agricultural products. Focusing on farmers, the mode could be backed by the issuance of farmer-aid cards, and safeguarded by the divisions at the county level, with priority given to developing micro-credit business for farmers. At end-2008, outstanding agricultural loans amounted to RMB 933 billion yuan, a y-o-y growth of RMB 135.1 billion yuan. Second, the dominant role of RCCs was effectively brought into play in providing financial support to the agricultural sector. As of the end of 2008, outstanding loans of the RCCs posted RMB 3.7 trillion yuan, RMB 1.7 trillion yuan of which were agricultural loans, accounting for 46% of the total loans. The outstanding balance of loans to farmers amounted to RMB 1.33 trillion yuan, accounting for 36% of the total loans. Third, pilot programs of new rural financial institutions were pushed forward extensively to expand the service area of rural financial institutions. At end-2008, 107 new-type rural financial institutions were approved to conduct business, including 91 village and township banks, 6 loan companies and 10 rural credit shops.

Credit services to SMEs were improved. In 2008, banking institutions attached great importance on the financing difficulties of SMEs and explored ways to grant differential treatment to various borrowers through market mechanisms and innovated financing channels so as to improve credit services for SMEs. First, credit support to SMEs was strengthened. Many commercial banks regarded SME lending as a strategic priority and as a source of growth of profits, and gradually increased loans to SMEs. At end-2008, outstanding SME loans in banking institutions reached RMB 10.9 trillion yuan, a y-o-y increase of 13.5%. Second, specialized financial services for SMEs have been underway. Some commercial banks established SME-specific lending procedures and management systems according to the characteristics of SMEs, and conducted due risk management for SMEs. In 2008, some commercial banks established departments specializing in credit services for SMEs.

Vigorous efforts have been made to provide financial support and services to disaster relief and post-disaster reconstruction. In 2008, given the heavy sleet and snow disaster and the devastating earthquake that took a toll on China, banking institutions made all-out efforts to provide financial support and services to disaster relief and post-disaster reconstruction. First, speedy efforts were made to resume business operation and adjust the layout of financial institutions' outlets to expand the coverage of financial services in the stricken areas. Second, with a view to implementing policies on post-disaster reconstruction, banks adopted preferential credit policies in the disaster-stricken areas and increased credit lending to agriculture, rural areas, and farmers, SMEs, and key infrastructural building of disaster-stricken areas. Third, active steps were taken to support housing development and construction in the disaster-stricken areas, intensify credit support for the construction of damaged residential housing and affordable housing projects, and expand loans to famers' self-occupied house rebuilding and rehabilitation. Fourth, measures were also taken to advance the building of credit environment in the stricken areas, protect legitimate rights and interests of clients, and timely write off NPLs qualified according to relevant rules. For loans that cannot be repaid on time due to the disaster, commercial banks would not take actions to urge repayment of loans, impose penalty interests, cite as bad credit record, or refuse to grant other credit support to the disaster-stricken areas.

Risk Management Capability Steadily Enhanced

In 2008, commercial banks steadily improved risk management in the process of countering the ongoing international financial crisis.

Active steps have been taken to tackle the international financial crisis. In 2008, some commercial banks incurred certain losses in their overseas investments due to the global financial crisis. However, since the overseas investments accounted for only a small proportion of the total assets of China's banking sector, the investment losses were limited and the overall risks remained under control. In the meantime, banks took a series of measures to actively cope with the financial crisis. First, efforts were made to closely monitor the dynamics of financial crisis, improve risk assessment and early-warning, and formulate contingency plans in response to crisis and every kind of emergencies, so as to forestall shocks inflicted by the crisis on the banking sector. Second, banks took actions to actively prevent and mitigate overseas investment risks, strengthen the management of overseas investments with the investment structure adjusted and improved, alleviate risks in foreign currency portfolio, and timely conduct full provisioning for the write-down of assets with an effort to become more resilient to risks. Third, international communication and cooperation were further intensified to promote the information sharing and coordination among regions so as to join forces in crisis resolution. Fourth, the reform of banks was further deepened to improve corporate governance, strengthen internal control, update the techniques of risk monitoring and assessment, and steadily enhance risk management capabilities through optimizing risk management procedures and strengthening staff training. Fifth, steps were taken to further strengthen functional supervision as well as prudential supervision, scientifically adjust and steadily implement the opening-up strategy, and enhance the international competitiveness of China's banking sector on a overall basis.

Preparation has been made for the implementation of Basel II. According to the objective and time table for the Basel II implementation in China's banking sector, regulatory authorities will accept the application by commercial banks for the Basel II adoption since 2010. In 2008, with an aim to promote the implementation of Basel II in commercial banks, regulatory authorities issued a series of regulatory guidance, including the *Guidelines for the Categorization of Banking-Book Credit Risk Exposures of Commercial Banks* and the *Guidelines for the Supervision of Credit Risk Internal Rating System of Commercial Banks*, which basically built up a legal framework for prudential supervision covering major risks in the banking sector. Meanwhile, major commercial banks successively established leading mechanism and working procedures on Basel II adoption according to their specific circumstances, sought to develop or introduce new models and techniques on risk measurement, improved risk assessment and management, and actively conducted stress testing using the existing risk measurement tools so as to enhance their capabilities to withstand adverse shocks.

Box 2 Basel II and Its Amendments

On June 26, 2004, the central bank Governors and the heads of supervisory authorities of the G10 countries reached a consensus on publishing *the International Convergence of Capital Measurement and Capital Standards: A Revised Framework* (Basel II), which mainly focused on three pillars, i. e., minimum capital requirements, supervisory review and market disciplines. In the formula of minimum capital requirement for banks (a CAR of 8% and a core CAR of 4%), metrics that simply reflect credit risks were supplemented by those reflecting market risks and operational risks for calculating risk-weighted assets, and the idea of full information disclosure was also raised by Basel II.

Since the outbreak of the global financial crisis, the weaknesses of Basel II revealed in the crisis have triggered concerns and discussions regarding the effects of Basel II on strengthening banks' risk management and dealing with the crisis. First, the risk measurement methodology constructed under Basel II undervalued credit risks. Second, the procyclicality of Basel II exacerbated risks of financial institutions in economic slump. Third, Basel II placed more emphasis on daily risks and little emphasis on crisis resolution. Fourth, the information disclosure under Basel II was not sufficient to prevent systemic risks. Fifth, Basel II encouraged regulatory arbitrage.

At present, BCBS was considering the amendments to Basel II. First, the Basel II framework should be examined comprehensively, including the risk assessment of capital framework, capital base and its composition. Second, in cooperation with FSF, BCBS should be conduct a review on the impacts of procyclicality in Basel II capital requirement, with an effort to alleviate the amplifying effects of regulatory capital on the shocks to financial sector and the real economy. Third, the definition of capital should be reassessed. Fourth, the guidelines on improving corporate governance and risk management under Pillar 2 should be released in order to formulate regulatory guidelines on the priorities of risk management, such as strengthening firm-wide risk management and internal control across the institution, intensifying the management of certain areas and improving banks' stress tests. Fifth, the Committee planned to reassess the management of counterparty credit risks under the three pillars of Basel II, including the adequacy of capital requirement, quality of risk management, internal and external transparency, etc. Sixth, relevant guidance should be released on strengthening information disclosure requirements under pillar 3.

Certain Risks Were Mitigated in a Timely Manner

In 2008, relevant authorities strengthened information sharing and policy coordination so as to timely ease certain risks in some areas of banking sector.

Liquidity difficulties were addressed for some foreign banks in China. Affected by the international financial crisis and the operational problems of parent institutions, some foreign banks in China were facing increasing liquidity pressures, with a few banks being exposed to liquidity crunch. PBC and other relevant authorities took prompt actions to address the financing difficulties of these banks. Meanwhile, coordination mechanism was set up for the regulation of foreign banks and small and medium-sized commercial banks with a view to strengthening prudential supervision and safeguarding financial stability. In addition, PBC introduced TAF and issued short-term pledged loans with a maturity of less than 3 months to eligible financial institutions in China (including foreign banks), which was an innovation in the pattern of providing liquidity support to banking institutions.

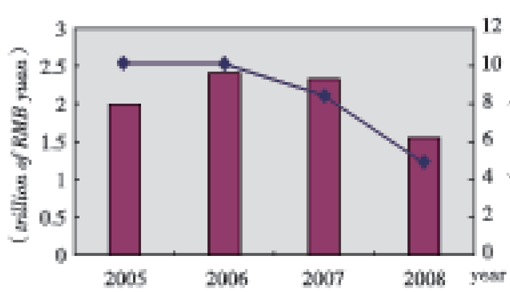
Risks in other small and medium-sized banks were properly handled. In 2008, risk disposal in some high-risk institutions was conducted in an orderly fashion. With concerted efforts, risks in city commercial banks were broadly eased, and the number of city credit cooperatives that were required to suspend business for rectification decreased to 12. Risk resolution was also timely conducted for high-risk trust companies and rural financial institutions. The exit of a few risky financial institutions left over by history was progressed smoothly, and bank runs caused by illegal fund-raising in Xiangxi autonomous prefecture of Hunan Province quickly blew over.

Soundness Assessment

In 2008, major indicators reflecting the sound performance of the banking sector remained favorable, featuring improved asset quality, enhanced capital adequacy and profitability, and abundant liquidity. However, banking sector saw a continued deceleration in the growth of profits, and was threatened with a rebound in NPLs.

Asset quality continued to improve, while the risk of NPL rebound increased. As of the end of 2008, both the outstanding NPLs and the NPL ratio of banking institutions dropped remarkably (Figure 2.2). In particular, outstanding NPLs of major commercial banks recorded RMB 0.49 trillion yuan, RMB 0.71 trillion yuan less than that recorded at the end of 2007, with the NPL ratio decreasing by 4.28 percentage points to 2.45%; outstanding NPLs of city commercial banks fell by RMB 2.67 billion yuan y-o-y to RMB 48.48 billion yuan and the NPL ratio recorded 2.33%, down 0.71 percentage points; outstanding NPLs of rural commercial banks amounted to RMB 19.145 billion yuan, an increase of RMB 6.082 billion yuan y-o-y.

Figure 2.2 NPLs and NPL Ratio of Banking Institutions

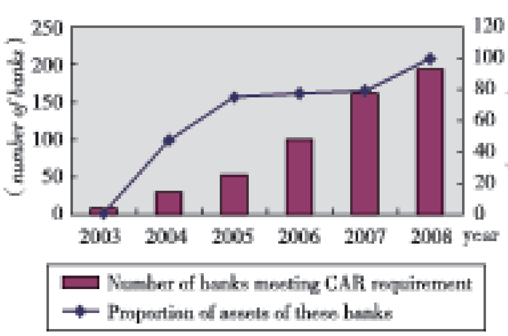


Source: PBC, CBRC.

In 2008, affected by such factors as the fluctuations in economic cycles, some export-oriented and processing enterprises were confronted with difficulties in production and operation, economic efficiencies declined in several sectors including iron, non-ferrous metal, chemical engineering and ship building, housing market remained sluggish, more enterprises were at a standstill, asset quality deteriorated in some sectors, and NPLs mounted, building up pressures on the rebound of NPLs in banking institutions.

CAR and loan loss provision adequacy ratio escalated year by year with the resilience further enhanced. At end-2008, the number of commercial banks meeting the CAR requirement of 8% reached 204, and the assets of these banks accounted for 99.9% of the total assets of commercial banks (Figure 2.3). In particular, the CARs of the big five commercial banks and 12 JSCBs stood at 12.14% and 10.54% respectively, both meeting CAR requirement.

Figure 2.3 Number of Commercial Banks Meeting CAR Requirement and the Proportion of Their Assets



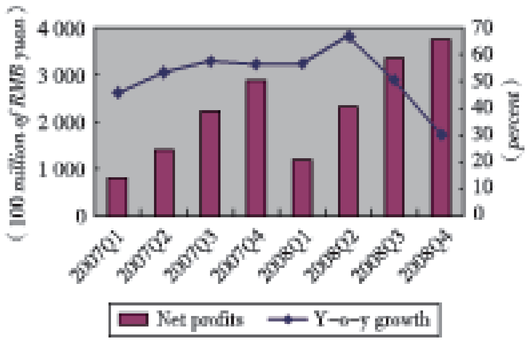
Source: CBRC.

The loan loss provision gap narrowed visibly. As of the end of 2008, the provision gap of banking institutions was RMB 122.283 billion yuan, a y-o-y decrease of RMB 775.347 billion yuan, with provision adequacy ratio increasing by 48.36 percentage points y-o-y to 183.43%. Specifically, the provision adequacy ratio of large commercial banks, JSCBs and city commercial banks posted 152.96%, 198.50% and 161.93% respectively.

Profits continued to increase but at a decelerated pace. In 2008, banking institutions realized a net profit of RMB 583.4 billion yuan after tax, maintaining a growth of over 30% for three consecutive years. ROE and ROA reached 17.09% and 1% respectively, both increasing from the previous year. In particular, the ROE and ROA of commercial banks recorded 19.45% and 1.2% respectively, higher than the average of the sector. However, affected by factors such as the squeezed spread between deposit and lending rates and gloomy financial markets both at home and abroad, the growth of profits in banking institutions slowed down for 8 months in a row since May 2008 (Figure 2.4).

Liquidity remained abundant amid large fluctuations. As of the end of 2008, the liquidity ratio of commercial banks rose by 9.72 percentage points over the previous year to 46.1%, with that of major commercial banks increasing by 8.47 percentage points to 44.3%, and that of small and medium-sized institutions including city commercial banks and rural commercial banks maintaining at above 50%, which was much higher than the

Figure 2.4 Growth of Net Profits of Listed Banks

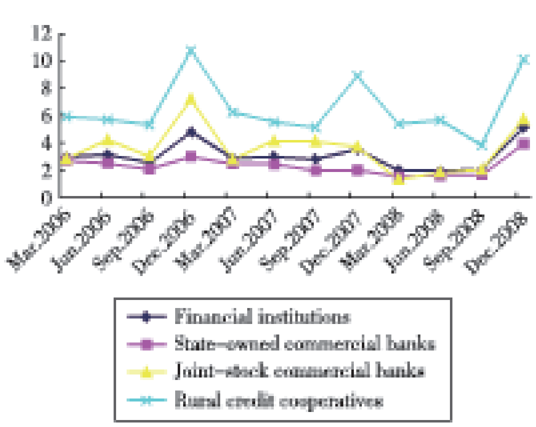


Source: Annual reports of listed banks.

lower limit of regulatory indicators (25%). The loan to deposit ratio of banking institutions registered 69.14%, down 3.35 percentage points y-o-y. The overall liquidity remained abundant in the banking system but fluctuated sharply (Figure 2.5).

Figure 2.5 Excess Reserve Ratio of Financial Institutions

(percent)



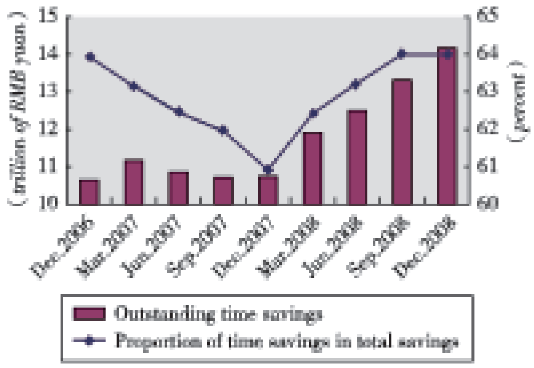
Source: PBC.

The growth of deposits accelerated, clearly tilting towards time deposits. As of the end of 2008, the outstanding deposits of banking institutions denominated in both domestic and foreign currencies totaled RMB 47.84 trillion yuan, increasing by 19.3% y-o-y. The growth of RMB deposits accelerated by 4.06 percentage points over the previous year. In particular, outstanding household savings rose by 25.70% to RMB 22.15 trillion yuan, an acceleration of 18.93 percentage points; corporate deposits grew by 13.52% to RMB 16.44 trillion yuan, 8.94 percentage points lower than the growth recorded in same period of last year.

As a result of interest rate cuts, the proportion of time deposits increased evidently in RMB deposits in 2008, especially in household savings. As of the end of 2008, outstanding RMB time savings reached RMB 13.9 trillion yuan, accounting for 63.93% of the total savings, an increase of RMB 3.44 trillion yuan from the beginning of the year that accounted for 75.94% of the new savings in 2008 (Figure 2.6).

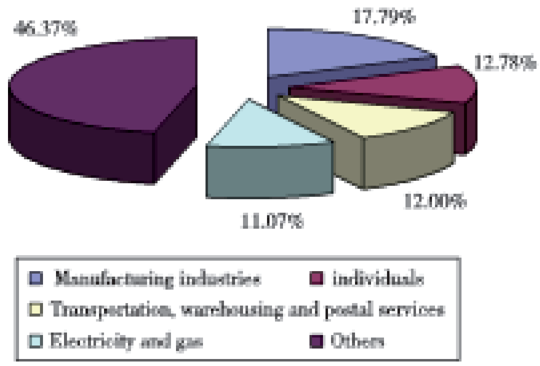
Loans of banking institutions grew steadily while the growth of real estate loans slowed down. As of the end of 2008, outstanding loans of banking institutions increased by 17.9% y-o-y to RMB 32.01 trillion yuan, flat with those recorded in the previous year. In particular, new loans to manufacturing industries, individuals, transportation, warehousing and postal services, and to electricity, gas and water industries amounted to RMB 754.144 billion yuan, RMB 541.68 billion yuan, RMB 508.963 billion yuan and

Figure 2.6 RMB Time Savings and Its Proportion in Total Savings



Source: PBC.

Figure 2.7 Sectoral Distribution of Loans

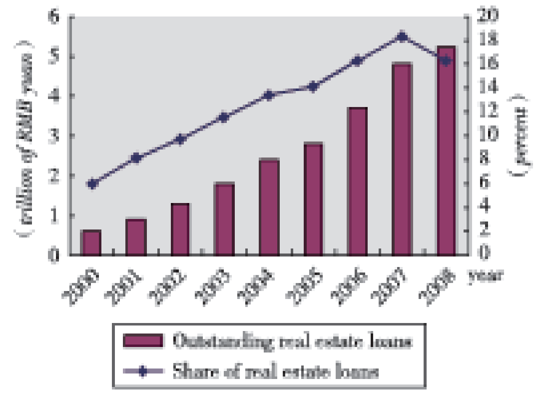


Source: PBC, CBRC.

RMB 469.16 billion yuan respectively, accounting for 53.63% of the total new loans (Figure 2.7), down 16.37% on a y-o-y basis. Commercial paper financing grew at a fast pace, with a y-o-y growth of 50% and its outstanding amount reaching nearly RMB 2 trillion yuan.

As a consequence of market adjustments, the growth of real estate development investment declined month by month since July, 2008. As of the end of 2008, outstanding real estate loans issued by major banking institutions rose by 8.75% y-o-y to RMB 5.22 trillion yuan and accounted for 16.31% of the total loans, down 1.2 percentage points (Figure 2.8). In particular, outstanding real estate development loans amounted to RMB 2.21 trillion yuan, increasing by 9.4%; outstanding home mortgage loans totaled RMB 3.01 trillion yuan, up 6.36%. The cooling real estate market in 2008 gave rise to risks in real estate loans.

Figure 2.8 Growth of Loans to Real Estate Industry



Source: PBC.

Issues Worth Attention and Reform Measures

In 2008, confronted with the complex and ever-changing economic and financial situations both at home and abroad, the banking sector continued to maintain good growth momentum and vigorously contributed to the sustained and sound development of the national economy. In 2009, the banking sector will continue to implement macro management policies, strengthen and improve credit services to intensify its support to economic development, prevent and mitigate various risks that may arise from economic fluctuations, handle the potential impact of the international financial crisis on China, and further enhance its comprehensive strength and resilience to risks.

Strengthen and Improve Credit Services to Meet Proper Financing Demand

In 2008, the banking sector actively implemented macro management policies and played a positive role in promoting economic growth. However, the credit structure of banks was still not so appropriate to accommodate current economic situations and market demand, and credit services were yet to be improved.

In 2009, following the new situations in macroeconomic management, the banking sector will concretely intensify credit support to economic and social development and effectively satisfy the proper needs for credit funds in the development of the real economy. First, according to the government's industrial policies, commercial banks are expected to increase their lending to projects aimed at improving the people's livelihood, major construction projects, post-disaster reconstruction, energy conservation and emission reduction, technological innovation, mergers and restructuring, as well as programs to promote balanced development among different regions. Second, measures should be taken to support the development of SMEs, and increase credit expansion to SMEs through providing financing guarantees and concessional loans. Third, credit support to "agriculture, rural areas and farmers" should be reinforced. Steps should be taken to further strengthen the role of the banking sector in providing financial services, actively expand consumer credit market in the rural area, develop micro credit business for farmers, and increase the expansion of concessional loans for poverty relief. Fourth, real estate credit services should be strengthened and improved. Credit support should be intensified for households willing to purchase their first ordinary homes, for the construction of low-rent housing and affordable housing, and for shantytown renovation.

Monitor the Performance of the Real Economy to Prevent Credit Risks

In 2008, the Chinese economic growth slowed down, as evidenced by a decelerated growth in both enterprise profits and fiscal revenue. Due to the impact of economic cycles, some sectors and enterprises were facing difficulties in their operation, giving rise to potential credit risks in the banking sector.

At present, banks should strike a balance between supporting economic development and preventing financial risks. Importance should be attached not only to avoiding the excessive reluctance to lending but also to curbing the blind credit expansion so as to actively forestall credit risks. First, the pace of credit expansion should be controlled to maintain the appropriate growth of credit aggregates. Attention shall be given to credit risks that may arise from low-level duplicated constructions. Second, credit structure should be further improved. Commercial banks should properly contain lending to ordinary processing industries and restrict loans to enterprises with high-energy consumption, high emissions, and excess capacity. Potential risks in intensive credit expansion should be monitored to alleviate the concentration of credit risks. Third, credit risk management should be strengthened. Credit monitoring and internal control should be intensified, and credit risk early warning and emergency resolution mechanism should be set up for major projects and enterprises in key sectors to properly handle unexpected credit risks. Fourth, credit risk management tools such as credit asset restructuring and transfer should be employed to appropriately diversify credit risks. Fifth, real estate credit risk management should be reinforced to closely follow the fluctuations in housing prices, actively conduct stress tests and dynamically assess credit risks in the real estate industry.

Steadily Advance Business Innovation to Improve Profitability

Since May 2008, the banking sector witnessed a continued decline in revenue growth, posing a larger pressure on commercial banks to increase profits. At the same time, the proportion of fee-based business income in total income was still far below the international average, and revenue structure was yet to be improved.

Going forward, commercial banks should speed up business innovation, maintain the appropriate growth of profits, and continue to improve revenue structure. First, taking advantage of the current policy of boosting domestic demand and maintaining economic growth, vigorous efforts should be made to adjust credit structure and actively conduct credit business that are in line with the policy guidance and conducive to restructuring, and have high rates of return, so as to enhance credit earnings. Second, the development of fee-based business should be fostered in accordance with the current situations and the changing market demands, and efforts should be made to further raise the proportion of fee and commission income as well as the earnings from non-credit assets. Third, innovation capability should be enhanced. Keeping risks under control, steps should be taken to strengthen financial innovation and develop new products and business with distinctive features in an effort to avoid unduly homogeneous and low-level competition and enhance the overall profitability. Fourth, financial consulting and wealth management services should be improved through perfecting the design and risk management of wealth management products, to increase profits in wealth management business. Fifth, credit risk pricing mechanism should be optimized to balance risk and revenue in a scientific approach and pursue reasonable returns.

Regulate and Guide Private Financing to Prevent Risks from Spreading to the Banking System

In recent years, the rapid development of private lending in China to a certain extent fills the shortfall of funds that formal financial institutions are reluctant, or fail to supply, and enhances the capacity of the economy to self-adjust. However, as irregularities in private financing may breed usury, illegal financing, financial fraud, money laundering and other criminal offenses, potential risks should not be ignored.

Therefore, effective measures should be taken to provide regulation and guidance to ensure that private financing develops in a healthy manner. First, relevant rules should be improved, and laws and market disciplines should be strengthened to actively guide the regulated development of private lending. The formation and development of a multi-layered credit supply market should be promoted to expand financing channels for SMEs. Second, Differentiated treatment and categorized management should be applied to the private lending market to protect legitimate private lending while cracking down on illegal financing activities. Third, formal financing should be further developed to strengthen its guidance for private lending, and create a favorable environment for the coexistence of the private lending market with the formal financial sector. Fourth, outreach activities should be strengthened so as to alert the general public to the harmfulness of illegal financial activities and to enhance their awareness of financial risks and their capacity to identify risks. Fifth, a monitoring and management system should be established to incorporate private lending into financial monitoring and macro management, so as to prevent the potential risks of private lending from spreading to the banking sector.

Continue to Watch the Impact of Global Financial Crisis on the Banking Sector and Better Respond to the Crisis

In light of the financial performance of major economies in the world in the first quarter of 2009, the international financial crisis may continue with its effect on China's economic and financial sector looming larger. As a result, the Chinese banking institutions are facing increasingly complex environment, and larger pressures and potential risks in their operation and management.

It is necessary to further improve banks' resilience to the crisis. First, the monitoring and analysis of the financial crisis should be intensified and the risk monitoring and assessment system should be improved for the banking sector to identify possible path of risk spreading to China's banking sector, with reference to international experiences and lessons in coping with the banking crisis. Second, the working mechanism dealing with the crisis and emergency programs for unexpected events should be put in place, and information sharing and coordination should be strengthened to guard against shocks that might be inflicted by internal and external uncertainties to the banking sector. Third, banking institutions should actively prevent and mitigate overseas investment risks, timely adjust the structure of overseas assets, strengthen the management of overseas branches and improve the dynamic risk assessment on the investments in major countries in the world. Fourth, continued efforts should be made to deepen the reform, further improve corporate governance, establish transparent compensation system compatible with risk and return, steadily reinforce the building of internal control system, and comprehensively enhance the risk management capability. Fifth, the extent and quality of opening-up of the banking sector should be enhanced. Market behaviors such as foreign strategic investors' reduction of shareholdings in the Chinese banks should be properly treated and the strategy of "bringing in" should be further implemented in a proactive and prudent way. Seizing the potential opportunities brought about by the international financial crisis, measures should be taken to scientifically adjust the "going out" strategy to enhance the international competitiveness of China's banking sector. Sixth, financial regulation system should be improved to strengthen functional and prudential supervision, intensify capital constraints and liquidity management, and improve market information disclosure system so as to guard against financial risks in the banking sector and safeguard financial stability.

(By Guo Dayong, Ouyang Changmin, Zhao Min, Lin Wenshun and Qu Tianshi)

Chapter III

Securities Sector and the Capital Market

In 2008, affected by complex factors such as worsening global financial crisis and uncertain domestic economic situation, the stock market of China continued to perform weakly accompanied by shrinking turnover, while the capital market withstood severe tests. In response to this, competent agencies unveiled a series of policy measures in a timely manner, so as to strengthen market confidence, enhance risk prevention capability of market participants, and further strengthen the inherent foundation of the healthy and stable development of the capital market.

Recent Developments

The stock market continuously weakened along with shrinking turnover. In 2008, the Shanghai Stock Exchange Composite Index was 5 522.78 points at its peak and 1 664.93 points at its trough, and closed at 1 820.81 points at the year end, down 65.39% from a year ago. The Shenzhen Stock Exchange Component Index was 19 219.89 points at its peak and 5 577.23 points at its trough, and closed at 6 485.51 points at the year end, down 63.36% from a year ago (Figure 3.1). As of the end of 2008, there were 1 625 listed companies on Shanghai and Shenzhen Stock Exchanges (among which there were 109 listed companies on the B-share market), 75 more than the previous year. The total capitalization was RMB 12.14 trillion yuan, a decrease of 62.89% y-o-y; the value of tradable shares stood at RMB 4.52 trillion yuan, a decrease of 51.42% y-o-y. The total trading volume on both exchanges amounted to RMB 26.71 trillion yuan, with a daily trading volume averaging RMB 108.582 billion yuan, down 42.00% and 42.95% respectively from the previous year.

Figure 3.1 Trends of Shanghai Stock Exchange Composite Index and Shenzhen Stock Exchange Component Index in 2008 (Based on Closing Prices)

Source: Shanghai and Shenzhen Stock Exchanges.

The financing role of the stock market decreased to some extent and new issuance of corporate bonds increased rapidly. In 2008, 181 companies issued equity-type securities, raising a total of RMB 310.817 billion yuan. Among the total, IPOs on the A-share market raised RMB 106.636 billion yuan, down 76.58% y-o-y; additional share offering raised RMB 51.805 billion yuan, down 21.76% y-o-y; rights offering raised RMB 14.227 billion yuan, down 35.92% y-o-y; convertible bonds raised RMB 7.72 billion yuan, down 15.07% y-o-y; splittable bonds raised RMB 63.285 billion yuan, up 203.69% y-o-y. New issuance of corporate bonds totaled RMB 872.34 billion yuan (including enterprise bonds, bonds issued by listed companies, short-term financing bills and medium-term notes, the same hereinafter), an increase of 68.37% y-o-y.

Futures market developed rapidly, and the trading volume of bond market increased steadily. In 2008, there was a total transaction of 1.364 billion lots on the futures market, an increase of 87.24% y-o-y; total trading volume amounted to RMB 71.92 trillion yuan, an increase of 75.52% y-o-y, with both the trading volume and turnover hitting historical highs. Compared with 2007, except for the wheat futures product, most futures products maintained a growth momentum, and the trading volume of chemical futures products and grease futures products, which were launched in recent years, increased notably. The gold futures market, which was launched in 2008, operated smoothly. The inter-bank bond market maintained a rapid growth momentum, with a trading volume of RMB 37.12 trillion yuan for the full year, an increase of 137.95% y-o-y.

The number of investors increased steadily, and the proportion of stock capitalization held by Securities Investment Funds decreased somewhat. In 2008, although investors were cautious to enter the stock market, the number of new investors increased steadily. At the year end, there were 121.2354 million A-share accounts on Shanghai and Shenzhen Stock Exchanges, 2.4035 million accounts on the B-share market, 28.3412 million mutual fund-type accounts, 10.7058 million, 60.4 thousand and 2.3437 million more than the previous year, or an increase of 9.69%, 2.58% and 9.02% y-o-y, respectively. Among institutional investors, the proportion of stock capitalization held by securities investment funds was 20.35%, down 6.18 percentage points from the previous year.

Securities and futures companies operated soundly, and remained profitable for the whole industry. As of the end of 2008, total assets of 107 securities companies were RMB 1.2 trillion yuan, net assets were RMB 358.5 billion yuan, net capital was RMB 288.7 billion yuan, and net profits registered a total of RMB 48.2 billion yuan. 95 securities companies realized profits, accounting for 89% of the securities industry. 61 fund management companies managed 439 securities investment funds, with funds' net asset value of RMB 1.9 trillion yuan. 162 futures companies realized RMB 71.4 trillion yuan of agency transaction volume and RMB 4.087 billion yuan of commission income, representing an increase of 77% and 55.5% y-o-y, respectively; realized profits amounted to RMB 0.909 billion yuan, down 8.2% y-o-y. Profits with investment revenue deducted amounted to RMB 0.774 billion yuan, an increase of 116.8% y-o-y.

Reform and Achievements

Some major reform measures since 2003, such as non-tradable share reform, improvement of listed-companies' quality, comprehensive restructuring of securities companies, cultivation of institutional investors and improvement of the market legal system and so on, eliminated the major institutional obstacles that the capital market had long been facing, promoted the market operation system, improved the overall quality and structure of the stock market, which created a beneficial condition for China to deal with global financial crisis and safeguard the financial system. In 2008, the positive effect of major reforms on the capital market gradually revealed, fundamental institutional building made new progress, a multi-layered capital market system proceeded orderly, and the opening up of the securities market steadily pushed forward.

Measures Were Taken to Cope with the Global Financial Crisis

In 2008, competent agencies took a series of emergency measures to cope with the impacts of global financial crisis on the securities industry and capital market of China, so as to mitigate the negative impacts on the capital market to the largest extent.

First, efforts were made to strengthen crisis resolution. The regulatory authority of the securities industry set up a leading group to cope with the global financial crisis, monitored both the domestic and international capital markets on a daily basis, and made and improved relevant emergency measures.

Second, measures were taken to control overseas investment risks of securities financial institutions. The authority urged securities companies, fund management companies and relevant firms to check their overseas investment positions, deal with relevant risks in a proper manner, and try their best to mitigate losses.

Third, the systemic risk associated with extreme market conditions in the futures market was dealt with properly. In October 2008, affected by excessive volatilities of commodities prices on the international market, prices of main products fell to their lowest limits on the domestic futures market sometimes. Authority timely required forced position reduction, strengthened the management of fund inflows and outflows, and conducted stress tests level by level, so as to help prevent risks from spreading.

Fourth, listed companies and its controlling shareholders were encouraged to repurchase listed companies' shares, so as to stabilize the stock market. With the resumed issuance of medium-term notes in the inter-bank bond market, listed companies, especially large-cap stock companies, were allowed to utilize the funds they raised through issuing medium-term notes, to repurchase their own shares. The *Administrative Measures on Takeover of Listed Companies* was amended, in order to increase the flexibility of share repurchase by incumbent shareholders. The *Supplementary Provisions on the Share Repurchase by Listed Companies by Means of Centralized Bidding* was promulgated to simplify the procedure of repurchase check and approval. As of the end of 2008, controlling shareholders of 125 listed companies added RMB 3.97 billion yuan of shares, and 2 listed companies conducted share repurchase, which played an active role in stabilizing the stock market.

Institutional Building Further Improved

In 2008, in response to the new issues on the securities market, and in order to heighten market confidence and improve the institutional building, relevant regulatory authorities took a bunch of policy measures upon underpinning the market and perfecting institutional building of the securities market.

First, regulating the transfer of listed companies' stock shares with terminated sales limit. The *Guidance Opinions on Transfer of Stock Shares with Terminated Sales Limit of Listed Companies* was released, so as to strengthen information disclosure of shareholding reduction, improve the block trading system, and promote the transfer of listed companies' stock shares with terminated sales limit orderly. As of the end of 2008, the trading volume of block trade increased 962% over the previous year.

Second, encouraging listed companies to have more cash dividends. The *Decisions on Amending Some Provisions of Cash Dividends by Listed Companies* was released to clarify the conditions for giving out cash dividends in refinancing. Listed companies were also required to have cash dividend policies stipulated in their statutes, so as to guide listed companies to reward shareholders persistently.

Third, supporting listed companies' M&A and restructuring. A set of regulations, such as the *Administrative Measures on Material Asset Reorganization of Listed companies* and the *Administrative Measures Regarding Financial Consultancy Services on the Mergers, Acquisitions and Restructuring of Listed Companies*, were released. The auditing committee system on M&A and restructuring of listed companies was reformed, specialist consultation mechanism was established, and relevant check and approval standards and procedure were improved. For the whole year, 171 companies completed their M&A and injected a total of superior assets of RMB 327.2 billion yuan, with the yield per share increasing by 75%.

Fourth, reducing or exempting market taxes. In April 2008, stock trading stamp tax was decreased from 3‰ to 1‰. In September 2008, stamp tax on buying shares was abolished. In October 2008, the interest tax on stock trading settlement funds was exempted temporarily, which greatly reduced stock trading cost.

The Building of a Multi-layered Capital Market System Was Steadily Pushed Ahead

In 2008, the building of a multi-layered capital market system proceeded smoothly, the direct financing channel was further broadened, and financial support to economic growth rendered by the capital market was further increased.

First, the main board market was further improved. A bunch of superior enterprises got listed on the stock market, and the main board market continued to develop. The small and medium-sized enterprise board developed rapidly. A large number of small and medium-sized enterprises with potential growth and high-tech background got listed, broadening the direct financing channel for small and medium-sized enterprises.

Second, the preparatory work for the launch of growth enterprise market board was pushed ahead. The *Administrative Measures on Initial Public Offering and Listing on the Growth Enterprise Board* completed its solicitation of public opinions.

Third, the building of the OTC market was steadily pushed forward. The role of the agency share transfer system in a multi-layered market and its relation to other markets and targeted clients were clarified on a gradual basis. The pilot work of letting enterprises located in the Zhongguancun High-tech Industrial Area enter into the agency share transfer system was carried out, and a total of 41 enterprises located in the area used the system by the end of 2008.

Fourth, the corporate bond market further developed. The application and approval system for issuance of corporate bonds was optimized, and bond issuance increased. 30 listed companies issued RMB 99.8 billion yuan of corporate bonds, accounting for 43% of the total refinancing amount, 2.43 times the previous year. Bond product structure was enriched, and research was conducted on introduction of exchangeable bonds. Fund management companies and securities companies were encouraged to issue bond-type products. Listed commercial banks returned to the stock exchange bond market on a trial basis.

The Legal System of the Securities Market Was Further Strengthened

In 2008, the legislative work was strengthened, the legal system for the securities and futures market was further improved, and the administration according to the laws was pushed forward steadily. Regulatory authorities issued the *Rules on Supervision and Administration of Securities Companies* and the *Rules on Risk Disposal of Securities Companies*, further clarifying the basic arrangements of supervision and risk disposal of securities companies. The risk control indicator system centered at net capital was improved, and the *Administrative Measures on Risk Control Indicators of Securities Companies* was amended, so as to strictly control and prevent the business risks of securities companies. 7 regulations and 41 standardizing rules including the *Implementation Measures on Supervision and Administration of Securities and Futures Market* were promulgated or amended, so as to improve the legal system of the securities and futures market and strengthen the foundation of standard market operation. The *Circular on Cracking Down on Illegal Securities Activities* was released to further improve the legal system on striking illegal securities activities. The reform on securities activities inspection and administrative punishment was deepened. A number of serious cases were sanctioned, and efforts were made to increase the transparency on sanctions of serious cases, which yielded positive social effects.

The Securities Market Was Further Opening Up to the Outside World

First, efforts were made to steadily promote foreign participation in the domestic capital market. The approval of joint-venture securities companies was resumed; the business scope of eligible joint-venture securities companies was broadened; the check and approval system for QFII was improved along its quota application, and the QFII supervisor system was established from scratch; 24 new QFII organizations were approved along with USD 2.86 billion of approved quota. Second, domestic enterprises and institutions were encouraged to participate in overseas markets. The legal and administration system for overseas listing was improved; 24 corporations were permitted to get listed on overseas exchanges, raising a total of USD 4.56 billion; 3 securities companies and 4 fund management companies were permitted to set up branch offices in Hong Kong; efforts were made to sum up the pilot practice of QDII and perfect its system; 11 fund management companies and 4 securities companies were approved for QDII, and 5 QDII products raised a total of RMB 5.1 billion yuan.

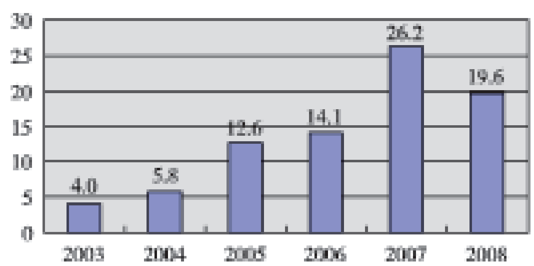
Soundness Assessment

The Proportion of Direct Financing Declined Somewhat, and the Financing Structure Was Yet to Be Optimized

In 2008, RMB 1.21 trillion yuan were raised via direct financing (including equity financing and corporate bond financing), accounting for 19.6% of total financing for the whole society, down 6.6 percentage points from the previous year.

Figure 3.2 The Proportion of Direct Financing in Total Fund-raising

(*percent*)



Source: PBC.

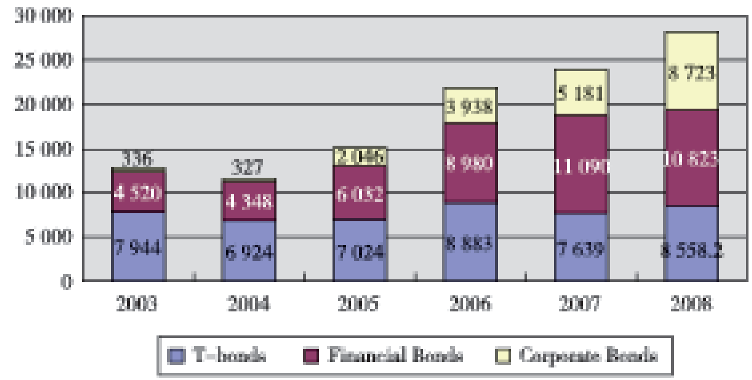
In general, at the current stage, indirect financing still accounted for a lion's share in China's financing structure, and the issue of enterprises' dependence on bank financing has not changed profoundly. The aforementioned financing structure, to some extent, resulted in concentration of credit risk in the banking system. Under the current business cycle, this risk was to be even more pronounced.

The Bond Market Continued to Develop, and the Potential Default Risks of Some Individual Corporate Bonds Warranted Attention

In 2008, China's bond market continued to develop rapidly. Bond financing (including T-bonds, policy bonds, financial bonds and corporate bonds) raised a total of RMB 2.81 trillion yuan, an increase of 17.5% y-o-y. In particular, the corporate bond market developed rapidly, and the issuance of medium-term notes brought more products to the corporate bonds family. In 2008, corporate bonds raised a total of RMB 872.3 billion yuan, an increase of RMB 354.2 billion yuan over the previous year, or 68% y-o-y, among which the issuance of enterprise bonds amounted to RMB 236.7 billion yuan, an increase of 38% y-o-y; the issuance of short-term bonds amounted to RMB 433.2 billion yuan, up 29% y-o-y; bonds issued by listed companies amounted to RMB 28.8 billion yuan, up 157% y-o-y; the issuance of medium-term notes amounted to RMB 173.7 billion yuan.

Figure 3.3 Structure of Bond Financing

(100 *million of RMB yuan*)



Source: PBC, CSRC.

The bond market is an integral part of the capital market, and the coordinated development of the stock market and the bond market is conducive to the diversification of financing channels. Only the complementary function of the stock market and the bond market is put into full play, can the negative impact of cyclical fluctuations be mitigated. Under the current economic situation, attention should be paid to potential default risks of individual corporate bonds, and more efforts should be made to perfect the fundamental system including information disclosure and the qualified institutional investor system.

The Stock Market Fluctuated Considerably, and the Internal Stabilizing Mechanism Needed to Be Improved

In 2008, the A-share market adjusted by a large margin. At the end of 2008, the CSI 300 index closed at 1 817.72 points, down 65.95% y-o-y, a drop only second to the

RTS stock index of Russia.

Table 3. 1 Major International Stock Indices in 2008

	Closing	Change
SSEC	1 820. 81	-65. 39%
CSI 300	1 817. 72	-65. 95%
Hang Seng	14 387. 48	-48. 27%
Dow Jones Industrial Average	8 776. 39	-33. 84%
CAC40	3 217. 97	-42. 68%
FTSE 100	4 434. 20	-31. 33%
Xetra DAX	4 810. 20	-40. 37%
IBOVESPA	37 550. 00	-41. 22%
Nikkei 225	8 859. 56	-42. 12%
RTS	631. 89	-72. 41%
Sensex	9 647. 31	-52. 45%

Source: Wind.

The significant stock market adjustment was affected by several factors, such as the reversion of stock prices to the intrinsic value, the impact of global financial crisis, and declining economic situation, etc. The stock prices on the A-share market in 2007 were apparently relatively high, and many stock prices diverged from their fundamental value, therefore, value reversion became the inherent requirement for stock market adjustment in 2008. The significant fluctuations in the stock market indicated the pronounced "emerging and transitional" characteristics of China's stock market and incomplete internal stabilizing mechanism. More efforts should be made to strengthen institutional building, improve the market-based system, and put the self-adjustment role of the stock market into play, so as to avoid the boom-and-bust of the stock market.

Box 3 Short Selling, Financing and Securities Lending

Short selling on the stock market usually refers to covered short selling, namely, an investor borrows an amount of stocks from a broker and then sells them. After a period of time, the investor buys back the stocks and returns them to their owner.

Short selling is an ordinary practice widely accepted in most international securities markets, and has important implication for the market operation mechanism. First, short selling helps the formation of the pricing mechanism. When an investor considers the stock price too high and short sells the stock, stock supplies are increased, which helps stock price to converge to a reasonable level and improves market efficiency. Second, short selling helps improve market liquidity. Liquidity is an important premise of the capital market operation. Short selling, to some extent, may magnify fund and stock supply and demand, increase the buoyancy of the stock market, and increase the breadth and depth of the market. Third, short selling provides a kind of means to prevent market risks and a new transaction means for investors, helps avoid one-side increase of the stock price, and provides an instrument for investors to prevent market risks.

As a credit transaction means, short selling also has leveraging effect, and in certain circumstances, may encourage market speculation, and act as a means to suppress the stock market. In particular, under the circumstance of imperfect market mechanism and lax regulation, naked short selling may come into existence, further exacerbating market fluctuations.

Naked short selling means an investor (usually large institutional investor and hedge fund) takes advantage of its special position, selling shares without making a securities-borrowing arrangement. Since naked short selling sells virtual shares the amount of which may exceed current shares, it has a significant impact on the stock price. Investors can influence stock price via naked short selling and profits from it. In the course of the current US financial crisis, some speculators used the naked short selling as a means to influence the stock market. In order to maintain the stability of the stock market, the US SEC released an emergence statute on July 15, 2008, suspending naked short selling activities of 19 main financial institutions. On September 17, 2008, the US SEC announced to penalize naked short selling as fraud activities. On September 19, 2008, the US SEC suspended covered short selling activities (Only after the Parliament passed the USD 700 billion bailout bill could the covered short selling be resumed). Besides, Australia, France, Germany, South Korea etc., announced a ban on naked short selling of specific shares for certain periods, and imposed temporary restriction on covered short selling.

China planned to introduce the pilot financing and securities lending business, i. e. short selling of shares, conducted by securities companies, in the near future. Judging from the published rules on the pilot financing and securities lending activities, relevant risk-preventing measures had been put in place. First, naked short selling was prohibited. Only after investor borrows shares from the market can he sell them. Therefore, without holding the stocks, investors can not conduct naked selling short activities, and short seller can not influence stock prices by naked short selling and make profits, which is conducive to controlling the risk of selling short and safeguarding market stability. Second, the margin system was established. In conducting the financing and securities lending transaction, the proportion of original margin should not be lower than 50%. In the meantime, investors have to use the margin, purchased securities via financing, and funds by selling securities as the collateral, and the proportion of the afore-mentioned collateral to investors' debts associated with financing and securities lending activities should not be lower than 130%. Third, transaction price and turnover is constrained. The selling price of the borrowed stock should not be lower than the latest market price, and the amount of financing and securities lending of a particular share should not be higher than 25% of market capitalization of that share, so as to prevent manipulative behavior of investors through using the financing and securities lending instrument.

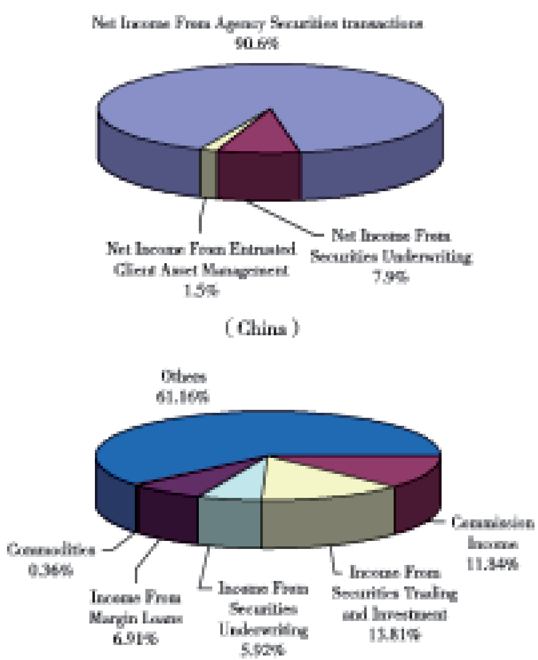
Margin trading is a common way of doing business in most securities markets across the world, and also a fundamental institutional building underway for China's securities market. Nevertheless, it is worth noting that, compared with ordinary securities business conducted by securities companies, margin trading bears a higher degree of risks. Therefore, the pilot program should be carried on in an active, timely but precautious way on the basis of a solid risk prevention mechanism, and emergency plans should be drawn for unusual market situations.

Both the Risk Prevention Capability and Profit-making Modes of Securities Companies Needed to Be Improved

Securities companies were important financial intermediaries and participants in the capital market. Due to relatively short development history and institutional shortcomings, there existed some problems in securities companies, such as lax internal control and irregular operation, and so on. Over the past few years, outbreaks of securities companies' risks took place at a relatively concentrated time, undermining financial and social stability. From July 2005, the comprehensive restructuring of securities companies was carried out across the board, which basically solved historical risks and improved the institutional arrangements of the securities market.

In 2008, the effects of Comprehensive Restructuring of securities companies were unfolded on a full basis. Although there were large volatilities on the stock market, the securities industry remained profitable as a whole. While in the past, due to appropriation of clients' settlement funds and inappropriate commissioned wealth management activities, systemic risks set in, fortunately, this situation did not repeat itself. According to statistics released by the Securities Association of China, as of the end of 2008, the pre-audited financial reports of 107 securities companies showed their total assets amounted to RMB 1.2 trillion yuan, down 29.4% y-o-y, and total profits registered RMB 48.2 billion yuan, down 63.5% y-o-y. In terms of income structure, the brokerage services remained the main source of income for securities companies, accounting for 90%, and the proportions of other businesses were relatively low. Securities companies needed to diversify their operations and broaden their business.

Figure 3.4 Comparison of Income Structures of Securities Companies both in China and US



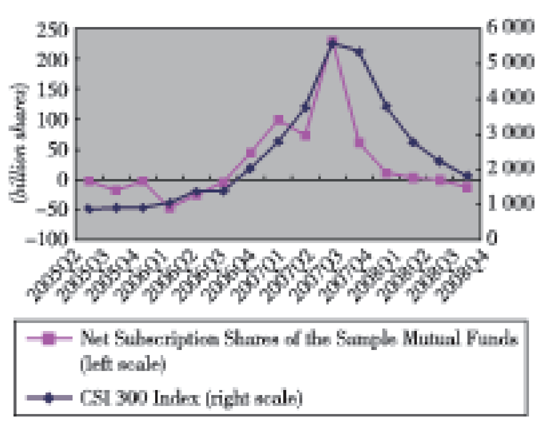
Source: the Securities Association of China (2008) and the Securities Industry and Financial Markets Association (2007).

Open-ended Mutual Funds Faced Redemption Pressure and Their Liquidity Risks Warranted Attention

In 2008, the stock market continued to perform weakly, and the investors were reluctant to invest, which influenced the operation of open-ended mutual funds. Taking the 96 open-ended funds (including equity-type mutual funds, relatively equity-oriented mutual funds and hybrid mutual funds) set up prior to June 30, 2005 as the fund sample, according to statistics of the Wind database, the fund sample had RMB 3.49 billion yuan of net subscription in Q2 2008, then had 9.5 million shares and 13.043 billion shares of redemption respectively on a net basis in the following two quarters, forcing the fund sample to cash on stocks. In the portfolio of fund sample in Q4 2008, equity-type assets accounted for 65.32%, down 11.3 percentage points from a year earlier. By selling stocks, the fund sample maintained a relatively high liquidity and coped well with the redemption pressure. The proportion of deposit-type assets increased from 8.98% in Q4 2007 to 10.32% in Q4 2008, and the proportion of bond-type assets increased from 11.15% to 23.41%, to some extent reducing potential losses in the course of continuing stock price decline.

Under the current circumstance in which the relatively high proportion of open-ended funds remained unchanged, close attention should be paid to liquidity risk of open-ended mutual funds. Judging by historical data of redemption of the fund sample, the funds were usually redeemed at turning points of the stock market, such as the initial stage of the bullish stock market in Q1 2006, when the redemption of the fund sample amounted to 46.16 billion shares on a net basis, indicating wary investors shied away from the stock market in the wake of stock market slump, and tended to sell stocks in the amidst of stock price rebounding. In Q4 2007, the stock market went down, and the subscription of the fund sample decreased notably on a net basis, and even larger than the decline of the stock market. With the stock market plummeting in Q2 2008, the redemption of the fund sample remained stable, indicating investors' willingness to hold the loss-making fund shares, and also reflecting the so-called Disposition Effect[1]. Since the uncertainty of the current economic and financial situation both at home or abroad still remained, and large market fluctuations may induce investors to redeem their shares at the same time, close attention needs to be paid to the liquidity risk of open-ended mutual funds.

Figure 3.5 Net Subscription of Open-ended Mutual Funds During 2005 – 2008



Source: Wind.

Issues Worth Attention and Reform Measures

Affected by current domestic and international complex economic and financial situation, the internal and external environment for China's capital market was undergoing profound changes with increased uncertainties. Therefore, efforts should be made to promote the reform of the capital market, consolidate the institutional infrastructure, perfect the mechanism, and strengthen the functions, so as to safeguard the sustainable and stable operation of the capital market, and put the role of the capital market in promoting the steady and rapid economic development into full play.

Attention Should be Paid to Impacts of International Financial Crisis and Measures Should be Taken to Prevent Systemic Risks

As China's capital market was increasingly interlinked with international economy and finance, impacts of evolution of the global financial crisis on China's capital market remained to be watched. In the next stage, efforts should be made to strengthen monitoring

1 The Disposition Effect is an important phenomenon in behavioral finance theory, reflecting the inclination of investors to sell the profit-making stocks at an earlier stage while keeping the loss-making stocks for a relatively longer time.

and analysis of the global financial crisis, and deal with it in a proper manner; further perfect the stress tests on the capital market, reinforce risk monitoring, early warming system and risk prevention capability of highly risky financial institutions, learn from the best crisis management practices, improve institutional building, deal with financial risks in a pre-emptive manner, safeguard financial and social stability; step up the opening up of the financial sector to the outside world in an appropriate pace, continue to adhere to the principle of liberalizing the financial sector in a step-by-step manner based on our own initiatives, and actively promote reform of the international financial system.

Box 4 Lessons Learned from Huge Losses Resulted from Overseas Derivative Investments by the Chinese Enterprises

In 2008, due to the global financial crisis, commodities prices witnessed a large slump on the international market, and many Chinese enterprises incurred huge losses in derivative investments, including the Air China and China Eastern Airlines incurring losses in gasoline hedge transactions, and Shenzheng Nanshan Power Station Co., Ltd irregularly signing petroleum option contracts.

The huge losses incurred regarding derivative investments not only resulted from the objective reasons of global financial crisis, but also from subjective reasons which needed to be summarized and learned lessons from. First, some enterprises inappropriately invested in highly risky and complex derivative products. Due to asymmetry of return and risks and asymmetric knowledge and information between trading partners, domestic enterprises tended to be misguided and even cheated. Second, some enterprises had loopholes in internal risk control, and had not established a risk control department and transaction reporting system independent of the trading department. The trading department and personnel tended to conduct derivative transaction without authorization. Third, some enterprises' derivative position exceeded their actual hedge demand, which was used for speculative purpose. Fourth, most enterprises lacked derivative trading specialists. Fifth, domestic financial institutions did not provide sufficient services to enterprises, and enterprises' reasonable hedge demand could not be satisfied.

The huge losses toll an alarm bell for us. Relevant authorities should explore the reasons behind them and take appropriate measures to prevent any potential losses. First, efforts should be made to supervise relevant enterprises to evaluate their derivative position risks and take effective measures to rectify them, so as to conserve their asset value, reduce losses, and avoid potential loss accumulation. Rule-breaking behaviors and personnel should be investigated and penalized. Second, efforts should be made to prevent domestic enterprises from participating in complex OTC derivative transactions. Third, efforts should be made to urge enterprises to improve their risk control mechanism, monitor their derivative trading position in an independent, paralleled and real-time manner, and avoid unauthorized derivative transactions. Fourth, efforts should be made to strengthen education on derivative trading, and help enterprises improve their trading skills. Fifth, efforts should be made to improve the services of financial institutions, and broaden the normal channels for enterprises in hedging their assets. Sixth, efforts should be made to strengthen legislation and supervision over derivative products transaction, such as strictly checking qualification of enterprises in conducting derivative business, requiring enterprises to conduct derivative transaction mainly for hedge reasons, and cracking down upon irregular sales and fraud activities of financial intermediaries.

Efforts Should Be Made to Further Improve the Quality of Listed Companies so as to Promote Stable and Relatively Fast Economic Growth

Listed companies were the foundation of the capital market development, and further efforts should be made to improve the quality of listed companies, and make them the backbone in promoting the steady and relatively fast development of the national economy.

First, efforts should be made to facilitate M&A of listed companies, such as, perfecting the institutional arrangements for M&A, improving the pricing mechanism of M&A and restructuring, and reforming the check and approval procedures, so as to increase the efficiency of restructuring, and promote industrial adjustment and upgrading. Second, efforts should be made to further improve independence and transparency of listed companies and help them improve their corporate governance. Third, efforts should be made to encourage listed companies to give out cash dividends so as to reward their shareholders.

Box 5 Conclusion From the Development of Overseas GEM Board

GEM Board is the outcome of government support to growth enterprises and innovation since 1970s. After more than three decades of exploration and practices, especially after the bust of network shares in 2000, for the time being, GEM board is rejuvenating its vigor throughout the world, and playing an increasingly important role in promoting industrial upgrading and scientific and technological innovation.

As of the end of 2008, there were 47 GEMs across the world, covering main economic regions and industry-concentrated areas. The development of the GEMs showed the following characteristics: First, the original GEMs developed in a steady way. In recent years, leading GEMs, such as the US Nasdaq, British AIM, Japanese Jasdaq, Korean Kasdaq, and Canadian TSX-V, showed a favorable development momentum. Although global stock markets withstood large fluctuations in 2008, market capitalization of these GEMs still increased 14% y-o-y by 2008, and turnover increased 119% y-o-y. Second, new GEMs have been established consecutively. According to statistics, 15 new GEMs were set up from 2002 to 2008. The Indian Bombay Stock Exchange set up the Indonext market in 2005, and there are more than 2 700 enterprises listed on the exchange, with market capitalization of over USD 20 billion, which promoted the development of Indian high technology and outsourcing enterprises greatly. Third, the image of GEM was on a continuous rise. After years of consolidation and development, main GEMs across the world ultimately got out of their low-end image, and played an increasingly important role in the global securities markets. For example, the US SEC approved the Nasdaq market as a national stock exchange in 2006, making a historical breakthrough. The Japanese Jasdaq became a stock exchange market in 2004. In 2005, the Korean Securities Exchange, the Korean Futures Exchange and the Kasdaq market were combined into the new Korean Securities and Futures Exchange, and the Kasdaq became an important part of Korean securities market since then.

The resurgence and success of the GEMs across the world, was not only due to global economic growth, but also to the main characteristics of GEM, such as independent discovery and selection mechanism, effective combination of science, technology and venture capital, and cultivation and promotion of the development of high-tech industries. The successful experiences of the GEM can be summarized as following. First, the market access threshold is relative low for growth enterprises. The Nasdaq and Kasdaq prescribed different flotation standards according to operating income, profit, asset, and operating period, so as to meet the demand of different enterprises. The second is convenient listing procedure and lower listing costs. The Nasdaq exchange checks and approves an enterprise' flotation application. After being approved, the enterprise then files with the SEC for securities registration, which becomes effective within 30 days, and the enterprise is qualified for listing on the Nasdaq market. The third is strict supervision. Although the listing standard in the GEM market is relatively low, successful GEMs generally have very strict supervision over listed companies. The approval rate for listing applications in the Kasdaq market was less than 50% in 2004 and 2005. The Nasdaq market carries out a strict de-listing standard to realize the survival of the fittest. The fourth is diversification of industries. A diversified industry structure not only increases the coverage of listed companies, but also helps avoid systemic market risks.

From the experience of overseas GEMs, the introduction of GEM is an effective way to realize economic restructuring and to weather economic distress with a market-oriented approach. For example, the US experienced the decline of traditional industries and economic growth slowed down in 1970s. The establishment of the Nasdaq market promoted the formation of silicon-valley high-tech industry, helped the economy quickly out of distress, and led to the new round economic growth represented by the so - called " new economy ". At the same time, Korea and Taiwan Province of the People's Republic of China energetically developed the GEMs, successfully achieved economic restructuring, and quickly got rid of impacts of the Asian financial crisis.

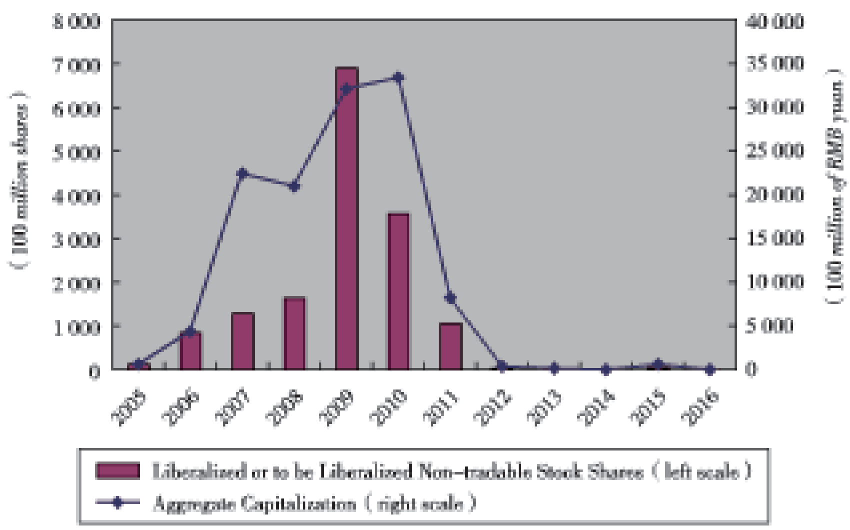
At present, China also faces the optimal opportunity to launch the GEM. The introduction of the GEM is an important measure to perfect China's capital market structure and increase the breadth and depth of the capital market. In the meantime, the GEM can promote private investment and industrial upgrading, create more employments, put the role of the capital market into a better play in resources allocation, strengthen the role of the capital market in supporting the national economy, and promote the building of an innovative society.

Measures Should Be Taken to Reasonably Adjust Market Demand and Supply, and Maintain the Stability of the Stock Market

In 2008, a total of 162.148 billion shares of non-tradable stocks were liberalized, with market capitalization of about RMB 2.1 trillion yuan. In 2009, another 688.883 billion shares would be liberalized, with market capitalization of about RMB 3.2 trillion yuan, an increase of 53.1% y-o-y. Attention should be paid to monitor the implication of liberalizing non-tradable stocks on the market operation.

Therefore, efforts should be made to guide enterprises to respond to changing market condition, and to select appropriate financing instruments, timing and scale. Efforts should also be made to perfect block trade system, such as setting up market entry conditions reasonably to increase the buoyancy of the block trade market, providing an effective platform for the large scale transfer of listed companies' stock shares with terminated sales limit, to standardize the large scale share sales by listed companies' shareholders and reasonably adjust the stock market demand and supply.

Figure 3. 6 Liberalization of Non-tradable Stock Shares during 2005 and 2016



Source: Wind.

Box 6 Stock Market Stabilization Fund

In 2008, the A-share market witnessed a large slump, which triggered the hot discussion of whether to establish the stock market stabilization fund (hereinafter referred to as the stabilization fund). A stabilization fund is established by the government and held by specific agency. During continuing stock market slump, the stabilization fund intervenes to stabilize both the stock market and the society. There are quite a very small number of countries and regions that establish the stabilization funds, which have two forms in general: one form is to combat irrational stock market busts due to outside impacts; the second form is to combat the continuing stock market slump due to domestic economic recession. However, the operation of stabilization funds did not prove successful. There exist problems, such as inadequate legal basis, difficulties in preventing moral hazard, and increasing psychological dependence on the governments.

From the perspective of international experiences, the results of the establishment of stabilization fund are unsatisfactory, and generally do more harm than good. First, in terms of management and operation, stabilization funds are usually managed by government officials or government agencies, which lack specific knowledge on investment. Besides, due to an opaque decision-making mechanism, the operation of the stabilization fund is widely questioned and criticized by the market. Second, in terms of timing of intervention, it is difficult to distinguish whether the stock market really deviates from its reasonable value and can return to the original level in a short period. The usually wrong timing of intervention will undermine the normal role of market mechanism. Last, in terms of effectiveness of stabilization fund operation, the performance of stabilization fund aimed to stabilize the stock market did not prove successful. Although the stabilization fund has some positive impacts on the stock market in short periods, it cannot smooth the market fluctuations by counter-cyclical operation in the long run. On the contrary, the side effects of stabilization fund cannot be underestimated. Due to opaque operation, the operation of stabilization funds in many countries and regions has engendered the following problems such as market manipulation, insider trading, even suspected corruption, etc.

Since China's stock market is still at its initial stage of development, and the market mechanism and supervisory system is far from perfect, to introduce the stabilization fund needs adequate testing and scientific evaluation. The top priority is to deepen reform and promote the stable and healthy development of the stock market, such as to continue to deepen enterprises reform, build a standardized corporate governance structure, and improve the quality of listed companies; perfect the rules of market operation, strengthen financial supervision in a down-to-earth manner, seriously investigate and crack down upon illegal activities on the capital market; speed up economic restructuring and the construction of credit system, and improve the operating environment of the capital market.

Efforts Should Be Made to Improve the Capital Market System and Structure, and Enhance Its Role in Servicing the National Economy

The capital market is an integral part of the national economy, and plays an important role in allocating resources and promoting economic development. After deepening reforms over the past years, China's capital market has undergone profound changes, however, it is still faced with some acute problems. Efforts should be made to perfect the capital market system, put the role into full play of the capital market in servicing the national economy and promoting the stable and relatively fast economic growth.

First, efforts should be made to continually step up the building of a multi-layered capital market. Additional supports should be rendered to the weak areas and industries, such as agriculture, rural areas and the rural economy, self-initiated technology innovation, energy-conservation and so on. The small and medium-sized enterprise board should be perfected, so as to alleviate financing difficulties of small- and medium-sized enterprises. The design of the GEM should be perfected, and GEM Board should be introduced at a due time. Efforts should be made to perfect the design of the pilot agency share transfer system, and spread the pilot program to eligible high-tech industrial areas. Second, efforts should be made to develop and standardize the corporate bond market, so as to optimize the investment and financing structure. The issuance rules and supervisory standards regarding the bond market should be uniform, so as to standardize bond issuance and trading. The corporate bond market should be comprehensively designed, so as to lay down solid foundation for a centralized national bond market. Third, efforts should be made to steadily develop the futures market and strengthen risk prevention capability. The futures products should be increased, and the function of futures market should be deepened. Especially for the agricultural futures market, the building of the market should be strengthened, and ways by which agricultural futures products better serve agriculture, rural areas and the rural economy should be explored. Measures should be taken to set up the information disclosure system, continue to strengthen the monitoring of net capital of futures companies, cultivate institutional investors in the futures market, and explore ways for futures companies to conduct agency overseas futures business on a pilot basis.

Efforts Should Be Made to Continually Promote Reform and Innovation of the Capital Market, and Increase the Breadth and Depth of the Capital Market

In order to better serve economic development, the capital market shall improve its efficiency and competitiveness. At the same time, the outbreak of the US sub-prime crisis and its spillover to other parts of the world indicated that the level of financial innovation should be appropriate and a bunch of factors should be taken into account, such as market acceptance, investors' risk-taking ability, and regulators' capacity, in order to ensure all risks are under close monitoring and management.

In response to the new circumstance of liberalization of all non-tradable stocks, the work of financial innovation should be promoted steadily. First, efforts should be made to step up reform of IPOs, perfect the price inquiry system of new stock issues, and standardize securities underwriting. Second, efforts should be made to steadily conduct the financing and securities lending business by securities companies on a pilot basis, introduce stock index futures at an optimal time, and perfect the risk management system. Third, efforts should be made to explore ways to set up the qualified institutional investor system, so as to gradually build an institutional arrangement for different investors, products and regulatory requirements. Efforts should be made to conduct research on policy measures to encourage various long-term funds to enter into the stock market, and increase the participation of pension funds, social security funds, and annuities in the stock market.

Efforts Should Be Made to Strengthen Market Supervision and Penalize Illegal and Irregular Activities

Sound legislation and an effective and fair law enforcement environment are the premise and foundation for the healthy and orderly operation of the capital market. With the development of the capital market especially upon the completion of non-tradable share reform, legal construction faces many new situations and problems. In the meantime, the widespread participation in the capital market directly relates to the interests of mass individual investors. Therefore, the legislation and law enforcement environment should be improved to meet the scientific requirement of the capital market.

Greater efforts should be made to perfect the legal system of the capital market, and crack down upon illegal and irregular activities including market manipulation, insider trading and interest transfer. Supervision should be enhanced on listed companies, securities companies, fund management companies and futures companies, such as strengthening corporate governance to standardize the remuneration management of senior managers of the companies in the securities sector, and improving internal control system to discover and solve potential risks in a timely manner.

(By Qin Guolou, Meng Hui and Na Lili)

Chapter IV

Insurance Sector

In 2008, the Chinese insurance sector actively joined the efforts to fight serious natural disasters and address the international financial crisis. It continued to expand insurance services, strengthened insurance supervision, and maintained a stable and relatively rapid growth.

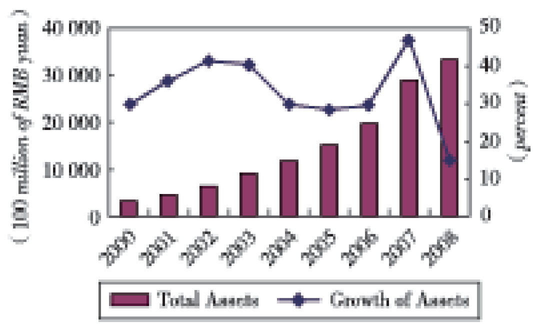
Recent Developments

Entities engaged in the insurance business continued to increase. In 2008, both insurance institutions and sales force increased. At end-2008, there were 130 insurance institutions and 2 445 professional insurance intermediaries, up 10 and 114 respectively over the previous year. The number of insurance sales representatives grew 546 000 from the previous year to 2 561 000 in 2008.

Assets increased further. Total assets of the insurance sector grew at a slower pace in 2008 due to a sluggish capital market. At end-2008, the total assets of the insurance sector reached RMB 3.34 trillion yuan, a rise of 15.2% y-o-y. The balance of invested insurance funds grew by 14.3% y-o-y to RMB 3.1 trillion yuan. This included RMB 808.755 billion yuan of bank deposits (26.47% of the total), RMB 1 768.417 billion yuan of bonds (57.89%), and RMB 407.182 billion yuan of stocks (equity) and securities investment funds (13.3%).

Premium income grew considerably. The year 2008 witnessed the fastest growth of premium income since 2002. In particular,

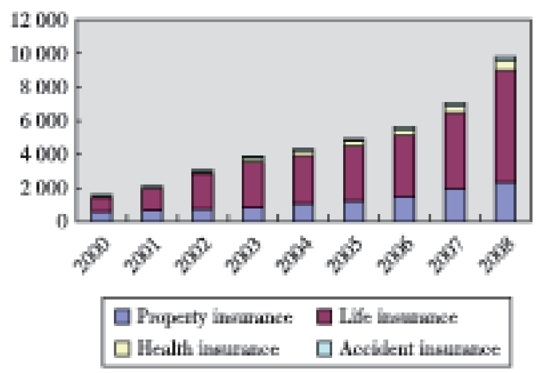
Figure 4.1 Asset Changes in the Insurance sector



Source: CIRC.

Figure 4.2 Premium Income Growth

(100 *million of RMB yuan*)



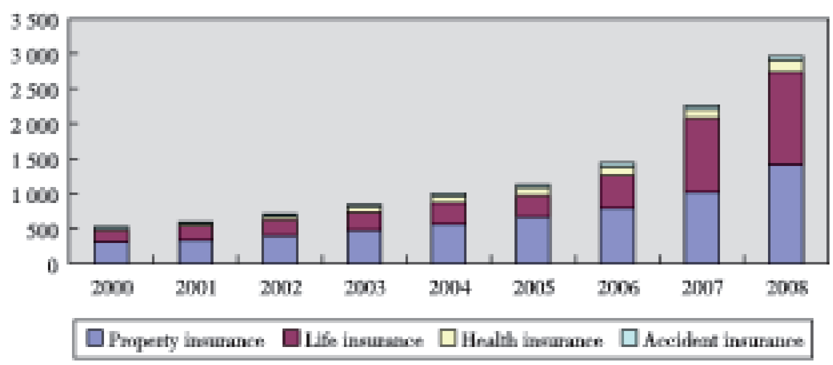
Source: CIRC.

premium income from health insurance and life insurance increased sharply. Total premium income in 2008 registered RMB 978.41 billion yuan, a y-o-y growth of 39.1%. Among this total, premium income from property insurance grew 17% to RMB 233.67 billion yuan; premium income from life insurance increased 49.2% to RMB 665.837 billion yuan; premium income from accident insurance totaled RMB 20.36 billion yuan, up 7.1%; and premium income from health insurance reached RMB 58.55 billion yuan, a rise of 52.4%.

Claim and benefit payments increased rapidly. Due to devastating disasters, claim and benefit payments increased rapidly in 2008. Claim and benefit payments by insurers nationwide totaled RMB 297.117 billion yuan, up 31.2% from the previous year. In particular, property insurance payments grew 39% to RMB 141.833 billion yuan; life insurance payments increased 23.5% to RMB 131.498 billion yuan; accident insurance payments declined 1.4% to RMB 6.257 billion yuan; and health insurance payments reached RMB 17.528 billion yuan, up 50%.

Figure 4.3 Claim and Benefit Payment Growth

(*100 million of RMB yuan*)



Source: CIRC.

Reform and Achievements

In 2008, progress was achieved in the efforts of the insurance sector to participate in disaster relief and post-disaster reconstruction, deal with the international financial crisis, expand insurance services, enhance insurance supervision and improve the insurance guarantee fund management system.

Participating in Disaster Relief and Post-disaster Reconstruction with All-out Efforts

In 2008, China was hit by a serious snow and sleet disaster in the south, which was followed by a catastrophic earthquake in Wenchuan.

Playing its role of risk protection, the insurance sector joined the disaster relief and reconstruction efforts. The insurance supervisor activated the contingency plan immediately, and provided guidance by issuing the *Notice on Strengthening the Emergency Work of the Insurance Sector in Disaster Fighting and Disaster Relief* and the *Emergency Notice on Strengthening Work on Earthquake Relief*. Insurers set up green passes, introduced special policies, enhanced service teams and streamlined procedures. They shortened the claim processes, improved claim efficiency, surveyed more quickly, and arranged adequate funds to ensure timely claim payments. The insurance sector paid RMB 5.5 billion yuan for the snow and sleet disaster in southern China, and RMB 1 billion yuan for the Wenchuan earthquake, playing an active role in stabilizing the production and people's life in disaster-stricken areas and in supporting reconstruction.

Actively Addressing the International Financial Crisis

In an effort to effectively deal with the international financial crisis, competent government agencies cooperated closely and adopted a wide range of measures, which effectively contained the spread of the impact of the financial crisis to China's insurance sector. First, we followed the developments and the fallout of the crisis, strengthened cooperation with insurance supervisors in relevant countries and regions, tracked the latest developments of the crisis, and conducted ongoing risk monitoring. Second, we intensified efforts to identify risks in the investment in stock, equity, overseas markets and real estate in the whole sector, and obtained a general picture of risk profile. We strengthened risk assessment, focused on key companies and addressed major risks. Moreover, we started to do stress tests, put in place a risk profile reporting system, and designed risk prevention and emergency management plans. We also properly addressed the surrender problem of certain insurer that was seriously hit by the financial crisis, and protected policyholders' interests. Third, we improved outbound investment policy, toughened supervision over overseas investment of insurance funds, and put risk control as the top priority.

Making Achievements in the Development of Insurance for Agriculture, Rural Areas and Farmers

In 2008, the Chinese government decided to "develop rural insurance and improve policy agricultural insurance system". As part of the efforts to carry out the decision and to support and guide the development of insurance for agriculture, rural areas and farmers, competent government agencies released the *Notice on Strengthening the Implementation of Policy Measures of Policy Agricultural Insurance*. With concerted efforts from all parties, much progress has been achieved in developing insurance for agriculture, rural areas and farmers. First, agricultural insurance business grew rapidly. The pilot policy agricultural insurance program, which was supported by the central government budget, was expanded to cover 16 provinces (autonomous regions) and the Xinjiang Production and Construction Corps from its original coverage of 6 provinces (autonomous regions). The agricultural insurance achieved nationwide coverage when the agricultural insurance operation network took shape, which includes national insurers and professional agricultural insurers. In 2008, 90.159 million rural households participated in agricultural insurance, with the annual premium income totaling RMB 11.07 billion yuan, a y-o-y growth of 107%, and the claims standing at RMB 6.9 billion yuan. Second, we launched the pilot micro-personal insurance program in rural areas. At end-2008, the pilot program had provided insurance to 2.39 million farmers, and saw a premium income of RMB 42.12 million yuan. The program greatly enhances farmers' ability to fend off the risks of accidental injuries and diseases. Third, we actively participated in the new rural cooperative medical insurance scheme through custody and insurance contracts. In 2008, incremental funds under custody reached RMB 2.61 billion yuan accumulatively, which covered 32.916 million people and saw a premium income of RMB 130 million yuan. A total number of 6.777 million claim payments totaling RMB 1.9 billion yuan were made throughout the year. Fourth, we further developed other agro-linked insurance businesses, including insurance on rural household property, farmers' credit guarantee, agricultural machinery and houses. These insurance businesses saw an annual premium income of RMB 2.44 billion yuan, and provided RMB 1.3 trillion yuan worth of risk protection.

Liability Insurance and Entrustment Management Business Grew Rapidly

Liability insurance developed steadily with a greater social management function. In order to improve the risk management mechanisms in schools and in environmental pollution, competent government agencies issued a series of documents, which promoted further development of liability insurance in schools, transportation, tourism, quality inspection, healthcare and construction, and pushed forward the pilot program of environmental pollution liability insurance. Further more, liability insurance services provided by insurers during the Beijing Olympic Games contributed greatly to the success of the Olympics and the Paralympics. Premium income of liability insurance stood at RMB 8.17 billion yuan in 2008, representing a growth of 22.7% y-o-y.

Insurers actively participated in the corporate annuity business and entrustment management of health insurance. At end-2008, pension insurance companies collected contributions of RMB 20.55 billion yuan in corporate annuity business, an increase of 140% y-o-y; corporate annuity entrusted assets and invested assets stood at RMB 47.36 billion yuan and RMB 37.74 billion yuan, growing 420% and 370% over the beginning of the year respectively. Entrustment management of health insurance took shape. Incremental mandatory management funds in 2008 amounted to RMB 5.19 billion yuan accumulatively, and RMB 7.392 million received payments from insurers.

Insurance Regulation and Supervision Continued to Be Strengthened, and the Insurance Guarantee Fund Management Further Improved

In 2008, the insurance supervisor further improved the supervisory framework where solvency supervision, corporate governance supervision and market behavior supervision constitute major pillars. It advanced classified supervision and strengthened oversight on insurance groups. In solvency supervision, with the introduction of the *Regulations on the Solvency of Insurance Companies*, the insurance supervisor toughened solvency supervision on insurers and took a series of measures on a few insurers with inadequate solvency, including suspending relevant businesses and approvals for setting up new branches, and asking the insurer to stop giving bonus to its directors and senior management. The insurance supervisor guided insurers to shift their focus from market share to solvency adequacy ratio. In 2008, a total number of 40 insurers increased capital through additional offering. In corporate governance supervision, the insurance supervisor released the *Guidance on the Operation of the Boards of Directors of Insurance Companies*, the *Opinions on Standardizing the Charters of Insurance Companies* and other documents. In market behavior supervision, the insurance supervisor toughened administrative punishment and imposed penalty on 723 institutions and 379 staff for their violation of laws and regulations in accordance with the law.

The insurance guarantee fund system was further improved. In order to regulate the pooling, management and use of the insurance guarantee fund, enhance the fund's independence, and improve its ability to maintain and increase asset value and dispose of risks, CIRC, the Ministry of Finance and PBC jointly issued *the Administrative Rules on the Insurance Guarantee Fund* in September, 2008. The China Insurance Guarantee Fund Co., Ltd was established in the same month. At end-2008, the balance of the fund reached RMB 14 billion yuan.

Box 7 Solvency Supervision in China's Insurance Sector

Solvency refers to a company's ability to pay its debts. Adequate solvency is the prerequisite for the insurance sector to play its role of economic compensationl, capital financing and social management. Therefore, solvency supervision is a priority for insurance supervisors to ensure insurers have adequate solvency.

In 2003, the CIRC released the *Administrative Rules on Solvency Margin of Insurance Companies and Supervision Indicators* (the old *Rules*), which prescribed how to calculate the actual and minimum solvency margin, and required insurers to maintain the actual solvency margin above the minimum level.

In order to adapt to the rapid development of the insurance sector, the CIRC, drawing on developed philosophies and principles on solvency supervision, issued the *Administrative Rules on Solvency of Insurance Companies* (the new *Rules*) in July 2008, which superseded the old *Rules*. The new *Rules* introduced the concept of capital adequacy for insurance companies, set up a scientific, complete and effective solvency supervision mechanism, established a risk-based dynamic solvency supervision framework in line with international practice, and specified measures to conduct classified supervision according to different solvency positions of insurers. The release of the new *Rules* helps improve the risk management of the Chinese insurance sector and maintain financial stability.

Soundness Assessment

The Chinese insurance sector maintained healthy development in general in 2008. However, the sector still needs to address a number of risks, including the over-expansion of investment-oriented insurance products, the irrational price competition that is intensifying in some areas, the plunging investment returns, and inadequate solvency of certain insurance companies.

Imbalanced Development Eased, While Investment-oriented Products Grew Too Fast

In terms of the insurance development in different regions, the gap between eastern and western China narrowed. In 2008, premium income in central and western China rose as percentage of the total, while the percentage of premium income in eastern China fell. Premium income in central China witnessed a y-o-y growth of 53.8%, which was far above the growth in eastern regions (Table 4.1). In terms of business structure, the imbalanced development of property insurance products was eased. Agricultural insurance, guarantee insurance and liability insurance saw rapid growth (Figure 4.4), while the premium income from vehicle insurance as percentage of total property insurance premium income dropped 1.5 percentage points y-o-y to 69.6%.

It is worth noting that investment-oriented life insurance products grew too fast. Life insurance premium income grew 49.2% in 2008. In particular, premium income increased 71% for participating insurance, 7.9% for investment-linked insurance, and 71.5% for universal insurance, while premium income for general life insurance declined 1.9%. As the return on investment-oriented insurance products is largely exposed to developments in capital markets, a persistently dwindling capital market took its toll on the sales of investment-oriented insurance products, hurting the stable and sound development of the sector. Moreover, a plummeting capital market also imposed enormous financial pressure on certain property insurers which sold some defined-benefit investment-oriented products[1].

Table 4.1 Premium Income Across Different Regions

(100 million of RMB yuan, percent)

	2008	Y-o-Y Growth	Share	2007	Share
Eastern China	5 749.7	32.4	58.9	4 341.5	61.8
Central China	2 287.4	53.8	23.4	1 487.1	21.2
Western China	1 731.8	45.2	17.7	1 193.0	17.0
Total premium income	9 768.9	39.1	100	7 021.6	100

Notes:

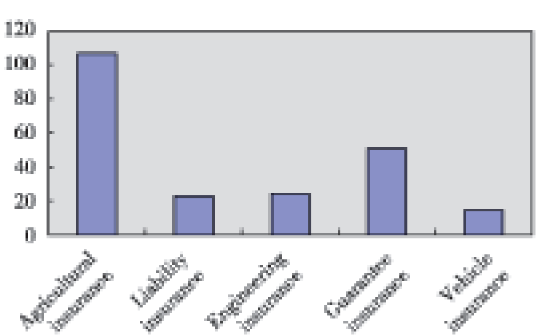
1. Eastern China includes Beijing, Tianjin, Hebei, Shanghai, Jiangsu, Zhejiang, Ningbo, Fujian, Xiamen, Shandong, Qingdao, Guangdong, Shenzhen, Hainan, Liaoning and Dalian, 16 provinces and cities; central China includes Shanxi, Anhui, Henan, Hubei, Hunan, Jiangxi, Heilongjiang and Jilin, 8 provinces; and western China includes Guangxi, Chongqing, Sichuan, Guizhou, Yunnan, Tibet, Shaanxi, Gansu, Ningxia, Inner Monglia, Qinghai and Xinjiang, 12 provinces, autonomous regions and municipality.

2. Total premium income does not include premium income of the headquarters of insurance groups.

Source: Compiled on the basis of data from the CIRC.

Figure 4.4 Y-o-Y Premium Income Growth of Some Property Insurance Products in 2008

(percent)



Source: CIRC.

Market Concentration Kept Declining, While Excessive Price Competition Remained a Problem

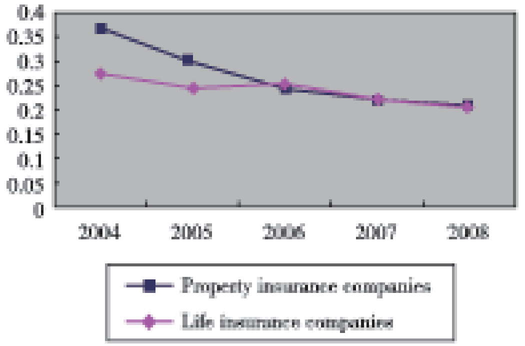
As the insurance sector grows rapidly over the recent years, insurers increase greatly, leading to a declining concentration in the market. At end-2008, the Herfindahl Index (HI)[2] in the property insurance and life insurance markets stood at 0.209 and 0.205, down 0.012 and 0.017 respectively over the previous year (Figure 4.5). The market share of premium income of the four largest property insurers dropped 1.1 percentage points from the previous year to 71.7%, and the market share of premium income of the four largest life insur-

1 In a defined benefit product, which is a type of insurance product, the insurance company pays the policyholder or the insured the invested funds and the investment return in line with the return rate, fixed or floating, agreed in the insurance contract when the insurance contract expires, or, when the insurance contract is revoked or terminated, pays the policyholder or the insured the funds as calculated in accordance with terms agreed in the insurance contract.

2 HI is the sum of the squares of the market share of each institution in one sector. Higher HI means higher market concentration.

ers fell 1.9 percentage points y-o-y to 71%.

Figure 4.5 HI of the Insurance Sector



Source: CIRC.

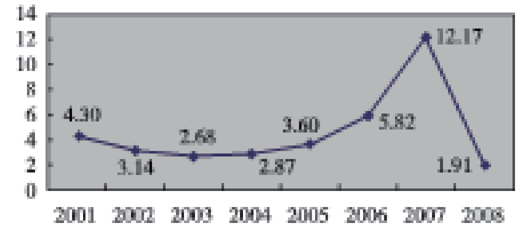
As the Chinese insurance sector is still in the early stage of development, there is only a small degree of difference in the products, technology and services offered by insurers, which contributes to a common homogeneity among insurance products. Consequently, insurers opt for lower price as the main measure to expand business, which results in a price war in the sector and an excessive price competition in some products. In the property insurance market, according to statistics from the PICC Property and Casualty Company Limited (PICCP & C), the average premium rates dropped from 0.26% to 0.19% from 2003 to 2007. In particular, the premium rates fell substantially by 47.8% for liability insurance, and declined by 35.5% for cargo insurance. In the life insurance market, to seek greater premium income, some insurers paid over 4% of intermediary fees to a bank[1]. Excessive price competition may lead to the risk of overly low price levels in the sector, which would damage its solvency, and is thus detrimental to the sound development of the insurance sector.

Investment of Insurance Funds Faced Challenge from a Volatile Capital Market

Both the Chinese and international capital markets plummeted amidst the global financial crisis in 2008. The Shanghai Stock Exchange Composite Index plunged by 65% annually, the Hang Seng Index fell by 48%, and the Dow Jones Industrial Average Index dropped by 34%, which translated into immense pressures on the investment of insurance funds. In 2008, the investment return on insurance funds was 1.91%, a decrease of over 10 percentage points y-o-y (Figure 4.6).

Figure 4.6 Investment Return of Insurance Funds

(*percent*)



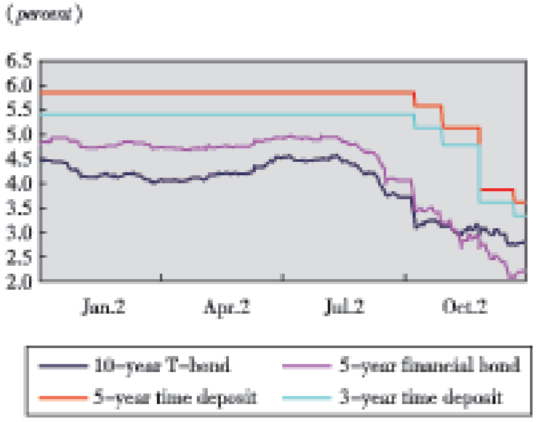
Source: CIRC.

In the face of the complex and severe economic and financial situation both at home and abroad, insurers adjusted investment portfolio. The share of bank deposits and products of fixed return, including various bonds, was increased, and the share of equity and securities

1 The Insurance Institute of China. *Insurance Information*, No. 2 (2009): 23–24.

investment funds was reduced. At end-2008, bank deposits and bonds accounted for 84.4% of the balance of invested insurance funds, up 16 percentage points from the beginning of the year; stocks (equities) and securities investment funds constituted 13.3%, down 13.8% from the beginning of the year. However, the return rates of bank deposits and bonds fell appreciably (Figure 4.7), posing great challenges to insurance funds investment.

Figure 4.7 Investment Return on Some Products in 2008



Source: integrated according to data from PBC, the Central Government Securities Depository Trust and Clearing Corporation, and Wind Info.

Some Insurers Saw Weakened Solvency and Difficulties in Replenishing Capital

The solvency adequacy ratio for some insurers dropped in 2008 due to the tumbling investment returns, the snow and sleet disaster that hit southern China, and the disastrous earthquake that shook Wenchuan. Various degrees of fall in the solvency adequacy ratio of four public insurers were presented in their annual reports (Table 4.2). One thing worth noting is certain insurer that had accumulated risks because of fast expansion and inadequate management in the early stage experienced inadequate solvency problem as business environment deteriorated.

Insurers with inadequate solvency need to strengthen their capital immediately. Such efforts, however, will be made more difficult amidst the intensifying financial crisis, which leads to slower growth both at home and abroad, sluggish stock and bond markets, and weaker willingness to invest on the part of potential investors.

Table 4.2 Changes of Solvency Adequacy Ratio of Public Insurers

	Life Insurance			Property Insurance		
	China Life	Ping An Life	CPIC Life	PICCP&C	CPIC Property	Ping An Property
End-2007	525%	288%	277%	189%	219%	182%
End-2008	310%	183.7%	234%	143%	188%	153.3%

Source: 2007 and 2008 annual reports of the China Life, PICC, China Ping An and CPIC.

Issues Worth Attention and Reform Measures

As both domestic and international economic and financial situation become increasingly severe under the impact of the intensifying global financial crisis, the Chinese insurance sector may sustain greater impacts. At the same time, the insurance sector also faces great opportunities to expand services and improve development level as the Chinese government adopts a wide range of measures aimed at expanding domestic demand and promoting economic growth. Taking advantage of the opportunities, the insurance sector should make efforts to achieve better and faster development as it serves economic and social development.

Closely Observe the Impact of the International Financial Crisis and Maintain Stability in the Insurance Sector

The factors leading up to the ongoing financial crisis are complex and extensive. Though the crisis only has a limited direct impact on the Chinese insurance sector, we still need to pay close attention to the developments of the crisis and possible risks it may cause to the insurance sector. These include risks facing Chinese branches of troubled foreign financial institutions, risks for domestic and overseas investment by insurers, risks of concentrated surrender in certain products in some regions, and risks brought about by macroeconomic fluctuations.

To maintain stability in the insurance sector, we first need to enhance qualitative and quantitative study on market risks, take stock of domestic and international experiences and lessons, design contingency plans, and improve early warning of risks. Second, we should urge Chinese branches of troubled foreign financial institutions to take necessary measures to protect the interests of policy holders. Third, we need to advance classified supervision, and take different supervision measures in line with varying degrees of risks of insurers. Drawing on this, we need to improve the dynamic solvency testing, stress tests and early warning of cash flows in an effort to make the solvency supervision more binding. Fourth, we need to strengthen supervision on market behaviors, forcefully deal with irregularities of insurers and insurance intermediaries and maintain order in the market. Fifth, we need to further improve the liaison and information sharing mechanisms with relevant government agencies, and step up cooperation with insurance supervisors in other countries and regions to closely follow the impacts of the crisis on the insurance sector.

Box 8 The Case of AIG

An internationally renowned insurer and the largest insurance company in the US, AIG has a strong presence in over 130 countries and regions, and its businesses cover a wide range of areas, including life insurance, property insurance, auto insurance, mortgage insurance, retirement services, loans, investment services, and aviation leasing. Total assets of the Group reached USD 1.1 trillion.

AIG suffered substantial losses from its CDS business following the outburst of the subprime mortgage crisis. It lost USD 25 billion in total from October 2007 to June 2008 in its CDS business. On September 15, 2008, AIG's share plummeted, and its credit rating was lowered subsequently, forcing the insurance giant to provide more collaterals to its counterparties. However, due to intensifying difficulty to raise funds and rising financing costs in a volatile financial market, AIG's financial positions worsened quickly. On September 16, 2008, it was taken over by the US government, which provided liquidity and loans to the beleaguered insurer. Four elements can be attributed to the enormous shock AIG sustained from the subprime mortgage crisis. First, huge losses from its subprime mortgage-related businesses; second, soaring financing costs as a result of liquidity shortage; third, excessive risk-taking because of weak internal control, lax risk management and improper compensation system; and fourth, the absence of external supervision.

Though the subprime mortgage crisis has limited direct impact on Chinese insurers, the Chinese insurance sector can draw several lessons from the AIG event. First, security should be given top priority in investing insurance funds; second, high risk businesses should be controlled within a proper size; third, internal control and risk management of insurance companies should be enhanced; and fourth, the supervision system should be further improved.

Continue to Expand Insurance Coverage to Play a Greater Role in Serving Economic and Social Development

An improving economic and social development level and an aging Chinese population are boosting the demand for insurance in China. However, the development of the Chinese insurance sector and the services it offers still lag behind world average and can not meet the demand of the economy and society. In terms of the overall development level, the insurance penetration (premium income as percentage of GDP) of the Chinese insurance sector was 3.25%, and the insurance density (premium income per capita) was RMB 736.74 yuan in 2008, in contrast to the world average of 7.5% and USD 607.7 respectively in 2007. In terms of the sector's ability to provide services, the limited coverage, low insured rates in many current business areas, and inadequate product innovation restrained the insurance sector from playing its important role in preventing disaster risks and in minimizing losses. For example, the insurance sector paid only less than 1% of the direct economic losses in the snow and sleet disaster and in the Wenchuan earthquake in 2008, far below the world average of 30%.

To this end, the insurance sector needs to further promote its development and expand insurance coverage so as to better play its role in serving the economic and social development. First, step up efforts to innovate and promote agricultural insurance products and services, expand the coverage of the agricultural insurance, and develop tailored micro-insurance products with low premium and simple clauses that offer proper protection, so as to let the insurance sector play its active role in improving rural social security system. Second, expedite the establishment of agricultural reinsurance and catastrophe risk diversification mechanisms to prevent catastrophe risks. Third, vigorously develop liability insurance. Efforts should be made to strengthen the accounting of compulsory liability insurance on motor vehicles, enhance cost control, improve the compulsory liability insurance on motor vehicles, and develop construction insurance and engineering insurance to provide risk protection for major infrastructure projects. Fourth, vigorously develop pension insurance and healthcare insurance. Efforts should be made to explore corporate annuity market by taking advantage of the professional expertise of insurers, and, on the basis of medical reform, to ensure that insurers participate in health protection custody services in an orderly manner. Fifth, explore the possibility of opening up the short-term export credit insurance market to allow commercial insurers take part in the competition so as to support exports.

Adjust the Insurance Business Structure to Provide Better Protection against Risks

Despite of rapid growth over recent years, Chinese insurers see a problem in the over-expansion of investment-oriented businesses, which curbs the sector's role in providing risk protection. The core value of insurance lies in the protection it offers against risks. International experiences suggest that, as the economy undergoes periodical adjustments, insurers may fend off risks by developing guarantee-oriented business, which grows stably and is less vulnerable to periodical economic adjustments.

At present, the insurance sector should focus on its major business of risk cecoverage, and properly decide the size of investment-oriented products in line with the assets and liability match, investment returns and risk control. Moreover, the insurance sector should focus on developing the risk protection function in product design and promotion. It should, in line with the adjustment of the macroeconomic policy and industrial policy, identify the access point to provide risk management and protection, step up product and services innovation, and develop more guarantee-oriented products so as to enhance the insurance guarantee function.

Steadily Expand Investment Channels While Keeping Risks under Control

Investment channels for Chinese insurance funds kept increasing in recent years. However, compared with the situation in countries with highly developed insurance sector, restrictions on both investment channels and investment proportion remain strict in China, which results in limited opportunities to invest in industries and an over-dependence on the capital markets for investment returns, making it difficult for the insurance sector to diversify risks and improve investment efficiency.

Therefore, it is necessary, in line with the demand from economic development and the risk control capability of the insurance sector, to leverage on the role of insurers as institutional investors and on the investment and financing function of insurance funds. We need to increase bond investment products and raise the proportion of bond investment, and increase stock investors. We need to steadily expand the pilot program of investing insurance funds in infrastructure projects, and push forward the pilot program of investing insurance funds in non-listed equity, commercial-use property, asset-backed securitization products, overseas markets and other financial products. The advantage of long investment cycle and stability of insurance funds should be fully used to support economic development.

Deepen Corporate Reform to Enhance the Insurance Sector's Competitive Edge

The Chinese insurance sector still lags behind the developed insurance sector in other countries and the domestic banking sector in terms of management, internal control and development pattern. The first problem is weak management. Corporate governance in some insurance companies is inadequate, problems exist in the board system, shareholders' behaviors and decision-making procedures remain acute, and a sound risk management mechanism and a scientific decision-making mechanism are yet to be established. The second problem is incomplete internal control system in some insurance companies. For example, a headquarter can not exercise effective control over its branches at the grass-root level, rules and regulations are not well observed, and instructions are not followed. The third problem is the extensive development pattern, which still persists in the sector. Some insurers rely on setting up branches and expanding network to develop business, and lack the ability to pursue intensive operation and endogenously driven growth. Such extensive growth pattern incurs considerable risks, undermines solvency, and affects the business of insurers that behaves properly.

Therefore, efforts should be made to further deepen reform, shift away from the extensive business pattern, improve corporate governance, and give full play to the role of capital providers and the board of directors. Qualified insurers will be supported in their efforts to strengthen capital and solvency by public listing, secondary offering and subordinated bond issuance. Moreover, banks will be encouraged to cooperate more closely with insurers to provide managerial experiences and expertise to insurers and to enhance their competitiveness. Insurers should put in place a strict internal control system, design a viable incentive mechanism, and improve the ability to manage assets and liabilities. They should enhance the risk management system, and establish a comprehensive risk management system that covers all business processes and operation procedures and is capable of providing ongoing risk monitoring, conducting regular risk assessments, and producing accurate early warnings.

(By Li Yan, Wang Shaoqun and Chen Min)

Chapter V

Financial Infrastructure

In 2008, China's financial infrastructure construction made new progress: the payment system progressed steadily, the legal foundation for financial industry operation further improved, the new enterprise accounting standards system was implemented smoothly, the credit environment was continuously improved, and the social effect of anti-money laundering was enhanced continually, all playing a positive role in improving financial service, safeguarding financial security and promoting healthy and stable performance of the financial sector.

Payment System

In 2008, confronted with complicated and changing economic and financial environment, China's payment system still maintained efficient and stable performance, with new developments in infrastructure building, outstanding achievements in the building of Olympics-friendly payment environment, continued innovation in non-cash payment instruments and strengthened supervision.

The Payment System Building Made Steady Headway

The payment system operated soundly and played a more positive role in supporting and safeguarding economic development. In 2008, the LVPS operated safely and soundly and continued to play a key role in China's payment system, handling 210 million payment transactions totaling RMB 640 trillion yuan, representing a growth of 24% and 20% y-o-y respectively. The BEPS transactions grew steadily and the BEPS served as a platform which remarkably supported the retail business and business innovation of commercial banks. In 2008, the BEPS handled 140 million payment transactions, totaling RMB 5.1 trillion yuan. Furthermore, the CIES witnessed gradual growing business and played a more impressive role in promoting regional economic exchanges and facilitating regional check uses.

The Construction of payment system infrastructure was improved and its capacity in coping with crisis was enhanced remarkably. First, the emergency backup system was continuously improved, with the establishment of the centralized emergency backup system for the CCPC and the emergency backup system for CIES, enhancing capacity of the payment system in risk prevention and crisis management. In particular, in response to the snow sleet disaster in southern China and the earthquake in Wenchuan, the emergency plan was initiated promptly, according to which the LVPS operated even in holidays and the ceiling for credit business of BEPS was relaxed so as to safeguard the efficient, safe and sound operation of payment system and provide a safe channel for fund transfer in disaster time. Second, the building of the second generation of payment system and central bank ACS was launched to further expand payment service scope, improve operational efficiency, enhance risk prevention capability and effectively meet new demands for central bank payment system from economic and financial development. Third, domestic foreign currency payment system was successfully put into operation, providing payment services for 8 kinds of foreign currencies including the US dollar, to improve foreign currency settlement efficiency and reduce settlement risk.

Box 9 Successful Establishment of the Domestic Foreign Currency Payment System

On April 28, 2008, the domestic foreign currency payment system was successfully launched. Till end-2008, the system had processed 71 281 foreign currency payment transactions, totaling USD 8.05 billion. The system provided a new channel for inter-bank foreign currency clearing, avoiding the high cost and risk when domestic foreign currency payments have to be cleared and settled abroad, increased settlement efficiency and reduced settlement risk. In particular, against the backdrop of global financial crisis, it effectively offset shocks from bankruptcy of foreign financial institutions to domestic payment security and helped to maintain financial information security in China.

The main types of business dealt by the system. First, the domestic cross-bank credit business. It refers to the payment conducted by domestic payer bank to the domestic payee bank through the system, mainly including the foreign exchange transferring business that can be denominated and settled in foreign currency and with both domestic paying and receiving banks. Second, the netting balance business, i.e. foreign currency clearing institution pays multilaterally through the system for settling net foreign currency balances.

The framework and participants of the system. The foreign currency payment system adopts the Y shape information flow structure, with the foreign currency clearing center receiving, clearing and forwarding payment orders, and correspondent settlement bank conducting settlement according to the payment orders. Till end-2008, 10 banks with legal person status had joined the domestic foreign currency payment system.

Features of the system. First, it supports payment and settlement of 8 kinds of currencies, including Hong Kong dollar, UK Sterling, Japanese Yen, Euro, Canadian dollar, Australian dollar, Swiss franc and US dollar. Second, it adopts the real time gross settlement mechanism, dealing with payment orders issued by participant and chartered participant in real time one by one. Third, it adopts the "one point connection and one account" structure. Commercial bank with legal person status has one point access into the system and manages funds from its branch offices. This practice helps encourage of more banking financial institutions to join the system and reduce risks. Fourth, its operation is market-based and the system is open to the voluntary participation. Agent settlement banks could price according to market situation.

The risk management and supervision of the system. Based on the advanced experience of international payment system, the foreign currency payment system adopts a series of measures and mechanism including intraday financing, overnight financing, real time full value settlement, queue management, clearing window, queue matching and so on to prevent relevant foreign currency payment risks. The issuance of *Rules on the Management of the Domestic Foreign Currency Payment System* and *Rules on the Management of Correspondent Bank of the Domestic Foreign Currency Payment System* regulates the rights and obligations of relevant parties of the system on entry standard, risk management, settlement arrangement, charging strategy and operation maintenance to facilitate the sound and safe operation of the system.

The intra-bank payment system for banking financial institutions was further improved, and service efficiency was enhanced gradually. As an internal fund transfer and clearing channel, the intra-bank payment system for banking financial institutions laid an important foundation to explore payment service market and increase market competitiveness. In 2008, banking financial institutions continuously endeavored to improve intra-bank payment system, strengthened internal control and payment risk prevention mechanism to guarantee safe and sound operation and enhance payment service efficiency and quality of banking system. A total of 2.88 billion payment transactions were handled through the system of banking financial institutions, involving RMB 408.6 trillion yuan, a growth of 29% and 39% respectively on y-o-y basis.

The payment system operated safely and efficiently during the Olympics, and the Olympic-friendly payment environment construction achieved remarkable results. In 2008, in order to create a safe, convenient and efficient Olympic payment environment, financial institutions and relevant departments made great efforts in strengthening payment system infrastructure, improving bank card acceptance environment, enhancing bank account service quality, optimizing foreign currency exchange services and strengthening payment risk management. During the Beijing Olympic Games, financial institutions provided institutional and personal clients both at home and abroad with high quality, convenient, safe and efficient payment services and successfully completed the Olympic payment task, demonstrating to the world China's payment system achievements and high payment service level. Accordingly, the building of Olympic-friendly payment environment promoted the improvement of national payment environment and strengthened the achievements made in the construction of payment system infrastructure.

Non-cash payment instruments were further innovated and more widely applied. First, bill business developed rapidly. The introduction of commercial bank promissory note business in the BEPS and commercial banks draft business for three provinces and one city in the Eastern China (namely, Jiangsu province, Zhejiang province, Anhui province and Shanghai) not only optimized business procedure, upgraded the commercial paper risk prevention standard, but also promoted the electronic development of bill business and further expanded the scope of bill business usage. Second, bankcard gradually became a frequently used payment instrument among the public. In 2008, bankcard transaction value totaled RMB 127 trillion yuan, with a penetration ratio[1] of over 24.2%. In particular, the international business of UnionPay bankcard achieved remarkable development. Merchants in 30 countries and regions and ATMs in about 50 countries and regions could accept UnionPay card, and 44 bankcard issuing institutions in 8 countries and regions issued standard UnionPay card till end-2008. In addition, the coverage of bankcard service tailored for migrant workers was further expanded and important progress was made in the pilot reform of business card. Third, with growing demands of public for prompt and convenient payment services, new electronic payment tools were innovated gradually with enlarged coverage, so as to play a positive role in reducing cash uses.

Payment system oversight was further strengthened and risk prevention capability enhanced. First, a payment service and policy consultation meeting system between the central bank and commercial banks was established to help the central bank make more scientific and effective decisions and better organize and monitor the payment system. Second, the implementation of real name account achieved new progress. The real name management of personal RMB deposit accounts was improved, with better standardized regulations on personal bank account opening and usage and the establishment of client's identity system and accountability system to strengthen supervision measures. Furthermore, for commercial bank's settlement accounts, efforts were made to verify the relevant individual identity information, playing a positive role in promoting anti-money laundering and the building of social credit information system. Third, daily monitor on the payment system participants was strengthened by making more detailed implementation requirement on the supervision of participants and implementing strict access standard and payment and clearing discipline. Fourth, achievements were made in the joint special task to rectify illegal and criminal bankcard-related activities. Risk management and case prevention level of commercial banks as well as public awareness and skill of how to use card safely were improved. As a result, a joint prevention mechanism in anti-bankcard criminal activities

1 The penetration ratio of bankcard refers to the share of bankcard consumption value after deducting the whole-sale large volume transaction and real estate transaction in the total social retail sales.

was taking form.

Promote the Building of Payment System

Influenced by the global financial crisis, the public became more aware of the importance of payment system. The performance of payment system greatly influences participants' judgement of their liquidity and risk exposure, and exerts impact on their activities and liquidity in the market. The global financial crisis also challenged the fulfillment of cross-border payment claims and cross-border oversight on payment and settlement. Therefore, we should continue to follow the principle of strengthening oversight and optimizing service, improve oversight on payment and prevent systemic risk.

Continue to promote the building of payment system infrastructure. Efforts should be made to study and introduce advanced payment and clearing management concept and technology and redefine, analyze and design the functions of payment system so as to speed up the construction of the second-generation payment system. To answer the need for handling comprehensive business, efforts should be made to realize breakthrough in process rebuilding, business integration and process consolidation and promote the construction of ACS. Efforts will also be made to speed up the establishment of electronic commercial draft system and relevant rules and regulations to safeguard the smooth conduct of electronic commercial draft business. We need to accelerate the construction of independent foreign exchange clearing house to increase the efficiency and security of foreign exchange settlement. Efforts will be made to develop and apply more widely the domestic foreign currency payment system, tap the information monitoring function of the system while maintaining its sound and safe operation, and upgrade the foreign currency clearing arrangement between the mainland and Hong Kong by adopting the system.

Promote and guide the development of electronic payment instruments. Efforts should be made to further improve the procedure, increase efficiency, make full use of the CIES, expand the bank promissory note business and the coverage of commercial bank draft business in the three provinces and one city of the Eastern China, and promote the electronic development of bill business. Bankcard acceptance environment construction should be strengthened so as to include more small and medium-sized chartered merchant and enhance the proportion of bankcard consumption. Moreover, we should monitor the development and risk profile of on-line payment, mobile payment and other new electronic payment instruments, stipulate relevant management policy in a timely manner so as to guide the healthy development of electronic payment and effectively prevent risks.

Strive to improve rural payment environment. Efforts should be made to apply the payment and clearing system in rural areas, to provide rural financial institutions with easy and low-cost access PBC's payment system, facilitate rural payment and settlement and improve rural financial institutions' service. The coverage of bankcard service tailored for migrant workers should be further enlarged to improve efficiency and facilitate their deposit and withdrawal in different places, let them really enjoy the convenience of network. The payment business system of banking financial institutions and China UnionPay should be upgraded, to improve acceptance efficiency and successful transaction ratio to effectively prevent and control risks and enhance the security and stability of payment business in rural areas.

Further strengthen the oversight over payment and settlement. PBC will continue to improve the rules and regulations on payment and settlement, by accelerating the issuance of *Regulations on Bank Card* and other relevant regulations. PBC will conduct researches and make China's payment system development plan, so as to further improve the oversight mechanism over payment and settlement and provide facilitating institutional arrangements for the development of payment system. PBC will also strengthen the oversight on payment system participants, evaluate relevant risks and effectively improve non-financial institutions' payment and settlement services. PBC will continue to strengthen network verification management, optimize the function of RMB bank account management system, use the bank settlement account information according to law, check individual identity information and strengthen risk and irregularities prevention in the payment system.

Legal System

The legal system for China's socialist market economy made further progress in 2008 and the law enforcement environment continued to improve. *Law on the State-owned Assets of Enterprises*, *Regulations on the Supervision and Administration of Securities Companies*, *Regulations on the Risk Disposal of Securities Companies*, *Rules on Foreign Exchange Administration*, *Provisional Regulations on Value-Added Tax*, *Provisional Regulations on Consumption Tax*, *Provisional Regulations on Business Tax*, *Regulations on the Implementation of Labor Contract* and a series of important judicial interpretations were issued and implemented, providing legal foundation for orderly and sound operation of the financial sectorin China.

New Achievements Made in the Legal Foundation of Financial Industry

The *Law on the State-owned Assets of Enterprises* provides legal support for strengthening management of state-owned financial assets. The *Law on the State-owned Assets of Enterprises* was passed on October 28, 2008 and took effect on May 1, 2009. It stipulates that state-invested enterprises have the right to make independent decisions concerning their operation. SOE employees are entitled to conduct democratic management and monitoring. The major persons in charge of SOEs should accept economic responsibility auditing and the agencies fulfilling the duty of investor on behalf of the state should be responsible for maintaining and increasing the value of state-owned assets. Senior management of SOEs shall not assume spare-time job. The *Law on the State-owned Assets of Enterprises* is applicable to the management and supervision of state-owned assets of financial institutions and is significant to strengthening the orderly operation of state-owned financial institutions, maintaining and increasing the value of state-owned financial assets and promoting sustainable and healthy development of socialist market economy.

The *Regulations on the Supervision and Administration of Securities Companies* and *Regulations on the Risk Disposal of Securities Companies* benefit the healthy and steady development of securities market. The *Regulations on the Supervision and Administration of Securities Companies* came into force on June 1, 2009 after its passage on April 23, 2008. *The Regulations on the Risk Disposal of Securities Companies*, took effect on April 23, 2008, the same day when it was passed. The *Regulations on the Supervision and Administration of Securities Companies* incorporates and generalizes rules on the classification of securities companies, rules on the management of risk control indicators, rules on operation outlets, and rules on the management of subsidiaries and branches and etc., which will improve the legal system for supervising securities companies in accordance with classification. The *Regulations on the Risk Disposal of Securities Companies* specifies many aspects including business suspension for restructuring, custody, takeover, closure, bankruptcy liquidation, coordinated regulations and legal responsibilities based on the experiences drawn from the three-year restructuring program of securities companies, which provides a standard in the disposal of risky securities companies and the prevention of risk spillover. The issuance of above-mentioned two Rules is an important measure in the fundamental institutional construction of the capital market, hence significant to implementing *Securities Law*, protecting investors' legal interests and promoting sound and healthy market development.

The amendment of *Rules on Foreign Exchange Administration* strengthens administration on cross-border capital movement. The amended *Rules on Foreign Exchange Administration* took effect on August 5, 2008 after passage on August 1, 2008. After revision, the *Rules on Foreign Exchange Administration*, according to the balanced management on foreign exchange inflow and outflow, further facilitates trade financing activities and improves RMB exchange rate formation mechanism and foreign exchange business management system of financial institutions, establishes the balance of payment emergency protection system, enhances monitoring on cross-border capital movement, improves foreign exchange regulatory measures and tools and defines relevant legal responsibilities. Such adjustments will help to improve foreign exchange administrative system, foster fair competition environment, promote an equilibrium balance of payment, prevent financial risks and maintain financial stability.

After amendment, the *Provisional Regulations on Value-Added Tax*, *Provisional Regulations on Consumption Tax* and the *Provisional Regulations on Business Tax* further improved current taxation system. The amended *Provisional Regulations on Value-Added Tax Provisional Regulations on Consumption Tax* and *the Provisional Regulations on Business Tax* (hereinafter referred to as the three Rules) were passed on November 5, 2008 and took effect on January 1, 2009. The Ministry of Finance and State Administration of Taxation revised relevant implementation rules in line with the amendment according to the relevant law, that is to say, issued operational standards in line with the content of the Rules, defining value-added tax transformation reform, mixed sale transaction, small-scale tax payer of value-added tax and identification of taxable labor service under domestic operation tax. Furthermore, they integrated and made consistent relevant provisions (including the definitions of sale and compensable transfer, the conversion of sale amount denominated in foreign currency, the scope of added charges to the full price, the verification procedures for unreasonably low price for taxable transactions, the time for tax obligations to arise). Such adjustments provides strong legal support to further improve the taxation system, provide fair and reasonable tax environment and mitigate the impacts of international financial crisis.

Some important judicial interpretations were issued consecutively. *The Interpretation of the Supreme People's Court of Several Issues Concerning the Enforcement Procedures in the Application of the Civil Procedure Law of the People's Republic of China* further clarifies case filing, objection to enforcement, enforcement period, property allocation and other issues, which is significant to enhance financial case enforcement efficiency and practically resolve financial debt disputes. The *Provisions of the Supreme People's Court on Some issues about the Application of the Company Law of the People's Republic of China* (*II*) stipulates in details about the applicable laws in company dissolution liquidation cases heard by the people's court, and further improves the market exit mechanism of financial companies, which will improve the financial eco-environment.

The judicial environment is better. To overcome difficulties in law enforcement, Commission of Politics and Law of the CPC Central Committee, the Supreme People's Court and other relevant departments jointly set up the Leading Group to guide the National Campaign to Solve Unenforced Cases from August 2008 till June 2009 to enforce the cases received before December 31, 2007 with enforceable property. The campaign will urge enforcee to fulfill legal obligations , increase financial institutions' claim recovery ratio, further promote social integrity and purify market environment.

Continuously Improve the Financial Legal System

Financial rules and regulations are the legal gist for regulating financial institutions' operation activities, conducting financial supervision and safeguarding financial safety. With the continued development of China's financial industry, financial legal system should develop and improve simultaneously, so as to address new problems.

Actively promote the building of relevant basic legal system. In December 2008, The Standing Committee of the 11th National People's Congress reviewed the *Draft Criminal Law Amendment* (7) and the *Draft Tort Liability Law*. The *Draft Criminal Law Amendment* (7) includes underground banks in its cracking down scope, regards illegal conduction of securities, futures and insurance business without approval of relevant authorities as illegal business activities, and will give criminal sanctions very serious cases. The *Draft Tort Liability Law* as an important component of the basic civil law system, stipulates in details about the definition of civil responsibility and compensation standards. Once issued successfully, these laws will further improve China's civil rights law and criminal law system and provide stronger legal protection in cracking down illegal financial activities and maintaining financial system safety.

Promote the early issuance of relevant financial regulations. Efforts should be made to actively promote the early issuance of relevant financial regulations in order to improve China's financial legal system and further clarify and improve relevant financial regulations and rules. First, preparation for the revision of *Bill Law* should be conducted actively, so as to make full use of the funding function of bills, enhance bill turnover efficiency, establish legal relations governing bills with new technology and improve legal environment for payment and settlement. Second, efforts should be made to issue the *Regulation on Credit Information Management* as soon as possible, to regulate the establishment of credit information registration institutions, credit information registration business standards, protection of information owner's rights, supervision and regulation, improving credit information registration rules concerning enterprises and individuals and promoting the construction of social credit information system. Third, efforts should be made to promote the revision of the *Regulation on Cash Management*, so as to regulate legal person, other organizations and nature persons' cash using activities, promote reasonable cash circulation, safeguard capital safety, encourage settlement through bank account transfer, and prevent illegal or criminal activities including tax dodging by cash and money laundering. Fourth, we need to promote the establishment of legal system to prevent financial crisis. At present, the financial legal framework in China in financial crisis prevention and mitigation has been established on a preliminary basis, relevant regulations and rules are rather fundamental and loose. So we should, based on the experience and lessons learned from the current global financial crisis, promote to establish a healthy legal system including financial supervisory legal system, law and regulations on financial crisis rescue and disposal and rules and regulations on financial eco-environment to provide a good legal environment for financial crisis prevention and mitigation. Fifth, great efforts should also be made to promote the legislation of *Regulations on Management of Gold Market*, *Regulations on Bankcard*, and other important economic and financial regulations, to strengthen management on gold market and promote healthy development of bankcard market.

Accounting Standards

2008 is the second year that China adopts the new enterprise accounting standards. In general, the transition from the old one to the new is fairly stable and successful, laying a solid foundation for wider adoption of the new enterprises accounting standards as well as gradual integration and equality between Chinese standards and IFRS, so as to benefit the further improvement of socialist market economy system and better meet the requirements of rapid marketization and internationalization of Chinese economy.

The New Enterprise Accounting Standards System Is Adopted Smoothly

As one of the fundamental institutional arrangements governing market economy operation, effective adoption of the new enterprise accounting standards is significant to promoting sustained development of enterprises and improving the socialist market economic system. In July 2008, the Ministry of Finance issued the Analytical Report About Listed Companies in China to Adopt the New Accounting Standards System in 2007, analyzing completely and thoroughly the implementation of new accounting standards of listed companies in 2007. According to the Report, the net assets of listed companies didn't fluctuate abnormally due to adoption of the new accounting standards, the shareholder's rights only changed by 2.4% after deducting the minority shareholders' rights. Therefore, adoption of the new enterprise accounting standards witnessed a smooth start, and played an important role in improving accounting information quality and transparency, promoting sustained development and speeding up enterprise's integration with the global economy and promoting financial enterprises to further improve operational management.

The quality and transparency of accounting information is improved. The new accounting standard system strictly defines the concept of key accounting elements, including asset, liability, revenue and expense, clearly stipulates the condition for identification of key accounting elements, especially stresses the authenticity and reliability of items in the asset and liability statement to fairly reflect asset and transaction so as to improve enterprises' accounting information quality and fully disclose financial risks. Meanwhile, the new standard system has higher requirements in enterprise information disclosure, so as to benefit investors to understand enterprises' profit in full scale and reduce investment risks.

Sustained enterprise development is promoted. The effective implementation of some accounting policies in the new enterprise accounting standard system plays a remarkable role in containing enterprises' short-term behavior and promoting healthy and sustained development. First, the new standards require enterprises to comprehensively review contracts or agreements relevant to various contingent items, besides guarantee, unsettled lawsuit, including dismiss welfare, loss contract, restructure obligation and discard expenses. It clarifies that any item that can be classified as liability should be confirmed in full value timely and the relevant costs and estimated liability should be calculated in order to avoid over-estimation of profits and ex-ante allocation to a greater extent. Second, standards for intangible asset allow applicable development expense to be capitalized so as to encourage enterprise to draw attention on research investment, enhance self-innovation efforts and realize sustainable development indeed. Third, the long-term equity investment in subsidiary is calculated based on cost method rather than equity method so as to avoid the possible false profits and ex-ante allocation between parent company and its subsidiary under the former equity method. Fourth, it stipulates that it cannot be changed when depreciation of fixed assets, intangible assets and other long-term assets is confirmed, avoiding profit adjustment at random.

The integration of Chinese company with global economy is accelerated. The new enterprise accounting standards has realized international convergence and will be accepted by major countries and economies in the world, meaning Chinese accounting standards have the equivalent power as the IFRS, so as to substantially lower funding costs in international capital market, and help Chinese enterprises to be mature and stronger as well as benefit the implementation of "going out" strategy. First, after the convergence of the new accounting standards and implementation for listed companies, relevant authorities revoked the dual auditing requirements on listed financial companies and B-share companies, and therefore enterprises only need to compile one set of statements to meet requirements of different investors without the burden of dual auditing from two accounting firms. Second, according to the Joint Statement on the Same Power of Chinese Accounting Standards and Hong Kong Financial Reporting Standards, Chinese accounting standards have the equivalent power as Hong Kong, so as to benefit mainland enterprises to list in Hong Kong market, reduce funding cost and promote the capital market development in both mainland and Hong Kong. Third, China Accounting Standards Commission signed the Sino-America Memorandum on Accounting Cooperation with USA FASB, realizing consensus in strengthening bilateral accounting cooperation and establishing work exchange mechanism to facilitate the equivalence of Chinese and American accounting standards. Fourth, European Securities Committee passed the report submitted by European Commission, which allows Chinese securities issuers to use Chinese accounting standards to enter into European market in the transition period of 2009-2011, so as to create a beneficial condition for Chinese enterprises' entry into the European market and the European Commission accepting the full market economy status of China.

Promoting financial institutions to further improve their management. First, the new accounting standards stress the accounting concept such as "giving priority to risks" and "essence is more important than format" and promotes financial institutions to reasonably classify, manage and monitor various assets and liabilities in terms of risks, realize coordination between speed and quality, scale and structure, risks and capital in their management and improve risk management capacity. Second, the new accounting standards promote financial institutions to re-formulate accounting item system, review and adjust the business management mode, procedure, product design and information system development so as to optimize internal control mechanism and procedure and establish sound information management system. Third, new accounting standard requires financial institutions to reflect their risk and investment management purpose in financial instruments classification and confirmation and accounting in fair value, so as to require communication among business, financial, capital, trading and risk control departments, focusing on the influence of each transaction on assets and liabilities as well as profit and loss statements, which will help to improve the general management of financial institutions. Fourth, the new accounting standard clearly defines the confirmation, calculation and report of financial derivative tools and the accounting treatment of arbitrage business, so as to lay an institutional foundation for business conduction and profit exploration of financial institutions.

Promote the Effective Implementation of the New Enterprise Accounting Standards

The Analytical Report of the Ministry of Finance on the Implementation of the New Accounting Standards of Listed Companies in 2007 points out the main issues detected in the implementation based on the summarization of implementation effect, including that accounting information was not fair due to inaccurate professional judgment, bias due to inadequate implementation of new standards, surplus maneuver due to breach of accounting standards. So, efforts should be made in institutional arrangement, operational guidance and professional staff training, promoting effective implementation of the new standards.

Prudently use the fair value. The new accounting standards have learned from the IFRS to introduce fair value standard, and stipulated the applicable condition and definition principle. Since the breakout of international financial crisis, the pro-cyclicality of fair value has drawn wide attention. The international community called for improvement of fair value calculation and enhancement of risk-alerting function of accounting standards. Against the backdrop, efforts should be made to closely track the development of fair value standards in international community, and strengthen research of Chinese specifics to guide enterprise to use the standards in practice.

Box 10 The Pro-cyclicality of the Fair Value Accounting Standards

In 2008, the sub-prime mortgage crisis in USA evolved into global financial crisis and severely stroke financial markets and real economies all over the world. Among problems exposed in financial crisis, the pro-cyclicality of fair value accounting standard attracted public attention.

The pro-cyclicality of the fair value accounting standard. The international accounting standards, the financial accounting sandards of the USA and the Chinese enterprises accounting sandards all stipulate the way to establish fair value, i. e., for financial assets and liabilities with an active market, the fair value of such financial assets and liabilities should be established as the quotation in the active market, namely mark-to-market accounting; for financial assets and liabilities without an active market, the fair value should be established through adopting reliable evaluation techniques, namely, mark-to-model accounting. The financial crisis fully discloses the pro-cyclicality of fair value accounting standard. In the recovery and prosperity phase of an economic cycle, the value of financial instruments increases continuously, and the asset value calculated with fair value approach surges as well, therefore, the return of investment surges, inducing enterprises and investors to increase investment, public to dramatically increase consumption, and the economy expands rapidly with the effects of multiplier and accelerator. In the downward and recession phase of an economic cycle, the value of financial instruments declines persistently, and the asset value calculated with fair value approach shrinks persistently as well, resulting in the reduction of investment and consumption demands, so the economic growth moderates, and then economic and financial crisis is aggravated.

Discussion about the relationship between pro-cyclicality of fair value accounting standard and financial crisis. Two different views exist in international community on the role of pro-cyclicality of fair value accounting standard in current global financial crisis. One view is that, even if fair value accounting standard is not the prime criminal of the crisis, it has aggravated the financial crisis. So, they require to review the financial business accounting standards and suspend the use of fair value accounting standards even. The other view is that, fair value accounting standard can "truly and fairly" reflect the financial situation and market fluctuation under crisis condition, and benefits investors to make decision and relevant authorities to carry out responding measures so as to avoid financial risks to be hidden and result in more serious damages.

Measures suggested by international community to improve fair value accounting standard. Although no consensus about the influence of fair value accounting standards on the financial crisis is reached yet, international community has actively studied how to improve the fair value approach since the breakout of crisis. On October 10, 2008, the Financial Accounting Standards Board of the USA announced to improve relevant guidance on fair value approach in US capital market. On October 13, 2008, the International Accounting Standards Commission released a notice, allowing re-classification of certain financial tools under crisis condition. On November 28, 2008, the Basel Committee consulted public opinion about the 10 principles on risk management and supervision of financial tools valuation, with a view to guiding commercial banks and regulators to improve the fair value establishment procedure of financial tools. On December 30, 2008, the Securities Exchange Committee of the USA submitted the Research on Mark-to-Market Accounting, officially opposing to abolish the fair value accounting standard, and raising relevant suggestions on how to improve the current practice. Generally speaking, the international community have realized that fair value accounting standard should be improved in increasing information disclosure of the fair value calculation, focusing on the fair value calculation in mark-to-model accounting, improving requirements on asset impairment and enhancing rational judgment. Furthermore, the pro-cyclicality of fair value accounting standard can be reduced through improving asset impairment provision and capital recharging mechanism.

The use of fair value accounting standard in China. The new enterprise accounting standards has converged with the IFRS, but China sets relatively strict application condition for adoption of fair value to calculate assets and liabilities, and adopts a proper and sound principle in introduce the fair value based on the Chinese specific situation. In 2008, 14 listed commercial banks held a total of RMB 259.3 billion yuan of tradable financial assets and RMB 2.6204 trillion yuan of financial assets that could be sold, accounting for 0.74% and 7.51% of the total assets respectively. The net balance of the profit and loss on the change of fair value stood at RMB 3.5 billion yuan, accounting for 0.94% of net profits, and the total change was not large[1]. At present, efforts should be made to pay close attention to the adjustment of advanced countries in the fair value accounting standard and adopt relevant accounting standards in accordance with the basic economic situation and market situation.

Enhance the quality of professional staff. The new accounting standards, in line with principle orientation, require accountants to make professional judgment in line with the

1 Relevant data came from the annual report in 2008 of each listed commercial banks.

standards in practice. But in practice, some enterprises were unbending in professional judgment or didn't fully implement the standards, therefore, they made some mistakes in asset classification, didn't strictly follow the format of financial statement, or didn't sufficiently disclose information and brought about errors in accounting treatment. Efforts should be made to deepen accounting standards training in enterprises, enhance accountant's professional judgment capacity and so that they could accurately grasp the essence of the new accounting standards in both practice and management concept, enhancing the quality and efficiency of accounting treatment.

Coordinate with relevant policies. The new accounting standards realized the transformation from profit & loss statement orientation to the assets and liabilities statement orientation, aiming to require enterprise to target at enhancement of quality of assets and liabilities in financial management, rather than short-term profits. In the implementation process, some performance evaluation indicators focus more on profit indicators, so enterprises might try to maneuver surplus with a view to chasing short-term performance or avoiding supervisory requirements and create short-sight behaviors. It is necessary to strengthen the coordination of the new accounting standards with relevant policies and further improve the financial evaluation indicators to improve the authenticity of accounting information.

Further intensify supervision. The effective implementation of the new accounting standards needs powerful supervision. In future, efforts should be made to strengthen coordination among relevant regulatory departments to synthesize supervisory force, strictly monitor and examine issues in the implementation of the new accounting standards, continually play the role of certificated accountant in auditing the implementation of new accounting standards, promote the implementation of new accounting standards in virtue of intermediation and social monitor, and severely punish irregular behaviors and strengthen market discipline.

Credit Environment

In 2008, China's credit environment improved continuously, characterized by a greater role of the credit information system in creditworthiness construction and stronger awareness of credit in society promoted by the education of credit information registration, hence conducive to the improvement of financial ecosystem, the promotion of active and abundant market trading activities and the healthy and sustainable development of economy.

The Credit Environment Improved Continuously

The nationwide credit information system offered effective tools for commercial banks' credit management. The nationwide enterprise and individual credit information database maintained sound operation, offered an effective tool for commercial banks to increase credit approval efficiency and enhance credit management level, supported creditworthiness construction of other industries and provided reference for the formulation and implementation of macro-financial policy. The system has connected with all banking financial institutions and can offer real time inquiry for credit outlets of banking financial institutions. As of end-2008, the enterprise and individual credit information database had credit records for 14.474 million enterprises (organizations) and 0.636 billion individuals and accumulatively provided 61.599 million enterprise credit reports and 0.29 billion individual credit reports for governmental agencies, financial institutions, enterprises and individuals.

Registration system of pledge receivables registration played remarkable role in prevention of credit risk. The registration system of pledge receivables registration, established according to the *Property Law*, provides property registration service for account receivable pledge across China, and it has the legal force of protecting the pledge right against the third party and could establish the sequence of settlement of multiple claims on the same property. The financing through account receivable pledge expands the property scope used for collateral by enterprises, compensate the insufficient creditworthiness of pledgeor with the relatively higher creditworthiness of the pledgee of account receivable so as to improve the financing situation of small and medium-sized enterprises and help commercial banks to promote product innovation and service, with gradually remarkable effect on preventing credit risk, improving social credit environment and maintaining economic and financial stability. As of end-2008, the system cumulatively received 43 thousand of registrations with the master contract value of RMB 840 billion yuan in the initial registration. In particular, the initial registration by small and medium-sized enterprises as pledgeor reached 16 thousand, accounting for 65% of the total initial registrations.

Social credit awareness gradually improved through public credit information education. In recent years, public education of credit registration was conducted steadily, with a view to educating public on credit registration and relevant financial knowledge and then fostering good credit practice. In 2008, PBC actively conducted normal credit registration education among governmental organizations, borrowers, students in colleges and others through credit registration educational handbooks and broadcast short plays, campaigned "credit registration knowledge education month" and "credit record caring-day" nationwide and received public attention and active participation. The creditworthiness of enterprises and individuals was enhanced gradually.

Further Improve Credit Information Management

The building of credit environment in China has made substantive progress, but strenuous efforts should be made in legal framework, departmental coordination, product innovation and public education to further improve the modern credit culture.

Promote the issuance of the *Regulation on Credit Information Management*. The issuance of the *Regulation on Credit Information Management* will strengthen supervision over the credit registration institutions and benefit the sound operation of financial markets through improving entry system of credit registration market, intensifying daily monitor mechanism and improving market exit mechanism and etc. We should earnestly consult all relevant parties' opinion and complete the revision and submission to promote the issuance of the Rules. At the same time, we should conduct research on relevant issues as soon as possible, prepare the formulating and releasing of supplementary rules after the issuance, such as formulating rules on management of credit imformation institutions, improving management rules on the credit information database, studying and formulating rules on the procedure of credit information inquiry by authorities.

Strengthen coordination among different departments. Improvement of the credit environment is a systemic project, involving various economic and social parties. Currently, many departments are constructing industrial credit system, but horizontal links and cooperation mechanism need to be improved to enhance the information share mechanism. Some regional credit registration information databases could not fully reflect the creditworthiness of enterprises and individuals resulting in resource waste. Accordingly, efforts should be made to strengthen departmental cooperation and coordination based on the ministerial joint-meeting for the establishment of social credit system, realize credit information sharing and promote the synergy between credit registration system construction and the departmental and industrial credit system establishment, so as to make full use of the credit registration system in maintaining economic order, preventing financial risks and enhancing social creditworthiness.

Speed up credit registration product innovation and widen the application scope of credit registration products. Efforts should be made to speed up the innovation of credit registration product, improve credit registration service level and promote the application of both enterprises' and individuals' credit report in business transaction, personal job hunting, government invitation of public bidding based on market demand so that the credit history of enterprise and individual could affect their future economic activities truly, and gradually establish and improve the discipline of rewarding integrity but punishing discredit to encourage enterprise and individual to pay attention to their credit records in economic activities, and then lay the micro-foundation for the improvement of social credit environment. Efforts should also be made to continue to improve the credit registration system construction both for enterprise and individual to make sure data quality and system stability, and enhance services to meet the requirements of economic and social development.

Actively conduct credit registration education. Public education of credit registration and relevant financial knowledge covers wide areas and requires long-term and sustained efforts. Efforts should be made to include the knowledge on credit registration and relevant financial knowledge into the national official education system and educate public relevant knowledge in full scale, so as to benefit the establishment of long-term effective education mechanism, enhance public financial knowledge and credit awareness and foster modern credit culture.

Anti-money Laundering

In 2008, the anti-money laundering work made progress steadily, which was demonstrated in the improvement of anti-money laundering institutional system and the working mechanism, the sustained enhancement of effective racking-down criminals in anti-money laundering field and continued deepening of international anti-money laundering cooperation.

Social Influence of Anti-money Laundering Work Was Improved Continuously

The legal framework governing anti-money laundering was improved. First, efforts were concentrated on the improvement of criminal law system on money laundering. Relevant departments have conducted many rounds of discussion and communication in the scope extention of money-laundering criminal subject, clarification of money-laundering crime behavior and legislation suggestion on terrorism financing crimes, and gradually reached consensus. The *Draft of Criminal Law Amendment* (7) added the institutional crime, and the Supreme People's Court and the Supreme People's Procuratorate have formally confirmed to study the interpretation of issues on the regulation applications in the criminal cases of money-laundering and terrorism financing. Second, efforts were made to study the establishment of anti-money laundering system in special non-financial institutions and in lottery, real estate and lawyer industries and payment and settlement area to promote the extension of anti-money laundering supervision. Third, efforts should be made to establish anti-money laundering management mechanism, study and stipulate management rules on anti-money laundering information on the cross-border movement of cash taken by individuals and bearer securities, and explore to establish the fund frozen mechanism relevant to terrorism financing.

Anti-money laundering supervision mechanism was further improved. Efforts were made to push forward the risk-based anti-money laundering supervision principle, study to establish the supervision mode with the co-function of on-site examination and off-site regulation, improve off-site regulation level and timely adjust the consideration and focus of on-site examination. In 2008, 5 504 financial institutions and their branch offices were received anti-money laundering on-site examination, financial institutions disobeyed anti-money laundering regulations and their direct responsible senior managers were punished. At the same time, efforts were made to closely focus on financial hot issues, strengthen supervision on cash and international remittance business with high money-laundering risks, develop and run the anti-money laundering comprehensive management information system to further enhance ant-money laundering quality and efficiency. Besides, with the anti-money laundering coverage extended from banking industry to securities, futures and insurance industry, CSRC and CIRC set up special anti-money laundering departments respectively to promote and improve the basic institutional development of anti-money laundering.

The effectiveness of cracking-down money-laundering crimes was improved continuously. Efforts in anti-money laundering investigation and assisted investigation were strengthened continuously and played an important role in detection and cracking-down money laundering. From September 2007 to September 2008, PBC took special actions nationwide to "enhance anti-money laundering effectiveness and promote money-laundering crime definition" (code name as "sky network action") and "crack-down underground banking" (code name as "thunderclap action") with remarkable achievements, assisting to solve 172 suspicious money laundering criminal cases, worth RMB 149.61 billion yuan. The enhanced effectiveness of cracking-down money-laundering crimes will benefit to expand the social influence of anti-money laundering and strengthen public attention on and understanding about anti-money laundering so that public could obey relevant rules and regulations and actively coordinate financial institutions in anti-money laundering.

International cooperation in anti-money laundering was continually deepened. PBC closely kept an eye on the new trend and change in international anti-money laundering area, actively participated international institutions' activities in anti-money laundering and sent evaluating expert for the first time to take part in the mutual evaluation of FATF. In September 2008, the expert group of FATF conducted on-site examination of China's anti-money laundering and fully affirmed at plenary session of FATF in October the progress China made in anti-money laundering, especially the prevention measures since one year, reached consensus that China submit the follow-up report every year according to normal procedure, representing China obtained basically equivalent treatments with other members in the follow-up procedure.

Further Promote the Full-scale and Deep Development of Anti-money Laundering Work

Thanks to the high attention of Chinese Government and promotion of relevant departments, China has made rapid progress in anti-money laundering and achieved good results. But against the close international economic and financial exchange and more and more complex use of financial innovative tools, anti-money laundering work faces with tremendous challenges. In line with international standards, PBC will continue to improve the anti-money laundering framework, fulfill anti-money laundering functions according to legal, effective and balanced principle, continuously reform and improve the anti-money laundering work mechanism, strengthen risk-orientated supervision philosophy and anti-money laundering monitor and analysis, effectively conduct anti-money laundering investigation and enhance the anti-money laundering effectiveness in full scale.

Continuously improve the anti-money laundering and anti-terrorism financing legal system. Regulations on money laundering and terrorism financing crime should be improved and relevant interpretations about applicable laws and regulations should be issued so as to enhance the effectiveness in cracking-down crimes of money laundering and terrorism financing. Efforts should be made to study the domestic implementation mechanism on the sanction resolution on terrorism financing of the UN Security Council, establish special terrorism-related assets frozen mechanism and prevent and crack-down terrorist financing activities. We should also establish the application mechanism for personal securities bearing, combating cross-border money laundering activities. The establishment of anti-money laundering institutions in payment and settlement organization, lottery, real estate and other non-financial industries should be steadily advanced, and the potential money-laundering risks in relevant industries should be thoroughly studied and analyzed, the anti-money laundering supervision should be initiated in proper time.

Communication and cooperation among relevant departments should be strengthened. Anti-money laundering is a cross-department and cross-industry systemic project, involving financial, public security, legislation, finance, taxation and customs and so on. Currently, the anti-money laundering coordination mechanism in China has been preliminarily established, but there haven't a completed resource sharing mechanism among various departments. In future, efforts should be made to further strengthen coordination in formulating anti-money laundering supervisory policy and communication and cooperation among members in the anti-terrorism financing coordinative group to share information on cracking-down terrorism financing, forming joint forces so as to effectively prevent and crack-down money laundering and terrorism financing activities.

Strengthen the risk-based anti-money laundering supervision philosophy. Efforts should be made to improve the data analysis indicator system of off-site examination in anti-money laundering, evaluate money laundering risks in financial institutions as a whole and money laundering risks in different business, conduct special anti-money laundering examination in line with the risk-based philosophy so as to enhance the pertinence and effectiveness of on-site examination, continuously promote large-value cash monitor in pilot cities and gradually improve the large-value cash management system and guide financial institutions to strengthen and promote the use of non-cash settlement. At the same time, efforts should also be made to strengthen information analysis, strengthen fund monitor and enhance the technology level in anti-money laundering inspection so as to realize information technology treatment of the anti-money laundering inspection.

International cooperation in anti-money laundering should be further deep-

ened. Efforts should be made to continuously deepen and widen the international cooperation in anti-money laundering and cracking-down terrorism financing, and actively participate in rules formulation and implementation to obtain self-initiative in international cooperation. Efforts should also be made to conduct research on money laundering risks and develop full-scale evaluation of money laundering risks nationwide at appropriate time in line with international standards. Endeavors should made to strengthen communication with overseas anti-money laundering authorities, broaden cooperation with foreign FIU, and to establish and improve a mechanism that prevents and combats cross-border transfer of illicit fund.

(By Zhang Tiantian)

Chapter VI

Response to the International Financial Crisis

In 2008, as the international financial crisis triggered by the US Sub-prime Crisis deteriorated, financial institutions suffered huge losses, financial markets were in great turbulence, and the world economy was hit badly. In response to the crisis, governments and international organizations took various measures to stabilize the financial system through recapitalization, nationalization and other means to help financial institutions tide over the difficulties. At the same time, economic stimulus packages were launched in a timely manner to prevent the economies from a deeper downturn. The financial crisis is unprecedented in terms of its impact, scope and depth. Since the third quarter of 2008, the continuing crisis wreaked damage to the real economy, and the world economy slid into a deep recession and entered an adjustment period. Reforming the current international financial system and reinforcing supervision after drawing lessons from the crisis have gradually become a consensus among countries and international financial organizations.

The International Financial Crisis Dealt a Heavy Blow to the World Economy and Finance

After its outbreak in 2007, the US Sub-prime Crisis continuously escalated with its scope and strength much greater than anticipated, and finally evolved into the most severe financial crisis since the Great Depression in the 20^{th} century.

Financial institutions suffered huge losses. As the crisis deepened, the types of distressed institutions expanded from home mortgage companies to mutual funds, investment banks, insurance companies, commercial banks and etc., and virtually no financial institutions remained unscathed. In 2008, 25 commercial banks in the US went bust, the two home mortgage guarantors, namely Fannie Mae and Freddie Mac, were taken over by the government under conservatorship, AIG, Citi Group and other major financial institutions wrote down substantial assets, and the five big investment banks were either bankrupt, sold out or taken over by the government. Many big European financial institutions mired in deep financial difficulties were sold out, reorganized or recapitalized and taken over by governments. IMF estimated that the total losses of financial institutions in the world would amount to USD 4 trillion.

Financial markets underwent drastic volatility. In 2008, major currencies fluctuated hugely. The US dollar depreciated and then appreciated; the Japanese yen revalued amidst fluctuations; currencies of emerging market economies such as Russia, Brazil and India devalued considerably. At end-2008, the US dollar gained value by 4.4% and 35.7% against the euro and the sterling from the beginning of the year, and the Japanese yen appreciated by 22.9%. Short-term interest rates of major currencies experienced great fluctuations. The 1-year dollar Libor and the 1-year euro Libor rose and then fell, and at end-2008 dropped to the lowest points of 2% and 3.05% respectively, a decrease of 2.23

and 2.48 percentage points from their year-round peaks. Yields of major types of bonds dropped. At the end of the year, 1-year Treasury bond yields in the US, euro zone and Japan dropped by 2.03, 1.40 and 0.33 percentage points respectively from the beginning of the year. The major stock indices tumbled. The Dow Jones Industrial Average, the Nasdaq Composite Index, the Dow Jones Euro Zone STOXX50 Index and the Nikkei 225 Index plunged by 33.8%, 40.5%, 44.3% and 42.1% respectively.

Market confidence was dampened. Affected by the crisis, asset prices plummeted rapidly, financial institutions underwent massive write-downs, some major financial institutions struggled in difficulties, counterparty risks heightened, market panic intensified, investors confidence was severely dampened and investors became more risk averse. Financial institutions reduced leverage ratios and were reluctant to make loans, which shored up cost of lending, squeezed or even froze up the credit markets, and led to serious liquidity shortage in financial systems. Transnational financial institutions withdrew funds from overseas markets to relieve domestic pressures, which resulted in massive outflows of capital from South Korea, Brazil, Pakistan and other countries. As a result, currencies of these countries depreciated rapidly, a lot of their foreign exchange reserves were consumed, and their debt servicing capability was impaired. The Icelandic financial system was on the brink of meltdown, and a foreign debt several times its GDP pushed the country to a possible "sovereign bankruptcy".

The real economy was severely impacted. The international financial crisis took a heavy toll on the real economy. The US, euro zone and Japan slid into recession, with their household consumption, industrial production and import and export growth declining by a large margin and employment deteriorating continuously. Economic growth of emerging market economies and developing countries also slowed down noticeably. According to the IMF, the world economic growth dropped from 5.2% in 2007 to 3.4% in 2008. In developed economies, growth fell from 2.7% to 1.0%, and in emerging market economies and developing countries from 8.3% to 6.3%. Since the beginning of 2009, the crisis was still unfolding, and the world economy might continue to weaken in the future. The IMF forecast that the world economy would shrink by 1.3% in 2009, and growth in the US, euro zone and Japan would register −2.8%, −4.2% and −6.2% in 2009 respectively.

The International Financial Crisis Revealed Problems in the International Financial Sector

The outbreak and rapid spread of the international financial crisis revealed many problems in the operations, risk management, supervisory philosophy and methods of the international financial sector.

The International Monetary System and the International Financial Organizational System Are Severely Flawed

An international monetary system dominated by a single credit-based national currency aggregated risks and aggravated the spread of the crisis. When a country's currency is used for pricing global primary commodities, international trade settlement and reserve denomination, it is very difficult for the monetary authority of the currency-issuing country to accommodate both the domestic monetary policy objectives and requirements of other countries for the reserve currency. The economic development model that relies on consumption by borrowing cannot sustain. Various international financial organizations and forums have overlapping mandates, and there is a lack of comprehensive, effective and well-coordinated global governance framework. Developed economies play a dominant role in international organizations, while emerging market economies and developing countries do not have enough voice, so the independence and authoritativeness of these organizations are limited, and they fail to supervise and balance economic and financial policies of the major economies. The international financial organizations are also short of necessary resources and financing channels, so they cannot put into full play their due role as the "global lender of the last resort" to deal with the crisis, and fail to build a scientific and efficient worldwide financial risk early warning and rescue mechanism.

Credit Derivative Products Were Too Complicated and Abused

Sub-prime loans, after dividing, packaging and pooling, gave birth to a series of extremely complicated derivatives that deviate from the fundamental value and whose underlying risks are very difficult to be detected by investors. The trading of credit derivatives involves mortgage loan companies, commercial banks, investment banks, hedge funds, insurance companies and other institutions, which lengthens the chain of financial transactions and risk transmission, and encourages speculation. Credit derivatives are increasingly designed on a case-by-case basis, priced according to complex theoretic models, and traded on OTC markets, all of which lead to insufficient disclosure and transparency. Usually credit derivatives are issued by SPV set up by commercial banks. As commercial banks provide standing credit line and emergency lending to such SPVs, it is very difficult to effectively separate the risks between them.

Risk Management and Incentives Mechanism of Financial Institutions Were Ineffective

In pursuit of high returns, financial institutions relaxed criteria on housing loans, or even introduced "zero down payment" and "zero record document" policies. They simply believed in high returns on mortgage loans presuming that housing price would grow continuously, and ignored credit risks brought about by market fluctuations. The related assets of many innovative financial products were off the balance sheet, and not well managed. Investment banks, hedge funds and other institutions operated on high leverage, which resulted in higher risks in their businesses. The compensation mechanism for the management of financial institutions emphasized too much on incentives but too little on disciplines. This situation also encouraged risk-taking, weakened the awareness of risks management, damaged clients' interests and impaired the long-term interests of the companies. The risks management and investment decision-making relied heavily on the rating results of the three major rating agencies and a few models designed by financial engineers, leading to homogeneity in the judgment of risks and risk-taking behaviors, hence "herding effects" among institutions.

Innovation and Development of the Financial System Was Not Well Regulated

Conventional regulation theories and regulatory frameworks failed to manage financial innovation and liberalization. The philosophy advocating, "the least regulation is the best regulation" couldn't adapt to the requirements of managing systemic financial risks. Inadequate information disclosure of cross-sector, cross-market and cross-border financial activities resulted in supervisory vacuum. The existing supervisory framework was inadequate during the crisis. For example, the Basel Accord II did not pay enough attention to complex credit products, and the minimum capital requirements failed to provide sufficient capital buffer during the crisis. Lack of liquidity supervision and lack of supervisory restrictions over the high leverage in financial institutions rendered financial institutions over reliant on wholesale market financing and short of stable funding sources. There were also inadequate supervisory rules and measures on investment banks, hedge funds and other shadow financial institutions and credit rating firms and other financial service providers. Due to lax regulation over OTC markets, regulatory agencies did not sufficiently monitor and analyze the risk chains of complicated products. The lack of smooth information sharing mechanism and efficient supervisory coordination among different regulators made them unable to take concerted efforts to contain the spread of the crisis.

Box 11 "Minibond" Anecdote and Its Lessons

Minibond refers to the bond issued by the Pacific International Financial Corporation (hereinafter PIFC) registered in Cayman Islands to individual investors and managed by Lehman Brothers Investment Company Limited (Asia). It includes CDO, CDS, interest rate swap and other complicated operations; therefore, it is a highly risky financial derivative product.

Lehman Brothers filed for bankruptcy protection on September 15, 2008. Because Lehman Brothers was the guarantor for interest rate swap transactions of minibonds, the swap contracts were automatically terminated, and PIFC had to redeem the minibonds before maturity. As a result, PIFC sold out CDO that was used as collaterals, and repaid retail investors after deducting related cost expenditures. Affected by the international financial crisis, CDO credit rating fell sharply , and their market value shrank substantially, so the principal of individual investors suffered great losses. Some investors staged protests, which triggered the "minibond" event. The government of the HK SAR came up with a solution, which required distributing banks and securities firms to evaluate the minibonds based on the relevant collaterals provided by bond trustees, and to repurchase bonds from bondholders.

The minibond anecdote revealed some problems in financial regulation in the process of financial innovation, which need to be addressed. First, appropriate limitation should be imposed on individual investors participating in the trading of complicated financial derivatives. Some innovative financial products are too complicated for retail investors who are usually not able to detect and analyze potential risks. Once the potential risks are materialized, serious consequences will occur. Second, it is necessary to correctly handle the relationship between financial innovation and risk control. Financial innovation should be encouraged in order to develop the financial markets; however, this does not mean that risk control can be relaxed. Financial products, after packing, repacking and transfer, bear high uncertainties, and any problem associated with the underlying products or anything wrong in the intermediate steps might lead to chain effects, and aggravate financial market volatility. Third, market regulatory mechanism should be improved to reinforce information disclosure. To avoid over lax regulatory environment and the subsequent over risk-taking, and to improve the transparency of the financial markets, supervision over the compliance of financial institutions should be pursued in tandem with strengthened OTC supervision and information disclosure so as to prevent potential risks.

Inherent Pro-cyclicality of the Financial System Aggravated Market Volatility

In terms of credit rating, the global financial system highly relied on external credit rating for investment decision-making and risk management; however, the three major credit rating agencies provided virtually all the important rating services, and the high degree of correlation of their rating results produced a strong cyclical force. In addition, there are many conflicts of interests in the issuer-pay model. During the current crisis, the rating agencies steeply downgraded the ratings of subprime related products from previous high ratings they granted, and such a reversal lead to massive write-down of financial institutions.

In terms of regulatory requirements over capital adequacy ratios, the *New Basel Capital Accord* allowed financial institutions to use internal-based rating to price complicated products and evaluate their risks, and the risk weights for the computation of capital adequacy ratios may come from the internal-based model. All else equal, risk weights are usually low in times of rapid economic growth, capital adequacy ratios are therefore high, and financial institutions are inclined to raise leverage; while financial institutions lower leverage in economic recession. This pro-cyclical adjustment of financial leverage feed into bubbles in economic upturn and exacerbate credit squeeze in times of downturn.

In terms of fair value accounting, compared to the historical cost accounting method, fair value accounting can better reflect the current value of assets and liabilities, but it also heightens value changes of assets and liabilities and create a vicious circle of "price drop—asset write-down—panic sales—further price drop". Moreover, due to the absence of a specific guideline for the application of fair value accounting in a less active market, accounting entities have to compute fair value based on market prices that are sometimes irrational, which further heightens market volatility.

Major Measures Taken by the International Community in Response to the Financial Crisis

To ease the severe impact of the international financial crisis, governments and international organizations have taken a series of response measures.

Improved Market Liquidity by Using Innovative Liquidity Support Instruments

To alleviate liquidity crunch, some central banks injected massive liquidity into the financial systems through open market operations, currency swap and other channels. As regard open market operations, the US Federal Reserve launched TAF, TSLF, PDCF, MMIFF, Term Asset-backed Securities Loan Facility and other innovative liquidity support instruments to meet the demand for liquidity of financial institutions, firms and households and to improve market liquidity conditions. The European Central Bank, on top of the conventional open market operations, comprehensively used non-conventional fine-tuning operations, supplementary longer-term refinancing operations and TAF dollar auction to address the liquidity shortage in the euro area financial market. In terms of currency swap arrangements, the Federal Reserve signed current swap agreements with central banks of several major economies so as to provide dollar liquidity to financial markets in the rest of the world. At the same time, many countries in Europe and Asia made currency swap arrangements in a bid to safeguard regional financial market stability.

Box 12 Innovation of the US Federal Reserve in Liquidity Support Instruments

Since December 2007, the Federal Reserve has launched a series of new liquidity support instruments. On December 12, 2007, faced with the increasingly serious credit crunch, the Fed launched TAF to provide 30- day loans to depository institutions that are eligible to preferable loans by means of auction, and all kinds of collaterals acceptable to the discount window can be used as pledge for such loans. On March 11, 2008, the Fed launched TSLF, a 28-day facility that will offer Treasury general collateral to the primary dealers in exchange for other program-eligible collateral. The eligible collaterals include loans issued by federal institutions, mortgage-backed securities issued by federal institutions, AAA/Aaa-rated securities backed by individual mortgages and etc. On March 17, the Fed launched PDCF, which allows primary dealers to borrow from discount window, and the rate paid on the loan is the same as the primary credit rate. Apart from eligible collaterals, investment grade corporate bonds, municipal bonds, mortgage-backed securities and asset-backed securities can also be used as collaterals. On September 19, the Fed established the money market fund financing instrument after using the special authority acquired during the Great Depression in the 1920s, to provide loans to bank so as to help them purchase asset-backed commercial paper from money market funds. On October 7, the Fed announced the creation of commercial paper financing instrument, to provide daily liquidity support to the issuance of commercial paper by banks and firms. On October 21, the Fed launched the MMIFF, according to which private financial institutions can set up a series of special purchase vehicles to purchase certificates of deposit, commercial paper having remaining maturities of 90 days or less and other money market instruments. The Federal Reserve Bank of New York can provide loans to PSPV through this mechanism, and the rate is the same as discount window primary credit rate, with PSPV proving collaterals with all its assets. On November 25, the Fed launched the Term Asset-backed Securities Loan Facility up to USD 200 billion to help market participants meet the credit needs of households and small businesses by supporting the issuance of asset-backed securities.

The above mentioned liquidity support instruments are quite innovative compared to conventional instruments in terms of supplementary maturity, expanded scope of eligible collaterals, increased accessibility by more entities and reduced financing costs, hence they have played a positive role in resolving liquidity squeeze on the financial market.

Bailed Out Problematic Financial Institutions through Recapitalization and Guarantees

Directly injected capital into financial institutions. For example, the US government took over Fannie Mae and Freddie Mac through recapitalization, injected about USD 157.5 billion to AIG, purchased equities of 9 major banks with USD 250 billion by drawing from the USD 700 billion financial rescue plan passed in October 2008. The British government nationalized Northern Rock Bank. Belgium, the Netherlands and Luxembourg provided 4.7 billion euros, 4 billion euros and

2. 5 billion euros respectively to purchase a total of 49 percent of stocks of the Fortis Group.

Provided loans and guarantees to financial institutions. For example, the Fed provided JP Morgan with guarantee support for its acquisition of Bell Sterns, and USD 25 billion loan to AIG. FDIC provided temporary liquidity guarantee to senior unsecured debt coming due before June 30, 2012. The Treasury Department and FDIC guaranteed a total of USD 306 billion debt of Citi Group. Governments in the euro area provided at least 1. 33 trillion euros guarantee with fiscal funds to financial institutions in the euro area. The British government announced a package of banking rescue plans on October 8, 2008, which provided 250 billion pounds guarantee to the refinancing of debts issued by eligible banks and coming due within 36 months.

Increased the Limit on Deposit Insurance to Boost Market Confidence

During the crisis, many countries leveraged on the deposit insurance system, and stabilized depositors' confidence through raising deposit-insurance limits or providing full-value guarantee. On October 2, 2008, FDIC announced that deposits were insured up to USD 250 000 per depositor until December 31, 2009; on October 12, FDIC announced to provide unlimited coverage to non interest-bearing bank accounts over USD 250 000. As of end-2008, FDIC took over and disposed of 28 problematic banks to avoid steep fall of the financial market. The European Union announced on October 7, 2008 that its member countries would raise the minimum deposit-insurance limit to 50 000 euros and maintain the level for at least one year. The Irish government adopted an emergency act on October 3, 2008 that approved to insure up to 400 billion euros individual deposits of 6 banks, effective for two years. Germany, Ireland, Denmark, Australia, Singapore, Malaysia, Hong Kong SAR and Macao SAR changed limited coverage of deposit insurance to unlimited coverage.

Box 13 The Role of Deposit Insurance Schemes in Dealing With the Financial Crisis

A well-designed deposit insurance scheme can help boost depositors' confidence and deal with financial risks in a timely manner, hence very important for maintaining financial stability and mitigating systemic risks. Among the various measures taken by governments during the crisis, deposit insurance schemes were strengthened, which have stabilized depositors' confidence and become a buffer to crisis.

Since the 1930s when the US set up the first explicit deposit insurance system in the world, over a hundred countries have followed suit. Most western advanced countries have put in place a deposit insurance scheme, with those of the US and Europe most representative. Since the outbreak of the crisis, some countries previously without a deposit insurance system, such as Australia and New Zealand, announced the creation of deposit insurance systems. The role of deposit insurance has been expanded both in and out of its conventional coverage and become a comprehensive crisis-management platform.

When a bank is closed down, a sound deposit insurance system can effective prevent risks from spreading, avoid financial panic and social instability. First, deposit insurance can maximally protect the rights and interests of depositors, and boost their confidence. During the crisis, various countries promptly introduced measures regarding deposit insurance and raised the limit of coverage based on the existing deposit insurance systems. Second, multiple methods were used to dispose of financial institutions to ensure that problematic banks could function well or exit the market in an orderly manner. Third, corrective measures were taken at an early stage to prevent financial risks. Fourth, the system of basing premiums and fees on risks was improved to promote commercial banks to strengthen internal risk management.

Traditionally, the primary functions of a deposit insurance system are to bail out banking institutions and prevent risks. During this crisis, apart from the conventional functions, the role of deposit insurance systems has been continuously expanded and has evolved into a comprehensive platform available for governments to deal with the crisis. First, full coverage is provided to make deposit insurance a platform that boosts confidence in the economy and market. Second, the function of guaranteeing banks' debt and inter-bank credit activities makes deposit insurance a platform for the provision of emergency liquidity. Third, deposit insurance becomes a platform for the government to bail out systematically important financial institutions through guaranteeing bad assets and purchasing shares. Fourth, deposit insurance scheme becomes a platform for the government to address the essential conundrum of credit lending to the real estate sector through loss amortization of mortgage loans. Fifth, deposit insurance has become a platform for the government to mitigate adverse impact of the international financial risks on financial stability in its jurisdiction through providing temporary guarantee to branch offices of foreign-invested banks. Sixth, deposit insurance agency works more closely with the central bank and regulatory authorities to jointly cope with the financial crisis, so it has become an important part of the regulatory coordination mechanism among government agencies.

Improve Financial Regulation and Supervision and Adjust Financial Market Trading Rules

In view of major loopholes in financial regulation and supervision and pro-cyclicality revealed by the crisis, countries concerned have taken a series of policy measures.

Strengthened prudential regulation. The Fed formulated a series of measures that aimed to regulate mortgage lending, including prohibition of lending to borrowers without income certificates; the US SEC, based on a survey on the three major rating agencies i. e. Moody's, Standard & Poor and Fitch, drafted supervisory rules on rating agencies; the Treasury Department announced a whole set of draft measures on "Best Practice" for the hedge fund industry. On October 1, 2008, the European Union announced new rules on banks and investment companies, asking financial regulators in the member countries to collaborate more closely so as to improve supervision over 40 cross-border banks in Europe.

Adjusted trading rules. Faced with extreme panic sentiment in the market place, the US, the UK, Australia, Italy, Spain, Denmark and Greece successively banned short selling of stocks of financial institutions or all the listed companies, and Russia, Iceland and Indonesia suspended stock trading.

Improved accounting standards. In order to prevent listed financial institutions from being dragged down by massive write-down based on fair value accounting, the US Congress authorized the SEC to halt the application of fair value accounting standards, while the International Accounting Standards Board also relaxed the use of fair value accounting, and allowed the use of historical costs accounting method in extreme conditions with a view to improving the financial standing of financial institutions.

Box 14 Efforts to Improve the Existing Credit Rating System

With regard to the problems in the CRAS have been revealed by the financial crisis such as lack of independence, inadequate effectiveness of rating models and methods, high degree of market monopoly and conflicts of national interests in the process of credit rating, IOSCO released the revised *Code of Conduct Fundamentals for Credit Rating Agencies* (hereinafter referred to as the new Code), which included substantive adjustments in improving the quality of credit rating, strengthening independence of rating agencies, avoiding conflicts of interests and strengthening information disclosure, and sparked broad attention from regulators, financial ministries and central banks across the world.

First, the new Code emphasizes the improvement of rating quality to ensure objective and fair rating results. The new Code stipulates that if the rating involves a type of financial product presenting limited historical data the CRA should make clear, in a prominent place, the limitations of the rating; a CRA should establish a review function made up of one or more senior managers with appropriate experience to review the feasibility of providing a credit rating for a type of structure that is materially different from the structures the CRA currently rates; a CRA should establish and implement a rigorous and formal review function responsible for periodically reviewing the methodologies and models and significant changes to the methodologies and models it uses; in cases where the complexity or structure of a new type of structured product or the lack of robust data about the assets underlying the structured product raise serious questions as to whether the CRA can determine a credible credit rating for the security, CRA should refrain from issuing a credit rating.

Second, CRA independence and avoidance of conflicts of interests. A CRA should disclose if it receives 10 percent or more of its annual revenue from a single issuer, originator, arranger, client or subscriber, and the CRA should also indicate in its rating report whether the issuer has publicly disclosed product information; a CRA should conduct formal and periodic reviews of compensation policies and practices for CRA analysts and other employees who participate in or who might otherwise have an effect on the rating process to ensure that these policies and practices do not compromise the objectivity of the CRA's rating process; a CRA should establish policies and procedures for reviewing the past work of analysts that leave the employ of the CRA and join an issuer the CRA analyst has been involved in rating, or a financial firm with which the CRA analyst has had significant dealings as part of his or her duties at the CRA.

Third, raise disclosure requirements to reveal relevant risks. A CRA shall indicate the date of last update of any rating result, and describe the methodologies used to arrive at the rating in the rating report; a CRA should differentiate ratings of structured finance products from traditional corporate bond ratings, and disclose how this differentiation functions; a CRA should assist investors in developing a greater understanding of what a credit rating is, and the limits to which credit ratings can be put to use vis-à-vis a particular type of financial product that the CRA rates.

Easing Monetary Policies Were Adopted, and Massive Economic Stimulus Plans Were Launched

In terms of monetary policy, some central banks cut interest rates substantially. In 2008, the Federal reserve cut re-discount rate by accumulatively 425 basis points on 8 occasions to 0.5 percent, and lowered the federal fund rate by 400 basis points on 7 occasion to a range of 0 ~ 0.25 percent, hitting the lowest record since 1990. The European Central Bank and the Bank of England cut benchmark interest rate by 175 basis points and 350 basis points respectively, and the Bank of Japan lowered the uncollateralized overnight call rate from 0.5 percent to 0.1 percent, which was equivalent to the resumption of "zero interest rate" policy.

In terms of fiscal policies, many countries promulgated large-scale economic

stimulus plans. In February 2008, the US introduced the USD 150 billion fiscal stimulus package with emphasis laid upon tax rebate. In November 2008, the European Commission approved the European economic stimulus plan worth 200 billion euros covering all the 27 member countries. Germany launched its economic stimulus plan with an amount of 31 billion euros in November 2008. Japan introduced separately in August and December two economic stimulus packages worth USD 107 billion and USD 255 billion respectively. Moreover, Australia, South Korea, India and other countries also came up with economic stimulus packages including expansion of public expenditures and infrastructure investment as well as tax reduction.

Strengthened International Cooperation to Cope with the Crisis Together

A number of central banks took joint actions. On October 8, 2008, the US Federal Reserve, the European Central Bank, the Bank of England, the Bank of Canada, the Sveriges RiksBank (central bank of Sweden) and the National Bank of Switzerland announced rate cut simultaneously, sending a signal of joint efforts to fight the financial crisis. In addition, the Federal Reserve worked with other central banks on several occasions to inject short-term dollar liquidity into the market, and some European countries and the US pumped liquidity into money markets and financial institutions collaboratively.

International financial institutions made rescue efforts. The IMF approved loans to Ukraine, Hungary, Iceland, Pakistan and etc. A number of international conferences called on the international community to strengthen cooperation. In 2008, the 63rd UN Assembly, the EU Summit, the 7th Asia-Europe Summit, the G20 Summit on Financial Markets and World Economy and APEC meetings put the financial crisis top on agenda, and urged the international community to strengthen cooperation and to use a spectrum of economic and financial means to restore market confidence, stabilize the global market and promote economic growth.

In addition, IMF, FSF, G30 Working Group on Regulatory Systems and other international financial institutions studied on possible response measures and put forward a raft of recommendations on how to improve the international financial system including strengthening capital, liquidity and risk supervision, improving transparency and valuation, establishing and improving a crisis resolution mechanism, reducing adverse impacts of cyclical factors and coordinating macroeconomic policies and financial prudential regulation.

Active Stance Adopted by China in Response to the Severe Blow of the International Financial Crisis

In 2008, faced with the increasingly severe impact of the international financial crisis on China's economic and financial system and the complicated and changing international economic and financial situation, the Chinese government made timely and resolute adjustments to macroeconomic policies, and in accordance with the requirement of acting fast, being forceful, taking targeted measures and stressing implementation, the central government issued a raft of policy measures after research to do everything possible to maintain steady and rapid economic development. The economy and society withstood major challenges and tests rarely seen in history.

Made Timely Adjustments to Macroeconomic Policies

In 2008, the Chinese government maintained the right direction, focus, intensity and pace of macro-management, and adopted a series of policies and measures to promote steady and rapid economic development. In the middle of the year, when energy and grain prices on the international market were high, world economic growth slowed down, and exports from and economic growth in China's coastal regions began to decline, we promptly shifted the priority of macro-management to maintaining steady and rapid economic development and controlling price hikes, and adopted relevant fiscal, taxation and financial measures. In September, the international economic situation started to deteriorate sharply and its negative impact became increasingly felt in China. Against this context, the government again resolutely shifted the focus of macro-management to preventing economic growth from slowing down too quickly, and implemented a proactive fiscal policy and a moderately loose monetary policy.

Implemented Moderately Loose Monetary Policy

To keep sufficient liquidity in the banking system, the intensity of open market operations was reduced, credit ceilings on financial institutions were explicitly eliminated, and the reserve requirement ratios for renminbi deposits were cut on four occasions in 2008, among which, the reserve requirement ratio for large-scale depository financial institutions was lowered by 2 percentage points, and for small- and mediums-sized depository financial institutions by 4 percentage points accumulatively. The leverage role of interest rate was put into full play. The benchmark renminbi lending interest rate was lowered on five occasions, and benchmark renminbi deposit rate cut on four occasions, and interest rate on the individual commercial housing mortgage interest rate was lowered. Specifically, the 1-year deposit and lending interest rates were lowered by 1.89 percentage points and 2.16 percentage points respectively, and the floor of interest rate on individual commercial housing mortgage loan was downward adjusted to 70 percent of the benchmark interest rate. The functions of credit policies were actively explored. Efforts were made to guide financial institutions to increase credit lending to programs that aim to improve people's livelihood, key engineering projects, small- and medium-sized enterprises, energy conservation and pollution reduction, scientific innovation and other priority areas in a differentiated manner. The renminbi exchange rate flexibility was continuously strengthened. The renminbi exchange rate formation mechanism was further improved as so as enhance the exchange rate flexibility, and to keep the renminbi exchange rate basically stable. The floor on foreign exchange positions of primary traders was lowered in a timely manner, and coverage of foreign exchange positions were adjusted to ensure sufficient liquidity of foreign exchange in the domestic market.

Comprehensive Measures Were Taken to Promote Economic Growth

Government spending increased by a large margin. Ten measures that aim to boost domestic demand and promote stable and rapid economic growth were launched, and a total of RMB 4 trillion yuan would be allocated for investment in a time span of two years, with the priorities investment destinations including agriculture, farmers and rural areas, government-subsidized affordable housing projects, traffic and other infrastructure, energy saving and pollution reduction and social welfare. Significant tax reduction programs were launched including the implementation of VAT reform, preferential tax policies on small- and medium-sized enterprises and real estate transactions, rescinding or suspension of 100 administrative changes. It was estimated that about RMB 500 billion yuan tax burden on enterprises and households would be eliminated. Efforts were made to promote job creation, improve people's livelihood, push ahead with the medical and health reform, enhance social welfare, take measures to increase employment of college graduates and migrant farmers, and to create more job positions that provide logistics services to the public. Scientific and technological innovation and technical upgrading were forged ahead to create more social demand and cultivate new potential growth points.

Maintain Safe and Sound Functioning of the Financial System

Since 2003, the asset quality and the counter-risk ability of China's financial industry have been significantly strengthened, which has laid a solid foundation to prevent and mitigate the impact of the international financial crisis. Moreover, the improvement of the investors protection system has played an active role in preventing the spread of financial risks and stabilizing public confidence. Since the outbreak of the financial crisis, the Chinese government has remained determined and calm, and has taken various measures to effectively deal with the crisis. We have closely followed the developments of the crisis, analyzed in depth the impact of the crisis on China's economy and finance, monitored potential risks in the financial industry on real-time basis, established an emergency crisis response mechanism, and improved all kinds of response plans. We have resolutely, flexibly and cautiously addressed a few risk events, solved liquidity difficulties faced by some foreign-funded financial institutions operating in China, and at the same time strengthened media guidance and stabilized market confidence. We have pushed ahead with the reform of financial institutions and the basic institutional building of the capital markets, so as to strengthen the resilience of the financial system to risks. We have formulated the nine measures and 30 opinions on finance promoting economic development, which sent a strong signal of our determination to keep economic growth and stabilize market confidence, and strengthen the mutual assistance and support between finance and economy. Great attention has been paid to economic and financial stability in Hong Kong and Macao, and cooperation with the financial authorities in Hong Kong and Macao SARs has been enhanced, and a stand-by cross-border liquidity arrangement between the Mainland and Hong Kong has been set up.

Actively Engaged in International Cooperation in Crisis Resolution

As a responsible big country, China, having adopted an active and responsibility-taking attitude, has capitalized on various international cooperation platforms, and worked with international organizations and foreign central banks to discuss current situations and come up with response measures. China has been actively involved in international conferences such as the G20 Summit on Financial Markets and the World Economy, studied on and proposed several policy recommendations on the reform of the international financial system and crisis response, and cooperated with the rest of the world to handle the crisis within its capacity. After the crisis broke out, China took part in the IMF crisis rescue efforts through IMF's financial transactions plan with China's contribution in proportion to its actually subscribed quotas, actively promoted the multilateralization of the Chiang Mai Initiative and the reserve pooling arrangement under the Initiative, and provided liquidity support to regional economic and financial stability. On December 12, 2008, PBC signed with the Bank of Korea a currency swap agreement worth 180 billion yuan.

Determinedly Promoted Reform to Establish a New International Financial Order

The international financial crisis is a global challenge, so the international community and governments shall take all measures possible, being confident and collaborative, to fight the crisis.

To Promote the Building of an Equal, Just, Inclusive and Orderly International Financial Order

The international monetary system should be reformed, and international reserve currencies should be adjusted in the direction of stable currency value, orderly supply and controllable aggregates, so as to fundamentally maintain global economic and financial stability. In order to avoid the shortcomings of using sovereign currencies as reserve currencies, an international reserve currency with long-term stable value and delinked from sovereign countries need to be created. The role of the SDR should be put into full play. IMF should manage partial reserves of its member countries so that it would become more capable of handling crisis and maintaining stability of the international monetary and financial system. The system of international financial organizations should be reformed, in which the representation and voice of emerging market economies and developing countries should be increased. International financial organizations should improve surveillance and ensure that all member countries are treated in an equal and just manner. IMF should strengthen its surveillance over economic and financial policies of the major issuing countries of reserve currencies and the major international financial markets, improve its governance structure and decision-making procedure, and enhance its capacity of crisis early warning and disposal. The role of regional financial organization, regional cooperative mechanism and bilateral cooperation in crisis rescue should be fully leveraged on.

To Speed Up the Financial Market Reform and Enhance Transparency of Financial Markets and Financial Products

Regulatory institutions should strengthen the infrastructure building of OTC markets, do research on and improve fair value accounting, accounting and disclosure of off-the-balance items, valuation of derivatives and so on, to make sure that information disclosure in accordance with accounting standards can fully reflect the exposure and potential losses. Efforts should be made to improve the information disclosure system, speed up the formulation of standards concerning information disclosure of derivative products and harmonize those standards on the major financial markets, specify that OTC market participants should make full disclosure to regulators, clients and shareholders. Market delivery and clearing services should be improved, clearing rules on derivatives trading be made, and an efficient central clearing facility for derivatives trading on OTC markets be provided so as to promote reliability of clearing and transparency of markets.

Stable Operation of Financial Institutions Should Be Pursued and a Sound Risk Management System Be Established and Improved

Financial institutions should follow principles of prudential operations, raise capital adequacy ratios, lower leverage ratios appropriately, and avoid excessive expansion of businesses. In particular, investment banks should improve the "originate-to-distribute" model of securitization, and reinforce risk management systems. An independent risk evaluation system should be set up, and outright outsourcing of risk assessment to rating agencies should be avoided. Instead, external rating should be accompanied with internal risk evaluation, which should be complementary to the former. In this way, homogeneity in decision-making, herding effects and consequently systemic risks can be avoided. Effort should be made to deepen the reform of human resources management, to establish a scientific incentives system to match compensation schemes and incentives with responsibilities. Higher corporate governance standards should be defined for systemically important and actively trading cross-border financial institutions. Qualifications of their independent non-executive directors should be improved, and their role in balancing the relationship between strategy-making, business expansion and development quality, as well as financial innovation and selection of the senior management.

Prudential Regulation Should Be Strengthened, and Ability to Mitigate Systemic Financial Risks Be Improved

Regulators for systemic financial risks should be defined, monitoring, evaluation and early warning of systemic financial risks be strengthened, and a financial regulatory college set up and enhanced to make sure smooth information flow and harmonization of goals between regulators overseeing systemic financial risks and other regulators. Prudential regulation over financial innovation, OTC markets and systemically important institutions should be strengthened; unified regulatory rules should be enacted for cross-market, cross-sector and cross-business financial institutions so as to avoid regulatory vacuum and regulatory arbitrage. Efforts should be made to build the human resources capacity of regulators, enhance their communication with the market, improve market sensitivity, get informed of recent developments of the financial industry so regulators can better perform their functions. The accuracy and farsightedness of FSAP should be improved, and an assessment system should be set up and tailored to the development characteristics of developing countries. All countries and international organizations should beef up cooperation, strengthen supervision over international speculative capital, improve transparency of international capital flows, promote regulatory coordination among cross-border financial institutions, develop a crisis pre-warning system that covers the whole world, international financial centers in particular, and improve the crisis rescue mechanism.

A Circuit-breaker Is Needed to Eliminate the Adverse Impact of Pro-cyclicality

Reinforce regulation over users of rating results and rating agencies, encourage financial institutions to cultivate their internal rating capability and reduce reliance on external rating. Strengthen international regulation over the rating system, formulate relevant code of conduct, eliminate the conflicts of interests between rating agencies and securities issuers, improve rating methodologies, enhance rating quality, reinforce rating review, and strengthen independence, fairness and transparency of rating agencies. A counter-cyclical mechanism for capital discipline should be set up, and the government agency responsible for overall financial stability should release reports on prospect and stability coefficients on a quarterly basis, according to which risk weights and capital adequacy requirements should be adjusted so as to buffer the adverse impact of procyclical factors. Accounting standards should be adjusted, and mark-to-market accounting and fair value accounting should be suspended as appropriate.

The Rescue Function of the Central Bank Should Be Reinforced, and a Crisis Rapid Response Mechanism Be Established

A financial stability operational framework that is fast, flexible and efficient should be established. A central bank should be equipped with various kinds of policy instruments, so when a financial institution is facing with liquidity difficulties and posing threat to financial stability, the central bank can adjust the frequency, maturities, counter-parties, terms of transactions of its open market operations and so on to satisfy the rapidly growing demand for liquidity in times of crisis. When necessary, the scope of financial institutions that the central bank is able to bail out can be expanded, and the central bank should be assigned with the right to oversee such financial institutions. An efficient mechanism that meets the financing need of commercial financial institutions should be set up to dispel their concerns over the reputation loss associated with government rescue. When problematic financial institutions have difficulties raising funds through market channels, the central bank should be allowed to provide the financial institutions with additional capital or purchase and hold their shares on temporary basis, with a view to avoiding the blow possibly to be caused by the collapse of a large number of financial institutions to the entire financial system.

Deposit Insurance Systems Should Be Built, and National Financial Safety Nets Be Improved

Deposit insurance system, prudential regulation by financial regulators and central bank's function as the lender of the last resort are broadly deemed as the three bedrocks for financial stability. The crisis once again proves that the creation of a deposit insurance system in line with the need for the development of the market economy and financial stability can protect depositors, strengthen the public's confidence in the financial system, and safeguard financial stability and security. Where risk disposal arrangements are not made, deposit insurance institutions may act as a platform that handle temporary risks if there is panic among financial institutions and in the financial markets. The deposit insurer can also take over the responsibilities of reorganizing institutions and providing specialized clearing, so as to avoid the spread of the crisis; therefore, it is an important part of the national financial safety net.

(By Tao Ling, Liu Jie, Liu Weijang and Quan Kejun)

Special Topic Ⅰ

The Reform of Financial Institutions in China Since 2003

Sound development of financial institutions is the micro foundation of financial stability. Attaching great importance to the reform and development of financial institutions, the Chinese government has taken a series of policy measures since 2003 for reforming key institutions in the financial sector. This is a forward-looking decision which has helped prevent financial risks and maintain financial stability at the micro level. Great progress has been made in the reform of financial institutions in these five years. The shareholding reform of large-sized state-owned banks has been basically accomplished, yielding remarkable results. ICBC, BOC, CCB and BOCOM have gone through the shareholding reform and got listed. The reform of CDB and ABC has been initiated in an all-around manner and significant progress has already been made. The reform of rural credit cooperatives has yielded results for the current stage, including improvements in property rights system, internal governance mechanism, legacy problem settlement and asset quality. China Everbright Bank and Guangdong Development Bank have accomplished their financial restructuring. Securities companies made progress in restructuring and risk disposal. The restructuring of nine securities companies including China Galaxy Securities Co., Ltd. and Huaxia Securities Co., Ltd., has been accomplished basically. 31 high-risk securities companies have managed their risk disposal properly. New progress has been made in the reform of the insurance industry. The shareholding reform of state-owned insurance companies is advancing steadily. People's Insurance Company of China and China Life Insurance Company have been successfully restructured, adopting the modern enterprise system and got listed both at home and abroad. Their corporate governance improved and competitiveness enhanced remarkably. Notable progress has been made in the capital injection and enterprise system reform of China Reinsurance (Group) Corporation.

China's financial industry has gone through historical changes thanks to the reform. As a result, China's financial system is more safe and sound with stronger financial institutions, enhanced confidence for the financial market and greatly improved financial service and international competitiveness. Thanks to the reform, China's financial system buffered the impacts of the current financial crisis, and enhanced the resilience of national economy in defending the international financial crisis, which has helped maintain the health and stability of the Chinese economy and contributed to stabilizing the international financial system.

Advance the Reform of Financial Institutions to Prevent Financial Crises on the Micro Level

The Shareholding Reform of Large-sized State-owned Banks Has Been Basically Accomplished

As the pillar of China's financial sector, large-sized state-owned banks have made important contributions in promoting economic reform and development and maintaining social stability. In the meantime, great risk exposures, however, have been accumulated. The government made strategic arrangements for the reform and development of China's financial system on two National Financial Work Conferences held in 1997 and 2002, attaching great importance to the reform and development of large-sized state-owned banks. Since 2003, the reform for 6 large-sized state-owned banks, BOC, CCB, BOCOM, ICBC, CDB and ABC were launched in succession. By the end of 2003, USD 22.5 billion had been injected to BOC and CCB respectively via Central Huijin Investment Company (Central Huijin); in 2005, USD 15 billion has been injected into ICBC through Central Huijin. BOC, ICBC and BOCOM have completed financial restructuring and shareholding reform and got listed at Hong Kong and Mainland. In 2008, against the backdrop of the financial crisis, the central government decisively launched the reform of CDB and ABC, injecting USD 20 billion and USD 19 billion respectively to CDB and ABC via Central Huijin, demonstrating the resolute confidence to deepen the financial reform and maintain financial stability. At present, CDB has been reformed from a policy bank into a joint-stock commercial bank; ABC has completed financial restructuring and is now a joint-stock company. Therefore, the shareholding reform of China's large-sized state-owned banks has been basically accomplished.

For more than five years, the large-sized state-owned banks have been improving corporate governance, updating operation models and strengthening internal-control system and risk management system for the purpose of providing better service and seeking more profits. Thanks to these efforts, remarkable results have been made as follows:

Large-sized state-owned banks steadily improved corporate governance and deepened internal reforms. First, the corporate governance structures have been more reasonable. Balanced and well-functioning governance structure constituted by the shareholders' meeting, board of directors, board of supervisors and senior management is gradually put into place, and the advantages of such a governance structure are displaying themselves. Second, progress has been made in internal control system and management capability, including improvements in the risk prevention system, the application of information technology, basic management and the development of risk-management culture. Third, the business and technological cooperation programs with strategic investors have been implemented. Strategic investors are making remarkable contributions to improving shareholding structure and corporate governance, upgrading operation models, strengthening risk control, developing financial products, enhancing financial service and fostering corporate culture. The effects of introducing expertise and institutional arrangements via cooperating with strategic investors are gradually seen. Fourth, having been listed, these banks have established a market-based capital raise mechanism, standardized information disclosure process and raised the standard for the senior management to perform their duties, and therefore, the capital market is playing a greater role in promoting and supervising the establishment of modern enterprise system in financial institutions. Meanwhile, their public listing has expanded the A-share market and enhanced the overall investment returns of A-share companies, which has stabilized the market and promoted the development of domestic capital market.

The social and financial benefits of the reform of large-sized state-owned banks are greatly enhanced. First, their capability and efficiency of promoting national economy and serving the society have been strengthened. In line with the scientific approach of development, the large-sized state-owned banks laid special emphasis on changing development and growth model and improving process and management system, so as to provide multi-layer and multi-dimensional financial service for the synergetic development of the economy and the society. At the same time, innovation of concepts, products, business lines and technologies have been promoted to enhance competitiveness. Investment for social responsibility has been given a greater emphasis to improve financial service in an all-around manner. Second, the financial situation has been greatly improved and presents relatively strong sustainability. ICBC, BOC, CCB and BOCOM have significantly increased their capital adequacy ratio, improved their asset quality, profitability and risk control, maintaining quite good profitability and relatively strong risk-preventing capability even when impacted by the international financial crisis (table A1.1). After the reform, the financial situations of ABC and CDB also improved significantly. At the end of 2008, the capital adequacy ratios of ABC and CDB were 9.29% and 11.31% respectively; NPL ratios were 4.33% and 0.97%; Profits before tax were RMB 60.985 billion yuan and RMB 26.4 billion yuan. The ROA and ROE of ICBC, the Bank of China, CCB and the Bank of Communications have been increasing year by year, approaching or even exceeding the average level of the top 20 international banks (figure A1.1, figure A1.2)[1]. Third, their market ranking and strength have been significantly enhanced. The capital injection of the central government yields large benefits. ICBC, CCB, BOC and BOCOM are among the top ten banks globally in terms of capitalization on March 10, 2009, with continuously improved market ranks and strength (figure A1.3). At present, state-owned shares account for more than 67% post-IPO shares of the four banks with dominating position. State-owned equities are enjoying significant book value premium and increasing dividends, which help maintain and increase the value of state-owned assets.

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1 In order to make domestic and foreign indicators comparable, these data are calculated according to international standard. The equation for ROA is profits before tax/ total asset at year end and the equation for ROE is profits before tax/ net assets at year end.

Table A1.1 Changes of the Financial Indicators of ICBC, BOC, CCB and BOCOM

(100 million of RMB yuan)

		End of 2003	End of 2004	End of 2005	End of 2006	End of 2007	End of 2008
ICBC	Capital Adequacy Ratio	-8.81%	-8.31%	9.89%	14.05%	13.09%	13.06%
	NPL Ratio	21.24%	18.99%	4.69%	3.79%	2.74%	2.29%
	Profits Before Tax	26.58	21.05	593.54	715.21	1 151.14	1 453.01
BOC	Capital Adequacy Ratio	5.39%	10.04%	10.42%	13.59%	13.34%	13.43%
	NPL Ratio	16.28%	5.12%	5.41%	4.04%	3.12%	2.65%
	Profits Before Tax	385.73	345.76	551.4	676.3	899.55	862.51
CCB	Capital Adequacy Ratio	6.51%	11.29%	13.57%	12.11%	12.58%	12.16%
	NPL Ratio	4.27%	3.92%	3.84%	3.29%	2.60%	2.21%
	Profits Before Tax	374.73	502.16	553.64	657.17	1 008.16	1 197.41
BOCOM	Capital Adequacy Ratio	7.41%	9.72%	11.20%	10.83%	14.44%	13.47%
	NPL Ratio	—	2.91%	2.37%	2.01%	2.05%*	1.92%
	Profits Before Tax	40.62	71.19	128.43	174.05	310.38	358.18

Note: * The indicator is impaired loan ratio.

Figure A1.1 Average ROB of the four banks and top 20 banks around the globe

(percent)

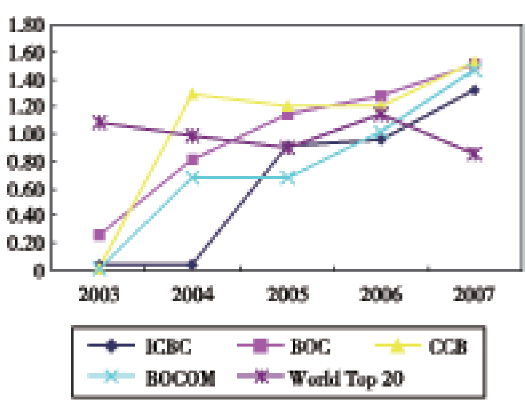


Figure A1.2 Average ROE of the four banks and top 20 banks around the world

(percent)

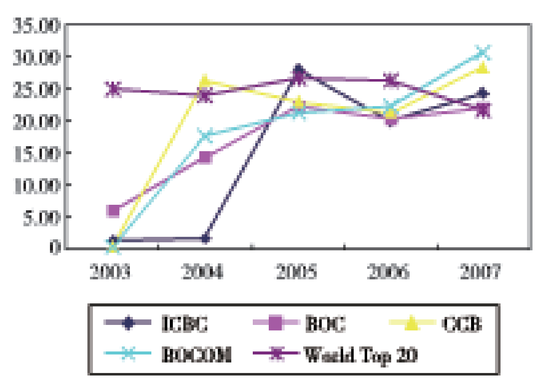
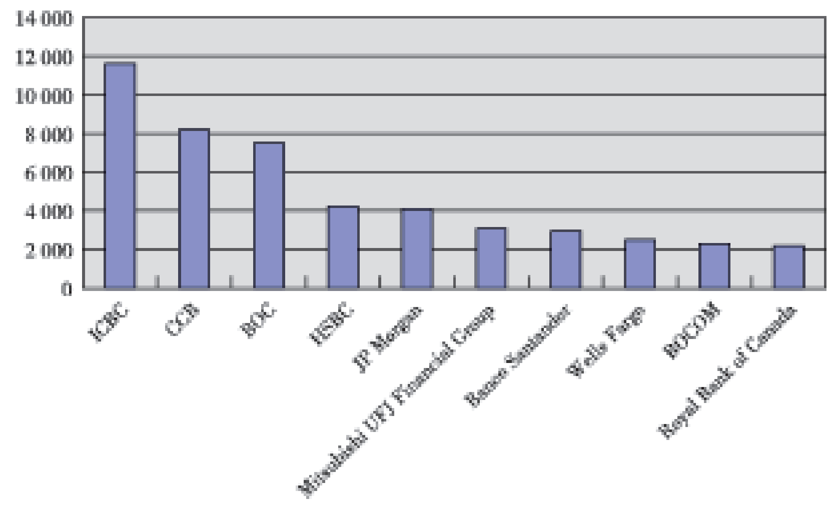


Figure A1.3 World Top 10 Banks in terms of capitalization on March 10, 2009

(100 *million of RMB yuan*)



Source: Bloomberg.

Significant Progress Has Been Made in the Reform of Rural Credit Cooperatives for the Current Stage

Rural credit cooperatives play a major role in providing financial services in rural areas. For many years, in line with national policies of financial services, rural credit cooperatives have played a positive role in promoting the development of agriculture and rural economy, facilitating the production of farmers and increasing their income. Meanwhile, they are also facing serious problems in property right, management system, function definition, corporate governance, legacy problems and asset quality.

In order to solve all the legacy problems of rural credit cooperatives and improve the financial system in rural areas, the central government launched the pilot project of rural credit cooperative reform in June 2003. Significant progress has been made since the initiation of the program, including improving management framework, deepening reform of the property right, prospering business lines, lessening risk exposure and increasing profitability. Therefore, rural credit cooperatives are playing a more important role in supporting agricultural development. At the beginning of the reform, the loans extended by rural credit cooperatives were RMB 1.4 trillion yuan, accounting for 10.6% of the total credit extended by financial institutions, which rose to RMB 3.7 trillion yuan by the end of 2008, accounting for 12.3% of the total. The value and ratio of non-performing loans were RMB 296.5 billion yuan and 7.9% as of end-2008, RMB 218.2 billion yuan and 28.9 percentage points lower over the beginning of the reform. In 2004, the whole industry reversed chronic loss and the profitability of rural credit cooperatives has been increasing year by year. The pre-tax profit of rural credit cooperatives stood at RMB 54.5 billion yuan in 2008. By the end of 2008, the outstanding loans for agriculture extended by rural credit cooperatives reached RMB 1.7 trillion yuan. Its proportion in all loans extended by rural credit cooperatives was enhanced from 40% when the reform was initiated to 46% as of end-2008 and its proportion in all outstanding loans for agriculture extended by various financial institutions rose from 81% at the beginning of the reform to 96% at the end of 2008. The reform of the property right system is well in progress and the legal person governance system is taking form. By the end of 2008, 20 rural commercial banks, 144 rural cooperative banks and 1 851 integrated credit cooperatives with legal person status at the county (city) level had been set up. Some rural credit cooperatives have made explorations in defining property rights and improving legal person governance, yielding preliminary results.

Remarkable Progress Has Been Made in the Restructuring and Reform of Shareholding Banks

While reforming state-owned commercial banks and rural credit cooperatives, the central government attaches great importance to the reform and development of joint-stock commercial banks. Since 2003, a group of joint-stock commercial banks including China Minsheng Bank, China Merchants Bank and China Citic Bank have got listed on the A-share market and the H-share market, which incentivises their improvement of corporate governance and compliance with market discipline. Meanwhile, PBC, together with other competent authorities, laid special emphasis on promoting the restructuring and reform of China Everbright Group (Everbright Group) and Guangdong Development Bank (GDB). Since 2007, with the advancement and coordination of PBC and other competent authorities, the reform of Everbright Group started with the financial restructuring of the Everbright Bank, the establishment of Everbright Industrial Company and the Everbright Financial Holding Company. In November 2007, Central Huijin injected 20 billion yuan worth US dollars into the Everbright Bank. The IPO of Everbright Bank is in process and the establishment of Everbright Industrial Company and Everbright Financial Holding Company is in steady progress. Due to historical reasons, GDB had quite a high NPL ratio and a negative capital adequacy ratio. In 2006, the government of the Guangdong Province took the lead in promoting the reform and restructuring of GDB together with PBC and other competent authorities. In addition to stripping non-performing assets, GDB increased their capital by issuing more shares and introducing strategic investors. In November 2006, GDB completed the introduction of domestic and foreign investors, and the first board of directors and the management were elected on December 18. With much progress in the restructuring, GDB now has remarkably enhanced its capital adequacy ratio and asset quality.

Prominent Achievements Have Been Made in the Restructuring and Institutional Arrangements of Security Companies

From 2004 to 2006, due to the prolonged downturn of the stock market, the concentrated materialization of securities companies' long-accumulated risk exposures rendered the whole industry in a difficult situation. In order to bolster the securities market and maintain social stability, PBC, together with other competent authorities, restructured 9 securities companies including China Galaxy Securities Company by means of shareholders' capital injection, provision of liquidity support and the introduction of strategic investors with Central Huijin and China Jianyin Investment Co., Ltd. as restructuring platforms. By the end of 2007, the restructuring of the 9 securities companies had been basically accomplished, which had not only effectively mitigated the risks of securities companies, boosted consumers' confidence and maintained the stability of securities market, but also enhanced the comprehensive strength of restructured securities companies through resource integration. Meanwhile, the third-party custodian of customers' settlement transactions fund has been implemented in the whole industry, which has effectively prevented securities companies' misappropriation of such funds.

The Reform of Insurance Companies Has Gone Deeper

In recent years, the government has been reforming the financial institutions in the insurance industry in a comprehensive manner, with the purpose of preventing and mitigating risks and enhancing the overall strength and competitiveness of the industry. The reform of state-owned insurance companies has seen fundamental progress and has gone deeper. The market share of state-owned insurance companies is over 70% in the nation-wide market. For a long time, however, state-owned insurance companies have been troubled by multiple problems including inadequate capital, inflexible operating mechanism, poor asset quality, serious legacy problems and insufficient competitiveness. According to the arrangements made at the National Financial Work Conference in 2002, the shareholding reform of state-owned insurance companies is progressing in a steady manner. Since 2003, PICC and China Life have accomplished the restructuring and adopted the modern enterprise system. They got listed in Hong Kong, New York and the A-share market successively. Their corporate governance has been improved, shareholding structure optimized and competitiveness greatly enhanced.

In the mean time, PBC, together with other competent authorities, focused on promoting the reform of China Reinsurance (Group) Corporation (China Reinsurance). In April 2007, Central Huijin injected USD 4 billion to China Reinsurance for its restructuring. In October 2007, China Reinsurance (Group) Co., Ltd. was established. After the shareholding reform, China Reinsurance is featured by more optimized capital structure, fundamentally improved capital adequacy ratio, greatly enhanced solvency and more rational corporate governance structure. The efficient and profitable group-wide development pattern is taking form, and the three pillar business lines namely reinsurance, direct insurance and asset management have achieved further development. By then, the shareholding reform of China Reinsurance had been basically completed. Moreover, progress has been made in the introduction of strategic investors and the public listing of shareholding insurance companies.

By shareholding reform and getting listed, some of the insurers have changed their organizational structure and management system, and gradually established relatively standard corporate governance structure. As a result, the players in the market on the micro level, namely the insurers, enjoy stronger performance and enhanced core competitiveness. Meanwhile, a sound insurance industry mainly constituted by life insurance, property insurance and reinsurance has been basically established.

In recent years, significant progress has been made in the reform of financial institutions, which lays a solid foundation of financial stability on the micro level and greatly helps the financial system in China in mitigating the impacts of the ongoing financial crisis. First, historical changes took place in the banking industry, which is equipped with stronger capabilities to prevent risks, much improved capital adequacy ratio and loan loss provisioning. At the end of 2008, the total asset of the banking financial institutions exceeded RMB 60 trillion yuan, and the 204 banks met the requirement concerning capital adequacy ratiocompared with 8 in 2003, whose total assets accounted for 99.9% of the total of commercial banks. Thanks to the reform, the banking industry has been continuously improving the concept, methods and means of service, providing more comprehensive business lines and services, which greatly enhanced their capability of survival and development. Currently, the overall strength of China's banking industry is at its best no matter in terms of the size of assets, asset quality, profitability, capital adequacy ratio or liquidity. Second, the securities industry expanded rapidly and the capital market developed further, playing a growing important role in national economy. By the end-December 2008, the 107 securities companies had a total asset of RMB 1.2 trillion yuan, a net asset of RMB 358.5 billion yuan, with the annual actualized net profits registering RMB 48.2 billion yuan; The managed assets of the 61 fund companies exceeded RMB 1.9 trillion yuan; A total of RMB 310.8 billion yuan has been raised accumulatively on the domestic market in 2008. Third, the capital strength of insurance companies was enhanced, which enabled them to play important roles in optimizing financial structure and increasing the efficiency of resource allocation in the financial market. At the end of December 2008, the total asset of the insurance industry was more than RMB 3.3 trillion yuan.

Continue to Deepen the Reform of Financial Institutions and Maintain Financial Stability

Deepen the Reform of Large-sized State-owned Banks

It is essential to further the reform of large-sized state-owned banks. Though great achievements have been made due to the reform, the banks are still facing the problems of inadequate corporate governance, unsound internal control mechanism and weak basic management. Their capability of risk management and control and the level of financial service are still to be improved. In the midst of the deterioration of the ongoing financial crisis and the recession of global economy, China's banking industry is facing new challenges. Therefore, unswerving efforts should be made to advance the reform.

First, continue the reform of the large-sized state-owned banks that have adopted the modern enterprise system. Firstly, keep strengthening internal control and risk prevention systems. Efforts should be made to honor the principle of prudential operation, prepare risk provisions in full, tighten capital constraint and enhance the efficiency of capital utilization. Special focus should be laid on strengthening internal control through updating operation mechanism to prevent risks, so as to avoid the rebound of non-performing assets and the decline of profitability. An accountability system should be established and irregularities strictly penalized to ensure sound operation. Secondly, improve corporate governance and decision-making mechanism. The reform of corporate governance should be deepened to better define the responsibilities of shareholders meeting, board of directors, board of supervisors and senior management, so that they can each play their roles and have well-functioning information sharing mechanism and effective balancing relationship, which will enable them to make better decisions in a more efficient manner when coping with financial crises.

Second, promote the market-based transformation of CDB into a commercial bank and further the reform of ABC. The reform of CDB will be deepened to improve the organizational system of its financial service. Earnest efforts will be made to promote the ABC to improve its corporate governance and risk control system and establish the county-level multi-divisional structure reform, in order to provide better financial service for agriculture, farmers and rural areas.

Third, accelerate the reform and development of policy financial institutions including the Export-Import Bank of China, China Agricultural Development Bank and China Export & Credit Insurance Corporation; in the mean time, efforts will be made to promote these financial institutions to expedite the reform of their internal system, update the operation model and strengthen risk control. The reform of the Postal Savings Bank will be furthered to strengthen its capability of serving the economy. The reform and development of financial asset management companies will be advanced to market oriented and put their role of managing the non-performing assets of financial institutions into full play.

Further the Reform of Rural Credit Cooperatives

Despite of the achievements made in the reform of rural credit cooperatives for the current stage, they are still, due to various reasons, facing many problems: the management system is not functioning well; a well-defined property right system is not in place yet; the legal person governance structure is unsound; the legacy problems haven't been solved; the overall risk level is still high; the base for sustainable development is still weak and their capabilities of providing financial service to support agricultural development and their overall competitiveness are yet to be improved. To solve the above-mentioned problems, efforts should be made to deepen the reform of rural credit cooperatives in a comprehensive manner so as to solve the deeply-rooted institutional problems serving as the bottleneck of reform and development, accelerate the establishment of modern rural financial system and further tap its potential of serving agricultural development.

First, further rationalize the management system of rural credit cooperatives. In line with the rule of economic and social development and the shift of the government's function, in accordance with the characteristics of the development of rural credit cooperatives in the current stage, and in light of the principle of separating governmental agencies from enterprises and assuming proportionate responsibilities with rights, efforts should be made to rationalize the relationship between the supervisors, provincial governments, provincial-level cooperatives and rural credit cooperatives, accelerate the reform of rural credit cooperatives, clarify the government's role of administration according to law and the shareholders' role as owners of rural credit cooperatives, so as to strengthen the supervision and management and ensure their sound operation in compliance with the law.

Second, improve the property right system and legal person governance system of rural credit cooperatives. In line with the modern financial enterprise system, a scientific and well-defined system of property rights should be established and the property right structure be optimized to build rural credit cooperatives into community-based financial institutions with shareholding system and establish a legal person governance structure in line with the characteristics of a diversified property right system.

Third, efforts will be made to strengthen effective supervision over rural credit cooperatives and enhance support via fiscal, taxation and other policies, so as to encourage them to conduct standardized operation in compliance with the law, control risks effectively, and increase financial sustainability and the incentive of supporting agricultural development on a continuous basis.

Deepen the Reform of Important Financial Institutions in the Securities and Insurance Industries

After comprehensive restructuring, the overall risk of securities companies has been preliminarily mitigated and their performance turned better, but efforts are still to be made to improve the corporate governance structure and strengthen the capability of sustainable development. The reform of securities companies should be deepened to establish sound corporate governance. The role of the investors should be better defined and further strengthened. The corporate governance structure constituted by shareholders meeting, board of directors, board of supervisors and senior management should be set up and their respective function should be defined to tap the potential of corporate governance in the development, operation and management of securities companies. Qualified securities companies are encouraged to expand and gain strength by IPO, restructuring or M&A, so as to enhance the industry's competitiveness and the capability of providing quality financial services. Meanwhile, innovation should be encouraged with the precondition of taking risks under control in order to establish a sustainable profit-making model.

Despite of the progress made in the reform of insurance companies, their competitiveness still lags behind when measured against the requirement of the modern enterprise system. They still face the problems of unsound corporate governance, inefficient operation and management, low profits and sluggish innovation. The development of group corporations needs to be further standardized. The reform of the insurance companies should be deepened to enhance the competitiveness of the insurance industry. Efforts will be made to improve the corporate governance structure, reinforce the functions of investors and put the role of modern corporate governance into full play. The reform of companies' internal management system and operation mechanism should be promoted to establish effective incentive and constraint mechanism, define the rights and responsibilities of various links in management and strictly enforce the internal control measures. The group-wide development of insurance companies should be standardized. The rights, responsibilities and positioning of the group and subsidiaries should be defined to realize synergetic development of the whole group by integrating all available resources efficiently. Group-wide risk management and control should be strengthened to prevent the cross-transmission of risks. Well-prepared groups and holding companies can launch shareholding reforms.

Provide Favorable External Environment for Sustainable and Healthy Development of Financial Institutions

In the midst of the current financial crisis, financial institutions are shouldering dual responsibilities of maintaining their own healthy development and stabilizing the overall economic development via expanding credit and stimulating domestic demand. Against such a macroeconomic background, it is essential to fine-tune the policies that influence the external environment for financial development, offering favorable conditions to consolidate financial stability on the micro level, promote the stable operation and healthy development of financial institutions and continuously enhance the capability of financial institutions in serving economic and social development. Macroeconomic management will be strengthened to keep stable and healthy development of national economy and prevent the financial risks which may be triggered by fluctuations during the business cycle. Favorable fiscal and taxation policies and other measures will be taken to raise the capability of disposing non-performing assets to increase the competitiveness of financial institutions and promote their health and sustainable development. Financial infrastructure should be reinforced by improving financial legislation and accounting system, accelerating the establishment of the credit reference system and improving credit environment, in order to lay a solid foundation for the stable and healthy development of the financial sector.

(By Xiong Lianhua, Qu Tianshi and Li Chao)

Special Topic II

The Development of Wealth Management Products in China

In recent years, with stable progress made in the pilot projects of integrated financial services in the financial sector, financial institutions have been more innovative, providing more diversified cross-market and cross-sector wealth management products and making market competition more dynamic. In 2008, the yields of some wealth management products registered large fall affected by the international financial crisis, and the risk of such products warranted close attention. In this context, it is necessary that effective measures be taken to promote the healthy development of wealth management products, so as to improve the profitability structure of financial institutions, optimize the allocation of financial resources and satisfy diversified financial needs.

Current Situation of Wealth Management Products

The recent years have witnessed rapid development of the wealth management business, with the diversification of wealth management institutions and products, broadening of investment channels, rapid expansion of the market and closer cooperation among various institutions.

Diversified Wealth Management Institutions

Currently, financial institutions in the banking, securities and insurance sectors are engaged in wealth management business. Specifically speaking, these financial institutions are commercial banks, trust companies, securities companies, fund management companies and insurance companies. Moreover, some enterprises, wealth management centers, wealth management services and individual-running investment counseling, investment advisory and financial management business are also involved in wealth management business.

Diversified Wealth Management Products

Commercial banks started to launch wealth management products in 2004, both in RMB and foreign currencies. As specialized operators of trusts, trust companies provide customized investment programs for particular clients and collective investment programs for common clients. Securities companies began to run asset management business in 1995, providing customized asset management for particular clients, collective asset management for common investors and target management of particular assets. Fund management companies are specialized operating institutions for securities investment funds, managing close-ended funds and open-ended funds. Insurance companies started to launch investment products with wealth management function in 1999, including participating insurance, universal insurance and investment-linked insurance.

More Channels for the Investment of Wealth Management Funds

For commercial banks, RMB wealth management products include direct investment in the money market and indirect investment in equities, funds, bonds, unlisted equities and etc via trust investment programs; foreign-currency wealth management products mainly cover the investment in the foreign exchange market, international financial derivatives, short-term foreign-currency bonds and so on. Trust companies enjoy the broadest investment channels including credit assets, equities, funds, bonds, unlisted equities, real estate, infrastructure and the industrial sector. The wealth management products of insurance companies and fund management companies mainly cover the investment in the capital market, including equities, bonds, funds and etc. The investment scope of insurance companies has expanded as the result of the expansion of investment scope of insurance funds. Originally, the insurance funds can only be channeled to bank deposits and treasury bonds; in 1999, insurance funds were allowed to purchase securities investment funds; in October 2004, insurance funds could be invested in the equity market; in December 2005, pilot projects were launched to invest insurance funds in infrastructure and venture capital firms; in October 2006, insurance funds were approved to purchase the equities of commercial banks; in May 2008, insurance funds were allowed the access to inter-bank bond market. (Table A2.1)

Table A2.1 The Development of Wealth Management Products

<table>
<tr><th>Wealth Management Institutions</th><th colspan="2">Type of Products</th><th>Investment Channels</th></tr>
<tr><td rowspan="2">Commercial Banks</td><td rowspan="2">Comprehensive Wealth Management Service</td><td>RMB Wealth Management</td><td>Money market, stock market, funds, bonds, unlisted equities</td></tr>
<tr><td>Foreign Currency Wealth Management</td><td>Foreign exchange market, International financial derivatives, Short-term foreign-currency bonds, and international inter-bank borrowing & lending</td></tr>
<tr><td rowspan="2">Trust Companies</td><td rowspan="2">Fund Trust Programs</td><td>Client-specific Fund Trust</td><td rowspan="2">Credit assets, Equities, Funds, bonds, Unlisted equities, Real estate, Infrastructure, Industrial Sector</td></tr>
<tr><td>Collective Fund Trust</td></tr>
<tr><td rowspan="3">Securities Companies</td><td rowspan="3">Client Asset Management</td><td>Client-specific Asset Management</td><td rowspan="3">Equities, bonds, funds and money market</td></tr>
<tr><td>Collective Asset Management</td></tr>
<tr><td>Target Asset Management</td></tr>
</table>

(concluded)

Wealth Management Institutions	Type of Products		Investment Channels
Fund Management Companies	Open-ended Funds		Equities, bonds, funds and money market
	Close-ended Funds		
Insurance Companies	Investment Products	Investment-linked Insurance	Deposits, equities, bonds, funds, unlisted equities, infrastructure, venture capital firms and money market
		Universal Insurance Participating Insurance	
Investment Counseling Enterprises, Financial Management Enterprises, Wealth Management Centers, Wealth Management Services and etc.	Private Equity and etc.		Most are investment and operation on the stock market

Rapid Growth of the Wealth Management Market

In 2007, commercial banks accumulatively launched 2 654 wealth management products, almost tripling the total of 2006 and pooling more than RMB 800 billion yuan. In 2008, commercial banks provided a total of 6 028 wealth management products, funding around RMB 2.3055 trillion yuan[1]. According to statistics available, the wealth management business of trust companies continued to grow rapidly in 2008, among which 2 330 of them were launched by the trust companies covered by PBC's monitoring system, 804 more over the same period of the previous year and a total of RMB 563.7 billion yuan was raised, up RMB 172.3 billion yuan[2] y-o-y. The focus of securities companies' asset management business shifted from client-specific asset management to collective asset management, with the latter becoming the major source of profits. In 2008, RMB 22.6 billion yuan[3] worth wealth management products were launched by securities companies. Generally speaking, the fund products launched by fund management companies were on the rise. By the end of 2007, a total of 346 fund products had been launched with the net worth registered RMB 3.28 trillion yuan, increasing by three times over that of 2006; by the end of 2008, there were altogether 444 fund products in the market, but

1 Source: Wind Info.

2 Source: PBC Shanghai Head Office.

3 Source: PBC Shanghai Head Office.

the net worth was reduced to RMB 1.95 trillion yuan due to market fluctuations.[1] Following the significant growth in 2007, insurance companies' premium revenue from wealth management products generally maintained relatively rapid growth in 2008. The premium revenue of participating insurance, universal insurance and investment-linked insurance was 379.887 billion yuan, RMB 145.053 billion yuan and RMB 42.503 billion yuan respectively, accounting for 51.77%, 19.77% and 5.79% in the total premium revenue of life insurance.[2]

Close Cooperation among Various Institutions

Financial institutions in various sectors such as commercial banks, trust companies and insurance companies have been cooperating more closely to develop cross-sector wealth management products. First, rapid progress have been made in the cooperation between banks and trust companies. On May 16th, 2006, China Minsheng Bank and Ping An Trust jointly launched "Superior RMB Wealth Management Products-T1 and T2 Programs", which represented the beginning of the bank-trust cooperative wealth management products. In 2008, a total of 3 283 such wealth management products were launched with the concerted efforts of banks and trust companies, accounting for 55.74% and 83.05% in the total number of wealth management products launched by commercial banks and trust companies respectively.[3] Second, banks and insurance companies are cooperating more closely. Commercial banks have become a very important sales channel for the wealth management products of insurance companies. In 2008, the premium revenue generated from the insurance products sold by banks as distributors increased by 106.53% over the previous year.[4]

Improving Regulatory Framework

Under the separate regulatory framework at present, CBRC, CSRC and CIRC are making regulatory rules governing the respective sectors under their supervision, regulating the approval, issuance, quota, return guarantee, funds custodian, business isolation, risk control, information disclosure and business promotion (Table A2.2). On the basis of improving institutional framework, relevant regulators are taking a mix of measures to urge the financial institutions to appropriately evaluate risks, strengthen risk control, improve risk warning, establish client assessment system, develop product design mechanism, and standardize the promotion and information disclosure of products, which have promoted the healthy development of wealth management products and helped prevent relevant risks.

1 Source: Wind Info.
2 Source: CIRC.
3 Source: Use Trust Studio.
4 Source: CIRC.

Table A2.2 Facts about the Regulation of Wealth Management Products

Wealth management products	Regulatory rules	Date of issuance	Regulator
Personal RMB Wealth Management Programs of Commercial Banks	*Provisional Rules on Commercial Banks' Individual Wealth Management Business* and the *Guidelines on Risk Management in Commercial Banks' Individual Wealth Management Business*	September 24, 2005	CBRC
Personal Foreign Currency Wealth Management Programs of Commercial Banks	*Interim Measures on Commercial Banks' Launching Overseas Wealth Management Businesses on Behalf of Clients*	April 17, 2006	
Personal Wealth Management Businesses of Commercial Banks	*Notice on Relevant Issues concerning Further Standardizing the Personal Wealth Management Business of Commercial Banks*	April 3, 2008	
Collective Fund Trust Programs of Trust Companies	*Notice on Issues Related to Improving Fund Custodian and Information Disclosure of the Collective Fund Trust Business of Trust Investment Companies*	June 30, 2006	
	Administrative Measures on Trust Companies and *Administrative Measures over Collective Fund Trust of Trust Companies*	January 23, 2007	
Wealth Management Products Jointly Launched by Banks and Trust Companies	*Guidance for Business Cooperation Between Banks and Trust Companies*	December 4, 2008	
Collective Asset Management Businesses of Securities Companies	*Provisionary Measures on Asset Management Business of Securities Companies*	December 18, 2003	CSRC
	Notice on Issues concerning the Collective Asset Management Business of Securities Companies	October 22, 2004	
	Administrative Rules on the Regulation of Securities Companies	April 23, 2008	
	Detailed Rules for the Implementation of Collective Asset Management Business of Securities Companies and *Detailed Rules for the Implementation of Target Asset Management Business of Securities Companies*	May 31, 2008	
Open-ended Funds	*Law of the People's Republic of China on Securities Investment Fund*	October 28, 2003	
Close-ended Funds			

(concluded)

Wealth management products	Regulatory rules	Date of issuance	Regulator
Participating Insurance	*Interim Administrative Measures on Participating Insurance*	February 18, 2000	CIRC
	Actuarial Rules on Personal Participating Insurance	July 1, 2003	
Investment-linked Insurance	*Interim Administrative Measures on Investment-linked Insurance*	August 25, 2003	
	Actuarial Rules on Investment-linked Insurance	March 26, 2007	
	Notice on Issues concerning the Sales and Management of Investment-linked Insurance	August 23, 2007	
	Notice on Strengthening the Investment-linked Insurance Business of Property Insurance Companies	November 20, 2008	
Universal Insurance	*Actuarial Rules on Universal Insurance*	March 26, 2007	

Issues of Concern in the Development of Wealth Management Products

Certain Gap in the Regulatory Rules of Various Wealth Management Products

In terms of the examination and approval of products, an approval-based approach is adopted in CSRC's regulation over all collective asset management programs of securities companies, CIRC's regulation over all investment-linked products of insurance companies and CBRC's regulation over wealth management products with return guarantees of commercial banks while a disclosure-based approach is adopted in CBRC's regulation over the rest of wealth management products. As for the threshold for launch, the minimum investment value is RMB 1 million yuan for the collective fund trust programs of trust companies; the threshold value of fund collected by securities companies from individual clients is either RMB 50 000 yuan (restrictive collective asset management programs) or RMB 100 000 yuan (non-restrictive collective asset management programs); commercial banks may decide the threshold value of wealth management products discretionarily (among which the threshold for wealth management products with return guarantee is RMB 50 000 yuan). With regard to return guarantee, commercial banks and insurance companies can make such guarantee while trust companies, securities companies and fund management companies cannot. Concerning the quota of products, trust companies are restricted by the rule that no more than 50 natural persons may participate in individual collective asset trust programs, while commercial banks and securities companies are not constrained by such a rule. Regarding the promotion and information disclosure of products, fund companies can conduct public offering and commercial banks promote their asset management products by making advertisements while securities companies and trust companies are forbidden to make such advertisements. In terms of the circulation of products, part of the asset management products of fund companies and securities companies can be traded publicly at trading places while the collective fund trust programs of trust companies have no circulation channels. As for the custodian of wealth management funds, securities companies, fund companies and trust companies have to refer to specialized custodian banks while commercial banks are not restricted by such a rule.

Inadequate Information Disclosure and Risk Warning for Some Wealth Management Products

Some financial institutions fail to give adequate warning on the risks of wealth management products, e. g. only pointing out the liquidity risk caused by the loss of other investment opportunities while failing to elaborate on the credit risk or market risk. Given some financial institutions lay excessive emphasis on high returns and the complicated product introductions obscure the real risks, clients will tend to complain in case the returns are lower than expected. Some institutions do not have standardized complaint record and solution mechanism, which expose the dispute between clients and financial institutions to escalation.

Increased Difficulty for Liquidity Management of Commercial Banks

At present, the credit created by the wealth management products of commercial banks exerts remarkable influence on aggregate credit while the total amount, maturity and destination of the funds pooled through wealth management products are neither disclosed as indirect credit of banks nor as direct credit on the capital market. Commercial banks' circulating capital will be especially volatile when large amount of wealth management funds go to the purchase of new shares during the boom of stock market, which adds to the difficulty of liquidity management.

Increased Risks of Investing in Wealth Management Products due to the International Financial Crisis

In 2008, against the backdrop of sustained turbulence in the international financial market and the significant fluctuations in the price of commodities and financial assets, domestic capital market underwent substantial correction and a wide range of wealth management products suffered great floating loss. Multiple structured wealth management products linked with international commodities and financial assets confronted significant uncertainties in price, and some products profits were even liquidated in advance with zero. The issuance scale and profitability of QDII decreased by a large margin. Along with the recession of domestic capital market, equities wealth management products yielded zero or even negative profits, and the products covering investment in new shares almost disappeared. Affected by the slowdown of economic growth, the issuance of credit wealth management products continued to fall from September 2008 and the level of returns was lowered significantly at the end of 2008. As many clients suspected financial institutions of obscuring risks, misleading clients and committing frauds and more claims for compensation were lodged, financial institutions' reputation and social stability were affected negatively.

Promote the Healthy Development of Wealth Management Products

Wealth management products have advantages in many aspects and comprehensive measures should be taken to facilitate their healthy development.

Foster the Development of Wealth Management Products to Put Their Positive Role into Full Play

Being an important component of financial innovation, wealth management products can make positive contributions to improving financial service, enhancing the profitability of financial institutions and optimizing resource allocation. Since the reform and opening-up, the Chinese households have accumulated more wealth, resulting in larger demand of investment and wealth management. In this context, wealth management products have become an effective way of increasing the households' property income and expanding investment channels. For a long time, China's commercial banks have taken interest spread as the major source of profits, and the development of wealth management products will help financial institutions tap business potential and optimize profitability structure. Developing wealth management business can enhance the share of direct financing and reduce the over-reliance on bank loans in the allocation of the financial resources in China, so as to optimize resource allocation. Moreover, the development of overseas wealth management products will facilitate the financial institutions to transfer domestic deposits into foreign currency assets, which can be invested overseas. This will broaden the channels for capital outflow, lessening the risks caused by high saving rate and huge foreign exchange reserves and improving the balance of payment.

Improve Regulatory Philosophy and Rules to Provide a Facilitating External Environment

Regulators should establish reasonable regulatory philosophy, and properly adjust the intensity and measure of regulation so as to coordinate and improve regulatory rules. Innovation of financial institutions should be respected so that their potential can be tapped in the innovation of wealth management products. Efforts should be made to improve the financial infrastructure including the payment system, legal system and credit environment in order to provide a facilitating external environment for the development of wealth management products.

Further Expand Investment Channels to Promote Diversification of Wealth Management Products

Greater efforts will be made to promote financial innovation, develop a multi-layered financial market system, enrich investment products in the financial market and discreetly develop interest rate and exchange rate derivatives to widen the channels for wealth management products. The development of QDII products will be pushed further to guide the external investment by enterprises and households. Financial institutions will be encouraged to bolster independent innovation based on market demand. The demand of clients should be further classified to optimize the structure and promote the diversification of wealth management products.

Strengthen Risk Supervision and Management to Guard against Hidden Risks

The statistics and monitoring system of wealth management products should be established and improved to conduct real-time monitoring over the types, amount, scale and fund flows concerning wealth management products and provide risk warnings in a timely manner. Efforts will be made to reinforce the internal risk control and liquidity management of financial institutions to improve the risk evaluation and management of the design, promotion, fund operation and cashing of wealth management products. The marketing behavior of financial institutions should be standardized by strengthening information disclosure, improving complaint treatment and solving clients' complaints appropriately. Investors should be educated and guided to be more aware of risks and choose appropriate wealth management products according to their own risk affordability.

(By Tao Ling, Liu Jie and Hu Ping)

Appendix Ⅰ

A Quantitative Analysis of the Soundness of the Banking Sector: the Case of 17 Major Commercial Banks

In 2008, China's banking sector continued to maintain sound performance with its asset scale, profits and risk management steadily improved, and played an important role in promoting the development of national economy. In order to make analysis of the operational condition of the banking sector and identify related risks as soon as possible, we selected the 17 major commercial banks[1] with their assets accounting for 65.57% of the total assets in banking institutions[2], and conducted a quantitative analysis in terms of profitability, assets, liabilities, capital and liquidity.[3]

Profitability Analysis

In 2008, profits of 17 major commercial banks continued to grow by a large margin. The total net profits after tax reached RMB 438.362 billion yuan for the year 2008, an increase of RMB 135.319 billion yuan or 44.65% y-o-y; the ROA stood at 1.14%, up 0.12 percentage points from 2007; and the ROE recorded 20.28%, up 2.94 percentage points.

Breakdown Analysis of ROE

As for 2008, the ROE of the 17 major commercial banks registered 20.28%, up almost 3 percentage points than that recorded in 2007. The breakdown analysis showed that the increase of ROE was primarily attributed to the dropof leverage ratio and operational risks as well as the increase in profit margin and risk-adjusted returns (Table B1.1), indicating that the risk management and profitability of the banking sector continued to improve with sounder performance.

The comparison suggested that the JSCBs' ROE was higher than that of the large commercial banks. In terms of the ROE breakdown analysis, the former had higher operational risks, risk-adjusted returns and leverage ratio but lower profit margin, and hence should further enhance their operational efficiency and improve risk management.

Figure B1.1 described the fluctuations in the ROE breakdown of the 17 major commercial banks from 2007 to 2008 by dividing the banks into two groups, i.e., the large commercial banks and JSCBs. The analysis concluded that, in 2008, the large commercial banks saw an increase in both profit margin and risk-adjusted returns, and a fall in operational risks and leverage ratio from 2007. However, JSCBs experienced a fast growth of risk-adjusted returns but a slightly decrease in profit margin, as well as a small increase in operational risks and a large decrease in leverage ratio.

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1 Including the 5 large commercial banks (ICBC, ABC, BOC, CCB and BOCOM) and 12 JSCBs (China CITIC Bank, Everbright Bank, Huaxia Bank, Guangdong Development Bank, Shenzhen Development Bank, China Merchants Bank, Shanghai Pudong Development Bank, Industrial Bank, China Minsheng Banking Corporation, Evergrowing Bank, China Zheshang Bank, and Bohai Bank).

2 Including policy banks, large commercial banks, JSCBs, city commercial banks, rural commercial banks, rural cooperative banks, foreign banks, UCCs, RCCs, non-banking financial institutions (TICs, finance companies, finance leasing companies, auto finance companies and money brokerage companies), and PSBC.

3 Source: PBC, CBRC, aggregate data at the legal person level.

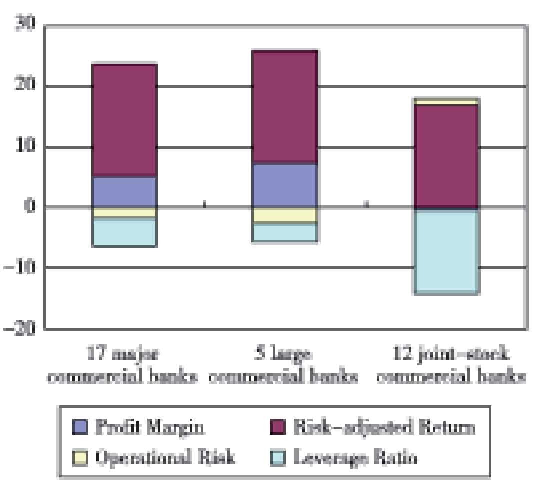
Table B1.1 ROE Breakdown of the 17 Major Commercial Banks

	Profit Margin (*percent*)		Risk-adjusted Return (*percent*)		Operational Risk (*percent*)		Leverage Ratio		ROE (*percent*)	
	2007	2008	2007	2008	2007	2008	2007	2008	2007	2008
17 Major Commercial Banks	22.67	23.85	7.55	8.95	54.14	53.22	18.72	17.85	17.34	20.28
5 Large Commercial Banks	24.08	25.86	7.26	8.60	53.53	52.15	17.78	17.24	16.64	19.99
12 Joint-stock Commercial Banks	18.03	17.96	8.69	10.16	56.65	57.25	23.95	20.64	21.26	21.56

Note: $$ROE = \frac{\text{Net Profits After Tax}}{\text{Operating Income}} \times \frac{\text{Operating Income}}{\text{Average Risk-weighted Assets}} \times \frac{\text{Average Risk-weighted Assets}}{\text{Average Total Assets}} \times \frac{\text{Average Total Assets}}{\text{Average Owner's Equity}}$$
$$= \text{Profit Margin} \times \text{Risk-adjusted Return} \times \text{Operational Risks} \times \text{Leverage Ratio}$$

Figure B1.1 Fluctuations in the ROE Breakdown of the 17 Major Commercial Banks in 2008

(*percent*)



Note: the vertical axis showed the changes in the items compared with that recorded in 2007.

Income Structure Analysis

In 2008, the net operating income of the 17 major commercial banks amounted to RMB 1 369.174 billion yuan, increasing by 28.93% y-o-y. In particular, the net operating income of the 5 large commercial banks rose by 26.18% to RMB 1 081.667 billion yuan, while that of JSCBs grew by 40.44% to RMB 287.507 billion yuan (Table B1.2).

The net interest income remained the major source of net operating income in the 17 major commercial banks, with its growth rate reaching 23.52% in 2008 and accounting for 55.20% of the net operating income, down 2.41 percentage points y-o-y. The investment income accounted for 28.03% of the net operating income, down 2.82 percentage points; and the net fee and commission income accounted for 12.11%, up 0.06 percentage points. The net interest income of the large commercial banks and JSCBs increased by 19.57% and 36.11% respectively, while the proportion of net interest income of the large commercial banks was 17.72 percentage points lower than that of JSCBs.

Table B1.2 Composition of Net Operating Income of the 17 Major Commercial Banks

Item		17 Major Commercial Banks		5 Large Commercial Banks		12 Joint-stock Commercial Banks	
		2007	2008	2007	2008	2007	2008
Balance (100 *million of RMB yuan*)	Net interest income	6 118.28	7 557.55	4 656.48	5 567.90	1 461.80	1 989.65
	Net fee and commission income	1 280.21	1 657.84	1 103.33	1 384.64	176.88	273.19
	Investment income	3 276.74	3 837.29	2 913.86	3 388.65	362.88	448.64
	Other business income	-55.36	639.06	-100.93	475.48	45.57	163.59
	Net operating income	10 619.87	13 691.74	8 572.74	10 816.67	2 047.13	2 875.07
Proportion (*percent*)	Net interest income	57.61	55.20	54.32	51.48	71.41	69.20
	Net fee and commission income	12.05	12.11	12.87	12.80	8.64	9.50
	Investment income	30.85	28.03	33.99	31.33	17.73	15.60
	Other business income	-0.52	4.67	-1.18	4.40	2.23	5.69
	Net operating income	100.00	100.00	100.00	100.00	100.00	100.00

Sustained pressure on the financial market led to marketing difficulties of fee-based business of commercial banks and losses in some of their asset management products, and as a result, the net fee and commission income of commercial banks grew at a slower pace. The net fee and commission income of the 17 major commercial banks increased by 29.50% from 2007, with the growth of the large commercial banks and JSCBs reaching 25.50% and 54.45% respectively. JSCBs saw a relatively faster growth in their fee-based business, but their proportion of net fee and commission income in net operating income was still 3.30 percentage points lower than that of the large commercial banks.

Influenced by the international financial crisis, among other factors, commercial banks witnessed more dramatic fluctuations in their income on overseas and domestic investments, and suffered losses in certain bond and equity investments, which resulted in slowdown of their investment income growth and declining in the proportion of investment income in net operating income. The y-o-y growth of investment income of the 17 major commercial banks reached 17.11%, with the large commercial banks and JSCBs rising by 16.29% and 23.63% respectively. The proportion of investment income in net operating income declined by 2.82 percentage points from 2007, with the large commercial banks and JSCBs down 2.66 and 2.13 percentage points respectively.

Cost Structure Analysis

In 2008, the operating cost[1] of the 17 major commercial banks amounted to RMB 573.772 billion yuan, representing a y-o-y growth of 21.85%. In particular, the operating cost of the large commercial banks increased by 16.87% to RMB 439.589 billion yuan, and that of the JSCBs rose by 41.61% to RMB 134.183 billion yuan.

In 2008, the cost/income ratio[2] of the 17 major commercial banks was 35.79%, down 2.44 percentage points over the previous year. In particular, the cost/income ratio of the large commercial banks decreased by 3.24 percentage points to 34.74%, while that of the 12 JSCBs increased by 0.45 percentage points to 39.73% (Figure B1.2). Compared with the large commercial banks, the JSCBs saw a relatively faster growth in their net operating income and operating cost, and the growth of their operating cost was higher than that of net operating income, indicating that cost management efficiency should be further enhanced.

Figure B1.2 Cost/Income Ratio of the 17 Major Commercial Banks

(*percent*)

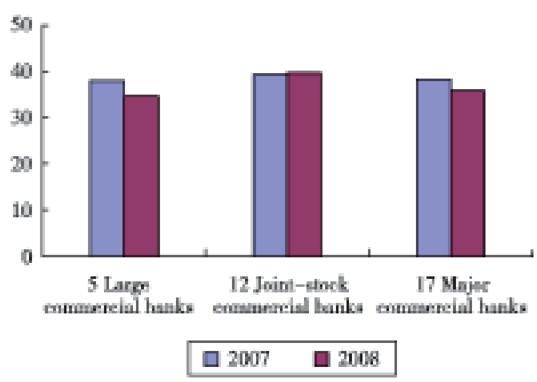
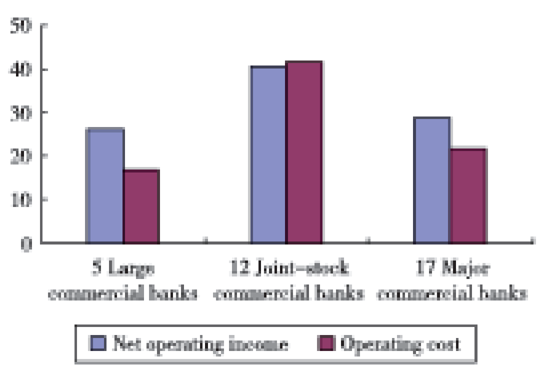


Figure B1.3 Growth of Net Operating Income and Operating Cost of the 17 Major Commercial Banks in 2008

(*percent*)



1 Operating cost includes operating expense, business tax and additions, and other operating expenditures.

2 Cost/income ratio = (operating cost − business tax and additions) / (net interest income + net fee and commission income + other business income + investment income) × 100%.

Asset Analysis

The Scale and Structure of Total Assets

In 2008, the total assets of commercial banks maintained a stable growth. As of the end of the year, the total assets of the 17 major commercial banks amounted to RMB 41.41 trillion yuan, increasing by 15.75% y-o-y and accounting for 65.57% of the total assets of all financial institutions in the banking sector. In particular, the assets of the large commercial banks totaled RMB 32.58 trillion yuan, increasing by 14.32%; the assets of the JSCBs totaled RMB 8.83 trillion yuan, up 21.46%.

In terms of the asset structure, loans and investment were still the main constituents of the total assets, accounting for above 70%. In 2008, the share of deposits in the central bank in total assets of the 17 major commercial banks rose by 2.99 percentage points. While the share of outstanding loans in total assets declined, down 2.64 percentage points, the share of discount increased by 0.86 percentage points. The growth of bond investment decelerated, and its share in total assets descended by 0.51 percentage points (Table B1.3)

Table B1.3 Asset Structure of the 17 Major Commercial Banks

	Balance (100 *million yuan*)		As a percentage of total assets (*percent*)	
	2007	2008	2007	2008
Deposits in the central bank	44 027.75	63 345.36	12.31	15.30
Inter-bank deposits	3 010.33	5 942.10	0.84	1.43
Loans	168 406.04	183 970.87	47.07	44.43
Discount	8 914.04	13 882.84	2.49	3.35
Trade finance	4 266.43	4 859.55	1.19	1.17
Inter-bank lending	7 165.95	8 352.90	2.00	2.02
Investment	96 914.56	110 066.68	27.09	26.58
Repurchase of assets	15 329.97	17 625.64	4.29	4.26
Others	9 707.01	6 041.87	2.71	1.46
Total assets	357 742.08	414 087.81	100.00	100.00

The Scale and Quality of Loans

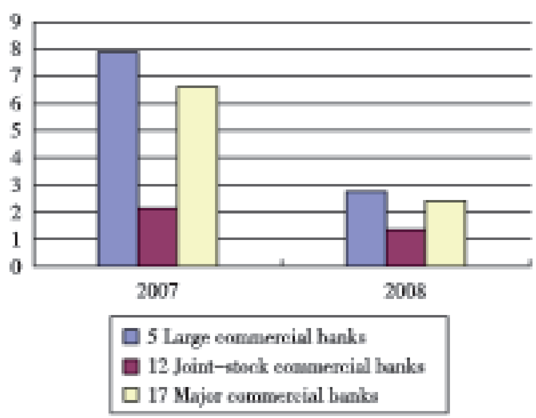
By the end of 2008, outstanding loans of the 17 major commercial banks reached RMB 20.28 trillion yuan, RMB 2.11 trillion yuan more than that in the previous year and up

11.61%. In particular, outstanding loans of the large commercial banks rose by 8.76% to RMB 15.40 trillion yuan, and that of the 12 JSCBs escalated by 21.39% to RMB 4.88 trillion yuan.

As of the end of 2008, outstanding NPLs of the 17 major commercial banks amounted to RMB 0.49 trillion yuan, decreasing by RMB 0.71 trillion yuan over the previous year; the NPL ratio registered 2.41%, down 4.21 percentage points. In particular, the NPL ratio for large commercial banks was 2.75%, down 5.14 percentage points (mainly because of ABC's NPL strip-off and the consequent large decrease in its NPL ratio); and the NPL ratio for JSCBs was 1.35%, down 0.79 percentage points (Figure B1.4).

Figure B1.4 NPL Ratio of the 17 Major Commercial Banks

(*percent*)

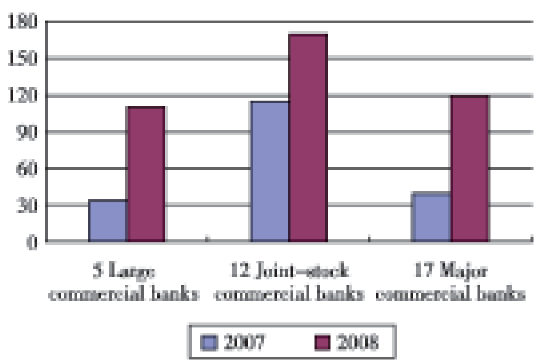


Provision Coverage Ratio[1]

In 2008, the 17 major commercial banks saw a dramatic increase in their provision coverage ratio, with the ratio elevating by 78.67 percentage points on a y-o-y basis to 118.14% at the end of 2008. In particular, the provision coverage ratio of the large commercial banks rose by 76.48 percentage points to 110.15%, and that of the 12 JSCBs increased by 54.97 percentage points to 169.57% (Figure B1.5).

Figure B1.5 Provision Coverage Ratio of the 17 Major Commercial Banks

(*percent*)



Liabilities, Capital and Liquidity

The Scale and Structure of Liabilities

As of the end of 2008, the liabilities of the 17 major commercial banks totaled RMB 39.01

1 Provision coverage ratio = loan loss provision / outstanding NPLs × 100%.

trillion yuan, representing a y-o-y growth of 15.22% and accounting for 65.72% of the total liabilities of all financial institutions in the banking sector. In particular, the liabilities of the large commercial banks accounted for 51.57% of the total liabilities, down 2.18 percentage points; the liabilities of the 12 JSCBs accounted for 14.13%, up 0.29 percentage points.

By the end of 2008, deposits of the 17 major commercial banks totaled RMB 33.32 trillion yuan, rising by 19.68% y-o-y. In particular, corporate deposits increased by 14.37%, with a drop of 6.52 percentage points in its growth rate; household savings rose by 25.26%, with an increase of 22.15 percentage points in its growth rate. As a result of stock market adjustment and international financial crisis impact, households were reluctant to invest and their savings increased dramatically. The proportion of corporate deposits and household savings in total liabilities of the 17 major commercial banks increased by 2.74 percentage points y-o-y.

Capital and CAR

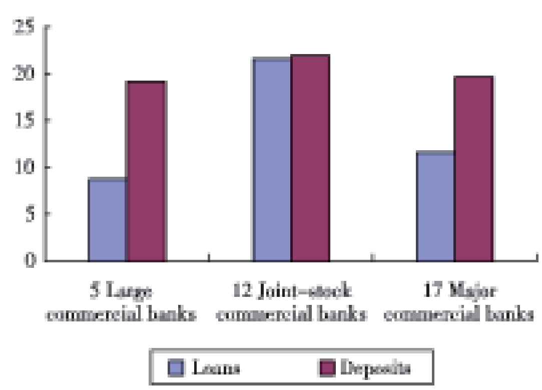
By the end of 2008, all the 17 major commercial banks had met the CAR requirement of the CBRC. Both the CCAR and CAR of the 17 major commercial banks saw an increase, reaching 9.52% and 11.76% respectively. In 2008, the net capital of the 17 major commercial banks grew by RMB 1 102.372 billion yuan or 74.01% y-o-y. The capital injection into ABC greatly improved its capital strength and therefore enhanced the overall CAR of major commercial banks.

Liquidity

In 2008, deposits of major commercial banks grew faster than their loans (Figure B1.6). At the end of 2008, the loan/deposit ratio of the 17 major commercial banks recorded 60.87%, down 1.2 percentage points over the previous year; the liquidity ratio[1] was 44.35%, increasing by 8.08 percentage points and indicating sufficient overall liquidity.

Figure B1.6 Growth of Loans and Deposits of the 17 Major Commercial Banks in 2008

(*percent*)



(By Wang Nan and Zhao Min)

1 Liquidity ratio = liquidity assets/ liquidity liabilities ×100%.

Appendix II

Chronology of the International Financial Crisis in 2008

January 22

The Federal Reserve urgently lowers its target for the federal funds rate 75 basis points from 4.25% to 3.5%, and at the same time, lowers the discount rate 75 basis points to 4.0%.

January 30

UBS announces a loss estimation of USD 11 billion for the fourth quarter of 2007, after writedowns of USD 14 billion on subprime mortgage assets.

February 17

The UK government decides to nationalize Northern Rock.

March 16

The Federal Reserve takes the lead to bail out Bear Stearns by providing liquidity support to it through JP Morgan Chase and supporting JP Morgan Chase to buy Bear Stearns.

May 2

The Federal Reserve announces an increase in the amounts auctioned under its TAF, increases its temporary reciprocal currency arrangements with ECB and the Swiss National Bank, and authorizes an expansion of the collateral that can be pledged in TSLF auctions.

July 11

IndyMac Bank, the US mortgage loan institution headquartered in California, is took over by FDIC due to its severe bank run.

July 30

The Federal Reserve announces four measures to enhance the effectiveness of its existing liquidity facilities, including extension of PDCF and TSLF through January 30, 2009; an increase of the amounts auctioned under TSLF; the introduction of 84-day TAF loans as a complement to 28-day TAF loans; an increase in the Federal Reserve's dollar swap line with ECB.

September 7

The US government announces to take over Fannie Mae and Freddie Mac.

September 15

Lehman Brothers files for bankruptcy protection.

September 15

Bank of America announces to acquire Merrill Lynch in a USD 50 billion all-stock transaction.

September 16

The Federal Reserve authorizes the Federal Reserve Bank of New York to lend up to USD 85 billion to AIG, so as to protect the interests of the US government and taxpayers.

September 18

Lloyds TSB, the UK fifth largest bank, announces to acquire Halifax and Bank of Scotland in an all-stock transaction with an amount of GBP 12.2 billion.

September 21

The Federal Reserve announces its approval of the applications by Goldman Sachs and Morgan Stanley to become bank holding companies.

September 25

Washington Mutual, the US largest savings and loan institution, is closed and took over by FDIC, marking the biggest bank failure in the US history.

September 28

The governments of Belgium, the Netherlands and Luxembourg jointly inject capital into the Fortis Group, with Belgium and the Netherlands paying EUR 4.7 billion and EUR 4 billion respectively, and Luxembourg providing a EUR 2.5 billion convertible loan.

October 3

The US House of Representatives approves a USD 700 billion financial system bailout bill, and President Bush signs the bill soon.

October 3

The UK government announces to raise the guaranteed compensation threshold from GBP 35 000 to GBP 50 000 for household deposits.

October 6

The Federal Reserve announces that it will pay interest on depository institutions' reserve balances at the Federal Reserve.

October 6

Bank of Japan continues to inject liquidity into the market and provide more loans in US dollar. By October 6, Bank of Japan has been providing liquidity to the short-term financial market for 14 consecutive working days, with the total amount of JPY 26.1 trillion.

October 7

The Federal Reserve announces the creation of the Commercial Paper Funding Facility, and the establishment of a SPV that will purchase three-month unsecured and asset-backed commercial paper directly from eligible US issuers.

October 8

The US Federal Open Market Committee decides to lower its target for the federal funds rate 50 basis points to 1.5%. On the same day, the Bank of England, Bank of Canada, Sveriges Riksbank, Swiss National Bank and ECB also announce reductions of 50 basis points in interest rates.

From September 29 to October 7

The Iceland government successively takes over the three big domestic banks, i.e. Glitnir bank, Landsbanki Islands and Kaupthing Bank.

October 10

The Japanese insurer Yamato Life Insurance Co. files for bankruptcy protection from the Tokyo court.

October 11

Both the G7 Finance Ministers' Meeting and the G20 meeting promise exceptional urgent actions to tackle the global credit crisis, and come out with a series of plans to avoid failure of major financial institutions and unfreeze credit and money markets.

October 12

In Paris, leaders of 15 countries of the eurozone hold the first summit since the euro was launched, and agree on an action plan by national governments to guarantee bank refunding and inject capital into banks.

October 12

The Australian Commonwealth Government announces three measures: to guarantee wholesale funding of all Australian banks in the international financial market, to guarantee all the deposits held in banks or other deposit-taking institutions in Australia for the future three years with no cap, and to direct the Australian Office of Financial Management to purchase RMBS totaling AUD 4 billion.

October 12

The Reserve Bank of New Zealand and the Ministry of Finance jointly announce to introduce a deposit guarantee scheme for all deposits of New Zealand-registered banks and non-bank deposit-taking financial institutions.

October 13

The UK government announces that it will inject capital into domestic banks and building societies.

October 14

The FDIC announces to guarantee the newly issued unsecured preferred debts of banks, thrifts and certain holding companies, and provide full deposit insurance coverage for non-interest bearing deposit transaction accounts.

October 15

EU member countries agree on a EUR 1.7 trillion (USD 2.3 trillion) continent-wide emergency bailout plan for the financial sector.

October 16

US President Bush announces that the government will use USD 250 billion to directly buy shares of major financial institutions, with USD 125 billion injected into the 9 big banks including Citigroup in the first place.

October 21

The Federal Reserve announces the creation of MMIFF, to provide liquidity to money market investors and ease the strain on short-term debt markets.

October 22

The Argentine government announces to nationalize private pension funds of USD 29 billion. Due to market concerns on the sovereign risk of Argentina, the CDS spread for the country surges to 42.5%.

October 24

The FDIC announces the Temporary Liquidity Guarantee Program, providing a guarantee for bank debts and deposits of about USD 2 trillion.

October 26

IMF and the Ukraine government reach an agreement that IMF will provide a USD 16.5 billion loan to Ukraine to help it stabilize the economy and financial system.

November 3

The UK HM Treasury announces the establishment of UK Financial Investments Limited to manage the government's shareholding in commercial banks.

November 4

Malaysia and Chile announce their economic stimulus plans, and German Chancellor Angela Merkel also endorses a stimulus plan to fend off shocks of the international financial crisis.

November 10

The Federal Reserve announces its approval of the applications by American Express Company and American Express Travel Related Services Company to become bank holding companies. On the same day, the US Treasury announces that it will purchase USD 40 billion of AIG senior preferred shares, as part of the overall rescue plan for AIG.

November 15

The G20 Summit on Financial Markets and the World Economy closes in Washington D. C.. The summit agrees to enhance international cooperation, make joint efforts to tackle the financial crisis and restore economic growth, and proposes to reform the global financial system to prevent a similar global crisis from happening again.

November 20

The Italian government proposes to provide financial aid of EUR 2 – 4 billion to businesses and households, as part of its stimulus package of EUR 80 billion to expand domestic demand.

November 21

The Singapore government announces its fiscal stimulus package of SGD 2.3 billion to provide more loans to enterprises.

November 23

The FDIC decides to guarantee all US banks' debts with the amount up to USD 1.4 trillion.

November 23

The US Treasury, Federal Reserve, and FDIC announce their rescue package for Citigroup. The Treasury and FDIC will provide protection on an asset pool of approximately USD 306 billion of Citigroup, and the Treasury will also invest USD 20 billion in Citigroup from the Troubled Asset Relief Program.

November 25

France is drawing up an economic stimulus plan of EUR 19 billion to support its automobile and construction industries.

November 25

Argentina decides to inject about USD 21 billion into its infrastructure industry.

November 26

The European Commission approves a stimulus package of about EUR 200 billion (approximately USD 260 billion) covering all member countries.

December 2

Finance ministers of 27 EU member countries agree to increase the minimum level of deposit insurance coverage from EUR 20 000 to EUR 100 000.

December 15

Bernie Madoff, a former chairman of the NASDAQ stock market, is found out to be running a USD 50 billion swindle.

December 16

The Federal Reserve announces to establish a target range for the federal funds rate of 0 to 0.25%.

December 19

The US government decides to offer General Motors Corp. and Chrysler LLC three-year emergency loans totaling USD 13.4 billion.

December 20

IMF, together with the World Bank and EU, decides to provide a EUR 7.5 billion (approximately USD 10.4 billion) emergency loan to Latvia.

December 24

The US GMAC Financial Services is approved by the Federal Reserve to become a bank holding company, so as to be qualified to apply for assistance from the treasury financial rescue package.

(By Guo Jia)

Appendix III

Chronology of China's Response to the International Financial Crisis in 2008

January 16

PBC decides to raise the RMB reserve requirement ratio for depository financial institutions by 0.5 percentage points to 15% as of January 25.

February 19

PBC, CBRC, CSRC and CIRC jointly release the *Eleventh Five-Year Plan for Financial Development and Reform*, which stipulates to promote the development of bond market especially the Enterprise Bond (Corporate Bond) market.

March 5

Premier Wen Jiabao delivers the Report on the Work of the Government at the First Session of the 11th National People's Congress. The report notes that in view of the current domestic and international economic situation, a sound fiscal policy and a tight monetary policy should be adopted for the year 2008. The primary task for macroeconomic management in 2008 is to prevent rapid economic growth from becoming overheated and prevent structural price increases from turning into significant inflation (also referred to as "two prevention").

March 18

PBC decides to raise the RMB reserve requirement ratio for depository financial institutions by 0.5 percentage points to 15.5% as of March 25.

March 19

PBC, CBRC, CSRC and CIRC jointly release the *Opinions on Extending Financial Support to Accelerate the Development of the Services Sector.*

April 16

PBC decides to raise the RMB reserve requirement ratio for depository financial institutions by 0.5 percentage points to 16% as of April 25.

May 12

PBC decides to raise the RMB reserve requirement ratio for depository financial institutions by 0.5 percentage points to 16.5% as of May 20.

May 19

PBC and CBRC issue the *Emergency Notice on Strengthening Financial Services in the Earthquake-hit Areas (No. 1)*, which specifies special policies to be adopted to resume financial services in areas most affected by the earthquake, including Sichuan, Gansu, Shaanxi, Chongqing and Yunnan.

June 7

PBC decides to raise the RMB reserve requirement ratio for depository financial institutions by 1 percentage point to 17.5%. The ratio is to be raised by 0.5 percentage points as of June 15 and by another 0.5 percentage points as of June 25. Financial institutions incorporated in the worst quake-hit areas will postpone carrying out the increases.

July 25

The Political Bureau of the CPC Central Committee holds a meeting to study the ongoing economic trend and work. The meeting decides to shift the primary task for macroeconomic management, which has been formerly defined to be "two prevention", to be maintenance of steady and rapid economic growth and curbing price hikes, indicating emphasis on containing inflation.

September 15

PBC announces that as of September 25, the RMB reserve requirement ratio is to be lowered by 1 percentage point for depository financial institutions, with the temporary exception of ICBC, ABC, BOC, CCB, BOCOM and PSBC. In particular, the reserve requirement ratio for financial institutions incorporated in areas worst hit by the Wenchuan Earthquake will be cut by 2 percentage points.

September 16

PBC decides to lower the RMB benchmark lending rate for financial institutions. The one-year RMB benchmark lending rate is cut from 7.47% to 7.20%, down 0.27 percentage points. Benchmark lending rates of other maturities are lowered accordingly. At the same time, the interest rates on individual housing provident fund loans are also lowered. The rate on individual housing provident fund loans with maturities of up to 5 years is lowered from 4.77% to 4.59%, down 0.18 percentage points; and the rate on loans with maturities of above 5 years is lowered from 5.22% to 5.13%, down 0.09 percentage points. The benchmark deposit rates remain unchanged.

September 23

The Central Huijin Investment Co. Ltd. spontaneously acquires shares of ICBC, BOC and CCB via the secondary market to promote the stable operation and development of major state-owned financial institutions and stabilize the stock price of state-owned commercial banks.

September 27

Premier Wen Jiabao attends the Summer Davos Forum 2008 in Tianjin, and delivers a speech titled *Reform and Opening-up is the Eternal Driving Force For China's Development*.

October 8

PBC decides to cut the RMB reserve requirement ratio for depository financial institutions by 0.5 percentage points as of October 15. It also decides to cut the one-year RMB benchmark deposit and lending rates both by 0.27 percentage points as of October 9. Benchmark deposit and lending rates for other maturities are to be adjusted accordingly.

From October 9 to 12

The third Plenum of the 17th Central Committee of CPC is held in Beijing, which reviews and issues the *Decision of the Central Committee of CPC on Several Major Issues Related to Promoting the Reform and Development of Rural Areas*.

October 14

The government of Hong Kong Special Administrative Region (SAR) announces to use the Exchange Fund to guarantee all deposits (held with all authorized institutions in Hong Kong including those held with Hong Kong branches of overseas institutions), and to establish a Contingent Bank Capital Facility (CBCF) for the purpose of making available additional capital to licensed banks.

October 14

The government of Macao Special Administrative Region announces that it will guarantee the full payment of all customer deposits held with authorized banks in Macao, and when necessary, will provide sufficient liquidity or even capital support to authorized banks in Macao.

October 15

PBC and CBRC jointly release the *Opinions on Accelerating Innovation of Financial Products and Services in Rural Areas*, deciding to launch a pilot program of rural financial products and services innovation in major grain-producing regions or selected counties and county-level cities with solid economic fundamentals in the 6 central provinces and 3 northeastern provinces.

October 24

President Hu Jintao addresses the opening ceremony of the Seventh Asia-Europe Meeting. In his speech, he stresses that China should, first and foremost, run its own affairs well by making efforts to expand domestic demand especially consumption demand, so as to maintain economic, financial and capital market stability, and promote the fast and sound development of the economy and society.

October 27

PBC decides to lower the floor rates on commercial individual housing loans to 0.7 times the benchmark lending rates, and the minimum down payment ratio to 20% as of October 27. Interest rates on individual housing provident fund loans are also lowered. The rates on individual housing provident fund loans with maturities up to 5 years (inclusive) and with maturities above 5 years will be lowered from the current 4.32% to 4.05% and from the current 4.86% to 4.59% respectively, both by 0.27 percentage points.

October 30

PBC decides to lower the one-year RMB benchmark deposit and lending rates for financial institutions to 3.60% and 6.66% respectively as of October 30, both by 0.27 percentage points. Benchmark deposit and lending rates for other maturities will be adjusted accordingly. Interest rates on individual housing provident fund loans remain unchanged.

October 30

CBRC releases the first set of rules for Basel II implementation in China, including the *Guidance on Classifying Credit Risk Exposure in Banking Book of Commercial Banks*, the *Supervisory Guidance on Internal Rating System for Credit Risk of Commercial Banks*, the *Guidance on Regulatory Capital Measurement for Special Lending of Commercial Banks*, the *Guidance on Regulatory Capital Measurement* *for Credit Risk Mitigation of Commercial Banks* and the *Guidance on Regulatory Capital Measurement for Operational Risk of Commercial Banks*. This set of rules lays a solid foundation for the scheduled implementation of Basel II by the end of 2010.

November 5

The State Council puts forward 10 specific measures to further expand domestic demand and promote economic growth.

November 6

The Central Huijin Investment Co. Ltd. injects the USD equivalent of RMB 130 billion yuan into ABC, and will hold 50% of ABC shares, becoming the first major shareholder of ABC together with the Ministry of Finance.

November 15

The G20 Summit on Financial Markets and the World Economy is held in Washington D. C.. President Hu Jintao attends the meeting and delivers an speech titled *Tiding Over Difficulties Through Concerted Efforts*.

November 16

An informal meeting held by Finance Ministers of China, Japan and South Korea agrees to boost bilateral currency swaps among the three countries.

November 18

PBC announces China's formal accession to the Inter-American Development Bank Group.

November 26

PBC decides to lower the one-year RMB benchmark deposit and lending rates for financial institutions by 1.08 percentage points as of November 27. Benchmark deposit and lending rates for other maturities are to be adjusted accordingly. Meanwhile, the interest rates on central bank lending and rediscounts are to be lowered. As of December 5, the RMB reserve requirement ratio is to be lowered by 1 percentage point for large depository financial institutions, including ICBC, ABC, BOC, CCB, BOCOM and PSBC, and by 2 percentage points for small and medium-sized depositary financial institutions. The preferential reserve requirement ratio for rural financial institutions and the financial institutions in the areas hit by Wenchuan Earthquake remains unchanged.

December 5

The fifth China-US Strategic Economic Dialogue, an important dialogue during the 30th anniversary of the establishment of China-US diplomatic relations, is wrapped up, leading to a number of consensus with 40 remarkable results achieved.

December 8

The Hong Kong SAR government announces 6 economic stimulus measures.

From December 8 to 10

The Central Economic Work Conference is held in Beijing. The conference puts forward the major task of the economic work for 2009, which is to enhance and improve macroeconomic management and carry out an active fiscal policy as well as a moderately loose monetary policy. Rural economic growth should be maintained and further enhanced, to ensure the effective supply of farm produce and the increase in farmers' income. The growth pattern should be further transformed to promote strategic adjustments of the economic structure. Efforts should be continued to advance the reform and opening-up, and improve the scientific development mechanism. It is also stressed that more efforts should be made to address the problems and difficulties related to interests of ordinary people, so as to maintain social stability.

December 10

CBRC releases the *Risk Management Guidelines on Merger and Acquisition Loans of Commercial Banks*, permitting qualified commercial banks to make merger and acquisition (M&A) loans.

December 12

China and South Korea announce to sign a bilateral currency swap agreement, which specifies the currency swap size of up to RMB 180 billion yuan/ KRW 38 trillion.

December 13

The State Council releases the *Several Opinions on Providing Financial Support for Economic Development Currently*, which is also mentioned as the 30 Measures of Providing Financial Support for Economic Development.

December 16

The Hong Kong Monetary Authority announces to lower the Base Rate to 0.5% by 1 percentage point.

December 16

The China Development Bank Co. Ltd. is officially inaugurated.

December 22

PBC decides to cut the one-year RMB benchmark deposit and lending rates both by 0.27 percentage points as of December 23, 2008. Benchmark deposit and lending rates for other maturities are to be adjusted accordingly. The central bank lending rates and rediscount rates will also be lowered. The RMB reserve requirement ratio for financial institutions is to be lowered by 0.5 percentage points as of December 25.

(By Xie Dan)

Appendix IV

Statistics

Table B4. 1 Selected Economic Indicators

(Year-end Balance)

Items	2004	2005	2006	2007	2008
Gross Domestic Product (100 *million of RMB yuan*)	159 878. 3	183 867. 9	211 923	249 530	300 670
Industrial Value Added	65 210. 0	77 230. 8	90 351. 0	107 367. 0	129 112. 0
Fixed Asset Investment (100 *million of RMB yuan*)	70 477. 4	88 773. 6	109 998. 2	137 239. 0	172 291. 0
Retail Sales of Consumer Goods (100 *million of RMB yuan*)	59 501. 0	67 176. 6	76 410. 0	89 210. 0	108 488. 0
Urban	39 695. 7	45 094. 3	51 542. 6	60 411. 0	73 735. 0
County & Below	19 805. 3	22 082. 3	24 867. 4	28 799. 0	34 753. 0
Export & Import (100 *million of USD*)	11 545. 5	14 219. 1	17 604. 0	21 738. 0	25 616. 0
Export	5 933. 2	7 619. 5	9 689. 4	12 180. 0	14 285. 0
Import	5 612. 3	6 599. 5	7 914. 6	9 558. 0	11 331. 0
Balance	320. 9	1 020. 0	1 774. 8	2 622. 0	2 955. 0
Foreign Direct Investment (100 *million of USD*)	606. 3	603. 3	694. 7	748. 0	924. 0
Foreign Exchange Reserve (100 *million of USD*)	6 099. 3	8 188. 7	10 663. 4	15 282. 5	19 460. 3
Consumer Price Index (*previous year* = 100)	103. 9	101. 8	101. 5	104. 8	105. 9
Fiscal Revenue (100 *million of RMB yuan*)	26 396. 5	31 649. 3	38 760. 2	51 304. 0	61 316. 9
Fiscal Expenditure (100 *million of RMB yuan*)	28 486. 9	33 930. 3	40 422. 7	49 565. 4	62 427. 0
Fiscal Balance (100 *million of RMB yuan*)	−2 090. 4	−2 281. 0	−2 162. 5	1 738. 6	−1 110. 1
Per Capita Urban residents Dispensable Income (*yuan*)	9 422. 0	10 493. 0	11 759. 0	13 786. 0	15 781. 0
Per Capita Rural residents Net Income (*yuan*)	2 936. 0	3 255. 0	3 587. 0	4 140. 0	4 761. 0
Number of Employed Persons in Urban Area (*million*)	264. 76	273. 31	283. 10	293. 50	302. 10
Registered Unemployment Rate in Urban Area (%)	4. 2	4. 2	4. 1	4. 0	4. 2
Total Population (*million*)	1 299. 9	1 307. 56	1 314. 48	1 321. 29	1 328. 02

Source: Calculated based on data from "China Statistical Yearbook", "Statistical Communique of The People's Republic of China on the National Economic and Social Development" and other related materials.

Data of 2008 was from "Statistical Communique of The People's Republic of China on the 2008 National Economic and Social Development" and "Report on the Implementation of the Central and Local Budgets for 2008 and on the Draft of Central and Local Budgets for 2009".

Table B4. 2 Selected Financial Indicators (1)

(Year-end Balance)

(*100 million of RMB yuan*)

Items	2004	2005	2006	2007	2008
Money & Quasi-money (M_2)	254 107. 0	298 755. 7	345 603. 6	403 442. 2	475 166. 6
Money (M_1)	95 969. 7	107 278. 8	126 035. 1	152 560. 1	166 217. 1
Currency in Circulation (M_0)	21 468. 3	24 031. 7	27 072. 6	30 375. 2	34 219. 0
Total Deposits with Financial Institutions	241 424. 3	287 169. 5	335 459. 8	389 371. 2	466 203. 3
Urban & Rural Household Deposits	119 555. 4	141 051. 0	161 587. 3	172 534. 2	217 885. 4
Enterprise Deposits	84 669. 5	96 143. 7	113 239. 0	138 673. 7	157 632. 2
Total Lending by Financial Institutions	178 197. 8	194 690. 4	225 347. 2	261 690. 9	303 394. 6

Source: PBC.

Table B4. 3 Selected Financial Indicators (2)

(Growth Rates)

(*percent*)

Items	2004	2005	2006	2007	2008
Money & Quasi-money (M_2)	14. 7	17. 6	16. 95	16. 74	17. 82
Money (M_1)	13. 6	11. 8	17. 49	21. 05	9. 06
Currency in Circulation (M_0)	8. 7	11. 9	12. 65	12. 20	12. 65
Total Deposits with Financial Institutions	16. 0	19. 0	16. 83	16. 07	19. 73
Urban & Rural Household Deposits	15. 4	18. 0	14. 56	6. 77	26. 29
Enterprise Deposits	16. 8	13. 6	17. 78	22. 46	13. 67
Total Lending by Financial Institutions	14. 5	13. 0	15. 10	16. 10	18. 73

Note: Growth rates have been adjusted to reflect recent changes in coverage.

Source: PBC.

Table B4. 4 International Liquidity

(*millions of USD*)

Items	2004	2005	2006	2007	2008
Total Reserves (minus gold)	613 725	821 514	1 068 538	1 530 279	1 949 260
Special Drawing Rights (SDRs)	912	1 251	1 113	1 191	1 199
Reserve Positions in IMF	2 432	1 391	1 081	839	2 031
Foreign Exchange	609 932	818 872	1 066 344	1 528 249	1 946 030
Gold (millions of ounce)	19. 29	19. 29	19. 29	19. 29	19. 29
Gold (national valuation)	4 074	4 074	4 074	4 074	4 074
Foreign Liabilities of Other Depository Companies	55 655	41 962	531 724	82 676	75 255

Note: ①According to the new classification of financial companies, the category of Other Depository Companies was added since 2006, meanwhile the category of Deposit Monetary Banks was cancelled.

②Other Depository Companies have a wider coverage, compared with Deposit Monetary Banks, i. e. including National Development Bank and China Import & Export Bank.

Source: PBC.

Table B4. 5 Gold and Foreign Exchange Reserves

Year	Gold Reserves (10 *thousand of ounce*)	Foreign Exchange Reserves (100 *million of USD*)	Change in Foreign Exchange Reserves (*percent*)
1995	1 267	736. 0	42. 6
1996	1 267	1 050. 3	42. 7
1997	1 267	1 398. 9	33. 2
1998	1 267	1 449. 6	3. 6
1999	1 267	1 546. 8	6. 7
2000	1 267	1 655. 7	7. 0
2001	1 608	2 121. 7	28. 1
2002	1 929	2 864. 1	35. 0
2003	1 929	4 032. 5	40. 8
2004	1 929	6 099. 3	51. 3
2005	1 929	8 188. 7	34. 3
2006	1 929	10 663. 4	30. 2
2007	1 929	15 282. 5	43. 3
2008	1 929	19 460. 3	27. 3

Note：PBC made adjustment to data of gold reserves in December 2001 and December 2002.

Source：PBC.

Table B4. 6 Assets of China's Financial Sector

(Including foreign currencies)

(December 31, 2008)

(*trillions of RMB yuan*)

Items	Balance
Financial Sector	87. 62
Central Bank	20. 70
Banking Financial Institutions	62. 39
Securities Financial Institutions	1. 19
Insurance Financial Institutions	3. 34

Note：Securities Financial Institutions only includes securities companies.

Source：Calculated by the Financial Stability Analysis Group of PBC.

Table B4.7 Depository Corporations Survey in 2008

(Quarter-end Balance)

(100 *million of RMB yuan*)

Items	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Net Foreign Assets	150 967.47	163 271.60	171 633.02	178 970.61
Domestic Credit	348 375.80	353 970.67	362 950.53	379 378.67
Claims on Governments (net)	24 267.45	18 903.12	18 578.28	29 434.59
Claims on Non-financial Sectors	300 399.64	310 871.96	320 022.51	325 640.89
Claims on other Financial Sectors	23 708.71	24 195.59	24 349.74	24 303.19
Money & Quasi-money	423 054.53	443 141.02	452 898.70	475 166.60
Money	150 867.47	154 820.15	155 748.97	166 217.13
Currency in Circulation	30 433.07	30 181.32	31 724.88	34 218.96
Demand Deposits	120 434.40	124 638.83	124 024.09	131 998.17
Quasi-money	272 187.06	288 320.87	297 149.73	308 949.47
Time Deposits	71 599.33	77 981.31	84 045.11	82 339.85
Household Deposits	187 414.88	194 269.47	204 424.17	217 801.36
Other Deposits	13 172.85	16 070.09	8 680.45	8 808.26
Deposits not Included in Broad Money	9 816.33	10 377.30	10 929.06	11 210.92
Bonds	36 737.70	38 220.29	39 816.65	42 335.28
Paid-in Capital	18 700.56	18 885.76	19 121.49	21 970.83
Other Items (net)	11 034.0	6 617.9	11 817.7	7 665.7

Notes: ①PBC began to compile Depository Corporations Survey from 2006. Depository Corporations Survey does not cover Trust Investment Company and Financial Lease Company, compared with former Banking Survey.

②Data of Other Deposits does not include margin deposits of Non-financial Companies since 2006.

Source: PBC.

Table B4.8 Balance Sheet of Monetary Authority in 2008

(Quarter-end Balance)

(*100 million of RMB yuan*)

Items	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Foreign Assets	137 436.82	149 580.16	157 908.88	162 543.52
Foreign Exchange	127 126.09	134 249.44	143 122.88	149 624.26
Money Gold	337.24	337.24	337.24	337.24
Other Foreign Assets	9 973.49	14 993.48	14 448.76	12 582.02
Claims on Governments	16 317.71	16 279.77	16 233.94	16 195.99
Of which: Central Government	16 317.71	16 279.77	16 233.94	16 195.99
Claims on Other Depository Corporations	8 037.30	8 097.51	8 544.44	8 432.50
Claims on Other Financial Corporations	12 291.74	12 190.11	12 103.44	11 852.66
Claims on Non-financial Corporations	44.12	44.12	44.12	44.12
Other Assets	7 920.10	7 913.27	8 089.58	8 027.20
Total Assets	**182 047.79**	**194 104.94**	**202 924.40**	**207 095.99**
Reserve Money	104 224.18	115 353.05	117 336.06	129 222.33
Currency Issuance	33 437.62	33 075.73	34 876.09	37 115.76
Deposits of Financial Corporations	70 786.56	82 277.32	82 459.97	92 106.57
Other Depository Corporations	70 608.43	82 177.06	82 378.54	91 894.72
Other Financial Corporations	178.13	100.26	81.43	211.85
Deposits of Non-financial Corporations	—	—	—	—
Demand Deposits	—	—	—	—
Deposits of Financial Corporations not included in Reserve Money	492.29	528.78	584.96	591.20
Bond Issuance	39 530.84	41 801.74	45 911.46	45 779.83
Foreign Liabilities	948.55	904.88	892.28	732.59
Deposits of Government	21 557.65	27 414.37	27 228.46	16 963.84
Own Capital	219.75	219.75	219.75	219.75
Other Liabilities	15 074.53	7 882.37	10 751.43	13 586.45
Total Liabilities	**182 047.79**	**194 104.94**	**202 924.40**	**207 095.99**

Note: The category of Deposits of Financial Corporations not included in Reserve Money was added since 2008, meanwhile the category of Deposits of Non-financial Corporations and Demand Deposits was cancelled.

Source: PBC.

Table B4.9 Balance Sheet of Other Depository Corporations in 2008

(Quarter-end Balance)

(100 *million of RMB yuan*)

Items	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Foreign Assets	20 325.16	20 155.05	20 180.47	22 303.06
Reserve Assets	72 927.87	83 884.50	84 806.01	93 915.32
Deposits with Central Bank	69 923.50	80 990.23	81 654.80	91 018.52
Cash in Vault	3 004.37	2 894.27	3 151.21	2 896.80
Claims on Governments	29 507.39	30 037.72	29 572.80	30 202.44
Of which: Central Government	29 507.39	30 037.72	29 572.80	30 202.44
Claims on Central Bank	41 969.95	38 101.05	40 419.02	42 682.96
Claims on Other Depository Corporations	64 907.30	68 746.26	71 614.81	75 741.12
Claims on Other Financial Corporations	11 416.97	12 005.48	12 246.30	12 450.53
Claims on Non-financial Corporations	247 252.87	255 526.98	263 080.86	268 459.83
Claims on Other Resident Sectors	53 102.65	55 300.86	56 897.53	57 136.94
Other Assets	32 975.66	32 547.17	32 399.50	38 609.49
Total Assets	**574 385.82**	**596 305.07**	**611 217.30**	**641 501.69**
Liabilities to Non-financial Institutions and Households	393 139.25	410 464.81	426 503.21	447 253.45
Deposits Included in Broad Money	379 448.61	396 889.61	412 493.37	432 139.38
Enterprise Demand Deposits	120 434.40	124 638.83	124 024.09	131 998.17
Enterprise Time Deposits	71 599.33	77 981.31	84 045.11	82 339.85
Household Savings Deposits	187 414.88	194 269.47	204 424.17	217 801.36
Deposits not Included in Broad Money	9 816.33	10 377.30	10 929.06	11 210.92
Transferable Deposits	3 457.15	3 660.75	3 738.91	4 339.16
Other Deposits	6 359.18	6 716.55	7 190.15	6 871.76
Other Liabilities	3 874.31	3 197.90	3 080.78	3 903.15
Liabilities to Central Bank	6 237.30	6 255.21	6 260.52	4 610.03
Liabilities to Other Depository Corporations	26 770.64	27 699.33	29 202.67	32 580.25
Liabilities to Other Financial Corporations	37 867.21	38 239.49	31 551.41	32 029.82
Of which: Deposits Included in Broad Money	13 172.85	16 070.09	8 680.45	8 808.26
Foreign Liabilities	5 845.96	5 558.73	5 564.05	5 143.38
Bond Issuance	36 737.70	38 220.29	39 816.65	42 335.28
Paid-in Capital	18 480.81	18 666.01	18 901.74	21 751.08
Other Liabilities	49 306.95	51 201.20	53 417.05	55 798.40
Total Liabilities	**574 385.82**	**596 305.07**	**611 217.30**	**641 501.69**

Source: PBC.

Table B4.10 Balance Sheet of Policy Banks in 2008

(Quarter-end Balance)

(*100 million of RMB yuan*)

Items	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Foreign Assets	4 486.96	4 681.99	5 004.17	5 527.83
Reserve Assets	1 108.25	1 545.72	1 539.60	5 240.30
Deposits with Central Bank	1 104.61	1 542.12	1 536.97	5 237.59
Cash in Vault	3.64	3.60	2.63	2.71
Claims on Governments	55.82	70.78	60.15	31.36
Of which: Central Government	55.82	70.78	60.15	31.36
Claims on Central Bank	1 480.76	1 576.38	1 765.76	1 601.33
Claims on Other Depository Corporations	2 968.17	3 253.12	2 977.35	1 454.83
Claims on Other Financial Corporations	1 037.29	1 033.71	1 182.73	49.92
Claims on Non-financial Corporations	37 396.00	38 728.32	39 647.83	41 814.32
Claims on Other Resident Sectors	39.32	34.73	32.78	57.58
Other Assets	778.30	891.08	1 067.40	1 952.54
Total Assets	**49 350.87**	**51 815.83**	**53 277.77**	**57 730.01**
Liabilities to Non-financial Institutions and Households	3 154.74	3 891.79	3 630.67	4 120.45
Deposits Included in Broad Money	2 842.93	3 587.80	3 403.11	3 761.80
Enterprise Demand Deposits	2 262.83	2 942.71	2 666.81	3 147.39
Enterprise Time Deposits	580.10	645.09	736.30	614.41
Household Savings Deposits				
Deposits not Included in Broad Money	307.87	301.17	224.75	321.79
Transferable Deposits	224.85	257.16	188.58	282.70
Other Deposits	83.02	44.01	36.17	39.09
Other Liabilities	3.94	2.82	2.81	36.86
Liabilities to Central Bank	3 658.50	3 658.50	3 658.50	3 658.50
Liabilities to Other Depository Corporations	1 619.86	1 914.23	2 166.89	3 290.28
Liabilities to Other Financial Corporations	790.83	1 019.16	1 333.36	1 318.95
Of which: Deposits Included in Broad Money				
Foreign Liabilities	755.53	731.54	737.65	750.37
Bond Issuance	32 927.67	34 279.04	35 226.46	37 703.86
Paid-in Capital	2 119.33	2 087.62	2 079.46	3 156.00
Other Liabilities	4 324.41	4 233.95	4 444.78	3 731.60
Total Liabilities	**49 350.87**	**51 815.83**	**53 277.77**	**57 730.01**

Source: PBC.

Table B4. 11 Balance Sheet of State-owned Commercial Banks in 2008

(Quarter-end Balance)

(100 *million of RMB yuan*)

Items	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Foreign Assets	12 976. 34	12 503. 17	11 686. 79	12 558. 66
Reserve Assets	36 490. 27	42 178. 39	43 938. 87	46 181. 14
Deposits with Central Bank	35 138. 64	40 880. 57	42 505. 80	44 847. 93
Cash in Vault	1 351. 63	1 297. 82	1 433. 07	1 333. 21
Claims on Governments	17 502. 06	17 745. 81	16 906. 93	17 206. 97
Of which: Central Government	17 502. 06	17 745. 81	16 906. 93	17 206. 97
Claims on Central Bank	29 712. 24	27 912. 00	29 399. 94	31 955. 98
Claims on Other Depository Corporations	24 267. 66	24 840. 81	24 831. 28	26 950. 04
Claims on Other Financial Corporations	8 579. 95	8 833. 73	8 893. 88	9 691. 11
Claims on Non-financial Corporations	115 000. 80	116 832. 34	118 514. 05	116 080. 37
Claims on Other Resident Sectors	26 332. 15	27 133. 27	27 807. 30	27 691. 43
Other Assets	16 080. 40	16 281. 53	15 846. 48	21 980. 28
Total Assets	**286 941. 87**	**294 261. 05**	**297 825. 52**	**310 295. 98**
Liabilities to Non-financial Institutions and Households	215 663. 21	222 614. 03	231 412. 01	240 415. 98
Deposits Included in Broad Money	206 360. 67	213 477. 54	222 059. 50	230 361. 81
Enterprise Demand Deposits	65 879. 93	67 613. 57	67 690. 39	70 301. 30
Enterprise Time Deposits	30 887. 04	33 096. 04	35 389. 09	33 858. 28
Household Savings Deposits	109 593. 70	112 767. 93	118 980. 02	126 202. 23
Deposits not Included in Broad Money	5 703. 57	6 263. 27	6 636. 05	6 600. 46
Transferable Deposits	1 796. 09	1 908. 86	1 894. 69	2 088. 01
Other Deposits	3 907. 48	4 354. 41	4 741. 36	4 512. 45
Other Liabilities	3 598. 97	2 873. 22	2 716. 46	3 453. 71
Liabilities to Central Bank	1 973. 01	1 962. 72	1 945. 21	426. 80
Liabilities to Other Depository Corporations	8 762. 23	8 433. 19	7 376. 27	8 142. 75
Liabilities to Other Financial Corporations	23 278. 69	23 294. 27	18 125. 25	18 724. 99
Of which: Deposits Included in Broad Money	7 743. 21	10 091. 53	5 128. 40	5 159. 03
Foreign Liabilities	904. 97	939. 54	1 110. 67	800. 51
Bond Issuance	1 379. 50	1 379. 52	1 439. 37	1 439. 42
Paid-in Capital	9 431. 52	9 431. 52	9 431. 52	10 815. 41
Other Liabilities	25 548. 74	26 206. 26	26 985. 22	29 530. 12
Total Liabilities	**286 941. 87**	**294 261. 05**	**297 825. 52**	**310 295. 98**

Source: PBC.

Table B4. 12 Balance Sheet of Joint-stock Commercial Banks in 2008

(Quarter-end Balance)

(*100 million of RMB yuan*)

Items	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Foreign Assets	1 472. 32	1 645. 20	2 043. 41	2 131. 77
Reserve Assets	11 907. 18	14 419. 23	14 388. 48	15 708. 76
Deposits with Central Bank	11 617. 23	14 120. 78	14 025. 54	15 378. 79
Cash in Vault	289. 95	298. 45	362. 94	329. 97
Claims on Governments	4 799. 74	4 825. 03	4 940. 66	5 136. 99
Of which: Central Government	4 799. 74	4 825. 03	4 940. 66	5 136. 99
Claims on Central Bank	7 216. 39	5 595. 87	5 764. 26	5 687. 42
Claims on Other Depository Corporations	15 553. 15	16 604. 92	16 749. 57	18 224. 46
Claims on Other Financial Corporations	1 160. 95	1 267. 58	1 146. 23	1 485. 22
Claims on Non-financial Corporations	44 407. 39	46 610. 67	48 457. 12	52 120. 40
Claims on Other Resident Sectors	9 895. 12	10 387. 25	10 777. 48	11 084. 81
Other Assets	6 770. 28	7 668. 90	7 289. 84	6 358. 51
Total Assets	**103 182. 52**	**109 024. 65**	**111 557. 05**	**117 938. 34**
Liabilities to Non-financial Institutions and Households	67 817. 25	71 694. 03	74 053. 14	78 308. 77
Deposits Included in Broad Money	65 477. 11	69 357. 96	71 638. 98	75 779. 03
Enterprise Demand Deposits	25 810. 34	26 429. 86	25 460. 39	27 571. 04
Enterprise Time Deposits	25 322. 27	27 689. 48	29 936. 11	29 852. 03
Household Savings Deposits	14 344. 50	15 238. 62	16 242. 48	18 355. 96
Deposits not Included in Broad Money	2 166. 25	2 123. 98	2 162. 45	2 239. 28
Transferable Deposits	694. 41	678. 36	733. 97	780. 43
Other Deposits	1 471. 84	1 445. 62	1 428. 48	1 458. 85
Other Liabilities	173. 89	212. 09	251. 71	290. 46
Liabilities to Central Bank	1. 51	1. 00	51. 22	12. 77
Liabilities to Other Depository Corporations	7 764. 24	8 236. 08	9 861. 05	12 056. 72
Liabilities to Other Financial Corporations	12 140. 97	12 435. 46	10 389. 96	10 581. 04
Of which: Deposits Included in Broad Money	5 131. 27	5 802. 88	3 322. 31	3 473. 74
Foreign Liabilities	248. 70	311. 31	261. 45	313. 77
Bond Issuance	2 183. 02	2 266. 41	2 735. 66	2 727. 72
Paid-in Capital	1 840. 92	1 839. 86	1 859. 17	1 874. 62
Other Liabilities	11 185. 91	12 240. 50	12 345. 40	12 062. 93
Total Liabilities	**103 182. 52**	**109 024. 65**	**111 557. 05**	**117 938. 34**

Note: This table covers all joint-stock commercial banks of country-level.

Source: PBC.

Table B4. 13 Balance Sheet of Urban Commercial Banks in 2008

(Quarter-end Balance)

(*100 million of RMB yuan*)

Items	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Foreign Assets	82. 18	80. 23	92. 03	105. 19
Reserve Assets	4 891. 49	5 853. 47	6 025. 47	7 067. 24
Deposits with Central Bank	4 717. 16	5 673. 02	5 839. 51	6 868. 13
Cash in Vault	174. 33	180. 45	185. 96	199. 11
Claims on Governments	3 465. 72	3 530. 40	3 592. 80	3 672. 97
Of which: Central Government	3 465. 72	3 530. 40	3 592. 80	3 672. 97
Claims on Central Bank	747. 22	750. 67	882. 33	963. 62
Claims on Other Depository Corporations	4 951. 28	5 096. 14	6 067. 75	6 099. 64
Claims on Other Financial Corporations	275. 72	389. 39	472. 61	646. 82
Claims on Non-financial Corporations	15 725. 53	16 626. 95	17 748. 79	18 705. 14
Claims on Other Resident Sectors	2 430. 18	2 567. 22	2 691. 15	2 783. 56
Other Assets	1 562. 99	1 516. 20	1 570. 22	1 639. 11
Total Assets	**34 132. 31**	**36 410. 67**	**39 143. 15**	**41 683. 29**
Liabilities to Non-financial Institutions and Households	25 949. 94	28 078. 40	29 968. 49	32 761. 24
Deposits Included in Broad Money	25 758. 83	27 911. 10	29 765. 78	32 540. 84
Enterprise Demand Deposits	11 571. 52	12 355. 16	12 690. 77	14 088. 16
Enterprise Time Deposits	6 856. 08	7 627. 52	8 444. 89	8 749. 86
Household Savings Deposits	7 331. 23	7 928. 42	8 630. 12	9 702. 82
Deposits not Included in Broad Money	149. 91	117. 23	153. 46	163. 02
Transferable Deposits	79. 19	54. 83	77. 18	89. 37
Other Deposits	70. 72	62. 40	76. 28	73. 65
Other Liabilities	41. 20	50. 07	49. 25	57. 38
Liabilities to Central Bank	61. 45	66. 05	69. 43	45. 25
Liabilities to Other Depository Corporations	3 567. 95	3 646. 34	4 035. 35	3 609. 10
Liabilities to Other Financial Corporations	1 151. 67	977. 96	1 112. 87	782. 56
Of which: Deposits Included in Broad Money	294. 35	173. 89	219. 39	170. 52
Foreign Liabilities	12. 95	6. 69	6. 50	4. 72
Bond Issuance	119. 01	127. 00	246. 82	278. 91
Paid-in Capital	1 117. 33	1 150. 58	1 198. 39	1 425. 36
Other Liabilities	2 152. 01	2 357. 65	2 505. 30	2 776. 15
Total Liabilities	**34 132. 31**	**36 410. 67**	**39 143. 15**	**41 683. 29**

Source: PBC.

Table B4. 14 Balance Sheet of Rural Commercial Banks in 2008

(Quarter-end Balance)

(*100 million of RMB yuan*)

Items	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Foreign Assets	6. 50	4. 39	5. 64	5. 68
Reserve Assets	999. 50	1 208. 83	1 215. 93	1 200. 41
Deposits with Central Bank	953. 57	1 161. 60	1 165. 64	1 145. 01
Cash in Vault	45. 93	47. 23	50. 29	55. 40
Claims on Governments	570. 22	587. 90	592. 10	653. 33
Of which: Central Government	570. 22	587. 90	592. 10	653. 33
Claims on Central Bank	219. 31	150. 11	174. 88	161. 66
Claims on Other Depository Corporations	806. 14	820. 73	900. 67	986. 53
Claims on Other Financial Corporations	3. 54	4. 75	4. 84	16. 49
Claims on Non-financial Corporations	3 337. 08	3 574. 00	3 747. 27	3 857. 88
Claims on Other Resident Sectors	453. 99	467. 40	489. 22	483. 94
Other Assets	365. 21	329. 41	328. 85	349. 63
Total Assets	**6 761. 49**	**7 147. 52**	**7 459. 40**	**7 715. 55**
Liabilities to Non-financial Institutions and Households	5 640. 78	5 922. 43	6 211. 23	6 605. 27
Deposits Included in Broad Money	5 612. 93	5 892. 41	6 177. 26	6 566. 87
Enterprise Demand Deposits	2 101. 00	2 149. 24	2 175. 27	2 298. 78
Enterprise Time Deposits	816. 85	945. 16	995. 36	1 006. 22
Household Savings Deposits	2 695. 08	2 798. 01	3 006. 63	3 261. 87
Deposits not Included in Broad Money	19. 19	16. 37	18. 19	22. 40
Transferable Deposits	9. 15	6. 34	7. 64	12. 20
Other Deposits	10. 04	10. 03	10. 55	10. 20
Other Liabilities	8. 66	13. 65	15. 78	16. 00
Liabilities to Central Bank				
Liabilities to Other Depository Corporations	376. 79	436. 13	429. 92	187. 86
Liabilities to Other Financial Corporations	13. 06	34. 89	30. 70	27. 61
Of which: Deposits Included in Broad Money	2. 50	0. 00	9. 36	2. 66
Foreign Liabilities				
Bond Issuance	12. 00	12. 00	12. 00	29. 03
Paid-in Capital	179. 50	185. 70	188. 46	194. 38
Other Liabilities	539. 36	556. 37	587. 09	671. 40
Total Liabilities	**6 761. 49**	**7 147. 52**	**7 459. 40**	**7 715. 55**

Source: PBC.

Table B4. 15 Balance Sheet of Foreign-funded Banks in 2008

(Quarter-end Balance)

(100 *million of RMB yuan*)

Items	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Foreign Assets	1 243. 45	1 190. 51	1 260. 46	1 719. 39
Reserve Assets	1 088. 90	1 069. 73	1 204. 72	1 309. 60
Deposits with Central Bank	1 084. 02	1 064. 28	1 196. 06	1 302. 32
Cash in Vault	4. 88	5. 45	8. 66	7. 28
Claims on Governments	724. 93	816. 93	873. 73	885. 15
Of which: Central Government	724. 93	816. 93	873. 73	885. 15
Claims on Central Bank				
Claims on Other Depository Corporations	2 358. 35	2 177. 39	2 224. 38	1 896. 74
Claims on Other Financial Corporations	53. 02	51. 60	56. 14	65. 84
Claims on Non-financial Corporations	6 679. 97	6 869. 46	7 133. 30	6 617. 08
Claims on Other Resident Sectors	145. 56	149. 27	152. 79	152. 87
Other Assets	1 096. 46	1 012. 00	1 178. 83	1 102. 50
Total Assets	**13 390. 64**	**13 336. 89**	**14 084. 35**	**13 739. 17**
Liabilities to Non-financial Institutions and Households	4 303. 06	4 901. 66	5 151. 14	5 335. 11
Deposits Included in Broad Money	3 030. 89	3 557. 74	3 656. 61	3 801. 63
Enterprise Demand Deposits	1 102. 63	1 229. 91	1 053. 21	1 348. 67
Enterprise Time Deposits	1 723. 75	2 069. 73	2 281. 78	2 071. 78
Household Savings Deposits	204. 51	258. 10	321. 62	381. 18
Deposits not Included in Broad Money	1 272. 17	1 343. 92	1 494. 53	1 533. 48
Transferable Deposits	583. 23	649. 29	666. 32	802. 79
Other Deposits	688. 94	694. 63	828. 21	730. 69
Other Liabilities				
Liabilities to Central Bank				34. 00
Liabilities to Other Depository Corporations	2 466. 40	2 264. 57	2 332. 65	1 905. 87
Liabilities to Other Financial Corporations	254. 02	266. 97	320. 14	420. 32
Of which: Deposits Included in Broad Money				
Foreign Liabilities	3 923. 79	3 569. 01	3 446. 21	3 265. 65
Bond Issuance				
Paid-in Capital	1 071. 24	1 119. 31	1 202. 05	1 209. 56
Other Liabilities	1 372. 13	1 215. 37	1 632. 16	1 568. 66
Total Liabilities	**13 390. 64**	**13 336. 89**	**14 084. 35**	**13 739. 17**

Source: PBC.

Table B4.16 Balance Sheet of Urban Credit Cooperatives in 2008

(Quarter-end Balance)

(*100 million of RMB yuan*)

Items	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Foreign Assets				
Reserve Assets	219.63	236.56	179.43	185.95
Deposits with Central Bank	208.63	224.70	170.71	178.01
Cash in Vault	11.00	11.86	8.72	7.94
Claims on Governments	58.44	53.40	42.19	49.82
Of which: Central Government	58.44	53.40	42.19	49.82
Claims on Central Bank	11.01	2.97	5.53	1.38
Claims on Other Depository Corporations	123.65	113.53	113.70	103.84
Claims on Other Financial Corporations	7.57	5.91	2.90	0.40
Claims on Non-financial Corporations	659.08	587.81	472.07	388.62
Claims on Other Resident Sectors	93.25	91.93	84.79	63.99
Other Assets	158.58	159.81	146.38	99.59
Total Assets	**1 331.21**	**1 251.92**	**1 046.99**	**893.59**
Liabilities to Non-financial Institutions and Households	1 145.52	1 077.86	901.74	762.10
Deposits Included in Broad Money	1 144.74	1 077.15	901.33	761.72
Enterprise Demand Deposits	346.89	312.95	238.60	203.13
Enterprise Time Deposits	144.62	143.07	118.15	86.72
Household Savings Deposits	653.23	621.13	544.58	471.87
Deposits not Included in Broad Money				
Transferable Deposits				
Other Deposits				
Other Liabilities	0.78	0.71	0.41	0.38
Liabilities to Central Bank	8.24	6.57	3.80	2.01
Liabilities to Other Depository Corporations	54.88	49.74	41.71	44.31
Liabilities to Other Financial Corporations	3.34	3.65	2.35	0.24
Of which: Deposits Included in Broad Money				
Foreign Liabilities				
Bond Issuance				
Paid-in Capital	45.26	39.82	39.80	35.44
Other Liabilities	73.97	74.28	57.59	49.49
Total Liabilities	**1 331.21**	**1 251.92**	**1 046.99**	**893.59**

Source: PBC.

Table B4. 17 Balance Sheet of Rural Credit Cooperatives in 2008

(Quarter-end Balance)

(100 *million of RMB yuan*)

Items	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Foreign Assets	8. 25	7. 92	11. 44	9. 66
Reserve Assets	7 345. 52	7 718. 34	7 521. 76	8 948. 34
Deposits with Central Bank	6 528. 44	6 952. 32	6 740. 44	8 340. 44
Cash in Vault	817. 08	766. 02	781. 32	607. 90
Claims on Governments	983. 42	961. 66	1 145. 07	1 197. 09
Of which: Central Government	983. 42	961. 66	1 145. 07	1 197. 09
Claims on Central Bank	185. 54	301. 14	434. 85	379. 61
Claims on Other Depository Corporations	5 453. 49	6 052. 78	6 535. 13	6 755. 12
Claims on Other Financial Corporations	184. 00	167. 87	211. 65	211. 54
Claims on Non-financial Corporations	14 311. 61	14 718. 57	15 508. 94	16 015. 93
Claims on Other Resident Sectors	12 057. 76	12 669. 02	12 835. 59	12 471. 09
Other Assets	3 475. 20	3 483. 35	3 627. 65	3 879. 28
Total Assets	**44 004. 79**	**46 080. 65**	**47 832. 08**	**49 867. 66**
Liabilities to Non-financial Institutions and Households	37 886. 07	39 231. 11	40 550. 13	41 766. 73
Deposits Included in Broad Money	37 843. 02	39 181. 64	40 503. 66	41 715. 87
Enterprise Demand Deposits	6 251. 52	6 425. 85	6 648. 64	6 804. 89
Enterprise Time Deposits	1 713. 85	1 828. 75	1 950. 04	1 875. 64
Household Savings Deposits	29 877. 65	30 927. 04	31 904. 98	33 035. 34
Deposits not Included in Broad Money	17. 75	20. 66	19. 14	19. 76
Transferable Deposits	1. 86	2. 44	3. 27	4. 08
Other Deposits	15. 89	18. 22	15. 87	15. 68
Other Liabilities	25. 30	28. 81	27. 33	31. 15
Liabilities to Central Bank	512. 30	541. 39	513. 81	413. 52
Liabilities to Other Depository Corporations	1 495. 61	1 797. 43	1 945. 64	2 386. 20
Liabilities to Other Financial Corporations	42. 29	127. 01	36. 76	42. 69
Of which: Deposits Included in Broad Money	0. 00	0. 00	0. 00	0. 00
Foreign Liabilities	0. 00	0. 00	0. 00	0. 00
Bond Issuance	0. 00	0. 00	0. 00	0. 00
Paid-in Capital	1 884. 05	1 930. 93	1 944. 12	2 014. 03
Other Liabilities	2 184. 47	2 452. 78	2 841. 62	3 244. 44
Total Liabilities	**44 004. 79**	**46 080. 65**	**47 832. 08**	**49 867. 66**

Source: PBC.

Table B4. 18 Balance Sheet of Postal Savings Bank of China in 2008

(Quarter-end Balance)

(100 *million of RMB yuan*)

Items	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Foreign Assets		0. 61	1. 13	2. 71
Reserve Assets	6 823. 80	7 135. 33	6 328. 39	5 628. 96
Deposits with Central Bank	6 603. 61	6 932. 56	6 098. 03	5 361. 44
Cash in Vault	220. 19	202. 77	230. 36	267. 52
Claims on Governments	955. 29	1 020. 35	978. 09	975. 86
Of which: Central Government	955. 29	1 020. 35	978. 09	975. 86
Claims on Central Bank	2 305. 10	1 711. 60	1 819. 60	1 846. 00
Claims on Other Depository Corporations	4 690. 72	6 445. 29	7 609. 44	9 071. 13
Claims on Other Financial Corporations	43. 72	3. 15	151. 10	176. 10
Claims on Non-financial Corporations	2 628. 17	3 126. 08	3 452. 25	3 831. 17
Claims on Other Resident Sectors	31. 92	36. 08	117. 94	318. 84
Other Assets	1 777. 01	107. 28	198. 35	34. 39
Total Assets	**19 255. 73**	**19 585. 77**	**20 656. 29**	**21 885. 16**
Liabilities to Non-financial Institutions and Households	18 561. 80	19 223. 83	19 977. 39	21 381. 37
Deposits Included in Broad Money	18 561. 80	19 221. 78	19 975. 22	21 377. 95
Enterprise Demand Deposits		46. 29	150. 09	518. 41
Enterprise Time Deposits		6. 15	21. 91	60. 33
Household Savings Deposits	18 561. 80	19 169. 34	19 803. 22	20 799. 21
Deposits not Included in Broad Money		2. 05	2. 17	3. 42
Transferable Deposits				
Other Deposits		2. 05	2. 17	3. 42
Other Liabilities				
Liabilities to Central Bank				
Liabilities to Other Depository Corporations	263. 30	135. 57	322. 91	174. 25
Liabilities to Other Financial Corporations	151. 50		75. 56	6. 22
Of which: Deposits Included in Broad Money				
Foreign Liabilities		0. 68	1. 57	6. 92
Bond Issuance				
Paid-in Capital				
Other Liabilities	279. 13	225. 69	278. 86	316. 40
Total Liabilities	**19 255. 73**	**19 585. 77**	**20 656. 29**	**21 885. 16**

Source: PBC.

Table B4.19 Balance Sheet of Finance Companies in 2008

(Quarter-end Balance)

(100 *million of RMB yuan*)

Items	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Foreign Assets	45.28	36.68	69.34	236.58
Reserve Assets	943.78	1 191.55	1 094.07	776.87
Deposits with Central Bank	943.73	1 191.51	1 094.03	776.84
Cash in Vault	0.05	0.04	0.04	0.03
Claims on Governments	157.70	168.37	163.80	127.32
Of which: Central Government	157.70	168.37	163.80	127.32
Claims on Central Bank	51.85	66.55	129.57	26.05
Claims on Other Depository Corporations	2 888.35	2 429.20	2 588.00	3 156.16
Claims on Other Financial Corporations	39.81	212.25	69.11	47.99
Claims on Non-financial Corporations	4 084.09	4 458.58	4 711.51	5 109.32
Claims on Other Resident Sectors	62.77	76.24	78.67	72.34
Other Assets	358.26	493.80	467.65	388.69
Total Assets	**8 631.89**	**9 133.22**	**9 371.72**	**9 941.32**
Liabilities to Non-financial Institutions and Households	6 641.83	6 751.69	6 990.66	7 552.18
Deposits Included in Broad Money	6 448.93	6 554.50	6 765.13	7 240.84
Enterprise Demand Deposits	3 657.12	3 554.83	3 572.43	3 996.90
Enterprise Time Deposits	2 791.81	2 999.67	3 192.70	3 243.94
Household Savings Deposits	0.00	0.00	0.00	0.00
Deposits not Included in Broad Money	173.48	183.35	211.49	297.62
Transferable Deposits	66.14	100.20	163.83	274.43
Other Deposits	107.34	83.15	47.66	23.19
Other Liabilities	19.42	13.84	14.04	13.72
Liabilities to Central Bank	1.54	1.52	1.42	1.26
Liabilities to Other Depository Corporations	245.69	596.85	482.86	505.89
Liabilities to Other Financial Corporations	30.06	55.99	98.09	97.87
Of which: Deposits Included in Broad Money	1.53	1.80	0.98	2.32
Foreign Liabilities	0.00	0.00	0.00	1.47
Bond Issuance	110.00	149.81	149.83	149.85
Paid-in Capital	595.99	661.27	728.93	762.18
Other Liabilities	1 006.78	916.09	919.93	870.62
Total Liabilities	**8 631.89**	**9 133.22**	**9 371.72**	**9 941.32**

Source: PBC.

Table B4. 20 Statistics of Securities Market

(100 *million of RMB yuan*)

Year	2002	2003	2004	2005	2006	2007	2008
Number of Domestic Listed Companies (A share and B share)	1 224	1 287	1 377	1 381	1 434	1 550	1 625
Number of Domestic Listed Foreign Companies (B share)	111	111	110	109	109	109	109
Number of Overseas Listed Companies (H share)	75	93	111	122	143	148	153
Number of Shares Issued (100 *million of shares*)	5 875. 45	6 428. 46	7 149. 43	7 629. 51	14 897. 5	22 416. 85	24 522. 85
Of Which: Negotiable Shares (100 *million of shares*)	2 036. 90	2 269. 92	2 577. 18	2 914. 77	5 637. 7	10 331. 52	12 578. 91
Total Market Value of Shares (100 *million of RMB yuan*)	38 329. 13	42 457. 72	37 055. 57	32 430. 28	89 403. 9	327 140. 90	12 136 644
Of Which: Negotiable Shares (100 *million of RMB yuan*)	12 484. 55	13 178. 52	11 688. 64	10 630. 51	25 003. 6	93 064. 35	45 213. 9
Trade Volume of Shares (*millions of shares*)	301 619. 49	416 308. 40	582 773. 29	662 373. 20	1 614 522	36 403. 76	2 413 138
Turnover of Shares (100 *million of RMB yuan*)	27 990. 46	32 115. 27	42 333. 95	31 664. 78	90 468. 9	460 556. 20	267 112. 64
Shanghai Composite Index (close)	1 357. 65	1 497. 04	1 266. 50	1 161. 06	2 675. 4	5 261. 56	1 820. 81
Shenzhen Composite Index (close)	388. 76	378. 62	315. 81	278. 75	550. 5	1 447. 02	553. 3
Number of Investor Accounts (10 *thousand*)	6 841. 84	6 981. 24	7 215. 74	7 336. 07	7 854. 0	13 887. 02	12 363. 89
Average P/E							
Shanghai	34. 43	36. 54	24. 23	16. 33	33. 3	59. 24	14. 86
Shenzhen	36. 97	36. 19	24. 63	16. 36	33. 6	72. 11	17. 13
Average Turnover Rate (percent)							
Shanghai	214. 00	250. 75	288. 71	274. 37	46. 3	37. 77	2. 52
Shenzhen	198. 79	214. 18	288. 29	316. 43	55. 9	42. 35	3. 02
Treasury Bonds Issue (100 *million of RMB yuan*)	5 934. 30	6 280. 10	6 923. 90	7 042. 00	8 883. 0	23 139. 10	8 558. 00
Corporate Bonds Issue (100 *million of RMB yuan*)	325. 00	358. 00	327. 00	2 046. 50	3 938. 0	5 181. 00	998. 00
Trade Volume of Bonds (10 *thousand of units*[1])	329 252. 26	620 194. 41	504 218. 50	283 714. 36			
Turnover of Bonds (100 *million of RMB yuan*)	53 249. 53	62 136. 36	50 323. 50	28 367. 85			
Turnover of Outright Treasury Bonds Purchase (100 *million of RMB yuan*)	8 708. 68	5 756. 11	2 966. 46	2 780. 63	1 540. 7		
Turnover of Treasury Bonds Repo (100 *million of RMB yuan*)	24 419. 64	52 999. 85	44 086. 61	23 621. 17	15 413. 2		
Number of Securities Investment Funds	71	95	161	218	301	346	439
Number of Shares of Securities Investment Funds (100 *million of shares*)	1 318. 85	1 614. 67	3 308. 79	4 714. 18	6 020. 0	22 339. 84	19 000
Turnover of Securities Investment Funds (100 *million of RMB yuan*)	1 166. 58	682. 65	728. 58	773. 15	1 909. 6	8 620. 10	483. 99
Trading Volume of Futures (10 *thousand lots*[2])	13 943. 37	27 992. 43	30 569. 76	32 287. 41	272 098. 5	71 565. 57	136 408. 41
Turnover of Futures (100 *million of RMB yuan*)	39 490. 28	108 396. 59	146 935. 32	134 463. 38	209 533. 7	400 733. 30	719 234. 35

Notes: ①1 Unit equals 100 shares.

②1 Lot refers to different measurement unit for different goods. For example, 1 lot of Copper, Aluminium, Zinc or Rubber equals 5 tonness, 1 lot of fuel oil equals 10 tonnes, 1 lot of gold equals 1 000 grams.

Source: CSRC.

Table B4. 21 Ratio of Stock Market Capitalization to GDP

(*100 million of RMB yuan unless otherwise noted*)

Year	GDP	Market Capitalization	Ratio (*percent*)	GDP	Negotiable Market Capitalization	Ratio (*percent*)
1994	48 198	3 691	7. 66	48 198	965	2. 00
1995	60 794	3 474	5. 71	60 794	938	1. 54
1996	71 177	9 842	13. 83	71 177	2 867	4. 03
1997	78 973	17 529	22. 20	78 973	5 204	6. 59
1998	84 402	19 506	23. 11	84 402	5 746	6. 81
1999	89 677	26 471	29. 52	89 677	8 214	9. 16
2000	99 215	48 091	48. 47	99 215	16 088	16. 21
2001	109 655	43 522	39. 69	109 655	14 463	13. 19
2002	120 333	38 329	31. 85	120 333	12 485	10. 38
2003	135 823	42 458	31. 26	135 823	13 179	9. 70
2004	159 878	37 056	23. 18	159 878	11 689	7. 31
2005	183 868	32 430	17. 64	183 868	10 631	5. 78
2006	211 923	89 404	42. 19	211 923	25 004	11. 80
2007	249 530	327 141	131. 10	249 530	93 064	37. 30
2008	300 670	121 366	40. 36	300 670	45 214	15. 04

Source: Calculated based on data from CSRC and State Statistics Bureau.

Table B4. 22 Ratio of Domestic Stock Financing to Bank Loan Increment

(*100 million of RMB yuan unless otherwise noted*)

Year	Domestic Stock Financing	Loan Increment	Ratio (*percent*)
1994	138. 05	7 216. 62	1. 91
1995	118. 86	9 339. 82	1. 27
1996	341. 52	10 683. 33	3. 20
1997	933. 82	10 712. 47	8. 72
1998	803. 57	11 490. 94	6. 99
1999	897. 39	10 846. 36	8. 27
2000	1 541. 02	13 346. 61	11. 55
2001	1 182. 13	12 439. 41	9. 50
2002	779. 75	18 979. 20	4. 11
2003	823. 10	27 702. 30	2. 97
2004	862. 67	19 201. 60	4. 49
2005	338. 13	16 492. 60	2. 05
2006	1 231. 89	31 441. 30	3. 92
2007	8 431. 86	36 322. 51	23. 21
2008	3 336. 41	49 854. 00	6. 69

Note: Domestic stock financing includes financing through A share and B share.

Source: Calculated based on data from PBC and CSRC.

Table B4.23 Statistics of Stock Market

Year		2002	2003	2004	2005	2006	2007	2008
Number of Domestic Listed Companies (A share, B share)		1 224	1 287	1 377	1 381	1 434	1 550	1 625
Of Which: ST Companies		89	99	135	115			178
Medium/ Small-sized Companies				38	50	102	202	273
Number of Domestic Listed Foreign Companies (B share)		111	111	110	109	109	109	109
Of Which: ST Companies		13	14	20	15			20
Number of Shares Issued (*millions of shares*)		546 299.21	599 794.35	671 473.31	716 354.05	1 489 757	22 417	2 452 285
Of Which: Medium/ Small-sized Companies				3 223.36	5 614.41	14 320.74	33 964.00	216.21
Total Market Value of Shares (100 *million of RMB yuan*)		3 832 912.86	4 245 771.60	3 705 556.82	3 243 028.14	8 940 390	327 141	12 136 644
Of Which: Medium/ Small-sized Companies (*millions of RMB yuan*)				41 343.14	48 115.15	201 529.59	1 064 684.00	626 968.00
Market Value of Negotiable Shares (100 *million of RMB yuan*)		1 248 455.65	1 317 851.70	1 168 863.95	1 063 051.43	2 500 364	93 064	4 521 390
Of Which: Medium/ Small-sized Companies (*millions of RMB yuan*)				11 996.09	18 529.34	72 362.66	382 366.00	267 268.00
Volume (*millions of shares*)	Total	301 619.49	416 308.40	582 773.29	662 373.20	1 614 522	36 404	2 413 138
	Daily Average	1 272.66	1 727.40	2 398.25	2 737.08	6 699	15 043	9 810
	Medium/ Small-sized			5 915.87	13 029.95	29 677.53		118 925.54
Turnover (*millions of RMB yuan*)	Total	2 799 045.51	3 211 527.00	4 233 394.72	3 166 477.62	9 046 891	460 556	26 711 264
	Daily Average	11 810.32	13 325.80	17 421.38	13 084.62	37 539	190 312	108 582
	Medium/ Small-sized			82 263.06	120 392.27	307 155.48	1 617 366.00	1 663 728.00

(concluded)

Year		2002	2003	2004	2005	2006	2007	2008
Average Turnover Rate (*percent*)	Shanghai	214. 00	250. 75	288. 71	274. 37	46. 31	37. 77	
	Shenzhen	198. 79	214. 18	288. 29	316. 43	55. 95	42. 35	
	Medium/ Small-sized	—	—	617. 75	999. 70	—	—	
Average P/E	Shanghai	34. 43	36. 54	24. 23	16. 33	33. 38	59. 24	14. 86
	Shenzhen	36. 97	36. 19	24. 63	16. 36	33. 61	72. 11	17. 13
	Medium/ Small-sized			31. 33	24. 49	42. 03	85. 07	24. 96
Shanghai Composite Index	Open	1 643. 49	1 347. 43	1 492. 72	1 260. 782	1 163. 880	2 728. 190	5 265. 000
	Highest	1 748. 89	1 649. 60	1 783. 01	1 328. 53	2 698. 90	6 124. 04	5 522. 78
	Date	2002 – 06 – 25	2003 – 04 – 16	2004 – 04 – 07	2005 – 02 – 25	2006 – 12 – 29	2007 – 10 – 16	2008 – 01 – 14
	Lowest	1 339. 20	1 307. 40	1 259. 43	998. 23	1 161. 91	2 617. 02	1 664. 92
	Date	2002 – 01 – 29	2003 – 04 – 07	2004 – 09 – 13	2005 – 06 – 06	2006 – 01 – 04	2007 – 01 – 05	2008 – 10 – 28
	Average	1 567. 23	1 467. 75	1 482. 85	1 153. 55	—	—	2 707. 32
	Close	1 357. 65	1 497. 04	1 266. 50	1 161. 06	2 675. 47	5 261. 56	1 820. 81
Shenzhen Composite Index	Open	475. 14	386. 61	377. 93	313. 81	278. 99	555. 26	1 450. 33
	Highest	512. 38	449. 42	470. 55	333. 28	552. 93	1 567. 74	1 584. 40
	Date	2002 – 06 – 24	2003 – 04 – 15	2004 – 04 – 07	2005 – 03 – 09	2006 – 12 – 29	2007 – 10 – 08	2008 – 01 – 15
	Lowest	371. 79	350. 74	315. 17	237. 18	278. 99	547. 89	452. 33
	Date	2002 – 01 – 22	2003 – 11 – 18	2004 – 09 – 13	2005 – 07 – 18	2006 – 01 – 04	2007 – 01 – 05	2008 – 11 – 04
	Average	455. 65	404. 08	379. 43	282. 64	—	—	785. 83
	Close	388. 76	378. 63	315. 81	278. 75	550. 59	1 447. 02	553. 30

Source: Shanghai and Shenzhen Stock Exchanges.

Table B4. 24 Summary of China's Bond Issuance

(100 *million of RMB yuan*)

Year	Treasury Bonds			Policy Financial Bonds			Subordinated Bonds			Corporate Bonds		
	Issuance	Redemption	Outstanding Balance	Issuance	Redemption	Outstanding Balance	Issuance	Redemption	Outstanding Balance	Issuance	Redemption	Outstanding Balance
1992	460. 78	238. 05	1 282. 72	55. 00	30. 00	143. 12	—	—	—	683. 71	192. 76	822. 04
1993	381. 31	123. 29	1 540. 74	—	34. 29	108. 83	—	—	—	235. 84	255. 48	802. 40
1994	1 137. 55	391. 89	2 286. 40	—	13. 54	95. 29	—	—	—	161. 75	282. 04	682. 11
1995	1 510. 86	496. 96	3 300. 30	—		1 708. 49	—	—	—	300. 80	336. 30	646. 61
1996	1 847. 77	786. 64	4 361. 43	1 055. 60	254. 50	2 509. 59	—	—	—	268. 92	317. 80	597. 73
1997	2 411. 79	1 264. 29	5 508. 93	1 431. 50	312. 30	3 628. 80	—	—	—	255. 23	219. 81	521. 02
1998	3 808. 77	2 060. 86	7 765. 70	1 950. 23	320. 40	5 121. 13	—	—	—	147. 89	105. 25	676. 98
1999	4 015. 00	1 238. 70	10 542. 00	1 800. 89	473. 20	6 447. 48	—	—	—	158. 20	56. 50	778. 63
2000	4 657. 00	2 179. 00	13 020. 00	1 645. 00	709. 20	7 383. 28	—	—	—	83. 00	—	861. 63
2001	4 884. 00	2 286. 00	15 618. 00	2 590. 00	1 438. 80	8 534. 48	—	—	—	147. 00	—	—
2002	5 934. 30	2 216. 20	19 336. 10	3 075. 00	1 555. 70	10 054. 10	—	—	—	325. 00	—	—
2003	6 280. 10	2 755. 80	22 603. 60	4 561. 40	2 505. 30	11 650. 00	—	—	—	358. 00	—	—
2004	6 923. 90	3 749. 90	25 777. 60	4 148. 00	1 778. 70	14 019. 30	918. 80	—	918. 80	327. 00	—	—
2005	7 042. 00	4 045. 50	28 774. 00	5 851. 70	2 053. 00	17 818. 00	966. 30	—	1 885. 10	2 046. 50	37. 00	—
2006	8 883. 30	6 208. 61	31 448. 69	8 980. 00	3 790. 00	23 008. 00	215. 00	—	2 100. 10	3 938. 30	1 672. 40	—
2007	23 139. 10	5 846. 80	48 741. 00	11 090. 20	4 133. 60	29 926. 80	376. 50	—	2 348. 50	5 181. 00	2 880. 90	7 683. 30
2008	8 558. 20	7 531. 40	49 767. 80	10 823. 00	4 063. 80	36 686. 00	724. 00		3 072. 50	8 723. 40		

Notes: ①Data of surbordinated bonds was adjusted because China Minsheng Banking Corp. , Ltd. issued RMB5. 81 billion Yuan of subordinated bonds in Oct. 2004, which was registered in 2005.

②From 2006, data of subordinated bonds included capital-mixed Bonds which were issued in Sep; 2006.

Source: PBC.

Table B4.25 Statistics of China's Insurance Development

(10 *thousand of RMB yuan unless otherwise noted*)

Items	2002	Increase Y-o-Y (*percent*)	2003	Increase Y-o-Y (*percent*)	2004	Increase Y-o-Y (*percent*)	2005	Increase Y-o-Y (*percent*)	2006	Increase Y-o-Y (*percent*)	2007	Increase Y-o-Y (*percent*)	2008
Premium Income	3 053.14	44.74	3 880.40	27.10	4 318.13	11.28	4 927.34	14.11	5 641.44	14.49	7 035.76	24.72	9 784.10
1. Property Insurance	778.30	13.56	869.40	11.71	1 089.89	25.36	1 229.86	12.84	1 509.43	22.73	1 997.74	32.35	2 336.71
2. Personal Accident Insurance	78.71	5.18	99.58	26.51	117.07	17.56	140.89	20.35	162.47	15.31	190.11	17.01	208.56
3. Health Insurance	122.45	98.94	241.92	97.57	259.88	7.42	312.30	20.17	376.90	20.69	384.17	1.98	585.46
4. Life Insurance	2 073.68	61.05	2 669.49	28.73	2 851.30	6.81	3 244.28	13.78	3 592.64	10.74	4 463.75	24.25	6 658.37
Claim Payment	706.73	18.13	841.01	19.00	1 004.44	19.43	1 129.67	12.47	1 438.46	27.33	2 265.21	57.47	2 971.17
1. Property Insurance	404.92	21.62	476.32	17.63	567.52	19.15	671.75	18.36	796.29	18.54	1 020.47	28.15	1 418.33
2. Personal Accident Insurance	26.73	−7.82	30.65	14.65	39.42	28.63	43.51	10.37	51.67	18.75	63.43	22.76	62.57
3. Health Insurance	49.94	48.98	69.90	39.98	89.10	27.47	107.92	21.11	125.10	15.92	116.86	−6.5825	175.28
4. Life Insurance	225.14	11.02	264.15	17.32	308.39	16.75	306.50	−0.62	465.41	51.85	1 064.45	128.71	1 314.98
Operating Expenses	314.37	21.68	361.22	14.90	435.82	20.65	525.96	20.68	667.06	26.83	947.62	42.06	1 079.52
Bank Deposits	3 026.27	56.75	4 549.67	50.34	4 968.78	9.21	5 241.43	5.49	5 989.10	14.26	6 516.26	8.80	8 087.55
Investment	2 504.06	46.22	3 828.87	52.91	5 711.94	49.18	8 894.41	55.72	11 796.29	32.63	20 205.69	71.29	22 465.22
Of Which: Treasury bonds	1 107.85	39.21	1 406.90	26.99	2 651.71	88.48	3 588.29	35.32	3 647.01	1.54	3 961.12	8.61	4 208.26
Securities Investment Funds	307.78	47.27	463.28	50.53	673.17	45.30	1 099.21	63.29	912.08	−17.62	2 530.46	177.44	1 646.46
Total assets	6 494.07	41.44	9 122.84	40.48	11 853.55	29.93	15 225.97	28.45	19 731.32	29.59	29 003.92	46.99	33 418.44

Notes: ①Data of premium income, claim payment and operating expenses are data for the year.

②Data of bank deposits, investment and total assets are data of year-end balance.

Source: Calculated based on data from CIRC Website.

Table B4. 26 The Structure of Non-life Insurance Premium Income

(10 *thousand of RMB yuan unless otherwise noted*)

Insurance Lines	2005	Ratio (*percent*)	2006	Ratio (*percent*)	2007	Ratio (*percent*)	2008	Ratio (*percent*)
Automobile Insurance	857. 88	66. 88	1 107. 87	70. 10	1 484. 28	71. 14	1 702. 52	69. 60
Enterprise Property Insurance	148. 78	11. 60	158. 12	10. 01	186. 83	8. 95	209. 63	8. 57
Cargo Transportation Insurance	51. 34	4. 00	55. 65	3. 52	63. 11	3. 02	70. 97	2. 90
Accident Insurance	46. 43	3. 62	62. 03	3. 93	74. 31	3. 56	72. 71	2. 97
Liability Insurance	45. 32	3. 53	56. 33	3. 56	66. 6	3. 19	81. 75	3. 34
Others	132. 98	10. 37	140. 36	8. 88	211. 35	10. 13	308. 67	12. 62
Total	1 282. 73	100. 00	1 580. 36	100. 00	2 086. 48	100. 00	2 446. 25	100. 00

Source: CIRC.

Table B4. 27 The Structure of Life Insurance Premium Income

(10 *thousand of RMB yuan unless otherwise noted*)

Insurance Lines	2005	Ratio (*percent*)	2006	Ratio (*percent*)	2007	Ratio (*percent*)	2008	Ratio (*percent*)
Life Insurance	3 246. 86	87. 75	3 592. 64	86. 95	4 463. 44	90. 19	6 658. 09	90. 74
Of Which: Common Life Insurance	960. 15	25. 95	999. 69	24. 19	1 002. 71	20. 26	983. 66	13. 41
Participating Insurance	2 021. 68	54. 64	2 133. 60	51. 64	2 221. 23	44. 88	3 798. 87	51. 77
Unit-linked Insurance	45. 84	1. 24	61. 64	1. 49	393. 83	7. 96	425. 03	5. 79
Accident Insurance	141. 41	3. 82	162. 47	3. 93	115. 80	2. 34	130. 85	1. 78
Health Insurance	311. 85	8. 43	376. 90	9. 12	369. 73	7. 47	548. 63	7. 48
Total	3 700. 12	100. 00	4 132. 01	100. 00	4 948. 97	100. 00	7 337. 57	100. 00

Source: CIRC.

Table B4. 28 Insurance Premium Income of China's Different Regions in 2008

(100 million of RMB yuan)

Regions	Insurance Premium Income	Property Insurance	Life Insurance	Accident Insurance	Health Insurance
Guangdong	9 784. 10	2 336. 71	6 658. 37	203. 56	585. 46
Jiangsu	884. 16	207. 77	601. 76	20. 53	54. 10
Beijing	775. 41	181. 11	528. 19	18. 31	47. 79
Shanghai	600. 06	131. 79	382. 06	12. 08	74. 12
Shandong	585. 95	134. 14	390. 58	9. 58	51. 65
Zhejiang	571. 23	135. 92	389. 54	12. 06	33. 71
Sichuan	518. 92	77. 85	411. 01	7. 70	22. 36
Hebei	494. 27	109. 76	344. 96	11. 81	27. 75
Henan	489. 23	163. 04	288. 06	12. 26	25. 87
Liaoning	480. 59	103. 14	351. 05	7. 04	19. 35
Anhui	328. 70	67. 93	233. 34	4. 54	22. 88
Hunan	317. 15	54. 99	240. 71	5. 97	15. 49
Hubei	312. 49	61. 62	229. 06	6. 91	14. 89
Shenzhen	296. 54	63. 96	218. 47	3. 67	10. 44
Fujian	260. 89	60. 09	187. 12	4. 01	9. 67
Shanxi	251. 20	47. 95	190. 87	3. 49	8. 89
Heilongjiang	243. 80	61. 66	159. 81	5. 71	16. 62
Tianjin	240. 82	84. 84	132. 90	7. 15	15. 93
Shaanxi	217. 78	46. 27	159. 24	3. 82	8. 45
Chongqing	200. 55	37. 76	148. 95	5. 27	8. 58
Jilin	175. 62	41. 82	118. 70	2. 52	12. 58
Jiangxi	171. 36	33. 46	127. 22	3. 69	6. 99
Yunnan	165. 39	55. 20	91. 69	6. 19	12. 31
Xinjiang	158. 92	32. 23	118. 66	1. 96	6. 07
Guangxi	152. 51	44. 25	94. 72	3. 48	10. 07
Inner Mongolia	141. 35	53. 59	79. 15	3. 46	5. 14
Dalian	133. 48	40. 04	82. 50	4. 59	6. 35
Qingdao	107. 43	27. 30	69. 90	2. 10	8. 13
Ningbo	102. 73	28. 31	63. 23	1. 75	9. 44
Gansu	97. 45	22. 62	68. 82	1. 73	4. 29
Guizhou	87. 11	40. 34	41. 07	2. 49	3. 21
Xiamen	79. 95	28. 58	45. 43	2. 83	3. 11
Ningxia	46. 87	15. 60	26. 29	1. 21	3. 77
Hainan	31. 79	9. 48	18. 11	0. 85	3. 36
Qinghai	30. 07	10. 49	17. 53	0. 86	1. 19
Tibet	14. 11	6. 28	6. 67	0. 43	0. 73
Group and Head Office Level	3. 25	2. 86	0. 09	0. 16	0. 13
Total	14. 99	12. 64	0. 92	1. 37	0. 05

Note: Data of Group and Head Office Level refers to the premium income earned by the group and head office, which is not included in regional data.

Source: CIRC.

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