

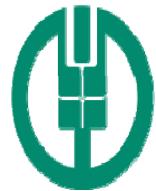
Strategic Transformation: Chinese Banking in a Dynamic and Maturing Economy

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1. Banking Industry in China: Reform

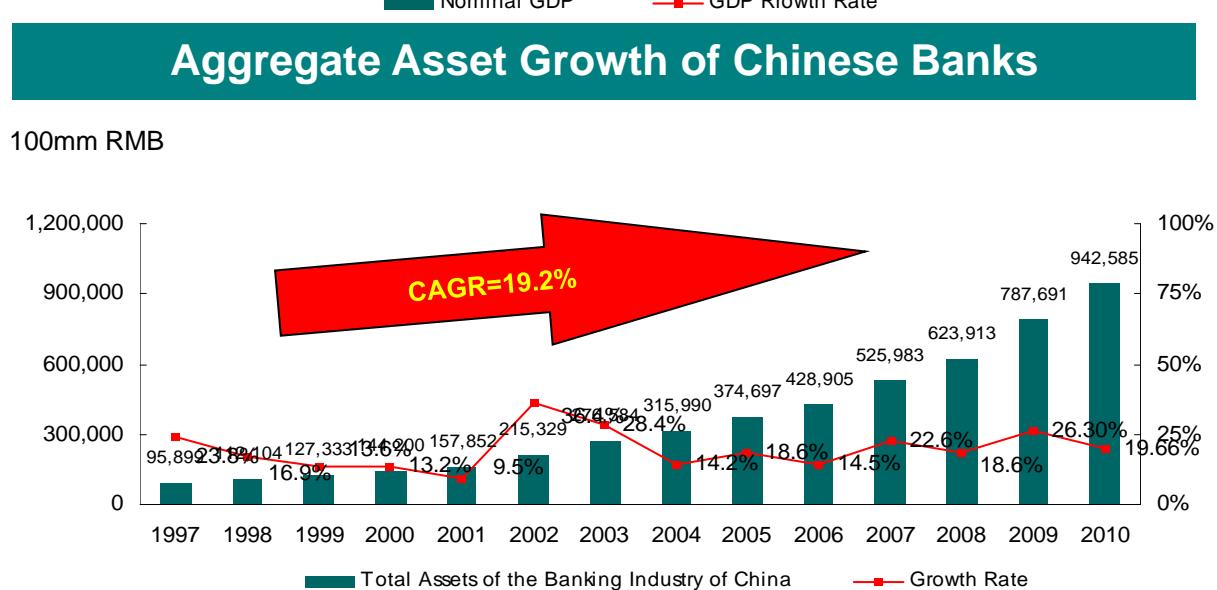


**2. The Future: Symbiosis – Banking
and Economic Restructuring**

Macroeconomic Growth: Strong Basis for Banking Development



➤ The past decade, China's GDP maintained rapid and healthy growth, with a CAGR of over 13% from 1997 to 2009.



➤ Robust momentum of Chinese economy has fueled the rapid growth of Chinese banks.

➤ By the end of 2010, the aggregate asset of Chinese banking industry was RMB 94.3 trillion, with a CAGR of 19% from 1997 to 2010.

Source: State Statistic Bureau, CBRC

Successful Strategic Transformation – An Eventful Decade!

10 YEARS AGO -- Investors were generally bearish on Chinese banking industry, primarily due to massive concentration of non-performing assets.

This was prominently reported in Western media.

10 YEARS LATER -- Financial restructuring has brought fundamental changes with improved asset quality and profitability.

The big 4 Chinese banks are among the top 10 global banks in terms of market capitalization.

This transformation too was widely reported in Western media.



enjoy this article from The Times & The Sunday Times archives. For ful

December 27, 2002

Bad debts put strain on Chinese bank system



EXPLORE WORLD NEWS

A bad loan bubble : Banking crisis imperils China

By Gordon G. Chang
Published: June 19, 2003

Commentary: Are China's Banks Caught in Quicksand?

Bad loans could cripple the system and the economy

China's Communist Party leaders are all proud Marxists. So they should know better than to pay too much attention to the hoopla over Jiang Zemin's retirement and Hu Jintao's promotion to party general secretary at the 16th Chinese Communist Party Congress just wrapping up in Beijing. If China's leaders were to dust off their tattered copies of *Das Kapital*, they would be reminded of the Marxist doctrine that the forces of labor and capital shape history. Individuals--even heavyweights such as Jiang and Hu--are simply along for the ride.

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By Kathy Chu, USA TODAY

HONG KONG — **Hong Kong and China** have dominated the global IPO market. That dominance will only increase when Agricultural Bank of China starts publicly trading next week.

In 2009, Hong Kong was the world's largest IPO market, with companies raising a combined \$32 billion in capital, according to Dealogic, a data-tracking firm. This year, China is on track to assume the mantle, with \$31.7 billion raised by early July.

The reason for these markets' strong performance amid a tepid global environment: "Investors are looking to put their funds in high-growth regions, and the financial tsunami" has affected growth in Europe and the U.S., says Edward Au, southern China regional leader in Deloitte's National Public Offering Group. (Deloitte is an auditor for AgBank's IPO.)

AgBank's dual listing in Shanghai and Hong Kong could raise as much as \$22.1 billion if an option is exercised to boost the

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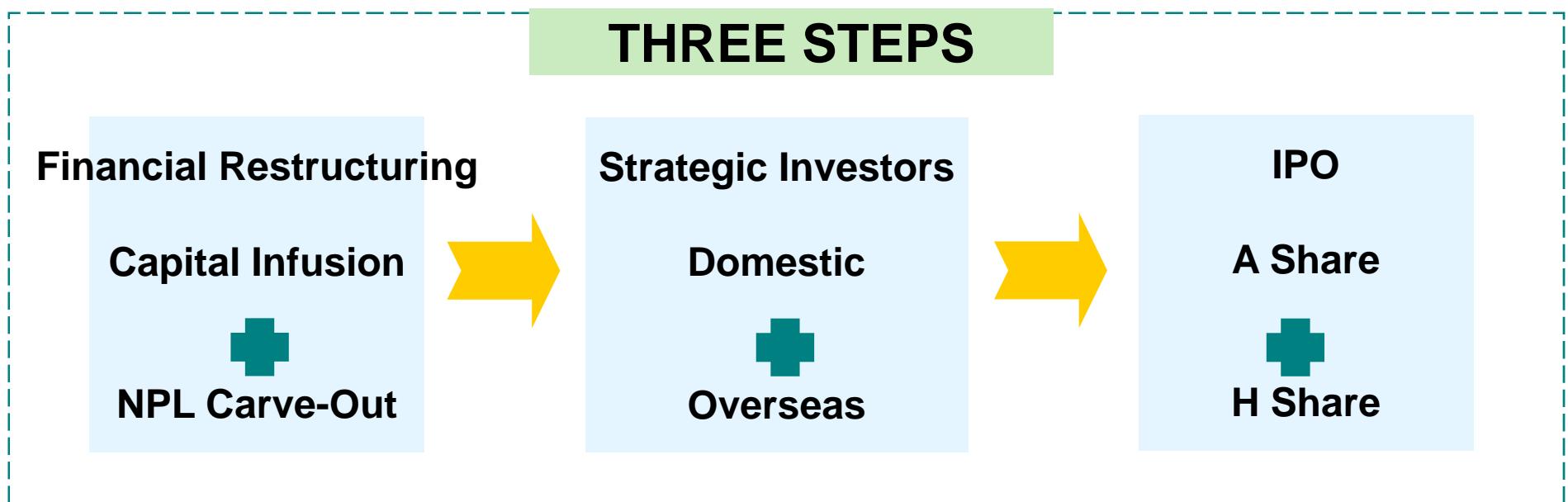
Reform Background



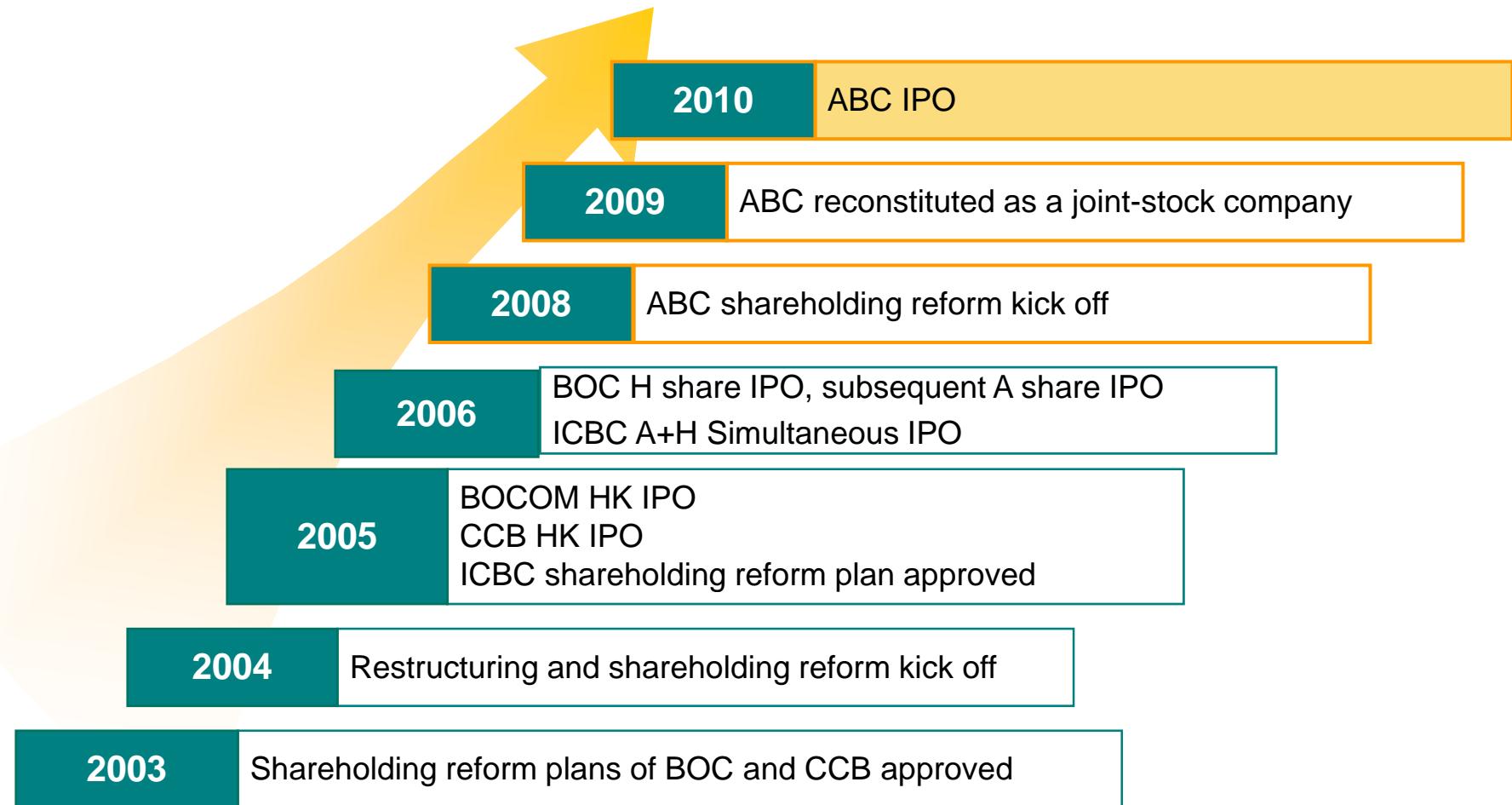
- The fragile banking system has been a substantial threat to the financial stability and long-term economic growth in China.
- The Asian financial crisis was a catalyst for fundamental banking system reform. The Chinese policymakers made bank restructuring a primary policy goal with most of the large public banks to be reconstituted as commercially viable financial entities within 5-10 ten year period.
- The WTO accession too was a major catalyst. Banking reform was a major component of the Chinese WTO accession process.

Reform Roadmap

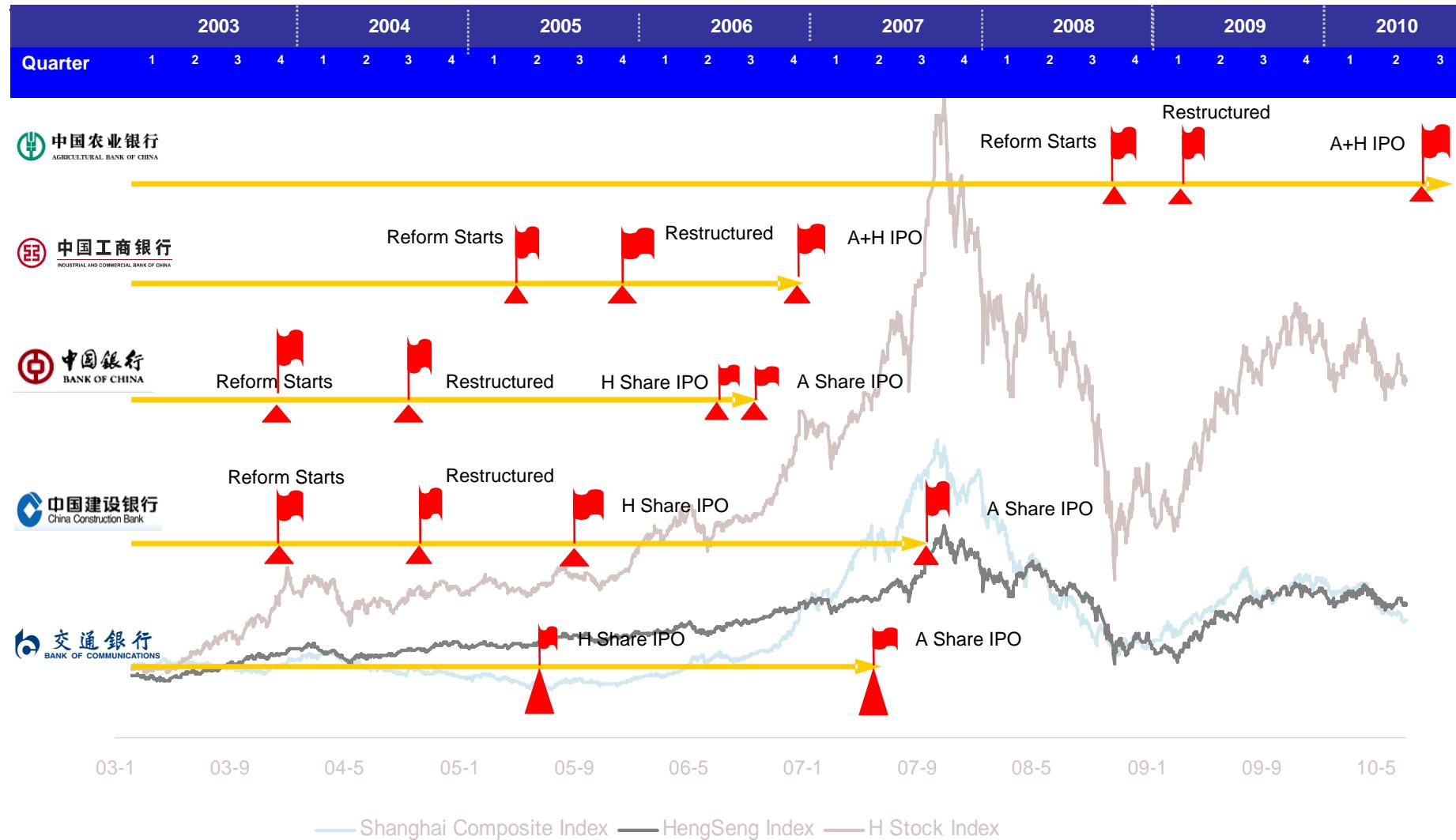
- By the end of 2003, the central government of China initiated state-owned commercial bank reforms.
 1. Financial restructuring through re-capitalization and NPL “carve-out” to clean bank balance sheets.
 2. Restructuring traditional ownership, operation mechanisms, and improving corporate governance.
 3. Strengthening the capital base through IPO (going public—domestic and international), robust market supervision over banks, and promoting consistent reform for the industry.
- The reform initiatives have been focused and pragmatic incorporating international best practices in global banking while paying due attention Chinese sensibilities. Similar restructuring processes have been followed by other countries subsequent to the Chinese reforms.



Reform Roadmap: The ABC's IPO Being the Milestone



Reform Roadmap: Timetable and Capital Market Volatility



Reform Results



- Corporate Governance: Profound improvements have taken place in the corporate structure, internal control, risk management and incentive mechanisms.
- Performance: Substantial improvements in performance indicators (CAR, NPL ratio, provision coverage ratio, cost to income ratio, ROE and ROA) comparable with best banks in any country.
- Economic Development: A healthy banking system with improved corporate governance is conducive to the effectiveness of macroeconomic policies, monetary policy in particular, competitiveness of enterprises and the quality and efficiency of the economy.

Reform Results: Improved Corporate Governance and Internal Management

➤ Improved Corporate Governance

- ✓ Diversified Shareholding Structure and Board Reforms
- ✓ Modern Corporate Governance Structure
- ✓ Information Disclosure Consistent with International Standards

➤ Enhanced Risk Management Capability

- ✓ Centralized Management: Credit Approval & Review, Fund Management and Treasury Management
- ✓ ERM (*Enterprise-Wide Risk Management*)
- ✓ State-of-the-art Risk Management Tools (*Internal Rating-Based Approach, IRB*)

➤ Leading IT Infrastructure

- ✓ *Integrated Data Processing System, Disaster Recovery System*
- ✓ IT Development In Line With Extended Business Scale

➤ Well-Refined Corporate Culture

- ✓ Well-Refined Corporate Culture & Modern Performance Assessment System

Reform Results: Banking Regulations in Line with the International Best Practices



- China Banking Regulatory Commission (CBRC) Founded in 2003
- Unified banking regulatory system

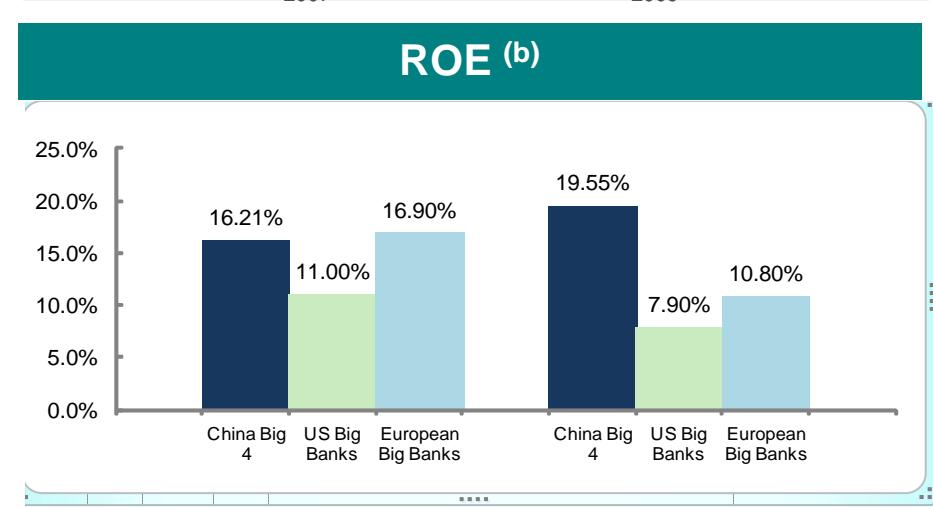
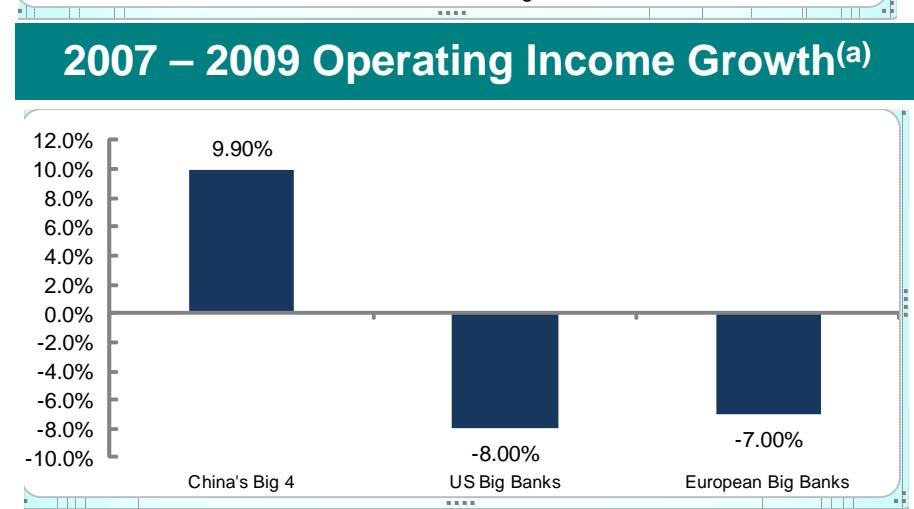
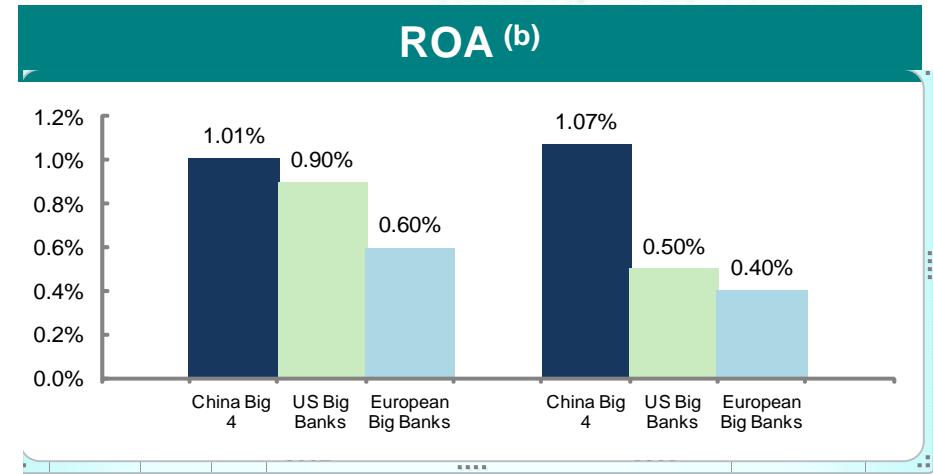
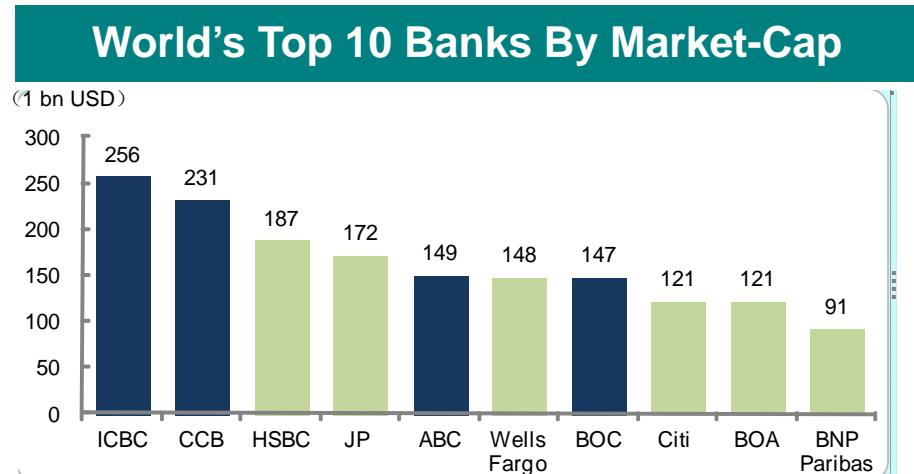
- 1 **Capital Regulations:** With special focus on macro-prudential regulatory framework, “Basel II” is being implemented, and “Basel III” is being studied for future implementation.
- 2 **Information Disclosure:** Information transparency mechanism with two “watchdog” institutions in mainland and HK.
- 3 **Loan Classification:** 5 category loan classification system strictly implemented.
- 4 **Provision Coverage:** Conservative regulatory targets for commercial banks with a view to strengthen risk control.
- 5 **Accounting Rules:** In line with international best practices.



- **Capital Adequacy Ratio:** 7.0% in 2003 to 12.2%
- **Information Disclosure In Line With Standards for Listed Banks:** Put operational risks under control
- **NPL Ratio:** 14.4% in 2003 to 1.1%
- **Provision Coverage Ratio:** Up from 14.4% in 2003 to current 218.3%
- **Accounting Rules:** Financial information has been prepared in accordance with International Accounting Rules

Improvement of Financial Environment: Promulgation of banking laws & regulations and the improvement of credit-worthiness of major market players have contributed to a healthy, efficient and competitive market climate.

Reform Results: Strengthened International Position and Competitiveness



(a) 07 – 09 CAGR

(b) Excluding Banks Suffering from Impairment During the Reporting Period.

Note: "Big 3" refer to ICBC, CCB and BOC; European Banks include: HSBC, RBS, Standard Chartered Bank, Lloyds TSB Group, Society General, BNP Paribas, Barclays; US Banks refer to Bank of America, JP Morgan, Wells Fargo and Citi group.

Reform Results: Strengthened International Position and Competitiveness

Among the world's top 1000 banks (The Banker - 2010 edition), 87 are from China. By assets, the "big 4"(ICBC, ABC, BOC, CCB) ranked among the world's top 25; by pre-tax profit, the "big 5"(ICBC, ABC, BOC, CCB, Bocom) ranked among the top 20 banks.

The World's Largest Commercial Banks (By Tier One Capital)

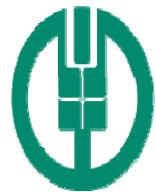
Million US Dollars

Rank	Banks	Tier-one Capital	Total Asset	Pre-tax Profit	CAR%	Core CAR%	ROA%	Profits on Average Capital(%)	NPL%
1	Bank of America	160,388	2,223,299	4,360	14.66	10.40	0.20	3.10	3.73
2	JP Morgan	132,971	2,031,989	16,143	14.78	11.10	0.79	12.00	2.77
3	Citigroup	127,034	1,856,646	-8,445	15.25	11.67	-0.45	-6.87	4.88
4	RBS	123,859	2,749,572	-4,336	16.10	14.10	-0.16	-3.87	4.70
5	HSBC	122,157	2,364,452	7,079	13.70	10.80	0.30	6.51	3.43
6	Wells Fargo	93,795	1,243,646	17,606	13.26	9.25	1.42	19.54	3.12
7	ICBC	91,111	1,725,938	24,494	12.36	9.90	1.42	28.71	1.54
14	BOC	73,667	1,281,183	16,319	11.14	9.07	1.27	23.54	1.52
15	CCB	71,974	1,409,355	20,316	11.70	9.31	1.44	30.08	1.50
28	ABC	39,786	1,026,021	7,682	10.07	7.74	0.75	19.31	2.91

Source: 1. *the Banker* magazine (Jul. 2010 edition),

2. Bloomberg

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1. Banking Industry in China: Reform



**2. The Future: Symbiosis – Banking
and Economic Restructuring**



Opportunities & Challenges



- Rapidly Growing Chinese Economy and the Stable Market Reform
- Accumulation of Household Wealth and growing middle class
- Transformation of China's Economic Structure
- Transformation of Global Financial Landscape

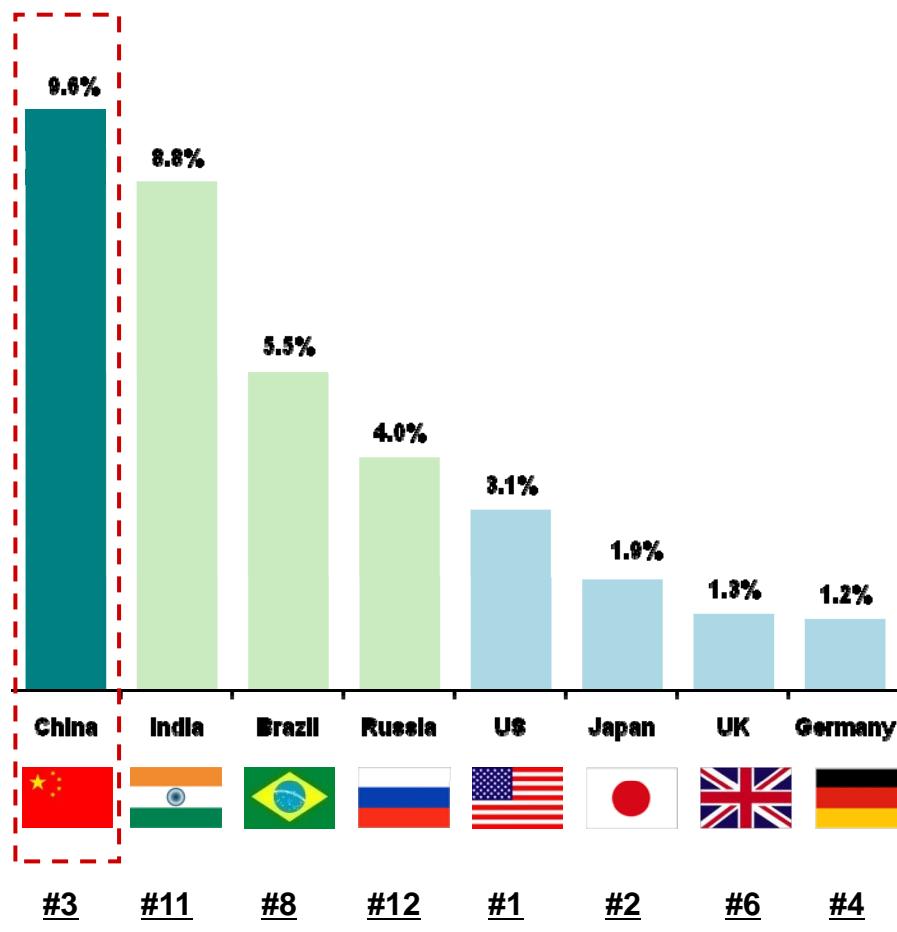
VS.

- Change in Competitive Landscape
- New Risks
- Liberalization of Interest Rates
- Funding Diversification
- Regulatory Reforms

Accelerated Economic Growth & Restructuring In China Has Laid A Solid Foundation For the Banking Industry Development

China Leads the World in Economic Growth

2011E Real GDP Growth¹



China is Now Shifting to a Consumption Driven Economy

Net Export
Capital Formation
Consumption Expenditure



(1) Source: (left) World Economic Outlook published by IMF on Jan 25, 2011.

(2) Source: (right) State Statistic Bureau, PBOC

Reshaping Economic Growth Model: Three Themes



- Promoting domestic consumption
 - Enhancing employment growth, raising household income, adjusting income distribution
 - Establishing a sound social security system, increasing the social security expenditure
- Adjusting supply structure
 - Encouraging the technology promotion and industry consolidation in traditional manufacturing sector
 - Promoting the development of strategic new industries and service industry
- Urbanization and balanced regional development

Banking Industry's vital role in China's Economic Restructuring



- Providing necessary and sufficient funding support to the real economy, allocating capital more efficiently, enhancing the sustainable and stable economic development
- Providing diversified financial services and products to households thus stimulating consumer finance
- Adjust the structure of credit provision.
 - Industry structure: promoting the development of strategic and new industries; developing green credit; restricting the credit to the polluted and energy-intensive industries
 - Client structure: strengthening the credit supply to SMEs, facilitating employment and consumption;
 - Regional structure: diverting more credit resources to the mid-west and counties; improving the balanced development of different regions and urbanization.

Spillover Effects – Financial Crises Lead to Economic Crises

Lessons From the Past

← 20th Century → 21st Century

1997

2007

Asian Financial Crisis

- Severity & Magnitude—
Extraordinary & Rarely seen
- Direct trigger—Thai Baht crisis
- Followed by—Drastic currency depreciation (Even RMB was under pressure)
- Foreign Exchange Rate Volatility—
—Lower market confidence
- A heavy toll on the world economy

10 Years

Sub-Prime Mortgage Crisis

- Severity & Magnitude—more devastating and contagion
- Multiplier Effect of Contagion
- 1. Globalization and interdependency in modern financial markets
- 2. Financial asymmetry
- 3. High leverage ratio
- 4. Complexity of products

Common Characteristics

Complicated
Abrupt
Contagious
Destructive

Building A Stable & Sustainable Banking System

An Integral Part of Economic Restructuring



- The financial restructuring, the shareholding reform and the subsequent IPOs are by no means the end of the reform endeavor, but the start of a new journey. The Chinese large commercial banks have now ushered in a new development era with diversified and dynamic shareholding structures, sound corporate governance, and enhanced management capabilities.
- Risk mitigation and control are crucial to bank management. A rational decision-making system, an internal control mechanism, and an integrated and effective risk management system keeping credit risk, market risk and operation risk under strict scrutiny are what it takes to boost asset quality and operation efficiency.
- The big commercial banks still need to work on refining corporate governance, transforming business philosophy and growth pattern, and nurturing sound and prudent risk management culture--The bank reform process was in essence an institutional culture change!



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Thank You !