

# Time to Go Green

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*Environmental Responsibility in the Chinese  
Banking Sector*



**Friends of  
the Earth**

United States

**BANK***Track*

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## *Environmental Responsibility in the Chinese Banking Sector*

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*May 2007*

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## Executive Summary

*Despite their new and influential role, Chinese banks have not yet adopted policies that are comparable to those of leading international lenders.*

*Although all Chinese banks should have policies requiring that clients comply with environmental laws, only two policy banks -- China Development Bank and Export-Import Bank of China -- have publicly disclosed their environmental financing standards. Like international banks, there are still questions about how well environmental policies are being implemented.*

Chinese multinational corporations are quickly expanding overseas, and generating the same kinds of environmental and community impacts that Western companies have created for years. As Chinese firms expand abroad, so do the banks which back them. Today, for example, Chinese banks are the leading lenders in Africa, making them new power players in international development finance. But despite their new and influential role, Chinese banks have not yet adopted policies that are comparable to those of leading international lenders.

At home, the Chinese banking sector is in the midst of massive reforms as it transitions to a market- and risk-based competitive industry. In the past, Chinese bank lending decisions were steered by the public policy priorities of the local or national government, which resulted in a massive amount of non-performing loans. The lack of strict financial standards and procedures also created serious corruption problems in the sector. Although China's policy banks (such as the Export-Import Bank of China) still lend in accordance with governmental objectives, commercial banks (such as the Industrial and Commercial Bank of China) now have greater independence.

Hastened by China's entry into the WTO, which requires the banking sector to open up to foreign competition, Beijing has taken dramatic steps to clean up its banks. The government has bought non-performing loans from banks, injected billions of RMB into individual institutions, and strengthened banking regulations. Lured by the possibility of breaking into the Chinese financial services market, dozens of international banks have bought shares of newly-reformed Chinese banks, with promises to help turn them into world-class financial institutions.

This report provides dossiers of ten of the most important banks in China, including China's government-owned policy banks, and the Big Four commercial banks. It finds that although all Chinese banks should have policies requiring that clients comply with environmental laws, only two policy banks -- China Development Bank and the Export-Import Bank of China -- have publicly disclosed their environmental financing standards. Like international banks, there are still questions about how well environmental policies are being implemented, particularly given both banks' involvement in environmentally-sensitive transactions.

The study also finds that, especially among the commercial institutions, Chinese banks currently view environmental issues as a matter of charity rather than a core business issue -- similar to how international banks viewed their environmental responsibility ten years ago.

However, there are many promising opportunities to promote stronger environmental and social standards at Chinese banks. For example, bank regulators have already taken some encouraging steps to require banks to integrate environmental considerations into financing decisions. In addition, NGOs and international banks -- particularly those with strategic investments in Chinese counterparts -- should work with individual Chinese banks to introduce or improve environmental financing standards.



## Introduction

Beijing's "Go Out" strategy, which encourages Chinese companies to expand abroad, was formally established in China's 10<sup>th</sup> 5 Year Plan (2001-2005). Since the launch of this policy, Beijing has mobilized the banking sector to "play a key role in facilitating international capital flows, mergers and acquisitions and in the country's efforts to seek resources."<sup>1</sup>

When "Go Out" was launched in 2001, the primary obstacle to Chinese companies' overseas expansion was lack of financing.<sup>2</sup> To rectify this problem, Beijing boosted the activities of its Export-Import Bank, created a new overseas financing arm (Sinosure), and also expanded the overseas lending activities of the China Development Bank. And as Chinese companies began expanding abroad, commercial banks also increased financing for these activities.

By 2005, the operations of Chinese companies had expanded to 200 countries and regions,<sup>3</sup> with overseas direct investment amounting to over USD 200 billion. Mining and manufacturing ventures comprised about 29% of China's overseas investment,<sup>4</sup> and according to the World Bank "in 2004 about half of China's outward [foreign direct investment] went to natural resources projects in Latin America."<sup>5</sup>

Because the most lucrative and accessible resource concessions have already been claimed by Western companies, Chinese companies are playing a disproportionately large role in developing some of the world's most socially and environmentally risky projects. Many of these projects are located in countries which are politically unstable and/or have poorly enforced environmental and labour laws. These environmental, social and political risks can have clear financial impacts.

Despite the fact that Chinese banks are getting involved in riskier transactions, relatively few institutions have developed environmental and social financing policies to mitigate these risks; even fewer banks have adopted policies that are comparable to those adopted by leading international institutions. NGOs, and even some international bankers, have warned that Chinese banks' lack of environmental and social financing standards may create a "race to the bottom" in developing countries. In a November 2006 *Financial Times* article, European Investment Bank president Philippe Maystadt claimed that due to lack of environmental and social standards, "Chinese banks have snatched projects from under the EIB's nose in Asia and Africa, after offering to undercut the conditions it imposed on labour standards and environmental protection."<sup>6</sup>

The lack of stringent environmental financing standards at Chinese banks also has obvious impacts within China itself, where the vast majority of Chinese bank lending is based. Chinese companies rely

*Mining and manufacturing ventures comprised about 29% of China's overseas investment, and according to the World Bank "in 2004 about half of China's outward [foreign direct investment] went to natural resources projects in Latin America."*

1 "Policy Banks Should Play Key Role In International Trade," *Business Daily Update*, 29 April 2006

2 "CHINA: Investors to look abroad," *Asiainfo Daily China News*, 20 March 2001

3 "'Go Out' Covers 200 Countries And Regions," *IPR Strategic Business Information Database*, 26 October 2005

4 "Transnational M&A makes up 57 pct of China's direct investment overseas," *Xinhua Economic News Service*, 14 December 2006.

5 *Global Development Finance 2006: The Development Potential of Surging Capital Flows*, World Bank, 2006, p 112.

6 Beattie, A and Parker, G 2006, "EIB accuses Chinese banks of undercutting Africa loans," *Financial Times*, 29 November.

overwhelmingly on bank loans to finance their new projects and expansion activities. If the banking sector could be enlisted in China's effort to protect the environment, it would benefit communities and ecosystems both within China and around the world.

This report is written to provide a baseline understanding of the Chinese banking industry, including key players in the sector.

The first section provides an overview of the Chinese banking sector, including its role, current reforms, and the main types of banks operating in China. The next section introduces some examples of controversial transactions currently financed by Chinese banks.

Finally, the bulk of the report is comprised of dossiers of ten Chinese banks, including China's main policy banks and the "Big Four" commercial banks.

# Role and reform of China's banking sector

## Role of China's banking sector

Like numerous other countries, China's banking and finance sector plays a crucial part in almost all matters of national policy and is used by the government as a tool of macroeconomic policy. During the earliest years of the People's Republic of China, the banking sector was the first economic sector to become completely nationalized, and quickly proved its effectiveness in halting the free-fall inflation caused by the previous Guomindang regime.<sup>7</sup> As Beijing's public policies change, the banking sector is repeatedly modified to advance new policy objectives.

*Today, China uses bank lending to strengthen or discourage growth in particular companies, industries and regions.*

Today, China uses bank lending to strengthen or discourage growth in particular companies, industries and regions. For example, most bank lending currently is concentrated on state-owned enterprises and on trade-oriented industries, which furthers government objectives relating to urban employment and economic growth. Banks have also played a role in government efforts to make state-owned enterprises (SOEs) more profitable. In the past few years, banks have cut off loans to weaker SOEs, forcing many of them to close. This unfortunately resulted in 30 million people losing their jobs.<sup>8</sup> To address this problem, banking regulators issued guaranteed micro-loans for unemployed workers to start their own businesses, for example.<sup>9</sup> Beijing has also identified other economic sectors to be strengthened via bank loans, including small- and medium-sized enterprises, which provide more jobs than SOEs; and rural agriculture to "support the building of a new socialist countryside."<sup>10</sup>

*Bank lending plays a paramount role in how corporations raise money in China. Chinese companies raise over ten times more capital from bank loans than from issuing stock or bonds.*

Finally, bank lending also plays a paramount role in how corporations raise money in China. Chinese companies raise over ten times more capital from bank loans than from issuing stock or bonds. For example, in the first half of 2006, companies received RMB 2.1 trillion in bank loans; in comparison, they raised about RMB 200 billion from the domestic bond market (even though the bond market is rapidly growing).<sup>11</sup> This means that the power of Chinese banks to influence their clients has the potential to be much greater than in other economies, where corporations raise a much larger proportion of money through the capital markets.

## Government reform objectives

Unsurprisingly, China's banking sector has changed dramatically as China's economy has surged in the Post-Reform Era. During the first decade of reforms, the banking system was diversified and expanded,

7 <http://countrystudies.us/china/96.htm> 7/21/2006

8 Testimony of Michael Petit, Managing Director, Standard & Poor's Asia-Pacific Corporate & Government Ratings for The U.S.-China Economic & Security Review Commission August 22, 2006

9 "The People's Bank of China, the Ministry of Finance and the Ministry of Labor and Social Security Jointly Issued the Notice on Improving Guaranteed Micro-Loan Policy," PBOC news release, 26 January 2006 (at <http://www.PBOC.gov.cn/english/detail.asp?col=6400&ID=635>)

10 "More central bank lending for agricultural sector to support the building of a socialist new countryside," PBOC news release, 10 July 2006 (at <http://www.PBOC.gov.cn/english/detail.asp?col=6400&ID=697>)

11 Ibid.

and the scale of banking activity increased quickly. From 1979 to 1985, deposits almost tripled and bank loan values increased by approximately 260%.<sup>12</sup>

After 2001, when China entered the World Trade Organization (WTO), China's efforts to reform its antiquated banking system into a modern competitive sector accelerated even more quickly. The reform of the Chinese banking system is based on three main policy objectives:<sup>13</sup>

- *Bank restructuring*: purging non-performing loans and injecting public capital, particularly in the "Big Four" state-owned commercial banks
- *Financial liberalization*: gradually letting the markets determine prices, introducing quality controls and opening the sector greater foreign competition
- *Strengthened financial regulation and supervision*, including introducing better risk management, corporate governance, and disclosure; and adopting international standards

Currently the Chinese banking and finance sector is in the complex and difficult process of transforming its banking structure from one that was originally designed as a channel for socialist state subsidies, to a modern profitable and competitive industry. Chinese financial institutions do not yet approach international standards of corporate governance and transparency. Many of China's banks are still subject to corruption and political pressure from the Chinese government, although it must be noted that the government is far less intrusive than it used to be. International experts mostly regard the future of Chinese banking sector with cautious optimism. While the progress made towards modernizing China's financial sector is certainly laudable, numerous problems remain.

## Key problems

### Non-performing loans

*The government estimates that bad loans account for about 9% of total loans, but independent analysts put the figure at around 20-25%.*

Non-performing loans (NPLs) are the most serious problem for the future of Chinese banks, especially state-owned banks such as the Big Four (Bank of China, China Agricultural Bank, China Construction Bank, China Industrial and Commercial Bank). The government estimates that NPLs account for about 9% of total loans, but independent analysts put the figure at around 20-25%.<sup>14</sup> Most of these non-performing loans are remnants of China's old centralized economy and the result of political pressure from the government to prop up ailing state-owned enterprises.<sup>15</sup>

To address this critical problem, the Chinese government has gone to great lengths to relieve key banks of their bad loans. Since 1998, the

<sup>12</sup> <http://countrystudies.us/china/96.htm> 7/21/2006

<sup>13</sup> Pg. 265 Saich, Tony. Governance and Politics of China. Palgrave Macmillian. New York, NY. 2004

<sup>14</sup> Testimony of Michael Petit, Managing Director, Standard & Poor's Asia-Pacific Corporate & Government Ratings for The U.S.-China Economic & Security Review Commission August 22, 2006

<sup>15</sup> Pg. 264 Saich, Tony. Governance and Politics of China. Palgrave Macmillian. New York, NY. 2004

*Since 1998, the government has infused Chinese banks with an estimated RMB 3.6 trillion – equivalent to about 18% of China's 2005 GDP.*

government has infused Chinese banks with an estimated RMB 3.6 trillion – equivalent to about 18% of China's 2005 GDP.<sup>16</sup> These capital infusions have taken many forms. For example, in 1998, the Ministry of Finance issued special government bonds worth RMB 270 billion to provide the Big Four with additional capital. In 1999, it established four asset management companies to purchase NPLs from the Big Four, in an effort to improve their asset quality. The government also created an investment company called Central Huijin Investment Company specifically to purchase shares of the Big Four banks. Huijin, for example, bought US\$22.5 billion in shares from China Construction Bank and Bank of China, which provided banks with additional money and allowed them to dispose of more non-performing loans. This also made them more attractive other investors, who later bought stocks and bonds issued by the banks, thus raising even more money.<sup>17</sup>

However, many analysts believe that these huge capital infusions are still not enough to transform these banks into commercially viable businesses. Standard & Poor's, for example, believes that Chinese banks ultimately must become more profitable to address the NPL problem. The more money banks lend out, the larger their capital bases need to be. (Banks need strong capital bases in order to cover a certain proportion of loans which unavoidably are not paid back.) To grow their capital bases, S&P maintains that banks need to become more profitable by lending less to SOEs and more to private enterprises.<sup>18</sup>

Currently, SOEs receive more than half of bank lending, but contribute to less than 25% of GDP.<sup>19</sup> Money-losing SOEs continue to receive bank loans in order to keep providing jobs and benefits to hundreds of millions of Chinese citizens. In this sense, the banking sector, through extending loans to unprofitable businesses, has historically helped sustain the social safety net in China.<sup>20</sup>

### Easy lending in an overheating economy

*This vast amount of cash, coupled with generous government injections of even more money, means that banks have an immense amount of money to disperse, which could lead to financially -- and environmentally -- careless lending*

To make matters worse, China's banks are awash with cash. Although a rapidly increasing proportion of Chinese citizens are beginning to invest in domestic stock markets, banks are one of the few places that individuals, institutional investors (such as pension funds), and companies in China can put their money. Because stock and bond markets are not yet well developed, RMB 32 trillion, or about 75% of total capital, is deposited in banks (compared to about 45% in India and 20% in the United States), a figure that is equal to 1.7 times China's 2005 GDP.<sup>21</sup> This vast amount of cash, coupled with generous government injections of even more money, means that banks have an immense amount of money to disperse, which could lead to financially -- and environmentally -- careless lending. Excessive bank lending and investment in sectors such as real estate and steel is already a problem;

16 Testimony of Michael Petit, Managing Director, Standard & Poor's Asia-Pacific Corporate & Government Ratings for The U.S.-China Economic & Security Review Commission August 22, 2006

17 ICBC prospectus 2006.

18 Testimony of Michael Petit, Managing Director, Standard & Poor's Asia-Pacific Corporate & Government Ratings for The U.S.-China Economic & Security Review Commission August 22, 2006

19 Ibid.

20 Hsu, Berry Fong-Chung; Arner, Douglas; Wan, Qun; and Wang, Wei, "Banking Liberalization and Restructuring in Post-WTO China," Banking & Finance Law Review, 1 October 2005.

21 Ibid.

prices in these sectors are vastly inflated, and when this speculative “bubble” bursts, investors and banks will lose their money.

A key strategy to slowing the economy and avoiding inflation is by having banks rein in their lending, but it does not seem to be working. In 2006 for example, the People’s Bank of China (China’s central bank) set a total bank lending quota of RMB 2.5 trillion. In order to meet this quota, it raised the deposit reserve ratio (how much banks must retain versus lend out) four separate times, and also raised interest rates twice. Despite these efforts, Chinese banks in 2006 lent RMB 3.18 trillion (USD 408 billion), exceeding the quota by RMB 826.5 billion, and creating a new record.<sup>22</sup> Observers fear that easy lending by Chinese banks will create another round of NPLs, and create a “crash landing” rather than a “soft landing” when China’s economy eventually slows down.

## Inadequate Laws and Regulations

Another problem is that China lacks a solid legal framework providing banks with the ability to recover NPLs. For example, in most industrial countries, bankruptcy laws give creditors certain rights when borrowers are in financial distress and cannot pay back their loans. Such rights may include binding negotiations between banks and borrowers to create plans for revenue generation, company reorganization, reallocation of assets, etc. In addition, creditors are usually one of the first parties in line when a bankrupt company’s assets are liquidated (sold off).

In contrast, China’s bankruptcy laws only apply to SOEs, and they prohibit banks from filing bankruptcy against public utilities and companies that are deemed important to the national interest. If a company’s assets must be liquidated, a Liquidation Committee, primarily comprised of local regulators (and not banks), is formed to decide how the assets should be distributed. There are no regulations over how Liquidation Committees make their decisions, and since Committee members they may have more allegiance to local officials and workers, banks may be last in line to get reimbursed.<sup>23</sup>

In addition, laws regulating banks in China continue to be problematic. Although Beijing has established new banking supervisory authorities, many foreign and domestic entrepreneurs still say that different (and sometimes rival) government agencies have rules that often contradict those of another agency. Completing a simple financial transaction may require several licenses from several different agencies.<sup>24</sup>

## Transparency and corporate governance

Finally, transparency and corporate governance are other weaknesses in the Chinese banking sector. Accurate and reliable information is sometimes difficult to obtain, and accounting figures are few,

<sup>22</sup> “Chinese banks lend record 3.18 trillion yuan in 2006,” People’s Daily Online, 15 January 2007 at [http://english.people.com.cn/200701/15/eng20070115\\_341425.html](http://english.people.com.cn/200701/15/eng20070115_341425.html)

<sup>23</sup> Testimony of Michael Petit, Managing Director, Standard & Poor’s Asia-Pacific Corporate & Government Ratings for The U.S.-China Economic & Security Review Commission August 22, 2006

<sup>24</sup> Jia, Boshen. Unpublished interviews with senior economists from Standard Chartered and Goldman Sachs, November 2005

*For foreign investors, faith in Chinese banks derives from strong government support of the banks and the booming Chinese economy, rather than from the actual financial institutions themselves*

particularly for those banks which have not issued shares to private investors. For foreign investors, faith in Chinese banks derives from strong government support of the banks and the booming Chinese economy, rather than from the actual financial institutions themselves. Currently, corruption within the banking sector is undeniable, and the lack of information makes it hard to gauge the extent of corruption and its effects on corporate efficiency and competitiveness.

Several high-profile corruption cases have revealed troubling evidence of malfeasance, but also have demonstrated authorities' resolve to punish offending officials. For example, in March of 2005, the chairman of China Construction Bank was removed for taking bribes.<sup>25</sup> In August 2005, the former vice-chairman of the Bank of China was sentenced to death for corruption, taking bribes, and the possession of enormous unaccountable assets.<sup>26</sup> However, the effectiveness of such draconian punishments in reassuring the public is uncertain.

## Recent Developments

Despite these problems, the Chinese banking sector is dynamic and exhibits undeniable adaptive ability. China's entry into the World Trade Organization and its consequent commitment to open its financial market to foreign competition by the end of 2006 has fuelled and accelerated international-style reform of the Chinese banking sector.<sup>27</sup>

Modern risk assessment procedures are being institutionalized and corporate governance is becoming more and more transparent. Since the 1995 Commercial Banking Law was introduced, banks have been given more policy independence, which allows them to detach themselves to a greater degree from politically motivated (and potentially non-performing) loans. In addition, state-owned enterprises are under tremendous pressure to become profitable or shut down, largely due to policies developed by former Premier Zhu Rongji.<sup>28</sup> This has helped banks reducing their NPLs. In 2005, the government reported that the NPL ratio of China's 13 major state shareholding banks fell below 5% compared with 16.6% in 2001.<sup>29</sup>

## Chinese banks invite international shareholders

Several Chinese banks have launched initial public offerings (IPOs) and sold shares to investors. For example, the Bank of China launched a record-high IPO in 2006. Its record was broken later that year by the Industrial and Commercial Bank of China, the largest of all Chinese commercial banks, which went public on the Hong Kong Stock Exchange. While Chinese banks have not yet fully implemented international standards, investors and foreign financial institutions seem confident in the steady and positive growth of Chinese banks, particularly because of

25 Chanda, Amit. Former Senior State Bank Official Accused of Corruption and Embezzlement in China. World Markets Analysis. 7/14/2005

26 Three Bank of China employees on trial for corruption. Agence France Presse. 7/5/2006

27 <http://www.china.org.cn/english/BAT/114565.htm> 8/20/2006

28 Saich, Tony. Governance and Politics of China. Palgrave Macmillan. New York, NY. 2004, pg. 257

29 China Banking Regulatory Commission



*Under government guidance, Chinese banks have sought out foreign business partners to not only raise more money, but also to provide expertise.*

the government's continued support and backing for policy banks and big banks.<sup>30</sup>

As a result of China's entry into the WTO, today foreign investors can own up to 25% of a given Chinese bank (the largest percentage any single foreign investor can own is 20%). Under government guidance, Chinese banks have sought out foreign business partners to not only raise more money, but also to provide expertise.

Aided by a rapidly going economy and with foreign firms eager to gain access to the expanding Chinese market, Chinese banks have had little difficulty finding willing partners. Goldman Sachs, Bank of America, Singaporean state investment firm Temasek, Royal Bank of Scotland and numerous other well-known financial firms have led the charge with multibillion dollar investments. As a condition for their investment, foreign firms have agreed to share technology and expertise with their Chinese partners. Such partnerships are seen to be mutually beneficial. In return for providing Chinese firms with assistance in improving their corporate governance and risk management practices, foreign firms hope to tap the vast networks of Chinese banks and enter the emerging and profitable credit card, automobile financing, and wealth management businesses.<sup>31</sup> For a list of Chinese banks and their strategic investment partners, see Appendix 2.

With China's entry into the WTO and restrictions on foreign financial firms lifted in 2006, it was originally thought that Chinese banks would simply be overwhelmed by foreign competition. However, many Chinese banks have turned potential competitors into partners. In a few cases (China Construction Bank, China CITIC Bank), Chinese banks have even bought out the China or Asia divisions of their Western competitors. Some big foreign firms such as Bank of America, Deutsche Bank, and UBS have partnered with Chinese banks; while others such as Citibank, Standard Chartered, and HSBC are also trying to compete directly in China by opening up local subsidiaries that can offer RMB banking services.<sup>32</sup> Foreign banks, such as Citibank and Standard Chartered, have complained about restrictions and difficulties in establishing such subsidiaries, but admit that China is abiding by its WTO timetable.<sup>33</sup>

## Main types of banks and banking structure

There are a few different ways to classify banks within China. The first is based on function: policy banks versus commercial banks; and the second is based on ownership: state ownership versus mixed ownership.

### Policy banks

The policy banks are the **China Development Bank, China Agricultural Development Bank, China Export-Import Bank**

<sup>30</sup> Moody's Changes Outlook For Some Chinese Banks To Positive. Market News International. 7/7/2005

<sup>31</sup> Chinese Banks to Fix Strategic Partners, SinoCast China Financial Watch, 5/23/2005

<sup>32</sup> Lau, Justine. RBS steps up to ride the Chinese dragon Buying a 10% stake in BoC is either brave or foolhardy, write Peter Thal Larsen and Francisco Guerrero. Financial Times, Hong Kong. 7/29/2005

<sup>33</sup> Jia, Boshen. Unpublished interviews with senior economists from Standard Chartered and Goldman Sachs, November 2005.



(Chexim), and **Sinosure**. These banks operate largely according to macroeconomic policy and political directives from Beijing. As a result, they enjoy substantial financial and political support from the central government, usually in the form of capital injections from the People's Bank of China. The China Development Bank is run under the direction of the State Council (国务院). Its primary lending is done within China and it focuses on development of infrastructure and core industries (e.g. transportation and power production). However, its overseas financing is growing rapidly. China Export-Import Bank and Sinosure focus on overseas financing, doing business in Oceania, Africa, the Middle East, Latin America, and Asia etc. As its name suggests, the China Agricultural Development Bank focuses on agriculture and rural development.

## Commercial banks

Commercial banks are subdivided into four state-owned banks, twelve joint stock banks, and over one hundred city-owned banks.

### *Big Four commercial banks*

The state-owned banks are the most high-profile and dominant of China's commercial banks, making about half of loans in China. They consist of the 'Big Four': **China Industrial and Commercial Bank, Bank of China, China Construction Bank, and China Agricultural Bank**. These banks are undergoing a process of reform, including selling some of its shares to private investors. However, the government still holds majority ownership of the Big Four.

### *National commercial banks*

National commercial banks include institutions like Bank of Communications, China Minsheng Bank, and China Everbright Bank. These banks are generally smaller in both size and market-share and less risk-averse than China's state owned banks.<sup>34</sup> They are more likely to invest in newer, more innovative technologies. It is expected that they will be positioned to capitalize on China's shift toward a more knowledge-based economy.

### *City commercial banks*

City commercial banks are largely restricted to their own cities of origin, such as the Bank of Beijing and Shanghai Pudong Development Bank. Unfortunately, it is also these more innovative and less risk-averse second-tier banks that are the most vulnerable to competition as they are smaller in size and do not enjoy the same degree of government support as the large state-owned commercial banks do. According to Standard and Poor's, the government is likely to encourage consolidation of the second-tier banks if they are unable to compete.<sup>35</sup>

## Joint stock banks

Another way to classify Chinese banks is by ownership: state ownership versus mixed ownership. The policy banks will likely remain under the

<sup>34</sup> Unpublished World Bank report: Developing Financial Intermediation Mechanisms for energy efficiency Projects in Brazil, China and India.

<sup>35</sup> Testimony of Michael Petit, Managing Director, Standard & Poor's Asia-Pacific Corporate & Government Ratings for The U.S.-China Economic & Security Review Commission August 22, 2006

total ownership of the state, but other banks are owned by a combination of local or national governments, and domestic and/or foreign investors, and are considered joint stock banks. Such banks include the three of the Big Four (Industrial and Commercial Bank of China, Bank of China, and the China Construction Bank), and many national and city commercial banks. State-owned banks must convert to joint stock banks before selling shares to other investors. During this conversion, the government-owned Central Huijin Investment Company takes ownership of the bank, and then a portion of the shares are sold to other investors.

## China's Top Banks

The following chart breaks down China's banks by type, including the number of institutions, their total assets, and total loans:<sup>36</sup>

China's Top Banks, by type					
		Total	Assets	Total	Loans
	# of banks	Billions RMB amt	% of total	Billions RMB amt	% of total
Big 4 comm. banks	4	20,552.2	53.5%	10,810.2	50.5%
Other national comm. Banks	13	5,897.5	15.3	3,530.6	16.5
City comm. banks	115	2,059.1	5.4	1,112.6	5.2
Urban credit cooperatives	681	205.1	0.5	114.8	0.5
Rural credit cooperatives	32,876	3,175.4	8.3	1,900.9	8.9
Foreign invested banks	211	635.3	1.6	330.1	1.6
Others	149	5,923.5	15.4	3,603.7	16.8

<sup>36</sup> From ICBC prospectus 2006

China's top ten banks (by assets) are: <sup>37</sup>

China's Top Ten Banks			
Bank	Assets	Pre-tax profit	Non-performing loans
Ranked by assets at end of 2005, RMB Billions			
ICBC	6,454	59.35	4.69%
Agricultural Bank of China	4,771	7.88	26.17%
Bank of China	4,740	53.81	4.90%
China Construction Bank	4,586	55.36	3.84%
Bank of Communications	1,423	12.84	2.80%
China Merchants Bank	734	6.63	2.58%
China Citic Bank	612	5.37	4.11%
Shanghai Pudong Development Bank	574	4.34	1.97%
China Minsheng	557	4.24	1.28%
Industrial Bank	474	3.53	2.33%

This report covers the top five Chinese banks in terms of assets, China's "Big Four" banks, and China's main policy banks.

## Regulation and supervision of the banking sector

New regulatory bodies have been established to strengthen and supervise the Chinese banking sector. The most important regulators are the China Banking Regulatory Commission and the People's Bank of China.

### China Banking Regulatory Commission

The CBRC was established in 2003 and is under the authority of the State Council. It is currently run headed by Mr. Liu Mingkang (刘明康), formerly the president of Bank of China. According to the CBRC,<sup>38</sup> its main objectives are to:

- Formulate supervisory rules and regulations governing the banking institutions;

<sup>37</sup> "Banks: Domestic banks," Country Finance Subscription, Economist Intelligence Unit, August 21, 2006

- Authorize the establishment, changes, termination and business scope of the banking institutions;
- Conduct on-site examination and off-site surveillance of the banking institutions, and take enforcement actions against rule-breaking behaviours;
- Conduct fit-and-proper tests on the senior managerial personnel of the banking institutions;
- Compile and publish statistics and reports of the overall banking industry in accordance with relevant regulations;
- Provide proposals on the resolution of problem deposit-taking institutions in consultation with relevant regulatory authorities;
- Responsible for the administration of the supervisory boards of the major State-owned banking institutions

*In 2004 the CBRC issued a notice to banks to stop lending to projects that are out of compliance with relevant laws, including those laws related to environmental protection, city construction and land management.*

One of the most important steps the CBRC has made since its founding is the establishment of a new set of loan classification guidelines which all banks must follow. Today, instead of classifying and tracking loans based on characteristics such as maturity (the length of loans), banks must classify them as Normal, Special Mention, Sub-standards, Doubtful and Loss Loans, and make adequate provisions based on the risk profile of their portfolios.

The CBRC's current priorities are to strengthen Chinese banks by reducing their nonperforming loan ratios and ensuring the banks meet international standards, such as WTO obligations, anti-money laundering laws, and the new Basel 2 Capital Accords.<sup>39</sup> In addition, the CBRC will be streamlining and modernizing various Chinese banking regulations.<sup>40</sup>

The CBRC has also taken some steps to encourage banks to lend in line with social priorities. For example, in 2004 the CBRC, in response to the government, issued a notice to banks (including the CDB and the Big Four) to stop lending to projects that are out of compliance with relevant laws, including those laws related to environmental protection, city construction and land management.

The notice particularly required banks to focus on "key construction projects in relation to steel, electrolytic aluminum, cement, government office buildings and training facilities, urban express railways, golf courses, conference or exhibition halls, logistic centers, large shopping malls, urban public facilities, as well as all the new projects under construction and preparation in 2004" and "ordered banks to stop lending to new projects in the sectors of steel, aluminum and cement scheduled for construction [in 2004] without the approval from the State Council."<sup>41</sup> Later that year, CBRC Chairman Mr. Liu also called on banks to offer more loans to investment projects that support education, science, health-care, and environmental protection.<sup>42</sup>

*The CRBC has called on banks to offer more loans to investment projects that support education, science, health-care, and environmental protection*

38 China Banking Regulatory Commission website (English version):

[http://www.cbrc.gov.cn/mod\\_en00/jsp/en001000.jsp](http://www.cbrc.gov.cn/mod_en00/jsp/en001000.jsp)

39 For more information on Basel 2, see BankTrack's Basel 2 fact sheet, [www.banktrack.org/?show=103&visitor=1](http://www.banktrack.org/?show=103&visitor=1)

40 Hansakul, Syetarn. "China's financial sector: Institutional framework and main challenges," Deutsche Bank Research, 9 January 2004.

41 "The CBRC Sets to Launch A Scrutiny of Loans to Fixed Asset Investment Projects Under Construction or Preparation," CBRC news release, 31 May 2004 (at [http://www.cbrc.gov.cn/mod\\_en00/jsp/en004002.jsp?infoID=626&type=1](http://www.cbrc.gov.cn/mod_en00/jsp/en004002.jsp?infoID=626&type=1))

42 "Strengthening Loan Risk Management and Building up the Safety and Soundness of Banking Sector In A Bid to Implement the Macro-economic Control

*In February 2007, Xinhua reported that the Shanghai Division of the China Banking Regulatory Commission was soliciting comments on a draft document, "Shanghai Banking guidance to financial institutions on corporate social responsibility."*

More recently (2006), the Chairman Liu held a meeting of leading Chinese bank executives, and warned them to pay attention to credit risks, particularly in four areas:

- real estate mortgages,
- land reserve loans,
- local government package loans and *cross-border project loans*, and
- *lending to the enterprises with high pollution and high consumption of energy and resources* (emphasis added)<sup>43</sup>

Finally, in February 2007, Xinhua reported that the Shanghai Division of the China Banking Regulatory Commission was soliciting comments on a draft document, "Shanghai Banking guidance to financial institutions on corporate social responsibility." This is likely the first such corporate social responsibility guidance to be issued in the Chinese market, which would address a bank's "shareholders, employees, financial consumers, communities, and other stakeholders, and social development and environmental protection."<sup>44</sup>

## People's Bank of China (PBOC)

At one time the People's Bank of China (中国人民银行) made direct loans to clients. But with the introduction of economic reforms (in particular the 1995 People's Bank of China Law), the commercial banking function of the People's Bank of China (PBOC) was split off. The PBOC then began to focus exclusively on duties of a central bank.<sup>45</sup> Today, it performs typical central bank functions such as printing currency, controlling the money supply, regulating financial institutions, and serving as the government's treasury.<sup>46</sup> It has responsibility for formulating and implementing monetary policy (adjusting interest rates in order to tighten or stimulate the economy), and setting reserve requirements (the amount of money a bank has to hold in reserve versus their deposits made).

The bank was restructured in 1998 when, in a move to curb the influence of local and provincial officials on the PBOC's policy decisions, all local and provincial branches were shut down and replaced by nine regional branches, whose boundaries did not correspond with local administrative borders. PBOC reports to the State Council, and its current Governor is Mr. Zhou Xiaochuan (周小川).

The PBOC can also authorize, suspend or terminate the operations of individual banks; and regulate the total amount of loans banks make. It attempts to guide bank lending through "financial macro control" efforts. For example, for the past few years it, along with the CBRC, has encouraged commercial banks to limit their total lending to overheating

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Policies: Chairman LIU Mingkang's remarks at the CBRC's video conference," CBRC news release, 3 June 2004 (at

[http://www.cbrc.gov.cn/mod\\_en00/jsp/en004002.jsp?infoID=694&type=1](http://www.cbrc.gov.cn/mod_en00/jsp/en004002.jsp?infoID=694&type=1))

43 "The CBRC calls for paying close attention to the risks facing the banking sector," CBRC news release, 14 July 2006.

[http://www.cbrc.gov.cn/mod\\_en00/jsp/en004002.jsp?infoID=2631&type=1](http://www.cbrc.gov.cn/mod_en00/jsp/en004002.jsp?infoID=2631&type=1)

44 [http://news.xinhuanet.com/fortune/2007-02/02/content\\_5687996.htm](http://news.xinhuanet.com/fortune/2007-02/02/content_5687996.htm) 2 February 2007

45 <http://www.PBOC.gov.cn/english/renhangjianjie/history.asp> 7/30/2006

*The PBOC cooperated with the State Development and Reform commission in 2004 to stop certain projects, and also reminded commercial banks that they should finance those clients that comply with environmental laws*

*The PBOC-SEPA credit database will include company environmental information; this will allow commercial banks to investigate borrowers' environmental records before extending loans.*

sectors, including steel, aluminum and cement, while issuing guidance for real estate lending. The PBOC has also boosted credit support for under-developed sectors such as agriculture, small and medium enterprises, and education. This strategy of providing "window guidance" follows the principle of "differentiated treatment which ensures support to certain sectors while controlling expansion of some other sectors." In the same vein, the PBOC cooperated with the State Development and Reform commission in 2004 to stop certain projects, and also reminded commercial banks that they should finance those clients that comply with environmental laws.<sup>47</sup>

The PBOC has also embarked on an ambitious initiative to create a credit database to help banks make better loans by providing more information on prospective clients. By the end of 2006 the database reportedly included over 11 million credit records, with 44 percent of those records representing current commercial banking clients. In 2007, PBOC's deputy governor Su Ning announced that the PBOC was working with State Environmental Protection Administration to enhance this database with company environmental information; this will allow commercial banks to investigate borrowers' environmental records before extending loans. Press reports suggest that there may even be a new requirement to require such environmental checks to be made before offering loans.<sup>48</sup> The database is expected to be active by 1 April 2007.<sup>49</sup>

## The future of finance and environment

As described above, Chinese banking regulatory authorities have taken some steps to explicitly encourage bank lending to further national environmental policies. Regulators have also introduced other laws that may have the secondary/ unintended effect of encouraging more financing of environmentally friendly enterprises. For example, on 28 October 2004, the PBOC abolished the upper limit on interest rates for commercial loans. Previously, the PBOC had dictated how much interest could be charged for loans, rather than letting banks set interest rates based on risk.<sup>50</sup> Using risk-based interest rates could make financing for new and risky markets more appealing. This could lead to more financing for innovative technologies in energy conservation, pollution reduction, and alternative energy.

Most banks, including joint stock banks, still are influenced by policy preferences from Beijing, which can create mixed results because of China's conflicting policies aimed at economic growth and environmental protection. However, this situation may improve as Beijing puts greater emphasis on environmental protection. The Eleventh Five-Year Plan

46 <http://www.PBOC.gov.cn/english/renhangjianjie/responsibilities.asp> 7/30/2006

47 "Improve Financial Macro Control to Promote Sustainable, Rapid, Coordinated and Healthy Economic Development: PBOC's Official Answers Questions Regarding Financial Macro Control," PBOC news release, 9 August 2004 (at <http://www.PBOC.gov.cn/english/detail.asp?col=6400&ID=410>) and "Highly focusing on economic performance and continuing to pursue sound monetary policy: PBOC branch presidents meet to review economic and financial developments and discuss work plans for the second half of the year," PBOC news release, 1 August 2005 (at <http://www.PBOC.gov.cn/english/detail.asp?col=6400&ID=549>)

48 Xin, Zhiming, "PBOC launches green scheme," China Daily, 10 January 2007.

49 "No bank loans for polluting firms," China Daily, 23 February 2007.

50 <http://www.PBOC.gov.cn/english/renhangjianjie/history.asp> 7/30/2006

*As SEPA gains greater political clout and patronage, better environmental enforcement may make environmentally-risky projects increasingly unappealing and unprofitable to finance*

issued in 2006 by the National People's Congress identified environmental protection as a national priority, thus giving political preference to environmentally friendly projects. This policy preference may translate into financing guidance by banking regulators.

In addition, as SEPA becomes increasingly more vocal and influential, it may directly impact projects, as well as the bankers involved. For example, a mandate from the State Environmental Protection Administration (SEPA) in December 2004 brought construction on approximately thirty big projects to a halt; this may have affected the banks which extended loans to them. Also, it is estimated that China currently enforces only about 10 percent of its environmental regulations effectively. As SEPA gains greater political clout and patronage (Premier Wen Jiabao has repeatedly praised its efforts), better environmental enforcement may make environmentally-risky projects increasingly unappealing and unprofitable to finance. Indeed, in a press conference announcing PBOC's collaboration with SEPA to include environmental data in its credit database, PBOC Credit Management Bureau Director Dai Genyou stated, "If banks lend money to enterprises that are later ordered to close down for violating environmental rules, banks will suffer losses."<sup>51</sup>

However, it should be noted that even though banks may soon integrate more environmental due diligence (research) into their financing procedures, most Chinese banks currently do not use on high environmental financing standards to decide whether to accept or decline transactions. Currently, it seems that Chinese banks, especially commercial banks, consider philanthropy (donations and volunteering) as the basis of their ecological responsibility, rather than the environmental impact of their financing operations.

The following section, "Controversial Cases," illustrates why Chinese banks should pay more attention to the environmental impacts and risks of their lending activities.

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<sup>51</sup> Xin, Zhiming, "PBOC launches green scheme," China Daily, 10 January 2007.



## Controversial cases

The following cases are examples of environmentally sensitive transactions financed by Chinese banks. Some of these transactions are almost solely financed by Chinese banks, while others have the participation of international banks as well.

### South-to-North Water Diversion project, China

The controversial RMB 500 billion South-to-North Water Diversion project in China aims to divert water from the Yangtze River system to the arid North. (Map of scheme below; image from WaterTechnology.com)

Industrial pollution is a key concern, as is resettlement. According to official government estimates, 400,000 people will need to be relocated for this project.

Environmentalists fear that irreparable harm may be done to the ecology and to river-dependent communities the Yangtze's hydrology is dramatically altered. In addition, archaeologists worry that government funds meant to protect cultural relics will only be enough to cover 45 of the 788 sites threatened by the project.<sup>52</sup>



### Financing by Chinese banks

In 2005, a RMB 21.3 billion loan was syndicated for the construction of South-to-North Water Diversion project in China. Members of the lending syndicate include:

- |  |                    |
|--|--------------------|
| • <b>China Development Bank</b>                  | (RMB 21.3 billion) |
| • <b>China Construction Bank</b>                 | (RMB 8.5 billion)  |
| • <b>Bank of China</b>                           | (RMB 6 billion)    |
| • <b>Agricultural Bank of China</b>              | (RMB 6 billion)    |
| • <b>Industrial and Commercial Bank of China</b> | (RMB 6 billion)    |
| • <b>Shanghai Pudong Development Bank</b>        | (RMB 500 million)  |
| • <b>CITIC Industrial Bank</b>                   | (RMB 500 million)  |

<sup>52</sup> Harris, Lucian, "China launches belated archaeological rescue," The Art Newspaper, 19 January 2006 at <http://www.theartnewspaper.com/article01.asp?id=139>



## **China International Marine Container, Suriname<sup>53</sup>**

The Saramaka are a maroon people (descendants of escaped African slaves) in Suriname who enjoy treaty rights entitling them to land and autonomy, similar to those rights granted to Indigenous Peoples under international law. In the 1960s, the construction of the Afobaka dam along the Suriname River flooded Saramaka territory and forced 6,000 persons to be relocated, putting significant pressure on the Saramaka people's remaining lands and resources.

In 1997, the Saramaka discovered that a Chinese logging company calling itself Tacoba had arrived in the area and were beginning operations. In Suriname, a company must obtain special permission from the parliament if its concession area is more than 150,000 hectares. When the community challenged Tacoba about the illegality of its operations, the company responded that it had governmental permission, and any attempt to interfere with or challenge its operations would be punished by imprisonment.

After years of investigation, NGOs discovered that Tacoba is a wholly owned subsidiary of China International Marine Container (CIMC), and that the company was cutting down hardwood for shipping containers. The Saramaka complain that Tacoba's operations have damaged their forest and water resources, reduced their game, and destroyed farms.

CIMC also sources wood from Cambodia, a country where illegal logging is a known problem.

### **Financing by Chinese banks**

According to its annual report, CIMC is financed by:

- **Export-Import Bank of China**
- **Bank of Communications**
- **China Merchants Bank**
- **China Construction Bank**
- **Bank of China**
- **Nanyang Commercial Bank**

It also is financed by some international banks such as Citibank, HSBC, and Standard Chartered.

**For more information, see: [www.forestpeoples.org](http://www.forestpeoples.org)**

## **China National Machinery & Equipment Import-Export Corp., China**

China National Machinery & Equipment Import-Export Corporation (CMEC) is one of China's leading construction companies, and is particularly active in overseas investment projects. Domestically, it was one of the companies that helped construct the Three Gorges dam.

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<sup>53</sup> "Pleadings, Motions and Evidence of the Victim's Representatives in the Case of 12 Saramaka Clans ( Case 12.338) Against the Republic of Suriname," a brief submitted to the Inter-American Court of Human Rights, 03 November 2006 on file with author. Also from McKay, Fergus. "Logging and Tribal Rights in Suriname," Forest Peoples' Programme at [http://www.forestpeoples.org/documents/s\\_c\\_america/suriname\\_logging\\_and\\_tribal\\_rights\\_dec01.shtml](http://www.forestpeoples.org/documents/s_c_america/suriname_logging_and_tribal_rights_dec01.shtml)

### Kiani Kertas pulp mill (Indonesia) <sup>54</sup>

Indonesian and international NGOs have long campaigned to protect the rights of indigenous peoples who have been impacted by the Sumalindo tree plantation in Indonesia. The Sumalindo plantation is located in territory of the Menamang people, and was established after the Menamang's ancestral forests were clear-cut without their consent. When community leaders attempted to meet with the plantation owners to discuss the damage, they instead were met with 200 military troops who appeared for "war games." The troops took the leaders prisoner, tortured them, and threatened to kill them if they told their story.

The proposed Kiani Kertas chip and pulp mill will source its timber from the Sumalindo plantation. In addition, NGOs believe that in order to supply the mill as planned with 525 tons of wood per year, owner United Fiber Systems (UFS) will have to source a significant amount of its timber from illegal sources. Moreover, the mill will likely impact the livelihoods of some 1,200 fishermen. As a result, NGOs have mounted an international campaign focusing on financiers of the mill. The campaign has achieved several victories, including forcing Deutsche Bank to drop UFS as a client (see image, above), getting UFS to withdraw an application for World Bank (Multilateral Investment Guarantee Agency) financing. NGOs also succeeded in pressuring a Dutch company to pull out of the mill.



However, UFS sidestepped Western financiers when it signed a deal with China National Machinery & Equipment Export-Import Corporation (CMEC). CMEC provided a loan of USD 690.4 million, about 80% of the mill's costs, and also won the right to construct the project.<sup>55</sup>

**For more information, see: [www.walhi.or.id](http://www.walhi.or.id)**

### Belinga iron ore mine (Gabon)

The Central African rainforest, which covers Cameroon, the Central African Republic, Congo Brazzaville, the Democratic Republic of Congo, Equatorial Guinea and Gabon, is the second largest rainforest in the world. According to Greenpeace, in as little as five to ten years Africa's

<sup>54</sup> From World Rainforest Movement January 2006 bulletin at <http://www.wrm.org.uy/bulletin/102/Asia.html#Indonesia> and "100 Groups Oppose European Involvement In Destructive Pulpmill Projects In Indonesian Borneo," Friends Of The Earth Indonesia press release 17 January 2006 at [http://www.foe.org.au/download/Indonesian\\_pulp\\_mill\\_Jan\\_2006.doc](http://www.foe.org.au/download/Indonesian_pulp_mill_Jan_2006.doc) and "IFC, MIGA, Merrill Lynch and ANZ Bank urged to reject United Fiber Systems and Kiani Kertas projects," Friends of the Earth Indonesia press release 16 September 2006 at [http://www.eng.walhi.or.id/kampanye/psda/060915\\_laws-anzbank\\_mr/](http://www.eng.walhi.or.id/kampanye/psda/060915_laws-anzbank_mr/)  
<sup>55</sup> Gulzar, Rosana. "Tough Fibre," The Edge Singapore 11 July 2005

apes, the gorillas, chimpanzees and bonobos, could disappear with the region's last undisturbed forest areas.<sup>56</sup>

In 2005, 70 conservation experts (including researchers, NGOs, governmental representatives and conservation managers) released a Regional Action Plan for the Conservation of Chimpanzees and Gorillas in Western Equatorial Africa. The Action Plan represents a consensus of the leading experts in this field, and it identifies important populations and habitats that were critical to protect for the survival of wild chimpanzees and gorillas in Western Equatorial Africa. One of these areas was the Belinga-Djoua (Gabon) which was classified as a "Priority Important Area." According to the Plan, "this site in North-East Gabon is important for ape conservation but threats will increase very significantly in the near future as iron reserves at Belinga are mined and a railway built to export the ore to Libreville."<sup>57</sup>

However, Gabon had difficulty identifying ready investors for the mine; because of the lack of infrastructure, the prospective developers had to build roads, 200 kilometers of railways, electricity resources, ports, etc. in order to extract the ore. In 2006, Gabon found its developer: CMEC won a USD 3 billion contract to develop the ore mine, as well as a port, rail system, and two dams. At the end, a Gabonese government minister said that there was "no contest" between CMEC's bid and the others, saying, "The Chinese state offered to guarantee the project financially and promised to buy the entirety of Belinga's production."<sup>58</sup>

### Financing by Chinese banks

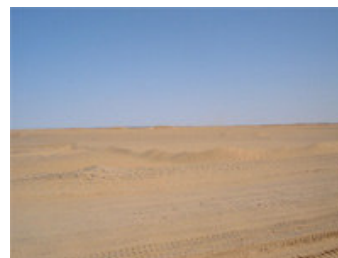
CMEC is financed by the following Chinese banks

- In 2002, CMEC was granted a RMB 8 billion line of credit from the **Bank of China**
- In 2003, the **Export-Import Bank of China** offered the company a 3 year RMB 8.28 trillion line of credit.

### Merowe Dam Project, Sudan

The Merowe Dam which is currently being built on the Nile in Sudan is one of the largest hydropower projects in Africa. The dam will create a reservoir with a length of 200 kilometers. With a capacity of 1250 megawatts, the project's power plant will roughly double power generation in Sudan. The project is being developed by companies from China (China International Water and Electric Company and China National Water Resources and Hydropower Engineering Corporation), Sudan, France, Germany, and Switzerland. It is expected to be completed in 2009.

The Merowe Dam Project will displace 50,000 people from the fertile Nile Valley to locations in the arid Nubian Desert



<sup>56</sup> Map of African Forests of Great Apes, Greenpeace website at <http://www.greenpeace.org/international/campaigns/forests/africa/map-of-african-forest-of-the-g>

<sup>57</sup> Tutin, C. et al. Regional Action Plan for the Conservation of Chimpanzees and Gorillas in Western Equatorial Africa, Conservation International, 2005 at [http://www.cbfp.org/docs\\_gb/great\\_apes\\_act\\_plan\\_english.pdf](http://www.cbfp.org/docs_gb/great_apes_act_plan_english.pdf)

<sup>58</sup> "China given monopoly to work Gabon's untapped iron ore resources," Agence France Presse, 2 June 2006.

(see photo of resettlement site; courtesy of International Rivers Network). The affected people request to be resettled at sites of their own choice along the new reservoir. The project authorities have responded with repression to these legitimate demands. In April 2006, militias of the project authorities killed three people and wounded 47 when affected villagers gathered peacefully in a school compound.

The project will have serious environmental impacts. According to a study by the Swiss Federal Institute of Aquatic Science and Technology, the dam and the strongly fluctuating water levels will make it difficult for farmers to fish and fetch water, will destroy spawning areas for fish and other organisms, and will create serious risks of waterborne diseases. In violation of Sudanese law, the country's Ministry of Environment did not have the chance to review and certify the project's Environmental Impact Assessment before construction started.

### Financing by Chinese banks

The dam is financed mainly by:

- **China Export Import Bank**, the main foreign financier of the project, has contributed of USD 387 million.

Non-governmental organizations informed the Bank about the problems of the Merowe Dam Project at several instances. In a meeting with International Rivers Network in December 2006, the President of China Exim Bank indicated that he was aware of the problems of the project, and would send a team to Sudan to learn more about the situation. By the time this report went to print, the Bank had not announced any measures to remedy the problems of the project.

For more information see: [www.irn.org](http://www.irn.org)

## Ramu Nickel Mine, Papua New Guinea

The Ramu Nickel Mine is a proposed nickel laterite mine in the Madang Province of Papua New Guinea, a region that is one of the main centres of tourism in the country and home to one of the most significant tuna fishing grounds in the Bismark Sea. When first proposed, the PNG Fisheries authority concluded that the project was 'economically, environmentally and socially unsustainable', and numerous independent studies discredited the proposal to use the controversial practice of submarine tailings disposal in the coastal zone whose pristine waters provided the basis for thriving tourism and tuna fishing industries. The mine is also upstream of the Ramu River, which is water resource relied upon by tens of thousands of indigenous people for drinking, transport and food production, many who are agriculturalists living subsistence livelihood. (See project map, below; from MCC presentation)

Local indigenous owners of land along the coast line petitioned against the proposal to dump the mine's waste in the coastal zone, leading to accusations of human rights abuses including an alleged incident in which their primary spokesperson was kidnapped, ordered to revoke his people's opposition, threatened and bashed at the company's offices. Despite this, large scale local community opposition continues. Communities downstream of the mine have also opposed the project based on the environmental impacts upon water resources, including erosion from the mine site of metal laden sediments that were already visible during mine feasibility testing.



The benefits of the mine to the PNG nation have been further questioned, when last year the mine was granted a tax holiday lasting 10 years, something never granted before to a PNG resource developer.

The mine is currently in construction phase, and has been subject to criticism by PNG government ministers for breaching labour and approval processes requirements. Mining Minister Sam Akoitai says that MCC has somehow overlooked the need to submit, let alone gain approval for, its feasibility study or development proposal, and that despite having commenced construction, it should not be building anything yet. PNG's labour and industrial relations body has also threatened to shut the mine down if labour conditions do not rapidly improve. This followed investigations revealing that workers were being paid just USD 4 a day, with overtime compensated by tins of fish rather than kina, with canteen arrangements "not fit for pigs", and toilet facilities so inadequate and public that employees used nearby bushes instead, out of embarrassment.

### **Ownership of the mine**

The mine is majority owned and operated by Metallurgical Group Corp (known as MCC), which is China's 39th biggest company and the world's 26th biggest contractor, earning USD15 billion in revenue during 2006.

MCC owns 51 per cent of Ramu, after last November selling down 17 per cent each to Chinese nickel houses Jinchuan Group and Jilin Ji'en Nickel Corp. A further 8.56 per cent is owned by the original explorer of the site, Brisbane-based Highlands Pacific Group, 3.94 per cent by the PNG government's Mineral Resources Development Corp and 2.5 per cent by landowner groups. A fully owned subsidiary of MCC, ENFI, is undertaking the preliminary construction of the mine, in Madang province.

### **Financing by Chinese banks**

20% of the project will be financed by the companies, while 80% will be financed by Chinese banks. Chinese banks named as financiers of the Ramu project include:<sup>59</sup>

- **Export-Import Bank of China**
- **China Development Bank**

Reportedly, the mine will also require the development of a 240 MW hydropower project, called Ramu 2. This associated project would be supported with a concessional loan of USD 400 million from the Chinese Development Corporation Initiative, and provided through China ExIm Bank.<sup>60</sup>

**For more information, see: <http://www.mpi.org.au/> or <http://www.minesandcommunities.org>**

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<sup>59</sup> Ramu Mine Set to Roll, The National, 10 April 2006, at <http://www.thenational.com.pg/041006/nation5.htm> and C to Start China Nickel Project at End of 2006, China Metals Weekly, 29 May 2006.

<sup>60</sup> Power for Ramu Mine, Dominic Krau, PNG-Post Courier, 28 September 2006.

## **Dossiers**

## Bank of China 中国银行<sup>61</sup>

### Background

The Bank of China (BOC) is one of the Big Four state-owned commercial banks in China. It is currently the second largest lender in the country after the Industrial and Commercial Bank of China and the largest foreign exchange lender. Its loans total RMB 2,235 billion.

Founded in 1912 under the urging of Sun Yatsen, the bank served as China's central bank, its international exchange bank, and its foreign trade bank until the establishment of the People's Republic of China in 1949. With the founding of the PRC and the subsequent nationalization and consolidation of the banking sector, the Bank of China was merged into the People's Bank of China and operated as the specialized state foreign exchange bank.

*Although other banks now offer foreign exchange services, BOC is still China's leading foreign currency-denominated loan provider and taker among commercial banks, with a market share of about 43%.*

Although the BOC became a full-fledged commercial bank in 1994, thus finalizing its break from the PBOC, the BOC's foreign exchange banking roots are still strong. Although other banks now offer foreign exchange services, BOC is still China's leading foreign currency-denominated loan provider and taker among commercial banks, with a market share of about 43%. Among the Big Four banks, it is the leading provider of trade finance, with a market share of almost 58% (December 31, 2005).

In 2000, it began getting into the investment banking business with the creation of Bank of China International (BOCI). Merrill Lynch and BOCI formed a joint venture, BOC International Investment Managers, in 2004.<sup>62</sup>

### Geographic reach

Despite its pride in its international orientation, business in mainland China still accounts for the bulk of Bank of China's operations. Its assets in mainland China amount to over RMB 3.8 trillion and make up 76.7% of its total assets. Hong Kong and Macau SARs amount to RMB 966 billion and make up 19.5% of its assets, while overseas assets account for the remainder with RMB 189 billion. 2005 operating profits on the mainland totalled RMB 32.8 billion; Hong Kong and Macau SAR RMB 20.4 billion; and other overseas regions RMB 1.9 billion.

Domestically, BOC's lending (both corporate and personal) breaks down as follows:

Northern China	17.9%
Northeastern China	7.3
Eastern China	40.0
Central and southern China	24.7
Western China	10.1

Looking ahead, the BOC has identified "10 Key Regions" and "40 Key Cities" in China. According to the BOC 2006 prospectus:

<sup>61</sup> All information derived from Bank of China's 2004 Annual Report and [www.bank-of-china.com](http://www.bank-of-china.com) unless otherwise stated

<sup>62</sup> "Banks: Domestic banks," Country Finance Subscription, August 21, 2006



*Of all the commercial banks of China, BOC maintains the highest international profile.*

"These regions include the more developed geographic markets in the Yangtze River Delta, Pearl River Delta and Bohai Rim Economic Zone, and selected major capital cities of certain inland provinces. As of the end of 2005, these 10 Key Regions accounted for approximately 61.9% of our total domestic deposits and approximately 61.8% of our total domestic loans based on our operating data. As of the end of 2005, the 40 Key Cities accounted for approximately 58.3% of our total domestic deposits and approximately 64.6% of our total domestic loans based on our operating data."

Of all the commercial banks of China, BOC maintains the highest international profile. About 20% of its loans originate from outside mainland China.<sup>63</sup> Its first overseas branch was established in London in 1929, since then Bank of China has opened branches and established networks in 27 countries and regions including Europe, North America, South America, and the Asia-Pacific region.<sup>64</sup> Since 1995, the Bank of China also operates as the currency issuing bank of both Hong Kong and Macau Special Administrative Regions. In 2004, Bank of China became the exclusive banking partner of the 2008 Beijing Olympics. On the Fortune Global 500, the Bank of China ranks 255<sup>th</sup> overall and 31<sup>st</sup> in the banking industry.<sup>65</sup>

## Sectoral exposure

Corporate lending accounts for about 79% of BOC's total lending. Its 2005 loan industry-distribution is as follows:

2005 Loan Industry Distribution		
Industry	Balance (mil RMB)	Percentage
Manufacturing	531,191	23.77
Commerce and services	301,863	13.51
Real estate	190,297	8.51
Energy, mining, agriculture	230,854	10.33
Transportation	193,428	8.65
Public utilities	91,924	4.11
Construction	36,050	1.61
Financial services	96,245	4.31
Residential mortgages	413,007	18.48
Credit card	6,785	0.3

<sup>63</sup> Bank of China's Global Offering Document (prospectus), 2006.

<sup>64</sup> Including Australia, Bahrain, Brazil, Canada, Cayman Islands, France, Germany, Hungary, Indonesia, Italy, Japan, Kazakhstan, Luxembourg, Macau, Hong Kong, Malaysia, Panama, the Philippines, Russia, Singapore, South Africa, South Korea, Thailand, the United Kingdom, the United States, Vietnam and Zambia

<sup>65</sup>

<http://money.cnn.com/magazines/fortune/global500/2006/snapshots/164.html>  
8/30/2006



Others	143,412	6.42
<b>Total</b>	<b>2,235,046</b>	<b>100</b>

Manufacturing includes metals, textiles, petroleum and chemicals, electronics, and machinery.

BOC does not disclose the names of its top ten clients, but it does indicate the business sector of these clients. The bank's top clients represent 3.6% of the bank's total loans.

<b>Top ten clients</b>			
<b>Client</b>	<b>Industry</b>	<b>RMB millions principal amt</b>	<b>% of loans</b>
A	Commerce and services	15,439	0.7%
B	Energy, mining and agriculture	10,462	0.5
C	Transportation and logistics	9,056	0.4
D	Commerce and services	8,440	0.4
E	Energy, mining and agriculture	7,770	0.3
F	Transportation logistics	7,542	0.3
G	Transportation logistics	7,346	0.3
H	Commerce and services	6,850	0.3
I	Energy, mining and agriculture	5,382	0.2
J	Transportation logistics	5,155	0.2
<b>Total</b>		<b>83,442</b>	<b>3.6%</b>

Recent transactions include:

- Participating in a HKD 2.6 billion syndicated loan in 2006 to China Overseas Land & Investment, a subsidiary of China State Construction Engineering Corporation, the largest construction conglomerate in China. The banks in the syndicate include HSBC, Bank of China, Hang Seng Bank and Industrial and Commercial Bank of China (HKD 300 million each), China Construction Bank contributed (HKD 270 million), Bank of East Asia, Calyon, Citic Ka Wah Bank and DBS (HKD 200million) and Standard Chartered (HKD 130 million).<sup>66</sup>
- Mandated arranger for a HKD 1.4 billion syndicated loan to Sino-French Water. Other arrangers include BNP Paribas, Calyon and Industrial and Commercial Bank of China.<sup>67</sup> This company is a joint venture of France-based Suez and Hong Kong-based New World Group, and is the

<sup>66</sup> "China Overseas Land & Investment; contracts for loan facility," Euroweek, 13 October 2006

<sup>67</sup> "Sino-French Water; loan facility," Euroweek, 29 September 2006

largest provider of water and wastewater services in China (2006)<sup>68</sup>

- Mandated arranger for a USD 350 million syndicated loan to Nine Dragons for future expansion. Nine Dragons is China's largest containerboard manufacturer, and commands a 17 percent market share in the Chinese pulp and paper industry (2006)<sup>69</sup>

## Reforms and restructuring

As mentioned, the Bank of China was established as a state-owned commercial bank independent of the People's Bank of China. In 2003, the State Council decided to reform it into a joint-stock bank and sell a portion of the shares to private investors. To prepare itself for foreign competition expected after WTO entry, the reform process at BOC focused on improving corporate governance, strengthening risk management and internal control mechanisms, integrating management and business procedures, and speeding along product and service innovation. To aid the bank in its restructuring as dictated by the 2003 Joint Stock Reform Plan, the Chinese government infused the Bank of China with RMB 186,390 million in the form of a USD 19,601 million capital injection and 7 million ounces of gold.<sup>70</sup> In June 2004, the bank sold non-performing loans valued at RMB 148,540 million to state-owned Cinda Asset Management Company and sold policy-related assets valued at RMB 18.1 billion to the People's Bank of China.<sup>71</sup> Central Huijin Investment Co, the investment arm of the State Council, owns the majority of Bank of China's shares.

*In 2005, the Bank of China has partnered with four foreign strategic investors to help its business development – the Royal Bank of Scotland (which now owns about 8.6%), Switzerland's UBS (which owns 1.3%), Singapore's Temasek Holdings and the Asian Development Bank (0.2%).*

In 2005, the Bank of China has partnered with four foreign strategic investors to help its business development – the Royal Bank of Scotland (which now owns about 8.6%), Switzerland's UBS (which owns 1.3%), Singapore's Temasek Holdings and the Asian Development Bank (0.2%). On June 1, 2006, the bank listed the fourth largest initial public offering (IPO) ever on the Hong Kong Stock Exchange raising approximately USD 9.7 billion.<sup>72</sup> In July 2006, it raised RMB 20 billion in mainland China's largest domestic IPO on the Shanghai stock exchange. Bank of China is the 8<sup>th</sup> largest bank in the world in term of market capitalization value (the total value of its shares).

## Governance

While it has come a long way in the past ten years, Bank of China still does not reach international standards of corporate governance. The 2003 capital infusion from the Chinese government to aid in its financial restructuring is essentially another bailout of a state bank. According to the bank, non-performing loans at the end of 2005 totalled 4.6%. Three

68 "Beginning of the Sanya (China) water management concession," SUEZ news release, 5 January 2004 at <http://www.suez.com/upload/up1097.pdf>

69 Ho, Prudence and Wong, Ka-Chun, "Nine Dragons Chooses Boc To Arrange US\$350m Term Loan," The Standard, 26 August 2006

70 "Bank of China Receives Green Light for Overseas Listing". World Markets Analysis. 1/9/2006

71 "Cinda Beats Deadline for Clearing Debt". China Daily. 12/29/2005

72 "Bank of China IPO Grows to World No.4". SinoCast China Financial Watch. 6/9/2006

former loan officials have been brought to trial for colluding with a land developer to defraud the bank of RMB 750 million.<sup>73</sup> Foreign and domestic investors continue to call for greater transparency especially about its loan policies.

A corporate governance feature at Bank of China is the General Meeting of Shareholders, where shareholders vote on significant policy issues at the bank. Both the Board of Directors and Board of Supervisors are directly responsible for what occurs at the General Meeting of Shareholders. Central SAFE Investment Co. (Huijin Investment), a government investment arm, holds the controlling share.

## **Board of Directors**

The Board of Directors serves as BOC's main decision-making body and oversees Senior Management. Its members are elected at the General Meeting of Shareholders for three-year terms. Its chairman and vice chairman are elected by the Board of Directors. In 2005, the board has passed resolutions on the bank's IPO plans, profit distribution plans, introduction of strategic investors, and appointment of auditors. The Board of Directors is also split into 5 committees, which are delegated different responsibilities.

- The Risk Policy Committee is responsible for risk assessment and management as well as credit policies and legal compliance.
- The Connected Transaction Control Committee is responsible for the procedural, legal and policy-related aspects of related party transactions (when a financing transaction is somehow connected to the business or financial interests of someone associated with the bank).
- The Audit Committee is responsible for financial disclosure, external and internal auditing, and overseeing internal controls.
- The Personnel and Remuneration Committee is responsible for all human resource policies including the evaluation and nomination of directors and senior management. The Strategic Development Committee is responsible for strategic development plans, annual budgets, capital allocation, mergers and acquisitions, key investments, and internal restructuring.

## **Board of Supervisors**

The Board of Supervisors is the bank's supervisory organ responsible to shareholders. It supervises financial activities, the activities of the Board of Directors and the senior management. The board is composed of five members; three are nominated by Central SAFE Investments, the controlling shareholder and two are elected by employees.

## **Senior Management**

Senior Management is the executive body of BOC responsible to the Board of Directors. It includes the President, Deputy Presidents and Assistant Presidents, who assist the President in managing business activities.

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<sup>73</sup> Macartney, Jane. "Bank of China Shares Soar on First Trading Day in Shanghai". The Times (London). 7/6/2006

## Agreements with strategic investors<sup>74</sup>

According to the BOC, its strategic investors are “expected to contribute their technologies and expertise in human resource management and training and other infrastructure development areas.”

RBS is the Bank of China’s largest foreign strategic partner. In 2005, Bank of China entered into a Master Agreement with RBS in which the two banks agreed to cooperate exclusively with each other (within China) in the following business areas: credit cards; wealth management; corporate banking in shipping and aircraft finance, debt capital markets, and project and structured finance; and general insurance.

Implementation of the Master Agreement is overseen by a Steering Committee comprised of four BOC staff, and four RBS staff, and chaired by Mr. Li Lihui (BOC) and Sir Frederick Goodwin (RBS).

According to BOC, under the Master Cooperation Agreement, “RBS Group will, upon [BOC’s] request, share with [BOC] its skills, experience and know-how relating to certain business areas, risk management, financial management and operational support.” Working teams have been established, including one on employee training. In addition, RBS Bank has seconded professionals to take management roles within the BOC, particularly for credit card operations, and to advise BOC on operational risk and credit risk management.

It should be noted that RBS is a signatory to the Equator Principles, but it appears to mostly be at the training, rather than implementation, stage. RBS also is a signatory to the UNEP Financial Initiatives sustainability statement, and a UN Global Compact endorser. However, compared with some of its peers, RBS does not have a very sophisticated environmental risk management approach, with much of its attention focused on greening direct environmental footprint (e.g. electricity and paper consumption) rather than the environmental risks of its transactions.

BOC and UBS AG have agreed to explore cooperation in the fields of securities investment products and services, fixed income products, and investment banking services as the initial areas for business cooperation.

Bank of China and the Asian Development Bank may cooperate on a number of issues as well, including: developing internal controls and corporate governance, anti-money laundering, combating terrorism financing, anti-corruption, environmental impact assessment in banking.

*Working teams have been established between Bank of China and Royal Bank of Scotland, including one on employee training.*

*Bank of China and the Asian Development Bank may cooperate on a number of issues, including environmental impact assessment in banking.*

## Capital raising<sup>75</sup>

The BOC raises money by borrowing from other banks, issuing bonds, and more recently, stock. Since 1984, the BOC has issued 27 bond offerings in the international market. In 2004, it issued RMB14.07 billion subordinated bonds in the PRC (the first RMB-denominated subordinated bond of any Chinese commercial bank).

Aside from RBS and UBS, the Bank of China’s largest corporate investors include:

- The Bank of East Asia, Limited

<sup>74</sup> This section is taken from the Bank of China’s Global Offering Document (prospectus), 2006.

<sup>75</sup> Ibid.

- The Bank of Tokyo-Mitsubishi UFJ, Ltd. (about 0.21%)
- Cheung Kong and Hutchison
- Chow Tai Fook Nominee Limited
- Kuok Group
- Nan Fung Group
- Ping An Insurance (Group) Company of China, Ltd.
- Sun Hung Kai Properties Group
- Sino Land Group
- Woo Kwong Ching, Peter

## Corporate lending and financial services<sup>76</sup>

Commercial banking (e.g. corporate lending, personal lending and treasury operations) comprise the bulk of BOC's operations, accounting for 92.7% of its operating profit in 2005. Its Bank of China International subsidiary offers investment banking services (e.g. underwriting), but investment banking currently only accounts for a small amount (about 0.5%) of operating profits.

*Lending to corporations (including state-owned enterprises and foreign companies) accounts for about half of the bank's total operating profit. BOC also lends money to corporations in foreign currencies, which allows it to participate in international syndicated loans (in which they cooperate with other banks – often international -- to provide a large loan package to a company).*

Lending to corporations (including state-owned enterprises and foreign companies) accounts for about half of the bank's (56.2%) total operating profit. BOC also lends money to corporations in foreign currencies, which allows it to participate in international syndicated loans (in which they cooperate with other banks – often international -- to provide a large loan package to a company). Foreign currency lending has also helped the bank build up strong relationships with companies in the energy, petroleum and chemicals, telecommunications, and transportation sectors.

Although corporate underwriting only accounts for a very small portion of their profits, it is (through Bank of China International - BOCI) one of the most active Chinese banks in this field. They are a leading arranger of US dollar-denominated syndicated loans and bonds for domestic clients, including the PRC, which issues sovereign bonds through BOCI. In fact, in 2005 BOCI was the leading brokerage firm for PRC sovereign bonds measured by volume.

BOCI is also engaged in underwriting corporate equity (stock); at the end of 2004, BOCI led over 27 global equity offering and participated in over 150 initial public offerings. They underwrite both A shares (Chinese company stocks denominated in RMB) and B shares (Chinese company stocks denominated in USD).

## The corporate loan cycle<sup>77</sup>

In 2000 BOC established a "three-in-one" credit approval process for corporate loans, which includes:

- (1) an independent due diligence investigation;
- (2) an assessment of credit applications by an independent credit review committee; and
- (3) final credit extension decision to be made by authorized credit application approvers.

The steps in a corporate loan cycle include:

<sup>76</sup> Ibid.

<sup>77</sup> Ibid

- Relationship managers in corporate banking department interview the potential client and do a preliminary screening based on pre-established criteria. These bankers are part of the loan origination team.
- The potential client submits a credit application with supplementary documents (e.g. audited financial statements, material contracts)
- The credit assessment process begins, looking at typical indicators such as the client's probability of default, purpose of the loan, etc.
- The client is assigned a credit rating, based on a 10-category rating system (the client's rating is updated at least yearly). Clients that are assigned "B" or higher needs to receive additional review and approval by higher authorities (for example, in head office)
- The client's collateral is evaluated by an independent appraiser
- *Independent due diligence teams* from the risk management department (separate from loan origination department) analyze the application, recommend risk mitigation measures, and submit a report to the credit review committee
- *An independent credit review committee* does an assessment, including an analysis of the client's legal compliance, and makes recommendation. Unless the application is considered low risk (e.g. repayment is guaranteed by the government), majority of the committee has to approve the application before it moves to the next step.
- *An independent authorized credit approver* uses a set of uniform standards to approve or deny the application.
- After a loan application is approved, it goes to the risk management office in the head office to ensure that the credit assessment was done in compliance with established processes.
- The credit administration department then disperses the funds after all conditions have been met.
- The loan is monitored by corporate banking, risk management and credit administration departments to ensure client compliance with loan conditions, including reporting requirements. The relationship managers are the key contact points during this phase.

## Environmentally-relevant activities

The most high profile and environmentally sensitive loans made by the Bank of China is its financing of the Three Gorges Dam with a foreign exchange loan. In addition, Bank of China has provided a loan of RMB 6 billion to the South-to-North Water Diversion Project, which will build a series of north-south canals to divert water from southern rivers to the drought-prone North.<sup>78</sup> Like the Three Gorges Dam, this project has also been the subject of much environmental concern and scepticism, and has been accused of being yet another short-sighted attempt to resolve environmental problems without addressing root causes with long-term solutions.

Bank of China also finances many companies with significant environmental and social impacts, including China International Marine

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<sup>78</sup> "CNY48.8bn Loans Made to South-to-North Water Diversion Project". SinoCast. 4/5/2005

Container, China National Machinery & Equipment Import-Export Corporation, Asia Pulp & Paper, China Datang, China National Petroleum Corporation, Sinopec, and sport shoe manufacturer Yue Yuen.

Internationally, Bank of China along with its partner Royal Bank of Scotland has loaned USD 60 million to China Export-Import Bank, which invests in development projects overseas especially in developing nations.<sup>79</sup> Many of these projects, such as mining, hydroelectric dams, and resource extraction, have significant environmental and social impacts.

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<sup>79</sup> "China's EX-IM Bank to Borrow US\$260mln for Trade". Asia Pulse. 2/9/2006

# Industrial and Commercial Bank of China

## 中国工商银行<sup>80</sup>

*The Industrial and Commercial Bank of China is one of the Big Four banks and is the largest of all Chinese commercial banks.*

### Background

The Industrial and Commercial Bank of China is one of the Big Four banks and is the largest of all Chinese commercial banks. It was formally established in 1984, when it assumed many of the functions previously performed by the PBOC, including making loans to state-owned enterprises. It also took over the PBOC's network of local branches.<sup>81</sup> Today, ICBC ranks first domestically in indexes such as total assets, total capital, core capital and operating profit. On the Fortune Global 500, ICBC ranks 199<sup>th</sup> overall and 27<sup>th</sup> in the banking industry.<sup>82</sup> It is the largest lender in all of China.

ICBC assets total RMB 6.14 trillion; deposits total RMB 5.3858 trillion; while loans total RMB 3.1122 trillion. Its operating profits for 2004 – the latest official figure available – total RMB 74.6 billion, which is an increase of over 17% from the previous year. Operating income was RMB 126.7 billion, an increase of 18% from the previous year. Like the rest of the Big Four banks, Industrial and Commercial Bank of China has reduced its non-performing loan ratio to below five percent – 4.58%. Large international banks have an average non-performing loan ratio of one to two percent. Like many Chinese banks, its lower NPL ratio largely is due to selling of NPLs to government-owned asset management companies. In January 2005, the state-owned China Huarong Asset Management Corporation signed an agreement with ICBC to dispose of an undisclosed amount of non-performing loans.<sup>83</sup>

### Geographic reach

ICBC has provincial branches in thirty provinces, autonomous regions, and municipalities throughout the country. It plans to increase lending in the Yangtze River Delta, Pearl River Delta and Bohai Rim regions, as well as central and western China, an area blessed with natural resources.<sup>84</sup> Classifying ICBC's loans based on the branch office where loans have originated, the bank's domestic lending profile is as follows:

Head Office	7.7%
Yangtze River Delta	24.8
Pearl River Delta	14.0
Bohai Rim	17.3
Central China	12.9

<sup>80</sup> All information derived from Industrial and Commercial Bank of China's 2004 Annual Report and [www.icbc.com](http://www.icbc.com) unless otherwise stated

<sup>81</sup> "Banks: Domestic banks," Country Finance Subscription, August 21, 2006

<sup>82</sup> <http://money.cnn.com/magazines/fortune/global500/2006/snapshots/164.html> 8/30/2006

<sup>83</sup> "Chinese Asset Management Firm Changes Direction". Asia Pulse. 1/26/2006

<sup>84</sup> ICBC Global Offering prospectus, 2006



Northeastern China	5.5
Western China	14.6
Overseas	3.2

ICBC has established 100 overseas branches and share-holding banks throughout international financial centers with total foreign currency assets of USD 49.5 million and foreign currency deposits of USD 30.9 million. Aside from Hong Kong and Macau, the bank has branches and representative offices in London, Tokyo, Seoul, Frankfurt, Busan (Korea), Singapore, Luxembourg, New York, Sydney, and Moscow. Its share-controlled subsidiaries are Hong Kong-based ICBC Asia Limited, Industrial and Commercial International Capital Limited, ICBC East Asia, UK-based ICBC London Limited, and Kazakhstan-based ICBC Almaty Limited.

Of these overseas subsidiaries, ICBC Asia is the most profitable and promising with assets of HKD 99.3 billion in 2004 (an increase of 32% over 2003) and 2004 net profit of HKD 760 million (increase of 46%). ICBC Asia is essentially ICBC's Hong Kong-based arm, and was created after ICBC bought 53.23% of Union Bank of Hong Kong in 2000; today it owns over 70% of ICBC Asia. ICBC Asia also bought Belgium-based Fortis Bank Asia in 2004 and changed its name to Belgian Bank.<sup>85</sup>

## Sectoral exposure

The bank has targeted the energy, transportation and telecommunications sectors as key areas in which to expand its market share. Its current corporate lending profile is as follows:

Manufacturing	27.8%
Chemicals	4.6
Machinery	3.3
Iron and steel	2.9
Textiles/ apparel	2.6
Metal processing	2.5
Petroleum processing	2.1
Automobile	1.6
Electronics	1.6
Cement	1.3
Others <sup>86</sup>	5.3
Transportation and logistics	17.2%
Power generation and supplies	13.0%
Retail, wholesale and catering	11.9%
Property development	9.1%
Education, hospitals, NPOs	5.5%

<sup>85</sup> "Banks: Domestic banks," Country Finance Subscription, August 21, 2006

<sup>86</sup> Includes pharmaceutical, food products, pulp and paper, beverage, and tobacco industries.

Construction	3.5%
Others <sup>87</sup>	12.0%

The bank does not disclose its top clients, but does provide some indication of what business the client is engaged in. Their top 10 single clients comprise about 3.3% of the bank's total loans, but they are large loans, representing 30% of the bank's net capital base. Accounting for the client's affiliated or associated entities, ICBC's top 10 group borrowers (entire corporate conglomerates, rather than individual subsidiaries) comprise about 60% of the bank's net capital base.

Top 10 Clients, by single client				
Single client	Industry	RMB millions	% total loans	% of net capital
Borrower A	Manufacturing	21,511	0.62%	5.82%
Borrower B*	Mining	16,030	0.46	4.34
Borrower C	Transportation	15,392	0.45	4.17
Borrower D	Water, enviro, public works	10,049	0.29	2.72
Borrower E	Construction	10,030	0.29	2.71
Borrower F	Water, enviro, public works	9,451	0.27	2.56
Borrower G	Data transmission, computer	8,100	0.24	2.19
Borrower H*	Mining	8,017	0.23	2.17
Borrower I	Water, enviro, public works	7,944	0.23	2.15
Borrower J	Power generation, supplies	7,908	0.23	2.14
<b>Total</b>		<b>114,432</b>	<b>3.31%</b>	<b>30.97%</b>

\*These two borrowers belong to the same conglomerate or group

Top 10 Clients, by group client				
Group client	Industry	RMB millions	% total loans	% of net capital
Group A	Manufacturing	33,813	0.98%	9.15%
Group B	Power generation &	29,571	0.85	8.00

<sup>87</sup> Includes data transmission, computer services and software, mining, and water works, environmental and administration of public facilities industries.

	supplies			
Group C	Power generation & supplies	27,750	0.80	7.51
Group D	Mining	25,506	0.74	6.90
Group E	Power generation & supplies	22,890	0.66	6.19
Group F	Data transmission, computer	20,233	0.58	5.48
Group G	Power generation & supplies	18,577	0.54	5.03
Group H	Power generation & supplies	17,597	0.51	4.76
Group I	Power generation & supplies	15,695	0.45	4.25
Group J	Transportation and logistics	15,237	0.44	4.12
<b>Total</b>		<b>226,869</b>	<b>6.55%</b>	<b>61.39%</b>

Recent ICBC transactions include:

- With ING, providing a term loan for BP Yangzi Petrochemicals Acetyls Company. The company is a joint venture between UK-based BP and a subsidiary of Sinopec, and the loan is comprised of two tranches: a USD 70.49 million tranche, and a (local currency) RMB 246 million tranche (2005)<sup>88</sup>
- Leading a USD 750 million syndicated loan for Hynix-ST semiconductor facility, owned jointly by Hynix Semiconductors and ST Microelectronics in Suzhou, Jiangsu Province (2005)<sup>89</sup>
- A RMB 20-year 1.5 billion loan for the construction of Guangzhao Hydropower Station (2005)<sup>90</sup>
- With China Development Bank, China Construction Bank, Agricultural Bank, Bank of Communications and Bank of China, participating in a syndicated loan of RMB 2.1 billion for Guangxi Huayin Aluminum, a joint venture of Aluminium Corp of China and China Minmentals, to develop bauxite in Guangxi.<sup>91</sup>

The bank also reportedly does business with about 80% of the country's small and medium-sized state-owned enterprises.<sup>92</sup>

88 "BP Yangzi Petrochemicals Acetyls Company; syndicated loans," Euroweek, 16 December 2005

89 "Hynix-ST-Bank-Loan," China Business News On-Line, 28 September 2005

90 "ICBC To Provide Loans Of Cny1.5bn For Guangzhao Hydropower Station," SinoCast China Business Daily News, 31 March 2005

91 "China's Guangxi Huayin Aluminium secures 7.3 bln yuan bank loan – report," AFX – Asia, 26 August 2005

92 "Banks: Domestic banks," Country Finance Subscription, August 21, 2006.

## Reforms and restructuring

As part of governmental effort to strengthen the banking sector, ICBC has received cash infusions and dumped some of its non-performing loans. In 1998, in an effort to help the Big Four banks, the Ministry of Finance issued a RMB 85.0 billion, 30-year special government bond to ICBC, and contributed the proceeds of that bond to ICBC as well. During the next two years, ICBC proceeded to transfer RMB 407.7 billion of non-performing assets to Huarong, and in return, received over RMB 400 billion in cash bonds. In preparation for its IPO, the ICBC in 2005 received US\$15.0 billion from Huijin.<sup>93</sup>

Despite its bigger size and market capitalization, ICBC is not as internationally recognized as the Bank of China. However, its 2006 initial public offering raised a staggering USD 21.2 billion, dwarfing the USD 11.2 billion IPO of Bank of China.<sup>94</sup> In 2005, Goldman Sachs, American Express, and Allianz, a large German insurer invested USD 3.8 billion in ICBC.<sup>95</sup> The combined shares of the three firms comprise a 9% stake in ICBC (Goldman Sachs, Allianz and American Express own 5.75%, 2.25% and 0.45%, respectively). ICBC has also received help from Price Waterhouse Coopers in building its risk management system, which will cover credit risk, market risk, and operational risk.

## Governance

The current corporate governance framework of ICBC was created October 2005 in preparation for ICBC's IPO. Decisions made at the ICBC General Meeting of Shareholders have binding authority. Both the Board of Directors and Board of Supervisors are directly responsible to the decisions made there. Central SAFE Investment Co. (Huijin Investment), a government investment arm, holds the controlling share.

### Board of Directors

The Board of Directors is the decision-making organ of ICBC, responsible for convening the shareholders' general meeting; implementing shareholder resolutions; designing business plans, development strategies and investment plans; formulating the basic management system; appointing senior management; risk management and internal control; managing information disclosure.

The Board of Directors is subdivided into four committees:

- Strategy and Nomination Committee sets operational targets, long-term development strategies, election procedures and standards for directors and members of senior management;
- The Audit Committee inspects accounting policies, financial status and the ICBC's financial report; examines the compliance and effectiveness of significant operational activities;
- Risk Management Committee supervises the control of credit risk, market risk and operational risk by Senior Management;

<sup>93</sup> ICBC Global Offering prospectus, 2006

<sup>94</sup> "Chinese bank ICBC exercises 'greenshoe' option of Hong Kong IPO to raise more money," Associated Press Financial Wire, 7 November 2006.

<sup>95</sup> "China's Biggest Bank Expands Overseas Services". Xinhua Economic News Service. 9/18/2006

## Board of Supervisors

The Board of Supervisors supervises the performance and diligence of the Board of Directors and Senior Management, financial activities, management decisions, risk management and internal control; and is responsible to shareholders.

## Senior Management

Senior management is the executive body of the ICBC and is responsible for organizing operation and management activities. The body reports directly to the Board of Directors.

## Agreements with strategic investors

Goldman Sachs is ICBC's most important overseas strategic investor. Goldman Sachs had developed a historic relationship with ICBC, with its 2003 deal to buy RMB 10 billion of non-performing loans (at a discount) from ICBC – the first time an international bank had directly bought NPLs from a Chinese bank.

As part of the banks' five-year agreement, Goldman Sachs has the right to nominate one director on to the ICBC board; this is Christopher A. Cole. The banks have also formed a joint steering committee chaired by Mr. Yang Kaisheng, the ICBC President; and Mr. Michael Evans, Chairman of GS Asia to oversee the agreement, while joint working groups and a project management office at each bank implements and coordinates. Goldman Sachs is expected to furnish technical assistance and employee training, and help improve corporate and management culture through enhancing risk management and corporate governance. Since Goldman Sachs is an investment bank, it will help ICBC develop non-lending products and services, such as underwriting, mergers & acquisitions, and asset management. In terms of risk management, GS is supposed to provide a range of capacity building services, including credit and environmental related risk management. 50 GS staff will serve as senior advisors on training, and at GS has committed to conduct at least 50 training sessions on "key business areas." At least 50 ICBC senior executives and 50 employees will be sent to GS trainings.

It should be noted that Goldman Sachs recently (2005) adopted an environmental policy. Although it is not the strongest of all international banks, GS is the first pure investment bank to adopt an environmental policy. GS is also in the process of building implementation capacity through doing trainings and hiring two new staff.

Allianz and American Express are ICBC's other two overseas strategic investors. Allianz will help develop the bank's bancassurance products; while American Express is set to help the bank develop its credit card business.

*GS is supposed to provide ICBC with a range of capacity building services, including credit and environmental related risk management.*

## Capital raising

ICBC has historically issued bonds to raise capital. For example, in 2005, ICBC issued three tranches of bonds with a total principal amount of RMB 35.0 billion, and may offer another RMB 65.0 billion tranche in 2007.

As evidenced by the bank's wildly successful initial public offering, ICBC has also raised capital through selling equity. In addition to Goldman Sachs, American Express, and Allianz, its largest corporate investors are:

China Life Group  
Cheung Kong and Hutchison  
Chow Tai Fook Nominee Limited  
CITIC Pacific Limited and Mr. Yung Chi Kin  
Dr. Lee Shau Kee  
GIC Direct Investments Pte. Ltd.  
Kuok Group  
Kuwait Investment Authority  
Nan Fung Group  
Qatar Investment Authority  
Sun Hung Kai Properties Group  
United Overseas Bank Limited  
Mr. Woo Kwong Ching

## Corporate lending and financial services

*ICBC's customers include 492 out of the 500 largest Chinese firms, and 238 of the Fortune 500 companies*

*Although it comprises a small portion of its overall business, ICBC is a leading player in loan syndications in China. Such credits are often used for large-scale expansions and development projects.*

As the largest bank in China, ICBC has more than 2.5 million corporate banking customers, including 492 out of the 500 largest Chinese firms, and 238 of the Fortune 500 companies. Corporate banking accounts for about half of ICBC's income, with corporate loans in particular making up almost 70% of its total loan portfolio. Project loans in particular, account for almost half (48.4%) of the bank's domestic corporate lending. These are usually medium- to long-term loans of up to 10 years for the "construction, expansion, renovation or acquisition of fixed assets." Such project loans are required to meet relevant regulations, and must be used for the specific project.

Syndicated loans account for a small portion of the bank's domestic corporate lending (3.4%). However, ICBC is a leading player in loan syndications in China, and such credits are often used for large-scale expansions and development projects.

Similarly, investment banking is a relatively small part of the bank's business, but yet ICBC is one of the leading investment bankers in China, and this business is growing rapidly (increased by almost 29% between 2005 and 2006). In particular, ICBC provides long-term financial advisory services to companies for project investment and financing.

## Corporate loan cycle<sup>97</sup>

The individual corporate loan cycle at ICBC is as follows:

- *Customer credit rating:* A bank relationship manager does an initial investigation of the client to screen out clients with bad credit histories. They then are assigned a credit rating (one of 12 internal ratings that the bank has developed). Depending on the rating, a client may be required to have collateral.
- *Credit line approval:* The client then has to apply for a credit line. An independent reviewer analyzes the application and a credit review committee assigns the client a total credit line, the maximum amount of credit to which the client is entitled. Larger credit lines must receive clearance by an authorized loan approver in the head office.
- *Individual loan evaluation:* After a client has established a line of credit, it can then apply for individual new loans. The corporate relationship manager will then initially evaluate the individual loan application, based on considerations such as recent developments in the client's financial condition and what the loan will be used for.
- *Loan Review and Approval:* If the manager recommends a loan for approval, a full application will be made to a primary reviewer in the credit approval department. That reviewer then analyzes the application and makes a further recommendation to the credit approval committee. The committee's decision is further reviewed by an authorized independent loan approver.
- *Project evaluation:* For medium- or long- term project loans, a project evaluation will be done by the credit authorization department. Technical consultants may be brought into the process.
- *Collateral appraisal:* The credit authorization department hires an external appraiser to determine the value of the client's collateral. The external appraiser's report is then reviewed by three internal collateral appraisers.
- *Fund disbursement:* The corporate relationship manager must ensure that the client meets all loan conditions before loan documents are finalized and funds are disbursed. Loan conditions can include obtaining government approvals, for example.
- *Loan monitoring:* Monitoring is done by credit management departments, and may include periodic assessments of the client.

## Environmentally-relevant activities and philanthropy

The Industrial and Commercial Bank of China is one of the leading lenders to the controversial Three Gorges Dam on the Yangtze River. It has also provided a loan of 6 billion RMB to the South-to-North Water Diversion Project.<sup>98</sup>

<sup>97</sup> Ibid.

<sup>98</sup> "CNY48.8bn Loans Made to South-to-North Water Diversion Project". SinoCast. 4/5/2005

Other controversial projects financed by ICBC include the Jinping Cascade 1 hydropower station, Tangguh LNG project, and the Trans Thai-Malaysia pipeline. It serves many clients involved in environmentally- and socially-sensitive activities, including Asia Pulp & Paper, China Datang, China Guodian, China National Petroleum Corporation, Sinopec, and sport shoe manufacturer Yue Yuen.

ICBC prides itself as a bank that is active in community improvement. Using international banks as examples, ICBC tries to promote its image as a community benefactor, although how truthful its boasts are is uncertain. Like most Chinese companies which have corporate responsibility programs, ICBC's efforts are focused on social causes and poverty alleviation, rather than environmental issues. ICBC has donated RMB 150,000 for tuition to high school students in underdeveloped counties in Sichuan province, RMB 60,000 to dedicated rural primary school teachers, and various financial and equipment donations (especially computers) to various schools for students from poor family backgrounds. ICBC has also contributed money and clothing to disaster-afflicted and impoverished areas such as Jiangxi province and Inner Mongolia Autonomous Region, although this is largely done to fulfil central government and Beijing municipal government requirements.



## China Construction Bank 中国建设银行<sup>99</sup>

### Background

China Construction Bank is one of the Big Four state-owned commercial banks, and is the second largest commercial bank in China. It was established in 1954 as a part of the People's Bank of China under the name "People's Construction Bank of China." It was a state policy bank specializing in urban development and large construction projects, but in 1994 it transferred its policy banking functions to the China Development Bank. In 1996, it was renamed China Construction Bank.

In 2005, China Construction Bank's assets totalled RMB 4.586 trillion. Its operating income totalled RMB 129 billion and net profits amounted to RMB 47 billion. CCB's subsidiaries include the China Investment Bank, Jian Sing Bank (in which it owns 40%) and a 42.5% stake in the China International Capital Corp (CITC). CCB and Morgan Stanley (35%) established CICC in 1995 as China's first investment bank.

### Geographic reach

Most of CCB's loans are for domestic clients. It plans to grow its business in the Yangtze River Delta, Pearl River Delta and Bohai Rim regions, as well as the capital cities in China's inland provinces. As of June 2005, its loans originated from the following locations:

Yangtze River Delta	24.8%
Pearl River Delta	13.1
Bohai Rim	20.0
Central	16.6
Western	16.3
Northeastern	6.1
Head Office	1.7
Overseas operations	1.4

CCB's overseas offices originate only about 1.4% of the bank's loans by volume, and the loans are given for both Chinese companies and foreign companies doing business with China. The bank boasts a network of 13,977 branches and sub-branches in mainland China; overseas branches in Hong Kong, Singapore, Frankfurt, Johannesburg, Tokyo, and Seoul; and representative offices in London and New York. It is ranked 25th among the world's top 1,000 banks based on tier-one capital according to the July 2005 issue of *The Banker* magazine. On the Fortune Global 500, it is listed as 34<sup>th</sup> among banks and 277<sup>th</sup> overall.<sup>100</sup>

<sup>99</sup> All information derived from China Construction Bank's 2005 Annual Report, Prospectus and [www.ccb.com.cn](http://www.ccb.com.cn) unless otherwise stated

<sup>100</sup>

<http://money.cnn.com/magazines/fortune/global500/2006/snapshots/164.html> 8/30/2006

According to some experts, China Construction Bank has the highest quality assets of the four state-owned commercial banks.<sup>101</sup> Its non-performing loan ratio (about 3%) is the lowest of all the Big Four banks, and approaches the average NPL ratio of 1-2% of internationally competitive banks.

## Sectoral exposure

*As its name suggests, CCB is a major player in infrastructure financing, and is the second largest lender of infrastructure loans among China's commercial banks.*

As its name suggests, CCB is a major player in infrastructure financing, and is the second largest lender of infrastructure loans among China's commercial banks. Reportedly, about 15% of BOC staff are trained engineers.<sup>102</sup> With a 27.7% market share in infrastructure financing, CCB plans to strengthen its position even more by developing closer ties with leading companies in the power, telecommunications, oil and gas, and infrastructure sectors, in addition to financial institutions and government agencies.

As of June 2005, CCB's sector exposure was as follows:

Manufacturing	24.2%
Petrochemical, coal, nuclear	1.5%
Iron and steel	3.1
Chemical products	2.4
Electronic products	2.1
Textile and garment	1.1
Metal processing	1.4
Cement processing	1.4
Others	11.2
Transportation, storage and postal services	15.6
Production/supply of power, gas, water	14.9
Property development	14.8
Construction	5.0
Telecommunications, computer services, software	4.3
Water, environment and public utility management	3.9
Wholesale and retail	3.5
Education	3.4
Mining	2.9
Others	7.5

Although CCB does not disclose the names of its largest clients, it does provide some indication of their business.

101 "Citigroup to Move on Construction Bank". SinoCast China Financial Watch. 10/28/2004

Top Clients		
Borrower	Industry	% of regulatory capital
Borrower A	Transportation, storage and postal services	9.4%
Borrower B*	Telecommunication, computer services & software	5.2
Borrower C*	Telecommunication, computer services & software	4.1
Borrower D*	Mining	3.7
Borrower E	Telecommunication, computer services & software	3.5
Borrower F	Property development	3.3
Borrower G*	Mining	2.5
Borrower H	Transportation, storage and postal services	2.1
Borrower I	Transportation, storage and postal services	2.1
Borrower J	Production and supply of electric power, gas, water	1.9

\* Note that Borrowers B and C are members of the same group, and that Borrowers D and G are also members of the same group.

Recent transactions include:

- A 2006 strategic cooperation agreement to finance China Guangdong Nuclear Power Holding Company's expansion plans.<sup>103</sup>
- Leading a USD 600 million syndicated loan for the Shanghai branch of Semiconductor Manufacturing International Corp, the largest semiconductor manufacturer in China. Other banks in the syndicate included ABN AMRO Bank NV, Bank of China (Hong Kong) Ltd, Bank of Communications, Bank of Tokyo-Mitsubishi UFJ, China Construction Bank, DBS Bank, Fubon Bank (Hong Kong), Industrial and Commercial Bank of China and Shanghai Pudong Development Bank (2006)<sup>104</sup>
- A USD 80 million loan facility to Beijing Subway to finance equipment imports for the Line 5 subway. CCB is cooperating with HSBC in this export credit agreement (2006)<sup>105</sup>

102 "Banks: Domestic banks," Country Finance Subscription, August 21, 2006

103 "China Construction Bank signs finance cooperation deal with Guangdong Nuclear," AFX – Asia, 24 November 2006

104 "SMIC Unit Signs Deal For Us\$600 Million Syndicated Term Loan," Business Daily Update, 9 June 2006

105 "Beijing Subway signs deal with CCB for 80 mln usd loan facility," Xinhua Financial Network News, 11 April 2006

- Co-arranging a HKD 254 million refinancing deal for Samson Paper Company (2006)<sup>106</sup>
- Participating in a USD 42 million syndicated project loan to Australia-based Sino Gold for the Jingfeng gold project in Guizhou province, China. Other banks include Standard Bank Plc, Bayerische Hypo-und Vereinsbank AG's Singapore (2005)<sup>107</sup>

## Reforms and restructuring

Beijing has worked to improve the asset quality of CCB since 1998, when it received RMB 49.2 billion from the government in the form of an equity contribution. In 1999, Cinda, one of the government's asset management companies, bought 250.0 billion of non-performing loans from CCB. In return, CCB received a bond from Cinda worth RMB 247.0 billion, as well as a cash payment of RMB 3.0 billion.

In 2003, the bank began a restructuring process in 2003 which included recapitalization, the disposal of non-performing loans, and the issuing of bonds. The bank was recapitalized by a USD 22.5 billion cash contribution from Huijin, which took an 85% ownership stake in CCB. It also received a RMB 65.5 billion capital injection from the government to make up for losses. In 2003 it also disposed of 128.9 billion of bad loans, selling them to Cinda for RMB 64.5 billion; it wrote off another RMB 56.9 billion by the end of the year. Finally, CCB raised RMB 40.0 billion in bonds in 2004 which helped increase its capital adequacy ratio.

All this allowed China Construction Bank to re-establish itself as a joint-stock bank in September 2004.

## Governance

Like ICBC and BOC, decisions made at China Construction Bank's General Meeting of Shareholders have binding power. Both the Board of Directors and Board of Supervisors are directly responsible to the decisions made at General Meeting of Shareholders. Central SAFE Investment Co. (Huijin Investment), a government investment arm, holds the controlling share.

### Board of Directors

- The Board of Directors is responsible for determining the objectives, strategies, policies and business plans; supervising and controlling operations and financial performance as well as formulating appropriate risk control policies. Members are elected to three-year terms.

There are five committees established under the Board of Directors. Aside from the Strategy Development Committee and the Risk

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106 "Samson Paper Co, loan facility," Euroweek, 27 January 2006

Management Committee, the committees are chaired by Independent Non-executive Directors ("independent" directors are not employed by the bank).

- The Strategy Development Committee drafts medium to long-term strategic development plans and assessing their implementation; reviews annual operational plans, financial budgets, strategic capital allocation plans, asset and liability management targets, material restructuring plans, investment and financing projects.
- The Audit Committee monitors and assesses the preparation of financial statements, disclosure of accounting information, internal controls, operational compliance, management procedures, internal audits, and external auditors.
- The Risk Management Committee formulates risk strategy and management policies, supervises internal control systems, conducts assessments of risk management and internal control system, and evaluates performance of chief risk officer.
- Nomination and Compensation Committee formulates procedures for selection of directors and senior management, nominates directors and senior management, drafts performance and compensation evaluation systems, and proposing the compensation of directors and senior management.
- Related Party Transactions Committee identifies CCB's related parties, reviews material related party transactions, formulating and proposing standards for transactions.

## **Board of Supervisors**

The Board of Supervisors is the supervisory authority of CCB, accountable to shareholders' general meeting. It supervises the performance of the Board of Directors and Senior Management; inspects and monitors financial affairs; verifies financial information; and conducts audits of business decisions, risk management, and internal control.

The Board of Supervisors is divided into 2 committees.

- The Performance and Due Diligence Supervision Committee formulates rules and regulations, work plans and proposals relevant to the performance of directors and senior management.
- The Finance and Internal Control Supervision Committee's responsibilities are the supervision of financial and internal control.

## **Senior Management**

CCB's Senior Management is directly responsible to the Board of Directors and shareholders. It has the responsibility of implementing strategic decisions and managing the bank. The members of Senior Management are:

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107 "Sino Gold Signs Us\$ 42m Loan For Jingfeng Gold Project," Business Daily Update, 20 September 2005

## Agreements with strategic investors

*The bank's key foreign partners include Bank of America, which has invested USD 3.1 billion, and was one of the first US banks to establish an environmental affairs department.*

China Construction Bank was the first of the Big Four banks to become a publicly-traded company. It went public on the Hong Kong Stock Exchange with an H-share listing in October 2005. At the time, the IPO was the largest IPO ever by a bank, the largest listing in the world that year, and raised USD 8.7 billion. Since then, CCB stock has risen 40% in value.

The bank's key foreign partners include Bank of America, which has invested USD 3.1 billion, and Singapore's Temasek, which has USD 1 billion invested in the bank. Temasek and CCB may sign an agreement in which Temasek would provide technical assistance to CCB.

Bank of America (BoFA) and CCB signed an exclusive agreement wherein BoFA has agreed to help CCB adopt international best practices in risk management, corporate governance, consumer products and other areas. As a shareholder owning over 5% the CCB's equity, Bank of America has the right to nominate one board member. BoFA also has the option of purchasing up to 15% of CCB's outstanding equity, which would give its board member a place on the board's strategy development committee. BoFA has also agreed to not acquire interests in other PRC banks, and to cease operating BoFA branches within China (except what is minimally required to maintain business relationships with existing clients). BoFA has agreed to assign about 50 staff to provide technical assistance, although they will not have any responsibility for CCB's operations; reportedly in February 2006, BoFA sent 40 experts to work in China Construction Bank. In a related matter, in August 2006, CCB bought Bank of America's Hong Kong-based subsidiary for USD 1.25 billion.<sup>108</sup>

It should be noted that Bank of America was one of the first United States banks to establish an environmental affairs department, which has been in operation for over 10 years. It also has established some of the world's strongest climate change policies. However, many NGOs believe that BoFA has not been doing a good enough job in implementing its environmental commitments, and it has fewer environmental staff than other banks.

Temasek has agreed to aid China Construction Bank in development of its corporate governance, treasury, institutional banking, small and medium-sized enterprise business and international financing. Small enterprise financial services are a market that is pitifully underserved in China. Small-scale entrepreneurs frequently complain about a financial environment that is geared towards large-scale businesses and ignores the needs of small-scale businesses. Morgan Stanley enjoys a very close working relationship with China Construction Bank; the two companies jointly control China International Capital Corporation, an independent Chinese investment bank, which has proved profitable for both partners.<sup>109</sup>

<sup>108</sup> "China Construction Bank To Acquire Bank Of America Subsidiary," Asia Pulse, 23 October 2006

<sup>109</sup> "China Construction Bank Restarting Investment Banking Ops". AFX International Focus. 7/13/2006

## Capital raising activities<sup>110</sup>

In 2004, CCB issued bonds worth RMB 40.0 billion. However, CCB does not seem to issue bonds as frequently as other Chinese banks, particularly the China Development Bank.

CCB's most notable capital raising effort was its 2005 initial public offering. The China Yangtze Power Company, which is the listed arm of the company that runs the Three Gorges Dam, bought RMB 2 billion worth of CCB stock, representing approximately a 1 percent share in the bank.<sup>111</sup> Baoshan Iron & Steel Company, China's largest steel company, and State Grid Corp, one of two state-owned power transmission companies, each own more than 1.5 percent stake in China Construction Bank.<sup>112</sup> The majority stake, approximately 85 percent, is held by Central Huijin Investment Co, the investment arm of China's State Council. CCB's main corporate investors include:

Jianyin	9.375%
Bank of America	8.739%
AFH	6.125%
State Grid	1.359%
Shanghai BaoSteel	1.359%
Reca Investment	0.906%
Other public shareholders	9.545%

It should be noted that in December 2006, China Yangtze Power Company (a subsidiary of the Three Gorges Development Corporation) sold its 400 million shares of China Construction Bank shares to Reca Investment (Hong Kong) for RMB 1.24 billion.<sup>113</sup>

## Corporate lending and financial services

Corporate banking accounts for about 58% of CCB's operating income, and the bank has relationships with 97 of the largest 100 companies in China (as determined by China Enterprise Confederation and the China Enterprise Directors Association). Loans to corporations represent about 73.4% of the bank's total loan portfolio.

Fixed asset loan products (medium- or long- term credits for infrastructure project development, construction, buying equipment), accounts for almost half of the CCB's corporate lending, with most of these loans going to infrastructure. CCB believes that its history of loans to government-sponsored infrastructure deals has given it valuable experience in assessing these kinds of loans. Working capital loans are generally short- term, less than one year.

<sup>110</sup> CCB Global Offering prospectus, 2005

<sup>111</sup> "Bank of China Considers JP Morgan, HSBC, Deutsche Bank as Investors". AFX.com. 10/29/2004

<sup>112</sup> "Bank of China Considers JP Morgan, HSBC, Deutsche Bank as Investors". AFX.com. 10/29/2004

<sup>113</sup> "China Yangtze to sell 400 mln China Construction Bank shares for 1.24 bln yuan," Xinhua Financial Network News, 7 December 2006

Working capital loans	53.6%
Fixed asset loans	44.8%
Infrastructure loans	28.9
Real estate development loans	9.9
Technological improvement loans	5.9
Corporate mortgage loans	0.1
Others	1.6%

### Corporate loan cycle

According to the CCB, its corporate loan cycle is as follows:

- The client is first interviewed by a relationship manager, who does a preliminary screening.
- If the client passes, it can submit a formal credit application, along with supporting documents such as financial statements and major contracts.
- A separate team within the bank (separate from the relationship manager) assigns a credit risk rating to the client, based on an internal rating system. An independent appraiser evaluates the quality of the collateral. For fixed asset loans, the team will look at the fundamentals of the underlying project, other sources of financing, etc.
- All this information is included in an evaluation report, which becomes part of the application to be presented for approval. The evaluation report also includes a recommendation of the maximum amount of credit the client should receive.
- An independent team from the credit approval department uses detailed criteria to evaluate the loan. For example, there are certain limits to the amount of lending that can be given to a particular client, through a particular branch, etc. Some loans require approvals from senior credit officers in the bank headquarters.
- The credit approval team can vote to approve, conditionally approve, or postpone evaluation on applications.
- Once all conditions are satisfied, loan documents can be signed and funds can be disbursed.
- Credit monitoring is performed by relationship managers and risk managers. The bank may visit projects to monitor their status, and write reports for the head of the business department. Borrowers are required to immediately report any events that could significantly affect loan repayment.

### Environmentally-relevant activities and philanthropy

Like most other Chinese commercial banks, the majority of China Construction Bank's loans are made to projects relating to infrastructure such as roads, railways, energy infrastructure and production. In 2005, China Construction Bank together with China Development Bank and



Agricultural Bank of China has arranged a USD 482 million loan to the CNOOC Fujian Liquefied Natural Gas project, which will build a liquefied natural gas terminal in Fujian province and deliver natural gas to counties throughout Fujian province.<sup>114</sup> China Construction Bank has provided a loan of RMB 8.5 billion, the most of the Big Four, to the South-to-North Water Diversion Project.<sup>115</sup> CCB also finances several clients involved in environmentally-sensitive activities, such as China International Marine Container, Asia Pulp & Paper, China Guodian, China National Petroleum Corporation, and Sinopec.

China Construction Bank's philanthropy primarily focuses on social programs. Its environmental activities are either not publicized or insignificant. China Construction Bank has a strategic partnership with the Red Cross Society of China. It also contributes tuition funds for underprivileged children in regions throughout China.

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<sup>114</sup> "China's CNOOC gets 4.15bln Yuan Bank Loans for Fujian LNG Project". AFX – Asia. 7/29/2005

<sup>115</sup> "CNY48.8bn Loans Made to South-to-North Water Diversion Project". SinoCast. 4/5/2005

## Agricultural Bank of China 中国农业银行<sup>116</sup>

### Background

The Agricultural Bank of China (AB China) is the smallest of the Big Four banks and the one most plagued by non-performing loans and corruption. Part of the reason for the bank's NPL problem is due to its historic focus on rural and farm financing, which has not accounted for much of China's economic growth. In 2005, its non-performing loan ratio was the highest of the Big Four banks at a troublesome 26.17%. It is also one of the least transparent banks.

AB China is ranked 44<sup>th</sup> among banks on the Fortune Global 500 list and 377<sup>th</sup> overall.<sup>117</sup> According to its most recent annual report in 2005, assets of Agricultural Bank of China totals RMB 4,771 billion. Its deposits total RMB 4,037 billion, and its loans total RMB 2,829 billion. Its total 2005 operational profit was RMB 42.48 billion with a net profit of RMB 1.04 billion.

### Geographic reach

AB China focuses mainly within China. Currently, the bank operates 32 provincial level branches, 5 directly affiliated branches, branches in Singapore and Hong Kong, and offices in London, Tokyo, and New York. Given its historic focus on agriculture financing, it is not surprising that AB China has the smallest international presence of the Big Four banks.

### Sectoral exposure

AB China's distribution of loans by economic sector is as follows:

*AB China may have agricultural roots, but today it has diversified into many other sectors. In particular, there has been a significant increase in money loaned to industry and commerce.*

Industry	2005 figure (billion RMB)	2004 figure (billion RMB)
Agriculture	556.315	574.556
Industry	508.14	383.389
Commerce	307.013	284.287
Consumer credit	301.696	304.509
Other	1,156.13	1,043.33
Total	2,829.29	2,590.07

AB China may have agricultural roots, but today it has diversified into many other sectors. In particular, there has been a significant increase in money loaned to industry and commerce, which are the most

<sup>116</sup> All information derived from Agricultural Bank of China's 2005 Annual Report unless otherwise stated

<sup>117</sup> <http://money.cnn.com/magazines/fortune/global500/2006/snapshots/164.html> 8/30/2006

profitable sectors of China's economy. Some of its recent transactions include:

- Participating with over 20 Chinese and international banks in a USD 2.6 billion project finance transaction for the CNOOC - Shell Petrochemicals CSPC-Nanhai Petrochemicals project (2003)
- Participating with several other Chinese banks to provide Formosa Plastics Corporation with a working loan worth over USD 200 million
- Participating with Citibank NA (Taipei); Shanghai Pudong Development Bank and Bank of Shanghai to provide a working capital loan worth over USD 317 million to a consortium of paper recycling companies.
- Participating with Bank of China; Industrial & Commercial Bank of China, China Construction Bank, and China Development Bank to provide Guangdong Dapeng Liquid Natural Gas Company (a SOE) with a project finance loan worth over USD 628 million
- Supplying an RMB 60 billion credit facility to the China Guangdong Nuclear Power Holding Company for the construction and operation of nuclear power projects during the next five years<sup>118</sup>
- Providing 52% of a RMB 4.15 million loan to China National Offshore Oil Corp (CNOOC) for its liquefied natural gas (LNG) project in Fujian.<sup>119</sup>
- A March 2006 agreement with Israel-based Bank Hapoalim for a credit line for financing Israeli exports to China. This agreement was made under the financial protocol signed by the Israeli and Chinese governments in 2005.<sup>120</sup> This example illustrates how AB China implements Beijing's foreign economic policies, and how trade-related finance does not occur only through the China Export-Import Bank.
- A 2005 comprehensive cooperation agreement with coal producer Yankuang Group which includes a credit line of RMB 10 billion for two years<sup>121</sup>
- An RMB 6 billion loan to Panzhihua Iron and Steel Group, the largest steel maker in southwestern China (2005)<sup>122</sup>

<sup>118</sup> "Agricultural Bank of China provides credit to Guangdong Nuclear Power," China Energy Weekly, 12 May 2006

<sup>119</sup> "China's CNOOC gets 4.15 bln yuan bank loans for Fujian LNG project," AFX - Asia, 29 July 2005

<sup>120</sup> Tsurriel-Harari, Keren, "Hapoalim Signs Agreement With Agricultural Bank Of China," Israel Business Arena, 20 March 2006.

<sup>121</sup> "Agricultural Bank Of China To Provide Credit Line To Coal Group," AsiaPulse News, 28 October 2005

## Reforms and restructuring

Despite being the beneficiary of combined USD 60 billion in recapitalization funds, the bank receives little attention and aid from the Chinese government when compared to other Big Four banks. Central Huijin Investment Co has been slow to rescue AB China because of what many fear to be gargantuan costs. Since 2003, the Agricultural Bank of China has only lagged further behind its sister banks (Bank of China, Industrial and Commercial Bank of China, and China Construction Bank) as they began to receive massive bailouts from the government. There is also reluctance to tighten credit policy at AB China for fear of resulting unrest in the countryside, where the bank is the predominant lender.

The China Banking Regulatory Commission has required the five largest Chinese banks – Bank of China, Industrial and Commercial Bank of China, China Construction Bank, Agricultural Bank of China, and Bank of Communications – to have a NPL ratio of less than five percent. It is improbable that AB China will be able to meet this requirement in the foreseeable future without large government bailouts like the ones given to the other Big Four banks.

*The bank will seek to become a publicly listed company in 2007 following in the footsteps of its three sister banks. But unlike the others, the Agricultural Bank of China does not yet have any foreign partners, and its financial weakness make any IPO listing a daunting and ambitious task.*

The bank will seek to become a publicly listed company in 2007 following in the footsteps of its three sister banks. But unlike the others, the Agricultural Bank of China does not yet have any foreign partners, and its financial weakness make any IPO listing a daunting and ambitious task. Press articles in December 2006 reported that China Life Insurance Company may become one of the bank's strategic investors after its restructuring,<sup>123</sup> and that UBS, China International, BOC International and HSBC are competing to be the underwriters on the IPO.<sup>124</sup>

To prepare for its public offering, Beijing is contemplating a massive capital injection; reports suggest that the government could pour as much as USD 100 billion into the bank – a sum amounting to about 10% of China's foreign reserves, and much more capital than the other Big Four combined.<sup>125</sup>

For its part, AB China is moving to improve the transparency of its information disclosure, which is the poorest of the Big Four Banks. It is also instituting performance management reforms by restructuring incentive methods and linking salary closely to job performance. In addition, the bank has contracted Deloitte to conduct its first institution-wide outside audit with hopes that it will help revamp the bank and bring it closer to international standards.<sup>126</sup> In June 2006, China's top auditing agency revealed RMB 60.3 billion in financial crimes and unaccounted irregularities during the 2004 fiscal year resulting in the termination and punishment of over 1,300 employees including 7 branch

122 "Agricultural Bank of China gives Pangang Steel USD 739.83 mln," China Metals Report Weekly, 19 August 2005

123 "Finance: Agricultural Bank Buy-in?" Shanghai Daily, 11 December 2006 on the China Daily website at [http://www.chinadaily.com.cn/bizchina/2006-12/11/content\\_755726.htm](http://www.chinadaily.com.cn/bizchina/2006-12/11/content_755726.htm)

124 Loader Wilkenson, Tara. "Merrill scoops second China mandate in a week," Financial news online – US, 7 December 2006 at <http://www.financialnews-us.com/?page=ushome&contentid=1046733212>

125 "Agricultural Bank Eyes Group Listing," SinoCast China Financial Watch, 21 August 2006.

126 "Agricultural Bank of China Reform Plan Due by Year End". AFX – Asia. 8/18/2006

heads.<sup>127</sup> The bank also plans to enlist the help of an international consulting agency to streamline its workforce. Analysts point out that its payrolls are “bloated,” with 489,425 employees; Citigroup, which operates in more than 100 countries and territories, employs approximately 275,000 people.<sup>128</sup>

## Governance

The AB China has a head office-branch structure, instead of the standard modern structure of corporate government like the three other Big Four banks and other joint stock banks. The Head Office serves as the decision-making and management body of the bank. The body’s responsibilities are delegated to its special committees, which are as follows:

- Asset and Liability Management Committee designs the bank’s development strategy and operation orientation; makes policies regarding capital management, liquidity management, interest rate and exchange rate risk management; and is responsible for the annual overall business operation plan of the bank.
- New Product Development Committee analyzes market demand and designs, develops and promotes new products
- Marketing and Promotion Committee is responsible for promotion tactics and strategies.
- Risk Management Committee is responsible for the bank’s overall risk management and the analysis of the bank’s credit risk, liquidity risk, exchange rate risk, interest rate risk, and operational risk.
- Credit Review Committee is responsible for the approval of credit business, including loans, discount, acceptance, letter of credit, and assessment of client credit ratings.
- IT Construction Committee is responsible for all IT construction, computer network design and software development plans.
- Internal Supervision Committee is responsible for internal supervision policies, mandates, compliance, and procedures.
- Centralized Procurement Committee reviews and approves centralized procurement processes.
- Overseas Institution Management Committee reviews and approves policies, procedures, mandates and measures for overseas institutions, and joint marketing initiatives between domestic and overseas institutions. (“Overseas institutions” probably refers to AB China’s overseas branches.)

127 “Agricultural Bank of China Disciplines 1,331 Employees for Fraud”. BBC Monitoring International Reports. 7/5/2006

128 <http://www.citigroup.com/citigroup/corporate/history/citigroup.htm> 8/13/2006

- Corporate Culture Committee is responsible for the cultural and ideological building of the bank, and activities for promoting ideology.

The Board of Supervisors of the AB China is appointed by the State Council and makes sure that the bank is in compliance with the state's economic and legal regulations and mandates.

*AB China has not yet issued bonds or stock to raise capital, but it is planning an IPO for as early as 2007*

## Capital raising

AB China has not yet issued bonds or stock to raise capital, but it is planning an IPO for as early as 2007. Also press reports indicate that it may soon issue RMB 10 billion of asset-backed securities (bonds issued by the bank to raise money for itself, which will be repaid by incoming revenue from bank cards, consumer loans and non-performing loans).<sup>129</sup>

## Environmentally-relevant activities and philanthropy

Despite its reputation as the weakest of the Big Four banks, AB China has the highest environmental philanthropy profile. It has organized its employees to donate 6 million RMB to reforestation efforts in Gansu Province as part of the national "Rebuilding Beautiful Hills and Rivers of the West" project. The bank has set up its own Ten Thousand Mu Forestation Project to funnel employee donations into environmental protection projects.

It is involved in several environmentally and socially controversial projects, including the South-to-North Water Diversion Project, the Jinping Cascade 1 hydropower station, and the Tangguh LNG project. Its clients include Asia Pulp & Paper and Sinopec.

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<sup>129</sup> "China to allow banks, AMCs to sell 60 bln yuan in asset-backed securities-report," AFX Asia, 12 November 2006

## China Development Bank 国家开发银行<sup>130</sup>

### Background

China Development Bank (CDB) was founded by the Policy Banks Law in 1994. The bank is under the direct jurisdiction of the State Council and the largest state policy bank, acting as a provider of state credit to facilitate economic development. It is also the only bank whose governor is a full government minister. Chen Yuan (陈元), the governor of the bank, is the secretary of CPC China Development Bank Committee and the son of the deceased conservative Party elder, Chen Yun.

CDB's main role is to help the government execute its economic development strategies by providing medium- and long-term financing for key infrastructure, public works, and basic industries within China. It also reportedly has been given authority to provide trade financing through extending credits to overseas buyers of Chinese goods and services.<sup>131</sup>

*The bank does not finance what it calls "purely welfare projects," as these kinds of activities would be funded directly by the government budget. However, it does receive state subsidies so that it can finance sub-commercial projects and activities.*

The bank does not finance what it calls "purely welfare projects," as these kinds of activities would be funded directly by the government budget. However, it does receive state subsidies so that it can finance sub-commercial projects and activities. The CDB is also an agent bank for "on-lending" from multilateral development institutions (e.g. re-lends World Bank loans procured by the government of China). Although the Ministry of Finance still has the sole coordination power for this on-lending, CDB handles some of the practical loan disbursement functions.

The assets of China Development Bank total RMB 1,898 billion. Its 2005 net profits amount to RMB 22.8 billion. Over the past decade, its loans have accumulated a total of RMB 1.73 trillion. The most impressive statistic of all is the bank's non-performing loan ratio of 0.87%, which is lower than many internationally renowned banking firms. It currently operates 32 branches and 4 representative offices throughout the country. As a policy bank, CDB does not accept personal deposits and therefore does not have thousands of local branches as commercial banks do.

### Geographic reach and overseas expansion

At the end of 2004, the geographic concentration of CDB's loan portfolio was:

- Eastern China region (Beijing, Liaoning, Hebei, Tianjin, Shandong, Shanghai, Jiangsu, Zhejiang, Fujian, Guangdong and Hainan): 53%
- Central China region (Jilin, Heilongjiang, Shanxi, Henan, Hubei, Anhui, Hunan and Jiangxi): 24%

<sup>130</sup> All information derived from China Development Bank's 2005 Annual Report and [www.cdb.com.cn](http://www.cdb.com.cn) unless otherwise stated

<sup>131</sup> Export-Import Bank of the United States. Report to the US Congress on Export Credit Competition and the Export-Import Bank of the United States for the Period January 1, 2005 through December 31, 2005. June 2006.

- Western China region (including Xinjiang, Tibet, Gansu, Qinghai, Ningxia, Inner Mongolia, Shaanxi, Sichuan, Chongqing, Guizhou, Yunnan and Guangxi): 23%

Historically, China Development Bank has focused primarily within China, and left overseas business to China Export-Import Bank. For example, currently only 1.88% of the bank's loans are for overseas activities. But CDB is beginning to break from this tradition and expand into overseas investments. For example, there are plans to establish a CDB branch in Islamabad, Pakistan in the near future.

Signs of CDB's growing international financing activities are evident at the highest governmental levels. For example:

- CDB has also expressed willingness to aid in Zimbabwe's economic recovery program. Preparations were discussed during a meeting between Chen Yuan and Zimbabwean Vice President Mujuru in Beijing. Mujuru stated that in exchange for Chinese technical knowledge and financial resources, Zimbabwe, beset by sanctions from most developed countries for its controversial land reform program, could offer China access to Zimbabwe's deposits of more than 600 valuable minerals.<sup>132</sup>
- CDB signed an agreement with the East African Development Bank to finance development projects through CDB, a deal which was signed during Premier Wen Jiabao's visit to Uganda and Tanzania.<sup>133</sup>
- A Memorandum of Understanding signed with Kazakhstan "sustainable development foundation" (Kazakhstan) for a joint fund of up to USD 5 billion for infrastructure and manufacturing development. The MOU was signed during Kazakh President Nursultan Nazarbayev's state visit to China.<sup>134</sup>
- Vietnamese Prime Minister Dung has promised to create favorable conditions for CDB to help local banks in professional training, provide loans for investment projects, and open branches in the country.<sup>135</sup>

## Sectoral exposure

Since its establishment in 1994, the bank has focused on eight key industries – power, road construction, railway, petrochemical, coal mining, telecommunications, public facilities, and agriculture & related industries – which account for 88.9% of its loans. In recent years, CDB has concentrated on developing the 'bottlenecks' in the Chinese economy, especially energy and transportation. Its 2005 disbursement of RMB loans is as follows:

<sup>132</sup> "China to Aid Zimbabwe Economic Programme". Africa News. 6/19/2006

<sup>133</sup> EA Development Bank to Act as Conduit for Chinese Funds". Africa News. 7/11/2006

<sup>134</sup> "Kazyna, China Development Bank consider establishing joint fund", Central Asia General Newswire, 22 December 2006.

<sup>135</sup> "Vietnam Pledges Favorable Conditions for China Development Bank". Asia Pulse. 7/26/2006



Industry	Percentage
Power	19.37
Road construction	19.5
Railway	1.29
Petro-chemical	2.3
Coal mining	1.19
Telecommunications	2.65
Agricultural & related industries	2.13
Public facility	34.47
Other	17.1

As a conduit for government investment, the China Development Bank has been active in its support of national development programs such as the Three Gorges Dam, the South-to-North Water Diversion Project, national petroleum storage, etc. Financing from CDB constitutes 21% of total lending in China's power industry. In addition to its funding of the Three Gorges Power Plant, CDB also provides significant investment for other large-scale power projects such as the Key Water Control Project at Xiaolangdi on the Yellow River, Tianwan Nuclear Power Plant, Northwest National Grid project, and a project for the transfer of electricity from the West to the East. CDB's investment in road construction accounts for nearly 21% of total investment.

In accordance with Beijing's 11th Five-Year Plan, CDB will continue to provide strong support for the power sector. CDB has partnerships with China Petroleum Group, Sinopec Corporation, and China National Offshore Oil Corporation, and bankrolls exploration, production, and distribution pipeline projects. In addition to petroleum, CDB provides lending support to liquefied natural gas projects along the eastern coastline.

*CDB is heavily involved in China's coal mining sector. It provides 30% of all loans to the industry*

The bank is heavily involved in China's coal mining sector. It provides 30% of all loans to the industry, participates in early planning of projects, and conducts industry analysis on hot topics such as safety.

## Key transactions<sup>136</sup>

The CDB can lend up to 70% of the total cost of a project (including guarantees and letters of credit). As of June 2005, the CDB's largest project loans are as follows:

<sup>136</sup> CDB global bond prospectus, 2005

Top project loans, in billions RMB				
Project	Borrower	Denom-ination	Loan Amt*	% of Total*
Guangdong Ling'ao Nuclear Power Station	Guangdong Nuclear Group Co. Ltd.	US\$, £, €	17.9	1.1%
Three Gorges Dam	China Three Gorges Development Corp.	Rmb	17.3	1.1%
Qinshan Nuclear Power Plant—Phase III	Qinshan Nuclear Power Corporation	US\$, Rmb	17.1	1.1%
Petroleum Refinery	China National Petroleum Corporation	Rmb	11.1	0.7%
Shanghai Urban Light Rail Transportation	Shanghai Jiushi Corporation	Rmb	10.7	0.7%
Oil/Gas Production and Refinery	PetroChina Company Limited	Rmb	10.4	0.7%
Jilin Province Highways	Jilin Province Transportation Department	Rmb	9.6	0.6%
Ertan Power Station	Ertan Hydropower Development Corp.	Rmb, US\$	9.4	0.6%
Railway Telecommunication	China Railway Communication Co., Ltd.	Rmb	9.3	0.6%

\* Amount outstanding.

The CDB's top ten borrowers, as of June 2005, are:

<b>Top Ten borrowers, in RMB billions</b>		
<b>Borrower</b>	<b>Total Outstanding Amount</b>	<b>% of Total Outstanding Loans</b>
Ministry of Railways Engineering Management Center	25.9	1.7
China Three Gorges Development Corp.	24.2	1.6
Shandong Province Department of Transportation	20.2	1.3
Shanxi Province Department of Transportation	18.6	1.2
Jilin Province Department of Transportation	18.5	1.2
Guangdong Nuclear Power Corporation	18.0	1.2
Tianjin Urban Infrastructure Construction and Development Corp.	17.3	1.1
Qinshan No. 3 Nuclear Power Company	17.1	1.1
China Railcom Group Company	15.5	1.0
Yunnan Province Department of Transportation	15.4	1.0
<b>Total</b>	<b>190.7</b>	<b>12.3</b>

Other recent CDB's transactions include:

- A December 2006 RMB 5 billion credit line to Sany Heavy Industry Company for import and export credits so that the company can further develop its overseas market.<sup>137</sup>
- A November 2006 RMB 2.1 billion loan to East Asia Power Co Ltd, a division of Hong Kong-based Pacific Oil & Gas. The loan will finance a Liquid Natural Gas (LNG) power plant in Xiamen, which will be fuelled by LNG from the Tangguh project in Indonesia.<sup>138</sup>
- An agreement with the Reconstruction and Development Fund of Uzbekistan to finance cooperative projects in the Uzbekistan

<sup>137</sup> "China Development Bank provides Sany Heavy Industry 5 bln yuan credit line," AFX – Asia, 25 December 2006.

<sup>138</sup> "China Development Bank makes 2.1 bln yuan loan to East Asia Power," AFX – Asia, 24 November 2006.

state investment program. The program has identified 77 projects amounting to over USD 1 billion.<sup>139</sup>

- A September 2006 RMB 45 billion credit line agreement with Sichuan Power Co Ltd, a unit of China Huadian Corp for Sichuan Power's hydropower projects on the Jinsha and Muli rivers<sup>140</sup>
- USD 200 million in credits for the USD 250 million-Moinak hydropower plant on Charyn River in Kazakhstan's Almaty oblast<sup>141</sup>
- A July 2006 strategic cooperation agreement with Yunnan Copper for its "go out" strategy.<sup>142</sup> Yunnan Copper, along with China Nonferrous Metal Mining operates Zambia's controversial Chambishi copper mine, which has been the site of the worst accident in Zambian mining history.
- A 2006 deal with Yongcheng Coal and Electricity to provide RMB 11.32 billion, the biggest bank financing package ever for Henan's coal chemical firms<sup>143</sup>
- A RMB 11.6 billion loan package for Shaanxi Coal Group Co. to develop new coal mines in the west and north parts of Shaanxi (2005)<sup>144</sup>
- An 2005 overall cooperation agreement with China National Chemical Corporation (ChemChina) for overseas expansion. Financial services include bond underwriting, corporate loans, and strategic investor introduction.<sup>145</sup>

## Governance

China Development Bank is governed directly by the State Council, which appoints the CDB Board of Supervisors and Governor. The Board of Supervisors is responsible to the State Council for supervising and monitoring the bank's management, operations, and financial performance. The Board consists of a chairman, several full-time supervisors and staff members as well as one part-time representative each from the Ministry of Finance, China Banking Regulatory Commission, China Development Bank, and a designated public accounting firm.

<sup>139</sup> "Uzbekistan to attract China Development Bank for investment program," Central Asia General Newswire, 15 November 2006

<sup>140</sup> "China Development Bank signs financial cooperation agreement with power company," Xinhua, 27 September 2006

<sup>141</sup> "Kazakhstan invites China Development Bank to infrastructure projects," Kazakhstan General Newswire, 29 September 2006

<sup>142</sup> "China Development Bank Signs Coop Agreement With Yunnan Copper," Asia Pulse, 6 July 2006

<sup>143</sup> "CDB to Invest In Henan's Coal Chemical Industry," SinoCast China Business Daily News, 17 May 2006

<sup>144</sup> "CDB Offers CNY11.6bn Loan To Shaanxi Coal Group," SinoCast China Business Daily News, 13 July 2005

<sup>145</sup> "Chemchina Gains Support From CDB," SinoCast China Business Daily News, 7 March 2005

- The executive and management body of the CDB consists of the Governor, four Vice Governors, two Assistant Governors, a Chief Compliance Officer, a CFO, a Chief Economist, and a Chief Auditor.

CDB has also established the International Advisory Council, which reviews the bank's performance and provides strategic guidance to management. During its last annual meeting in late October 2005, the council focused on three areas: the status of the global economy and the financial services industry; development trends in the Chinese economy and financial services; and development financing in China. The members of the council are as follows:

- Huang Ju, Member of Politburo Bureau Standing Committee, Vice Premier of State Council
- Chen Yuan, Governor of CDB
- Tasuku Takagaki, Senior Advisor and former Chairman of Bank of Tokyo-Mitsubishi
- Jacquesde Larosere, Senior Advisor of BNP Paribas (France), former Chairman of European Bank for Reconstruction and Development
- Paul Keating, former Prime Minister of Australia
- Tadao Chino, former Governor of Asian Development Bank Senior Advisor of Nomura Research Institute
- Yao Zhongmin, Vice Governor of China Development Bank
- Leonard Appleyard, Senior Advisor of Barclays Bank PLC, former British Ambassador in China
- Kee Choe Ng, Senior Advisor of Development Bank of Singapore
- Andrew L.T. Sheng, former Chairman of Securities and Future Commission (Hong Kong)
- Jacob A. Frenkel, Vice Chairman of American International Group
- Dominique Strauss Kahn, member of French Parliament, former French Minister of Economy, Finance and Industry
- Hans W. Reich, Chairman of the Board of Managing Directors of KfW (Germany)

It should be noted that the International Advisory Council does not have any power to make policy.

## Capital raising

*The CDB raises both RMB and foreign capital, with the vast majority of its capital raised within China.*

The CDB raises both RMB and foreign capital, with the vast majority of its capital raised within China. It secures funding for RMB-denominated loans from the Ministry of Finance (e.g. government appropriations), by borrowing from other Chinese banks, and deposits from corporate customers. Within China, the CDB has issued USD 135.445 billion worth of RMB-denominated bonds, and has also borrowed the equivalent of USD 500 million from other Chinese banks.<sup>146</sup>

CDB raises foreign capital from overseas governments, export credit agencies, commercial banks, and multilateral development banks. It on-lends the PRC's own foreign exchange reserves, purchases foreign currency with RMB, and issues international bonds. As of December

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<sup>146</sup> CDB preliminary bond prospectus, 2005.

2004, CDB had issued USD 2.6 billion in foreign currency bonds, including:

- A 2005 USD 500 million tranche of 10-year international bonds, underwritten by BNP Paribas, Merrill Lynch & Co, Barclays Capital, Citigroup Inc, Goldman Sachs Group Inc, HSBC Holdings Plc, JPMorgan Chase & Co and UBS AG.<sup>147</sup>
- A 2004 USD 1 billion global bond led by Goldman Sachs.<sup>148</sup>

Also, in 2006 CDB raised a USD 700 million loan syndicated loan from 21 domestic and international banks, led by Hong Kong Shanghai Banking Corporation, Tokyo Mitsubishi UFJ Bank, Banque De l'IndoChine, DBS Bank, ING Bank N.V., Mizuho Bank, Sumitomo Mitsui Bank Corp. and BNP Paribas.<sup>149</sup> This is probably the largest single loan any Chinese bank has ever taken out.

Finally, it should be noted that CDB is in discussions with Australia-based Macquarie Bank to raise more money for itself by selling infrastructure-linked asset-backed securities (bonds that are repaid by the revenues generated by CDB's infrastructure lending portfolio).<sup>150</sup>

## Corporate loan cycle

Because CDB is a policy bank, it has not established credit risk management systems that are commensurate with other Chinese commercial banks (particularly the ones that have gone public). However, the bank describes its credit risk management system as follows:

- Two project appraisal departments, which specialize in particular industries, are responsible for completing an initial project evaluation and feasibility study. These studies include assigning an internal credit rating to the project, in which the creditworthiness of the country, region, industry, individual borrower and individual facility is analyzed.
- After the initial evaluation and feasibility study is finished, more due diligence is performed by the project appraisal administration department. The department consults with at least 25 members of independent committee (which is comprised of 100 appraisal experts)
- The department also consults with the comprehensive planning department, the legal department and credit risk management department in the CDB headquarters.
- The department then submits all the reports and makes a recommendation to the loan approval committee, which makes the final decision on the project. The committee includes the vice governor and heads of certain departments (e.g. credit risk management, comprehensive planning, legal). The loan approval committee also reports to the governor, and the governor can veto committee decisions.

<sup>147</sup> "China Development Bank To Sell 10-Year Dollar Bonds," Asia Pulse, 21 September 2005

<sup>148</sup> "China Development Bank issues 1 bln usd in global bonds," AFX European Focus, 29 September 2004

<sup>149</sup> "China Development Bank Obtains US\$700 Mln Syndicated Loan," Asia Pulse, 18 May 2006

<sup>150</sup> Davies, Rob, "CDB and Macquarie Bank team up for infrastructure ABS deal," Asset Securitization Report, 18 December 2006

- After the loan is disbursed, the credit administration department, as well as the bank branches, monitor the loans.

## Environmentally-relevant activities and policy

*The CDB is one of only two Chinese banks with a publicly disclosed summary of its environmental policy.*

The CDB is one of two Chinese banks with a publicly disclosed (summary of its) environmental policy. Its environmental policy is described in the bank's 2005 global bond prospectus (probably as a result of repeated queries from CDB's international bond underwriters, who were criticized for years by international NGOs for CDB's role in financing the Three Gorges dam):

"In recent years, environmental compliance has become an aspect of our loan evaluation process. We will not consider a loan application complete until the applicant has obtained approval from the relevant environmental agencies and we are otherwise satisfied with its environmental compliance. Under the Law on Environmental Impact Assessment effective September 1, 2003, project companies must submit environmental impact assessment reports to the State Environmental Protection Administration at the relevant national, provincial or local levels with respect to environmentally sensitive projects. In accordance with this law, the State Environmental Protection Administration has published a catalog, which lists environmentally sensitive projects and specifies the requirements and coverage of their environmental impact assessment reports. The catalog currently lists many industries subject to this reporting requirement, including coal mining, oil and gas exploration and development, pulp mill, petroleum refinery, chemical and petrochemical production, machinery and equipment manufacturing, power generation and transmission, hydropower facilities, urban transportation infrastructure, waste disposal facilities, railways, highways, ports, and nuclear facilities. A project company must engage an independent and qualified environmental appraiser to assess the environmental impact and to prepare the report for submission to the government. In addition, the law does not permit any project listed in the catalog to begin construction until government regulators are satisfied with the environmental impact assessment."

*Given CDB's increasing role in financing overseas activities, such as the Ramu nickel mine in Papua New Guinea, it is unclear how CDB applies its environmental policies, which seem largely tailored for projects within China.*

It should also be noted that many large-scale projects funded by CDB, most notably the Three Gorges Dam and the South-to-North Water Diversion project, have dubious environmental reputations despite approval by governmental authorities. Other environmentally controversial projects include the Jinping Cascade 1 hydropower station, and Tangguh LNG project; the bank also counts China Datang, China National Petroleum Corporation, Sinopec, and China Poly as its clients. Given CDB's increasing role in financing overseas activities, such as the Ramu nickel mine in Papua New Guinea, it is unclear how CDB applies its environmental policies, which seem largely tailored for projects within China.

In terms of environmental protection, CDB has signed an agreement with SEPA to provide financial support to environmental protection

initiatives with plans to extend lending to a total of RMB 50 billion within the next 5 years. The bank has advanced RMB 135 million for a project to plant 4.5 million acres of sand willow (*Salix Cheilophila*) in Inner Mongolia AR. The project is intended to prevent desertification and soil erosion from strong Siberian wind currents, as well as provide additional income for local farmers. The trees will provide raw materials for paper products, fiber and particle boards, and leaves as feed for livestock. CDB also provided RMB 959 million in emergency loans in response to disasters such as bird flu outbreak, the explosion at the Jilin Chemical Plant, pollution of the Songhua River, Typhoon "Yunna", and floods in Guangxi. Unfortunately, these loans represent emergency responses to disasters caused or exacerbated by environmental problems, whereas preventive measures in the form of environmental protection projects would have provided a cheaper solution.

As reflection of its role as a state policy bank, CDB bases its finance decisions on state priority; thus funding for projects are based the political favor and priority they receive from the government, not necessarily on the impact they have on the environment. But as environmental protection receives greater attention from the government (as demonstrated by the Eleventh Five-Year Plan), environmental projects may receive greater financial support from CDB and other banks.



## China Export-Import Bank

### 中国进出口银行<sup>151</sup>

#### Background

*Together, Chexim and Sinosure are set to become the world's largest export credits provider by 2010.*

Along with Sinosure, the China Export-Import Bank (Chexim) was created to finance the overseas operations of Chinese businesses and promote Chinese exports. Together, Chexim and Sinosure are set to become the world's largest export credits provider by 2010.<sup>152</sup> Chexim also serves as a channel for dispersing foreign government loans within China, and is Beijing's sole agent bank for extending concessional (low-interest or subsidized) loans abroad.<sup>153</sup>

Chexim was established by the Policy Banks Law in 1994 and operates under the direction of the State Council. Currently, the bank operates seven business branches, six domestic representative offices and overseas representative offices in Abidjan, Cote d'Ivoire; Johannesburg, South Africa; and Paris, France. As of 2005, Chinese export and import volumes total USD 1.4 trillion, ranking third in the world.

Chexim's assets total RMB 204.8 billion with loans of RMB 176 billion; however if its off-book lending assets of RMB 145.85 billion (for example, its USD 16.8 billion in on-lending from foreign governments) are included, Chexim's assets would stand at RMB 350.6 billion. Its total income for 2005 is RMB 9.26 billion and net profit for 2005 is RMB 72 million. Currently, Chexim's non-performing loan ratio stands at 4.4%. In 2005, the bank launched several products, including its import credit service and export credit service for agricultural produce; it also extended financing to Hong Kong, Macao and Taiwanese enterprises as well as to small and medium-sized enterprises (currently an underserved market).

Chexim has been growing rapidly. The United States Export-Import Bank conservatively estimates that while Chexim's medium- and long-term financing was about USD 4.5 billion in 2002, it could reach USD 40 billion by 2010. If the bank finances 5% of Chinese exports by this time, the figure could reach a staggering USD 80 billion.<sup>154</sup> (The World Bank's total financing currently stands at about USD 25 billion.)

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<sup>151</sup> All information derived from China EXIM Bank's 2005 Annual Report and [www.eximbank.gov.cn](http://www.eximbank.gov.cn) unless otherwise stated

<sup>152</sup> Export-Import Bank of the United States. Report to the US Congress on Export Credit Competition and the Export-Import Bank of the United States for the Period January 1, 2005 through December 31, 2005. June 2006.

<sup>153</sup> "Export-Import Bank of China: Bank Credit Report," Standard & Poor's, 10 August 2006.

<sup>154</sup> Export-Import Bank of the United States. Report to the US Congress on Export Credit Competition and the Export-Import Bank of the United States for the Period January 1, 2005 through December 31, 2005. June 2006.

## Corporate lending and financial services

### What is trade financing?

*Exporters are eager to sell their products overseas, but face many risks. For example, how can they make sure the buyer of their product can or will pay for the goods? Importers may be eager to buy Chinese products too, but what if the goods turn out to be different than they expected? Sellers want payment up front, while buyers want to pay when at a time most convenient for them. (This is called an "open account," and only the largest and most respected buyers can do this.) In order to bridge this gap, the buyer's and seller's banks handle the trade financing. The most common form of trade financing is a Letter of Credit, which the buyer obtains from its bank. This Letter of Credit is given to the seller's bank, and stipulates that when the goods arrive and certain conditions are met, the buyer's bank will transfer the payment to the seller's bank. Other risks (such as the possibility that the buyer's bank will go out of business, or that the exporter's goods will not be of good quality) can be mitigated through guarantees and insurance offered by Chexim and Sinosure.*

### Trade finance

Like many governments, Chexim offers products to encourage trade in Chinese goods:

- *Export seller's credit*, which is a loan at preferential rates for Chinese firms wanting to sell their goods abroad
- *Export buyer's credit*, which is a medium- or long-term loan to a foreign buyer who wants to purchase Chinese-made goods. Often large construction projects need to buy equipment, and Chexim financing makes buying Chinese equipment more attractive
- *Guarantees* for either Chinese exporters, foreign importers, and/or their banks

Buyers and sellers of Chinese goods need bank financing in order to facilitate the trade of Chinese products. For example, a dam builder in Sudan may want to import equipment from a Chinese seller; an export seller's credit would ensure that the Chinese seller would get paid once the equipment arrives in Sudan. This is especially important for dam projects, since it may be many years before the dam is built and generates enough money to actually pay for itself. In another example, an overseas buyer of Chinese products may need financing to pay for the product and its shipment. An export buyer's credit would provide this financing for the buyer/importer. For Chexim's helpful explanation of export buyer's credit, see Appendix 1. It should be noted that although Chexim offers export and import financing, commercial banks can also provide such credits.

Finally, Chexim offers guarantees (for buyers, sellers and/or their banks) in case either side does not fulfil its contract. For example, a Chinese company may require some advance payment before exporting its goods; however, this puts the buyer at a risk (called an advance payment risk) because the seller could fail to ship the products. Chexim offers a guarantee that would ensure that if the goods never arrive, the buyer's advance payment would be refunded. Some of these risks can also be covered through export credit insurance, offered through Sinosure.

### Agency banking for governmental lending

Chexim differs from most export credit agencies, because it serves the country's official conduit for governmental lending. In this capacity, Chexim also provides:

- *Low interest or concessional loans* from Beijing to poor governments in order to enable them to buy Chinese goods and services for development projects
- *Onlending of foreign government loans*, which means that Chexim channels loans from foreign governments to specific government agencies, provincial governments, or NGOs within China.

Because Chexim makes concessional loans, it receives capital injections and subsidies from the government to make up for the losses.<sup>155</sup>

It should be noted that most export credit agencies are moving away from aid/ concessional loans, and instead concentrating on commercial transactions. Since 1992, the OECD has worked with national export credit agencies to make sure that “tied aid” (government grants or concessional loans that require the recipient to use that money to purchase goods or services from companies based in the donor country) goes to genuine aid projects. When it goes instead to commercially viable business activities, such as energy or industrial projects, it creates unfair advantages to companies based in the donor country. For example, in October 2006 Chexim gave Sri Lanka a 20-year concessional loan of USD 300 million (at a cheap 3.5% interest rate) so that it could pay a Chinese company to construct a power plant. Some OECD export credit agencies have expressed concern that Chexim, whose concessional lending is increasing at a rate of about 35% per year, is not cooperating with international efforts to reduce the trade-distorting efforts of tied aid.<sup>156</sup>

## **Export credits: geographic and sectoral exposure**

### **Export sellers credits**

As the national export-import bank, Chexim maintains a high profile overseas, with most of its business focused on Central Asia and Africa. Loans for Chinese exporters accounted for about 73% of all export credits, and the vast majority of these credits were for SOEs. Loans to Chinese sellers are usually made in RMB.<sup>157</sup>

The United States Export-Import Bank compiled a list of Chexim exporter credits,<sup>158</sup> which include:

- A RMB 10.3 billion agreement to assist with the export financing of Beijing Construction Engineering Group Corporation, the Founder Group and CGC Overseas Construction.
- A RMB 5 billion export financing package for Hunan Valin Steel and Iron
- A USD 3 billion export credit agreement with China Machinery Group
- A RMB 6 billion export credit agreement to TCL group (electronics)
- A USD 5 billion line of credit for China Huaneng Group

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<sup>155</sup> Ibid.

<sup>156</sup> Ibid.

<sup>157</sup> Ibid.

<sup>158</sup> Ibid.

In 2005, Chexim extended RMB 82.42 billion in credit to export sellers – an increase of 33% from the year before. The distribution of approved credit (RMB 94.11 billion) for export sellers are as follows:

<b>Export Sellers Credits</b>		
<b>Industry</b>	<b>RMB, billions</b>	<b>Percentage</b>
Offshore construction & overseas investment projects	31.02	33
Equipment Exports	2.41	2.5
High-tech and new-technology products	33.71	35.8
Export of ships and vessels	15.87	16.9
Export of general mechanical, electronic products	11.09	11.8

It should be noted that on a cumulative basis (by the end of 2005), some 85% of Chexim's export sellers' credits were for ships and vessels, high/new technology projects and "going global" projects.

### Export buyer's credits

By comparison, Chexim's export buyer's credit operation stands at USD 4.37 billion (2005); although this figure is small compared to the bank's export seller's financing window, it constitutes a 95% increase over 2004. Loans to buyers of Chinese goods are usually made in foreign currency,<sup>159</sup> and usually involve capital construction projects. The maturities (pay back period) for these buyer's credits can be long, up to 15-20 years.<sup>160</sup> Examples of Chexim's export buyer's deals include:

- USD 1.5 billion USD in loans to A.P. Moller – Maersk Corporation, one of the world's largest shipping companies and the largest purchaser of Chinese ships and vessels, for the procurement of ships, containers and harbor crane equipment from China (2005)
- A buyer's loan to Nigerian customers of Huawei Technologies, a Chinese telecommunications company (2005)
- A USD 2 billion buyer's credit loan facility to the government of Zimbabwe, which will be supposed to help the country combat inflation. According to press reports, the Zimbabwean government will likely "mortgage its mineral proceeds to attain the loan facility from the Chinese government. Shares in state

<sup>159</sup> Export-Import Bank of the United States. Report to the US Congress on Export Credit Competition and the Export-Import Bank of the United States for the Period January 1, 2005 through December 31, 2005. June 2006.

<sup>160</sup> Ibid.

parastatals are also rumoured to be used as collateral for the financing.”<sup>161</sup>

Chexim’s annual report particularly notes that in 2005 they made “breakthrough in market expansion in Africa,” and that “the proportion of loans agreements for international economic cooperation was enhanced to 20%, making it another fast-growing area following ship finance.”

## On-lending from foreign governments: sectoral exposure

It is important to note that on-lending from foreign governments, particularly Japan, accounts for almost half of the loans that Chexim makes. In 2005, the bank approved 52 on-lending transactions with a total value of USD 16.8 billion from foreign governments. These loans are provided for projects in China by the governments of Japan, Germany, the Netherlands, Austria, Spain, Australia, Norway, Finland, Denmark, Kuwait, Korea, Belgium, Great Britain, Sweden, Luxembourg, Poland, Canada, Saudi Arabia, Switzerland, France, the European Investment Bank, the Nordic Investment Bank, and the Nordic Development Fund. In particular, 82% of outstanding foreign government lending comes from Japan Project Finance (日本政府贷款项目). The bank has stated that it will manage the funds to support key state projects in the fields of transportation, environmental protection, and education. The distribution of foreign government on-lending follows:

Industry	Percentage
Municipal construction	20
Electric power	11
Industry	10
Transportation	39
Agriculture	5
Telecommunications	1
Others	14

## Chinese concessional lending: geographic and sectoral exposure

Chexim acts as a conduit for concessional loans from the Chinese government to other nations. As of December 2005, official concessional lending accounted for about 3% of Chexim’s assets. The Ministry of

<sup>161</sup> Fourie, Thea, “China and Zimbabwe to Negotiate Possible US\$2-bil. Loan Facility,” Global Insight, 22 December 2006

*Between 2001-2005, Chexim made 78 concessional loans as part of Beijing's foreign aid activities, with such loans growing at about a rate of about 35% per year.*

Commerce plays a role in deciding which overseas development projects should be supported with concessional loans.<sup>162</sup>

Between 2001-2005, Chexim made 78 concessional loans as part of Beijing's foreign aid activities, with such loans growing at about a rate of about 35% per year. Examples include a 2005 Concessional Loan Agreement between the Chinese government and the Ministry of Finance of Vietnam to upgrade railways and telecommunications in the Greater Mekong Delta. In December 2006, Beijing also provided a RMB 200 million preferential credit from Chexim to Turkmenistan for telecommunications equipment.<sup>163</sup> Other examples compiled by the United States Export-Import Bank and press reports include:

- A USD 400 million concessional loan to the Philippines for the North Rail project, which involves China National Machinery and Equipment company
- A concessional loan to Uzbekistan for computer equipment
- A USD 400 million export credit package for three projects, including a bridge that would be built with the participation of Chinese exporters
- A USD 455 million loan (USD 300 million on concessional terms) for China National Machinery and Equipment Import and Export Corporation (CMEC) to construct a coal power plant at Norochcholai, Sri Lanka (2006). Environmentalists and community members had successfully campaigned to postpone the project in the late 1990s.<sup>164</sup>

Other recent transactions include:

- A USD 2 billion line of credit for China Minmetals Corp for overseas expansion over the next three years (2005), which will probably finance MCC's controversial Ramu nickel mine in Papua New Guinea.<sup>165</sup>
- A 5-year USD 3 billion cooperation with the China State Construction Engineering Corporation to support its "go out" efforts<sup>166</sup>
- A USD 2 billion line of credit to Chalco to fund its overseas expansion. Over the next three years, the company wants to double its bauxite reserves to 600 million tons.<sup>167</sup>

162 "Export-Import Bank of China: Bank Credit Report," Standard & Poor's, 10 August 2006.

163 "Turkmen Communications Sector Gets 200m-Yuan Chinese Credit," BBC Monitoring International Reports, 20 December 2006.

164 "China National Machinery Import Export secures financing for 300-MW phase of Sri Lankan project," Global Power Report, October 12, 2006

165 "Export-Import Bank of China to offer China Minmetals 2 bln usd credit line," AFX – Asia, 11 November 2005

166 "CSCEC Deal Propels 'Go Global' Scheme," Business Daily Update, 29 December 2005

- A 2006 agreement with UK-based Barclays Capital, and Absa Capital (a South Africa-based investment bank owned by Barclays Group) to provide 20 large Chinese companies with consulting services in energy, mining and infrastructure<sup>168</sup>

## Governance

The China Export-Import Bank, like all the policy banks, report to the State Council. It also is under the partial direction of the Ministry of Commerce and the Ministries of Finance and Foreign Affairs.<sup>169</sup> At the top of Chexim's governance structure is its Board of Directors. Beneath the Board of the Directors is the Office of the Chairman and President, which is the executive body that carries out the resolutions of the Board of Directors.

The Office of the Chairman and President is divided into the Credit Assets Management Committee and the Project Evaluation Committee.

The bank reports to the State Council and its credit plan must be approved by the PBOC. However, Chexim "enjoys relative autonomy in its project evaluation and approval process."<sup>170</sup> In 2005 Chexim established a Credit Risk Management Committee. In addition, Chexim reportedly sees the need for developing better post-financing management strategies.<sup>171</sup>

## Capital raising activities

Chexim raises capital in several different ways. The Ministry of Finance has provided the bank with all of its registered capital (the amount of money that a bank needs to have in order to start operations).<sup>172</sup> Its foreign government onlending comes from overseas governments, of course. Its concessional loans to other developing countries come from Beijing.

As for its own financing activities, Chexim currently raises most of its capital from China's domestic bond markets. For example, in 2005, it issued RMB 40 billion in bonds, and USD 500 million in floating rate notes (another kind of bond, which was notable because it was one of the first times a Chinese bank raised dollars in China). However, it also has raised money from international sources as well. Examples include:

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167 Lee Master, Tim, "Guangxi Bauxite Venture Secures 7.3b Yuan Loan," *The Standard*, 26 August 2005

168 "China's Exim Bank, Barclays Join Hands To Tap African Market," *Asia Pulse*, 27 October 2006

169 Export-Import Bank of the United States. Report to the US Congress on Export Credit Competition and the Export-Import Bank of the United States for the Period January 1, 2005 through December 31, 2005. June 2006.

170 "Export-Import Bank of China: Bank Credit Report," Standard & Poor's, 10 August 2006.

171 "Export-Import Bank of China: Bank Credit Report," Standard & Poor's, 10 August 2006.

172 "Export-Import Bank of China: Bank Credit Report," Standard & Poor's, 10 August 2006.

- A USD 260 million loan from nine banks in February 2006. The syndicate was led by Bank of China, and included Royal Bank of Scotland Group Plc, Sumitomo Mitsui Banking Corp, ING Greop NV, Bank of Montreal, HSBC Holdings Plc, BNP Paribas SA, Bank of Tokyo-Mitsubishi UFJ Ltd and Mizuho Corporate Bank Ltd.<sup>173</sup>
- A USD 500 million syndicated loan agreement with Calyon, ING, and Standard Chartered as mandated lead arrangers. Other banks in the syndicate included 13 Chinese banks and Chinese branches of foreign banks such as Barclays and Mizuho Bank, Bank of Tokyo-Mitsubishi UFJ (July 2006)<sup>174</sup>
- A USD 1 billion global bond led by Merrill Lynch, Citigroup, HSBC, BNP Paribas, Bank of China International and Goldman Sachs (June 2005)
- A syndicated bank loan of USD 750 million, led by Citigroup. 19 Chinese and foreign banks were members of the syndicate, including Agricultural Bank of China, Bank of China and Bank of East Asia (November 2004)
- A USD 1 billion global bond led by Goldman Sachs, Citigroup, Deutsche Bank and HSBC (issued in two tranches, June and August 2004)

Chexim's international fund raising is likely to increase given the banks' plans for growth.

## **Environmentally-relevant activities and policies**

Chexim finally disclosed a public copy of its environmental policy in April 2007 (See Appendix 3). There are three key points to its policy:

- In the pre-finance phase, the bank requires project sponsors to conduct environmental impact assessments, and to obtain proper environmental approvals.
- In the implementation phase, the bank routinely monitors the environmental impact of projects; if it finds that the project is or will pose unacceptable negative impacts, the bank will require the project sponsor to take remedial or preventive measures. Otherwise, the bank will discontinue financial support.
- In the post-completion phase, the bank states that it conducts reviews of projects (including reviewing projects' environmental impacts), which inform future environmental standards setting at the bank.

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<sup>173</sup> "Exim Bank seeks loans to finance China firms," Xinhua online, 9 February 2006.

<sup>174</sup> "The US\$500million Syndicated Loan Helps Sustained Rapid Business Growth of The Export-Import Bank of China," China Export-Import bank news release, 4 July 2006 at [http://english.eximbank.gov.cn/info/Article.jsp?a\\_no=1556&col\\_no=84](http://english.eximbank.gov.cn/info/Article.jsp?a_no=1556&col_no=84)



Despite this policy, many projects funded by Chexim are socially and environmentally controversial. Almost all of these projects are based in other developing countries, many of which are home to some of the world's most biologically-diverse and ecologically-fragile ecosystems. For example, the Chexim-backed Ramu nickel mine in Papua New Guinea employs the destructive practice of submarine tailings disposal (discharging mining waste into the ocean), and was described by the New Guinean National Fisheries Authority as "an unsustainable project socially, economically, and environmentally; and cannot be allowed to proceed."<sup>175</sup>

Chexim provided the majority of financing for Laos' Nam Mang 3 Dam, which is accused of opening the area for illegal logging and destroying local spawning grounds and the habitat of elephants, bears, bison, and other rare species.<sup>176</sup> In August 2003, the bank approved a USD 200 million loan for the construction of the equally environmentally suspect Yeywa Dam in Burma.<sup>177</sup> Most recently, it has been looking into investment opportunities in the Eritrean mining and fishery industries with the encouragement of the Eritrean government. In June 2006, Chexim, along with Bank of China and China Development Bank, offered a USD four billion loan to Indonesia to help build coal-fired power plants with Chinese technology and contractors.<sup>178</sup> It has also signed a loan agreement with CNOOC to provide RMB 12.8 billion for its operations in Nigeria.<sup>179</sup>

The bank also has many clients involved in environmentally-sensitive activities, including China International Marine Container, China National Machinery & Equipment Import-Export Corporation, China Non-Ferrous Metal Mining, and Sinopec.

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175 Mineral Policy Institute, "Ramu Nickel Mine: Ocean dumping mine source of controversy," at <http://www.mpi.org.au/regions/pacific/png/ramu/>

176 Unpublished World Bank report: Developing Financial Intermediation Mechanisms for energy efficiency Projects in Brazil, China and India.

177 Unpublished World Bank report: Developing Financial Intermediation Mechanisms for energy efficiency Projects in Brazil, China and India.

178 Aurora, Leony. "Indonesia Sidesteps Open Bids; State Power Company Will Award Contracts". The International Herald Tribune. 7/10/2006

179 "CNOOC Signs US\$1.6bln Loan Pact for Nigeria Oil Project". Asia Pulse. 6/5/2006

## Sinosure 中国出口信用保险公司<sup>180</sup>

### Background

China Export & Credit Insurance Corporation (Sinosure) was established in 2001 through a merger of China Export-Import Bank's Export Credit Insurance Departments and PICC's (formerly the People's Insurance Company of China) export credit insurance business. Sinosure was initially founded through a governmental allocation of RMB 4 billion from the Export Credit Insurance Risk Fund.

Sinosure is a policy bank with a mission to support and promote Chinese exports and foreign investments. It specializes in providing export credit insurance, which guarantees other banks for the loans they make to buyers and sellers of Chinese products.

According to Sinosure's website, it has set a goal of increasing its business by 16 times in the next three years. Indeed, Sinosure is on target to meet this goal; the US Export-Import Bank predicts that Sinosure's financing volume will grow from a total of USD 2.27 billion in 2001 to a projected level of USD 1.2 trillion by 2010.<sup>181</sup>

### Products

Like many other governmental export insurance agencies (e.g. the United States Overseas Private Investment Corporation, and France's COFACE), Sinosure offers a range of export credit insurance products, including:

- Short-term export credit insurance, which lasts less than one year, and guarantees that Chinese exporters will get paid if their overseas buyers default.
- Medium- and long-term credit insurance, which lasts more than one year, and encourages Chinese firms to bid for large construction projects where equipment and machinery is needed.
- Investment insurance, which is offered to Chinese companies (as well as their shareholders and banks) that want to operate overseas, but are worried about certain political risks, such as the threat of war.
- Guarantees, which are offered to the banks of Chinese exporters that want to participate in overseas projects.
- SinoRating, research and analysis to help Chinese companies understand the risks associated with operating in various countries, or with certain potential business partners.

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<sup>180</sup> Information from Sinosure website and 2004 annual report, unless otherwise noted.

<sup>181</sup> Export-Import Bank of the United States. Report to the US Congress on Export Credit Competition and the Export-Import Bank of the United States for the Period January 1, 2005 through December 31, 2005. June 2006.

Buyers and sellers of Chinese goods need to get bank financing in order to facilitate the trade of Chinese products. This puts both the seller (usually a Chinese company) and its bank (usually a Chinese bank) at risk, since the buyer could fail to make payment for a variety of reasons. For example, the buyer or the buyer's bank could go out of business, or the government of the country in which the buyer operates could restrict the movement of foreign exchange. On the other hand, buyers and their banks also have their own set of worries, especially when it comes to large construction projects. For example, the seller's products/services could be of unsatisfactory quality, or perhaps the seller's bank is so nervous about the threat of civil war in the project country that it may refuse financing. Sinasure guarantees against these kinds of commercial and political risks, by promising to pay the debt if such events occur.

## Geographic exposure

According to Sinasure's 2004 annual report, its financial products went to support overseas trade and investment in:

- Asia (39%)
- North America (29%)
- Europe (23%)
- Latin America (4%)
- Oceania (3%)
- Africa (3%)

It should be noted that most of Sinasure's short-term trade financing goes to exports and imports to/from developing countries. However, when it comes to medium- and long-term financing, a majority (56%) of its medium- and long-term insurance goes to the countries of Iran, Sudan, the Philippines and Pakistan.

## Sectoral exposure

The sectoral exposure of Sinasure's products are:

Light industrial products	59%
Mechanical and electronic products	25%
Others	11%
Agricultural products	4%

The United States Export-Import Bank notes that "the exporter/sectoral composition of Sinasure's current portfolio is apparently dominated by large [state-owned enterprises] as well as a number of private or minority government share companies in certain key sectors: Telecommunications (both Huawei which is employee-owned and ZTE,

*Less than one tenth of Sinosure's financing goes for medium and long term investment credits, which are usually associated with large overseas project development*

*About 60% of Sinosure's medium and long term financing goes to cover Chexim projects and transactions.*

state owned); Sinopec (petroleum); forestry (mainly in Russia); and hydropower.”<sup>182</sup>

Finally, it should be noted that short-term buyer and seller credits comprise the vast majority of Sinosure's financing, about USD 10.64 billion. Only about USD 100 million goes for medium and long term investment credits, which are usually associated with large overseas project development. Also, about 60% of Sinosure's medium and long term financing goes to cover Chexim projects and transactions.<sup>183</sup>

Sinosure's transactions include<sup>184</sup>:

- Cooperation agreements with PetroChina, Sinopec, CNOOC, Sinochem, Zhenhua Oil and Citic Group to provide “all sided risk guarantees” for overseas projects<sup>185</sup>
- Insuring a buyer credit (\$15.6 million) and a commercial credit (\$2.5 million) for BNP Paribas Bank's loan of \$18.1 million to the Vietnam Construction Export and Import Corporation (Vinaconex), which is building the Cua Dat Hydroelectric Plant in Vietnam (\$100 million)
- Calcined soda plant in Uzbekistan<sup>186</sup>
- Blanket export insurance for Sinochem Corporation
- Cuban Government agreement on debt re-organization
- Blanket policy agreement on short-term export credit insurance with the China Machinery Equipment Import and Export Corporation
- China Chemical Industry Engineering Company and the China Chengda Engineering Company to build a power plant in Indonesia
- Yunnan Machinery Equipment Import and Export Company, Yunnan Machinery Import and Export Company, and the China Complete Plant Equipment Yunnan Branch
- China Aerospace Technology Import and Export Corporation Beijing Branch for exporting cargo ships to Iran.
- China Dongfang Electric Corporation and Sichuan Provincial Machinery and Equipment Import and Export Co. Ltd.
- Hebei Provincial Textile Import and Export Group Company;
- Chongqing Foreign Construction Corporation to build P-H highway development project in Uganda (financed by the World Bank)
- Government of Myanmar on debt restructuring
- Various operating and financing agreements with Nigerian oil developers, including: Amni Petroleum, Emerald Energy Resources Limited and BlueWater Oil and Gas Investment Company<sup>187</sup>

182 Export-Import Bank of the United States. Report to the US Congress on Export Credit Competition and the Export-Import Bank of the United States for the Period January 1, 2005 through December 31, 2005. June 2006.

183 Export-Import Bank of the United States. Report to the US Congress on Export Credit Competition and the Export-Import Bank of the United States for the Period January 1, 2005 through December 31, 2005. June 2006.

184 All deals from Sinosure website, unless otherwise noted.

185 “China's Policy Insurer Helps Energy Firms Go Global,” Asia Pulse, November 15, 2006

186 “Banking & Finance: BNP Paribas to Lend \$181mln To Power Project In Vietnam,” Vietnam News Briefs, October 12, 2006.

187 “Nigeria; Diamond Bank Signs Pact With Chinese Insurance Corporation,” Africa News, December 27, 2004.

## Governance

Sinosure is overseen by the Ministry of Finance, and also has relationships with the Ministries of Commerce and Foreign Affairs.

## Corporate financing cycle

Sinosure can independently make decisions on smaller and short-term transactions. However, the Ministry of Finance must approve financing decisions for medium and long term transactions amounting to over USD 30 million.<sup>188</sup>

## Foreign links

Sinosure works with international banks, notably as BNP Paribas, Société Générale, and Citigroup. It also cooperates with other international public financing agencies such as Sace (Italy), EDC (Canada), Hermes (Germany) and the World Bank's Multilateral Investment Guarantee Agency.<sup>189</sup>

*Standard Chartered bank states that it is "actively pursuing mandates for Sinosure-backed deals into Africa."*

Standard Chartered bank states that it is "actively pursuing mandates for Sinosure-backed deals into Africa," and claims that it already won the sole mandate to arrange a Sinosure-backed \$75 million credit facility to support Alcatel Shanghai's sale of telecoms equipment to Ghana Telecom.<sup>190</sup>

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188 Export-Import Bank of the United States. Report to the US Congress on Export Credit Competition and the Export-Import Bank of the United States for the Period January 1, 2005 through December 31, 2005. June 2006.

189 Export-Import Bank of the United States. Report to the US Congress on Export Credit Competition and the Export-Import Bank of the United States for the Period January 1, 2005 through December 31, 2005. June 2006.

190 Spong, Rebecca, "Perseverance will pay dividends," Trade Finance, 1 September 2006.

## Agricultural Development Bank of China

### 中国农业开发银行<sup>191</sup>

#### Background

The Agricultural Development Bank of China (ADBC) is one of three state policy banks founded by the Policy Banks Laws in 1994. It was established for the purpose of promoting further development of agriculture and rural economic development. Like CDB and Chexim, ADBC operates under the direction of the State Council. The bank is the most troubled and financially weak of the state-owned policy banks. According to its latest self-issued report in 2005, ADBC's total assets amount to RMB 850.2 billion with loans totalling RMB 787 billion, operating profits of RMB 5.32 billion and net profits of RMB 24 million.

Its non-performing loan ratio stands at 10.1%, compared to 0.87% for China Development Bank and 4.4% for China Export-Import Bank. In August, ADBC officials had to fend off rumors that the bank's NPL ratio was much higher. Much of ADBC's poorer financial figures are due to its focus on providing financing to agriculture and rural areas, which is a low-margin business.

Since its inception, ADBC has been lending money for procurement, reserve and marketing of grain, edible oils and cotton in accordance with Beijing's policy directives. In contrast, CDB and Chexim provided financial services to economic infrastructure and Chinese exporters, which are less risky and more profitable. The risks of rural financing are reflected in the poor finances of the Agricultural Bank of China, the commercial counterpart of ADBC. Notably, Agricultural Bank used to be the main lender to the country's hundreds of millions of farmers before it split off some policy-based operations to ADBC over a decade ago.

#### Geographic and sectoral exposure

ADBC's financing is focused on rural areas of China.

Its financial services are relatively concentrated in agriculture, although the China Banking Regulatory Commission has recently allowed ADBC to expand its loans slightly. The bank will now be able to lend money to leading companies in forestry, animal husbandry, and fishery industries, in addition to agriculture companies. This expansion is part of Beijing's larger rural finance reform program, which is designed to stimulate the sector by reforming major rural loan providers such as Agricultural Bank of China, ADBC, and rural credit cooperatives.

The ADBC actively extends loans for purchase, sale and processing of agricultural products such as grain, cotton, and oil. Recent activities include:

*Its financial services are relatively concentrated in agriculture, although the China Banking Regulatory Commission has recently allowed ADBC to expand its loans slightly to forestry and fisheries operations.*

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191 All information derived from ADBC's 2005 Annual Report and [www.adbc.com.cn](http://www.adbc.com.cn) unless otherwise stated

- A new loan product for small farmers, which signifies a new trend towards lending to small clients, rather than large government-directed agriculture schemes (2006)<sup>192</sup>
- Extending loans to wheat farmers in an effort to compensate for low wheat prices (2006)<sup>193</sup>

## **Governance**

ADBC is structured in the Head Office – Branch model. At the apex of the governance structure is the Head Office and its Head Office Banking Department, which acts as the executive and management body of the bank.

ADBC also has a Supervisor Board, which is appointed by the State Council. It is charged with supervising the quality of the assets of the bank and ensuring the expansion and security of state assets.

## **Capital raising activities**

ADBC has been busy raising money for itself. In 2006, it increasingly turned to the domestic bond market for financing, raising an estimated RMB 200 billion in 2006.<sup>194</sup>

## **Environmentally relevant activities**

While the Agricultural Bank of China is active in supporting some environmental protection projects, ADBC does not have (or does not attempt to publicize) a significant environmental profile. Like most other Chinese banks, ADBC's corporate charity efforts are largely focused on social undertakings such as poverty alleviation and disaster relief.

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<sup>192</sup> "ADBC to Promote Loans for Small Agricultural Businesses," SinoCast, 19 December 2006.

<sup>193</sup> "China's ADBC Grants Us\$8.3 Bln In Loans To Support Wheat Price," Asia Pulse, October 17, 2006

<sup>194</sup> "Chinese Policy Bank Adopts Market Approaches To Raise Capital," Asia Pulse, 1 August 2006.

## Bank of Communications 交通银行<sup>195</sup>

### Background

Bank of Communications (BOCOM) is a national commercial bank and one of the first Chinese banks to issue bonds. It is one of the oldest banks in China, established in 1908 when China was still under the rule of the Qing dynasty. With the founding of the People's Republic of China, the bank continued to operate through its Hong Kong branch while its mainland branches were incorporated into the People's Bank of China. After the implementation of Deng Xiaoping's economic reforms, the Bank of Communications became first state-owned shareholding commercial bank in April 1987 with the approval of the State Council. As of the end of 2005, the bank's assets total RMB 1.43 trillion with deposits of RMB 1.22 trillion and loans of RMB 771.4 billion. Operating profit for 2005 amounted to RMB 12.84 billion with net profit of RMB 9.24 billion.

*Bank of Communications is the fifth largest commercial bank in China and the largest non-Big Four commercial bank.*

The bank prides itself as a pioneer among Chinese banks. It was the first to implement a shareholding system for its capital and mode of ownership; the first to create a market-oriented organizational structure; the first to introduce competition into the Chinese banking industry; the first to introduce assets/liability ratio management and apply it to the regulation of business operations and risk; the first to build new bank-client relationships based on mutual selection; and the first commercial bank to integrate banking, insurance and securities businesses. Today, it is the fifth largest commercial bank in China and the largest non-Big Four commercial bank.

### Geographic exposure

The bank's geographical exposure follows (loan balances as of 30 June 2006):

- Northern China (including Beijing Municipality, Tianjin Municipality, Hebei Province, Shanxi Province, Inner Mongolia Autonomous Region): RMB 144,332 million
- Northern-eastern China (including Liaoning Province, Jilin Province and Heilongjiang Province): RMB 63,180 million
- Eastern China (including Shanghai Municipality, Jiangsu Province, Zhejiang Province, Anhui Province, Fujian Province, Jiangxi Province and Shandong Province): RMB 376,618 million
- Central & Southern China (including Henan Province, Hunan Province, Hubei Province, Guangdong Province, Guangxi Autonomous Region and Hainan Province): RMB 177,967 million
- Western China (including Chongqing Municipality, Sichuan Province, Guizhou Province, Yunnan Province, Shaanxi Province,

<sup>195</sup> All information derived from Bank of Communications' 2005 Annual Report and [www.bankcomm.com](http://www.bankcomm.com) unless otherwise stated



Gansu Province and Xinjiang Autonomous Region): RMB 78,352 million

- Overseas (including Hong Kong, New York, Singapore and Tokyo): RMB 58,488 million

On the mainland, Bank of Communications operates in 137 cities with 27 provincial branches. Since 1987, it has focused on the Yangtze River Delta, the Bohai Rim Economic Zone and the Pearl River Delta. By the middle of 2006, BOCOM's Eastern China, Central China, Southern China and Northern China lending accounted for 90.87% of the bank's net profits.<sup>196</sup>

Overseas, the bank has branches in New York, Tokyo, Hong Kong, Singapore, and Seoul with representative offices in London and Frankfurt. BOCOM's overseas loans outstanding account for about 5.7% of their total loans outstanding. Despite its wide geographical presence, it possesses a lean staff of 55,000 employees compared with China's Big Four banks (whose average staff size of about 300,000), which suggests inefficiency.

## Sectoral exposure

*Bank of Communications was established to financier for the telecommunications and transportation industries. However, BOCOM's corporate lending is currently concentrated in the manufacturing sector.*

As its name suggests, BOCOM was established to financier for the telecommunications and transportation industries. However, BOCOM's corporate lending is currently concentrated in the manufacturing sector:

Manufacturing	35.4
Steel	3.8%
Machinery	3.7
Electronics	4.7
Petroleum and chemical	5.5
Textile	3.7
Other manufacturing*	14.0
Trading	3.3
Real estate	12.4
Transportation	8.5
Services	6.7
Post and telecommunications	3.0
Construction	4.1
Utilities	7.1
Education and scientific research	5.2
Agriculture	0.4
Non-banking financial institutions	1.6
Others	2.3

<sup>196</sup> Bank of Communications 2006 Interim financial report.

\* Includes, among others, light industry, food processing, pharmaceutical and non-ferrous metal industry. Note that "utilities" includes power generation, water purification and infrastructure construction

Recent news reports indicate that BOCOM plans to increase financing to communications, power, petro-chemicals and retail companies, and reduce lending to the iron and steel sector.<sup>197</sup>

Although BOCOM does not provide the names of its top ten clients, it does provide their area of business (as of December 2004):

<b>Top ten clients</b>		
<b>Company category</b>	<b>Type of company</b>	<b>RMB millions</b>
Petrochemical	Joint stock	4,796
Services	State owned	2,855
Transportation	State owned	2,800
Petrochemical	State owned	2,000
Transportation	State owned	1,968
Post and telecommunications	State owned	1,950
Trading	State owned	1,749
Petrochemical	Sino foreign joint venture	1,680
Steel	State owned	1,661
Transportation	Sino foreign joint venture	1,618
<b>Top ten</b>		<b>23,077</b>

Recent transactions include:

- Participating in a RMB 15.3 billion syndicated loan to Wuhan Iron and Steel (Group) Corp, parent company of Wuhan Steel Processing Co Ltd. Other banks in the syndicate include Industrial and Commercial Bank of China (ICBC), China Construction Bank (CCB), Bank of China, Agricultural Bank of China, CITIC Bank, China Merchants Bank, Industrial Bank, Everbright Bank and Wuhan Urban Commercial Bank (2006)<sup>198</sup>
- Participating in a HKD 1 billion loan syndication for Lee & Man Paper Manufacturing Ltd. Others in the syndicate include Citigroup, Agricultural Bank of China, The Bank of Tokyo-Mitsubishi UFJ, Ltd, BNP Paribas, China Construction Bank, Export Development Canada, Fortis Bank SA/NV, Industrial and

<sup>197</sup> "Bank Of Communications First Half Net Up Almost One Third," Banking Newslink, 25 August 2006

<sup>198</sup> "China's Wuhan Steel signs 15.3 bln yuan syndicated loan deal," AFX Asia, 2 August 2006

Commercial Bank of China (Asia) Ltd, Mizuho Corporate Bank Ltd, Sumitomo Mitsui Banking Corporation and United Overseas Bank Ltd (2006)<sup>199</sup>

## Reforms and restructuring

BOCOM began a series of reforms in 2004 in preparation for its IPO on the Hong Kong Stock Exchange in 2005. BOCOM received substantial capital injections from the government through selling RMB 19 billion worth of shares to government investors. In addition, BOCOM sold RMB 53,020 million of bad loans to the government in exchange for bonds worth RMB 20,700 million. By purging its books of bad loans and infusing itself with more capital, the bank was able to attract HSBC as a strategic investor. In August 2004, HSBC bought 19.9% stake in BOCOM for USD 1.75 billion.

On the management side, BOCOM is completing a reorganizing process that will make it more aligned with how major international banks are operated; instead of organizing itself geographically, it will now organize itself into front office (dealing with customers), mid-office (assessing and managing credit risks), and back office (human resources, auditing, etc.) functions. It is thought that this kind of structure will reduce the possibility of corruption and ensure a robust system of checks and balances at the bank.

## Governance

Having gone public over a year ago, the Bank of Communications shares the same shareholder-oriented governance structure utilized by China Construction Bank, Bank of China, and the Industrial and Commercial Bank of China. Core authority for decision-making rests at the General Meeting of Shareholders, to which both the Board of Supervisors and the Board of Directors are directly accountable. Of all Chinese banks, Banks of Communications is arguably the most transparent in its governance practices.

### Board of Directors

The Board of Directors forms the bank's main executive body. It implements shareholders' decisions, determines business plans and investment proposals, and formulates dividend and bonus policies as well as capitalization plans.

### Board Committees

- The Strategy Committee studies and formulates business strategies, and assesses the management of capital.
- The Audit Committee reviews and oversees the bank's financial reporting procedures and the bank's auditor, and evaluates the effectiveness of the bank's internal control.

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<sup>199</sup> "Hong Kong's Lee & Man Paper secures 1 bln hkd loan from 12-bank group," AFX – Asia, 1 August 2006

- The Risk Management Committee monitors and assesses risk management, as well as approving major connected transactions.
- The Personnel and Compensation Committee nominates directors and senior management, evaluates the performance of senior management, and determines their remuneration packages.

## Board of Supervisors

The Board of Supervisors approves financial reports prepared by the Board of Directors to be presented at shareholders meetings, reviewing the bank's financial results, and monitoring compliance with laws and regulations.

## Senior management

The Senior Management of BOCOM consists mainly of the President, Vice Presidents, Chief Financial Officer, and Chief Information Officer. All senior executives report directly to the President, who is accountable to the Board of Directors. Senior Management is charged with overseeing daily operations; implementing shareholder resolutions; and drafting annual business, investment, and budget plans.

## Strategic investor

On June 23, 2005, Bank of Communications went public the Hong Kong Stock Exchange, becoming the first Chinese commercial bank to list outside of the mainland. Its initial public offering raised USD 1.9 billion, and stock value has almost doubled since.

*HSBC has the right to nominate two members of the BOCOM Board as Directors. In particular, HSBC can also instruct that this director serve on the audit committee and/or the personnel and compensation committee.*

In 2004, BOCOM entered into a strategic partnership with HSBC by signing an Investor Rights Agreement. This agreement provides HSBC with the right to nominate two members of the Board as Directors. In particular, HSBC can also instruct that this director serve on the audit committee and/or the personnel and compensation committee. However, HSBC waived this right when BCOM decided to list on the Hong Kong Stock Exchange. HSBC can also put someone in a senior management position at BCOM, subject to Board approval. BCOM must also use HSBC as one of its lead underwriters in any public offerings.

In return, HSBC will provide advice and guidance in areas such as risk management, corporate governance, and "other areas as identified by HSBC and agreed with [BOCOM] in an annual technical support and assistance plan." The Technical Support and Assistance Agreement ends on August 18, 2007, but can be renewed at HSBC's discretion.

In 2006, the two banks jointly hosted their first BOCOM-HSBC Forum, which is described as a "platform for communication and exchange of views on financial market development in China"; BOCOM characterized this as a "great success."<sup>200</sup> HSBC and BOCOM have cooperated to launch a pension joint venture and overseas investment management products.

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200 Bank of Communications 2006 interim financial report.

It should be noted that HSBC is widely regarded as a leader among international banks in developing environmental financing standards. HSBC is also relatively advanced in developing systems and processes to implement their environmental policies, including the Equator Principles.

*Loans to companies make up about 86% of BOCOM's total loan volume, and most of these company loans are short-term working capital loans, which last for less than one year but get renewed.*

## Corporate lending and financial services

Loans to companies make up about 86% of BOCOM's total loan volume, and the bank serves 500,000 corporate clients, including state-owned enterprises, private companies, and foreign firms. About 65% (by volume) of these company loans are short-term working capital loans, which last for less than one year but get renewed. The bank provides a small amount of non-lending corporate banking services, such as underwriting.

Currently, retail banking only generates about 10% of the bank's revenue, but it appears as if the bank wants to expand significantly in this area.

## Corporate loan cycle

- The first step in the loan cycle is for the relationship manager to conduct a pre-approval credit investigation. This establishes basic information on the borrower's background and overall credit risk, the purpose of the loan, etc. During this stage an initial credit rating is assigned, which is included in a credit evaluation report.
- A formal credit rating is assigned based on an internal 10-category system, which takes many factors into accounting, including the borrower's financial condition, industry, repayment history, country risks, and the potential impact of external factors and unforeseen events.
- Different risk management departments evaluate the applications, create a credit review report, and then submit them to a credit review committee (which usually consists of 7 or 9 members), which is independent from the bankers who originate the loan.
- Large loans require review from the head office credit review center, which will either approve the loan or elevate it to the head office review committee. This committee is comprised of nine members, seven of whom must approve application for the loan to move forward.
- "High risk clients" and loan restructuring applications receive extra due diligence from the assets preservation department and risk management committee.
- Group customers and/or affiliated companies also are subject to additional due diligence.
- Relationship managers prepare loan monitoring reports, which are reviewed by various entities, including the credit risk management department, and the risk monitoring department (which occasionally conducts inspections). Frequency and level of monitoring is determined by the client's credit rating.

## Capital raising activities

BOCOM raised USD 1.8 billion with its 2005 initial public offering in Hong Kong (underwritten by Goldman Sachs).<sup>201</sup> The following are BOCOM's major shareholders:

Ministry of Finance	25.53%
HSBC	19.90
National Council for Social Security Fund	14.22
China SAFE Investments Ltd	7.68
Capital Airports Holding (Group) Company	2.52
Shanghai Tobacco (Group) Corp	0.97
Yunnan Hongta Group Co., Ltd	0.88
Shandong Electric Power Corporation	0.77
Huaneng Capital Services Company	0.51
China FAWGroup Corporation	0.45
Others	26.57

In 2007, BOCOM plans to issue USD 7 billion worth of in a RMB-denominated shares and bonds to Chinese investors. Its equity offering is expected to raise USD 2.54 billion and will be underwritten by Goldman Sachs Gao Hua Securities Co, China Galaxy Securities Co, CITIC Securities Co and Haitong Securities.<sup>202</sup>

## Environmentally-relevant activities and philanthropy

The bank finances several companies involved in environmentally-sensitive activities, including China International Marine Container, Asia Pulp & Paper, and China National Petroleum Corporation.

The bank's charitable donations for 2005 totalled RMB 9.63 million. The projects and/or charities to which the funds were donated remained undisclosed, but it is likely that the majority of the donations were given to support social programs as opposed to environmental projects.

201 "China's Bank of Communications raises 1.88 bln usd from IPO - Goldman," Xinhua Financial Network News, 20 June 2005

202 Bremner, Brian, "Demand Skyrockets for Chinese Bank Shares," Business Week Online, 21 November 2006 and "China's Bank of Communications plans \$2.54 billion Shanghai IPO in 2007," Associated Press Financial Wire, 9 November 2006

## China CITIC Group 中国中信集团公司<sup>203</sup>

### Background

*China International Trust and Investment Corporation (CITIC) was founded as a conglomerate to help spearhead Chinese economic reform and integration into the world economy. The business focus of CITIC Group is centered on finance and industry.*

China International Trust and Investment Corporation (CITIC) was founded in 1979 as a state-owned Chinese conglomerate to help spearhead Chinese economic reform and integration into the world economy. Its earliest business efforts were aimed at attracting foreign investment to the Chinese economy. Today, it has diversified its operations and fosters the development of domestic as well as overseas industries. According to its latest report in 2004, CITIC's assets stood at RMB 701.4 billion with net profits at RMB 1.78 billion. The business focus of CITIC Group is centered on two sectors – finance and industry.

### Geographic exposure

CITIC's overseas subsidiaries are CITIC Hong Kong Ltd, CITIC Australia Pty. Ltd, CITIC Canada Inc, CITIC USA Holding Inc, and Citifor Inc. CITIC Australia focuses on investment and trading in resources and primary industries. It has significant investments in Portland Aluminum Smelter, which prides itself as an environmental-low-impact company, and Australian Coal Industry. CITIC Canada invests in pulp mills, lumber mills, and owns Sundance Forest Industries Ltd, a logging and lumber processing company. Citifor is a Seattle-based logging subsidiary, which operates in Washington, Oregon, and Alaska and has investments in timber industries in Russia and Chile.

As a state-owned corporation founded at the direction of the State Council, CITIC's overseas operations are used as an instrument of the government's foreign policy. Recently, CITIC agreed to lend USD 1.2 billion to Venezuela's housing program. The agreement was signed during President Hugo Chavez's visit to Beijing in an effort to deepen ties between the two nations. Chavez is also seeking Chinese investment to build more oil drills and to increase its oil exports to China.<sup>204</sup> CITIC Resources, a Hong Kong-listed arm of CITIC Group made its first entry into an overseas oil asset yesterday by purchasing a majority stake in an Indonesian oilfield for USD 97.4 million.<sup>205</sup> CITIC Group will likely increase its investments in overseas energy resources as the Chinese government seeks secure energy sources to maintain its economic growth.

### Sector exposure

The most important and biggest of the CITIC's business operations is finance, which accounts for 81% of CITIC's total assets and consists of commercial banks, securities, insurance, trust and investment. To manage its numerous financial subsidiaries, CITIC established *CITIC*

<sup>203</sup> All information derived from CITIC Group's 2004 Annual Report and [www.citic.com](http://www.citic.com) unless otherwise stated

<sup>204</sup> "Venezuela Inks Housing Deal With China". Business Daily Update. 8/23/2006

<sup>205</sup> "CITIC Resources to Buy Interest in Indonesian Oilfield". SinoCast. 7/19/2006

*Holdings*, a wholly-state-owned limited-liability company. CITIC's financial subsidiaries include China CITIC Bank, CITIC Securities Co. Ltd, CITIC Trust & Investment Co. Ltd, CITIC-PRU Life Insurance Co. Ltd, and CITIC International Financial Holdings Ltd. CITIC International Financial Holdings Ltd owns CITIC Ka Wah Bank Ltd, CITIC Capital Markets Holdings Ltd, CITIC International Asset Management Co. Ltd, and CITIC Frontier China Research Ltd; all of which are list on the Hong Kong Stock Exchange.

Industry accounts for 18% of CITIC's assets, which includes manufacturing, information, infrastructure, energy, and real estate. These firms include CITIC Machinery Manufacturing Co. Ltd, CITIC Real Estate Co. Ltd, CITIC Automobile Co. Ltd, CITIC Construction, CITIC Heavy Machinery CO. Ltd, CITIC Metal Co. Ltd, Bohai Aluminum Industries Ltd, Macau Cement Manufacturing Co. Ltd, and Sunburst Energy Development Inc.

## China CITIC Bank 中国中信银行<sup>206</sup>

China CITIC Bank (CNCB) was established by CITIC Group and the People's Bank of China in 1987 as part of China's efforts to modernize its economy. Since then it has been one of the mostly experienced Chinese banks when it comes to working with foreign firms. In 1987 shortly after its establishment, it cooperated with Pratt & Whitney Securities Investment Company for the import leasing of passenger planes to the Civil Aviation Administration of China. It installed the first foreign exchange automated teller machine (ATM) in China with the help of American Express in 1992, and also was the first bank on China to provide export buyer credit. In 1995, CNCB was the first Chinese bank to participate in underwriting the bonds of a foreign company when it jointly underwrote the USD 200 million "dragon bond" (international bonds sold in China) of the Ford Motors Corporation with Lehman Brothers.

As of 2005, the total assets of CNCB stands at RMB 419.8 billion with profits of RMB 2.45 billion, deposits of RMB 371.3 billion, and loans of RMB 261.9 billion. In 2006, CNCB received RMB 13.6 billion in capital injection from its parent, CITIC Group, in preparation for its projected HKD 15 billion IPO on the Hong Kong Stock Exchange in the first half of 2007. Citigroup, Lehman Brothers, HSBC and China International Capital Corp are expected to handle the underwriting.<sup>207</sup>

As the wholly owned subsidiary of CITIC Group, which was founded at the direction of the State Council, CITIC Bank has a history of working closely with Beijing's policy directives and priorities. This close tie with the government is reflected by its decision to provide RMB 500 million in loans to the South-to-North Water Diversion Project.<sup>208</sup>

*As the wholly owned subsidiary of CITIC Group, which was founded at the direction of the State Council, CITIC Bank has a history of working closely with Beijing's policy directives and priorities.*

<sup>206</sup> Unless otherwise stated, all information derived from: [http://www.citic.com/wps/portal/!ut/p/\\_s.7\\_0\\_A/7\\_0\\_7O/.cmd/ad/.ar/sa.nodevie w/.c/6\\_2\\_12F/.ce/7\\_2\\_D5T/.p/5\\_2\\_681/.d/0/\\_th/1\\_2\\_CH/\\_s.7\\_0\\_A/7\\_0\\_7O#7\\_2\\_D5T](http://www.citic.com/wps/portal/!ut/p/_s.7_0_A/7_0_7O/.cmd/ad/.ar/sa.nodevie w/.c/6_2_12F/.ce/7_2_D5T/.p/5_2_681/.d/0/_th/1_2_CH/_s.7_0_A/7_0_7O#7_2_D5T)

<sup>207</sup> "China's CITIC Bank eyes Hong Kong, Shanghai listing in April or May – report," Xinhua Financial Network News, 19 January 2007

<sup>208</sup> "CNY48.8bn Loans Made to South-to-North Water Diversion Project". SinoCast. 4/5/2005



*With the BBVA alliance, CNCB may be expected to finance more transactions in support of Chinese corporations' activities in Latin America.*

## Capital raising and strategic investors

In November 2006, Spain-based Banco Bilbao Vizcaya Argentaria (BBVA) agreed to purchase a 5% stake in China-based CNCB and a 15% stake in the Hong Kong-based CITIC International Financial Holdings Limited, a company traded company. BBVA is supposed to help CNCB develop its retail and corporate banking business, and to assist CIFH improve its corporate and investment banking services.<sup>209</sup> The CNCB deal also includes an option to buy an additional 4.9% stake in the bank, and the right to nominate one board member (out of 6).<sup>210</sup>

BBVA is an Equator bank and has strong operations in Latin America. With this alliance, CNCB may be expected to finance more transactions in support of Chinese corporations' activities in Latin America.

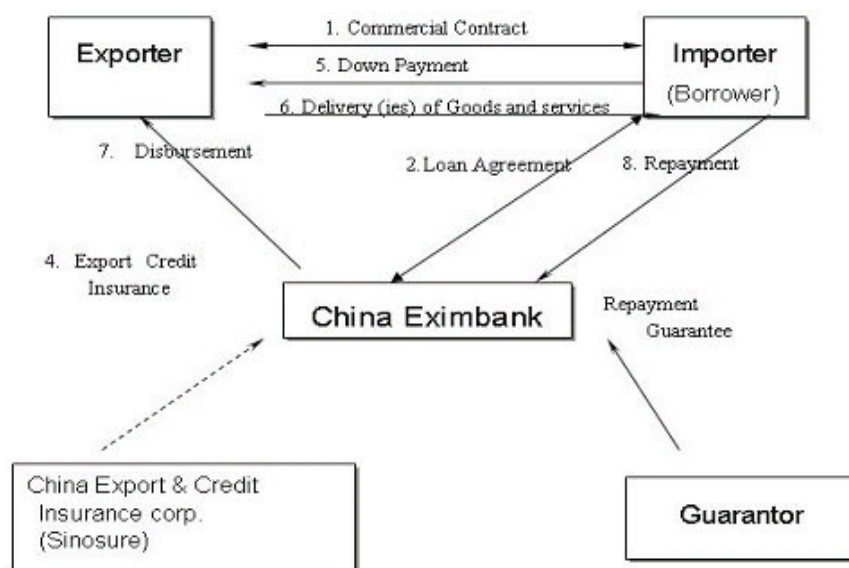
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209 "BBVA Buys 5% of CITIC Bank," Sinocast, November 24, 2006

210 Banco Bilbao Vizcaya Argentaria, S.A. (BBVA). "Acquisition of strategic stakes in China Citic Bank and Citic International Financial Holdings Limited Presentation – Final," November 22, 2006

## Appendix 1: Trade Financing

The following chart is taken from Chexim's website<sup>211</sup>, and provides a helpful explanation of how export buyer's credits work.



The Structure of Export Buyer's Credit

1. A commercial contract is signed between the exporter and the importer. The value of the contract should be no less than USD 2 million.
2. A loan agreement is signed between China Eximbank and the borrower. The loan amount should not exceed 85% of the commercial contract value while 80% in the case of a ship export project.
3. Repayment guarantee provided by the guarantor to China Eximbank may be required according to the project case by case.
4. Whether to require export credit insurance or not shall be determined by China Eximbank according to the country risk of the importing country.
5. The down payment should not be lower than 15% of the commercial contract value and no less than 20% for a ship export project.
6. The exporter delivers goods to the importer as stipulated in the commercial contract.
7. China Eximbank disburses the loan after the delivery of the goods.
8. The borrower shall semi-annually repay to China Eximbank the principal, the interest and all the fees and charges of the loan in accordance with the provisions of the loan agreement.

<sup>211</sup> <http://english.eximbank.gov.cn/business/buyer.jsp>

## Appendix 2: Strategic Investors in Chinese Banks

The following table compiled by Andrew Newton and taken from the November 2006 Ethical Corporation special report "Financial Sector Responsibility: The State of the Art."<sup>212</sup> It was updated by Michelle Chan-Fishel on 20 December 2006.

<b>Institution</b>	<b>Strategic investors [CSR code]</b>
<b>Assets (billions), non-performing loans (%)</b>	(millions paid, % held)
Agricultural Bank of China \$610, 26%	No foreign investment at present. Reforms expected over the next two to three years, including a search for foreign strategic investors. China Life Insurance Co. has declared an intention to take a stake.
Bank of Beijing \$29.9, 4.06%	ING Group [138] (\$215, 19.9%) IFC [148] (\$50, 5%) A listing is planned for 2007.
Bank of China \$591, 4.9%	Temasek Holdings (\$1,500, 5%) Royal Bank of Scotland1238gc (\$1,500, 5%) Merrill Lynch [149] (\$750, 2.5%) Li Ka-shing Foundation (\$750, 2.5%) UBS [129hk] (\$500, 1.6%) Asian Development Bank [1] (\$75, <1%). Hong Kong IPO in May 2006 raised \$11.2 billion. A simultaneous private placement with 12 additional corporate investors including Bank of Tokyo-Mitsubishi UFJ [1238gcpri], China Life Group, Ping An Insurance Group [56] (19.9% owned by HSBC [1234689gcpri]) and Bank of East Asia brought in a further \$2.2 billion. The July 2006 listing in Shanghai raised \$2.5 billion.
Bank of Communications \$161, 2.14%	HSBC [1234689gcpri] (\$2,100, 19.9%) Listed in Hong Kong. Mainland listing expected in 2007.
Bank of Shanghai2 \$29.9, 3.92%	HSBC [1234689gcpri] (\$64, 8%) IFC [148] (\$50, 7%) Shanghai Commercial Bank (Hong Kong) (NA, 3%)
China CITIC Bank	Banco Bilbao Vizcaya Argentaria [1238gc] acquired a 5% stake with an option to increase

212 See <http://www.ethicalcorp.com/fsr/>

\$84.13, 2.51%	to 9.9%. BBVA also bought 15% of CITIC International Financial Holdings.
China Construction Bank \$472, 3.4%	Bank of America [1238] (\$2,500, 9%) Temasek Holdings (\$1,470, 5.1%) Listed in Hong Kong. Mainland listing being considered.
China Everbright Bank \$49.1, 11%	China Everbright Group (NA, 21.4%) ADB [14] (\$20, 1.9%) Ping An Insurance Group [56] (19.9% owned by HSBC [1234689gcprj]) is understood to be in talks potentially with a view to taking a stake in the bank.
China Merchants Bank57 \$103.3, 2.3%	No foreign investors, although reported to be seeking strategic investors among Hong Kong billionaires. Listed in Hong Kong in September 2006.
China Minsheng Banking Corporation \$62.3, 2%	Temasek Holdings (NA, 3.9%) IFC [148] (\$23, 1.08%) Though discussions are rumoured to have been held with potential foreign investors including National Australia Bank [28] and Société Générale [128] (\$370, 5%-10%), the bank is now understood to be delaying new foreign investment until 2007. Listed in Shanghai. Agreed private placement to institutional shareholders. Temasek Holdings rumoured likely to increase its stake.
Chongqing City Commercial Bank NA, 4.93%	Sold 7.99 pct stake to Carlyle Group (US) and 17 pct to DahSing Bank
Dalian Bank \$4.2, 5%	Hoping to join forces with Scotiabank [123] and/or National Australia Bank [28] by early 2007 Listing expected in Hong Kong in 2006.
Guangdong Development Bank4 \$38.25, 25%	Citigroup [123489] is seeking "effective control" through building a consortium with Chinese investors including China Life Insurance Co. to take a combined 85.6% of the bank. Citigroup itself holds 20%
Hangzhou City Commercial Bank \$4.8, 2.3%	Commonwealth Bank of Australia [1] (\$75; 19.9%) ADB [14] (\$30, 5%)
Hua Xia Bank \$44.6, 3.04% (NPL figure being	Deutsche Bank [128gc] (\$330, 9.9%) Sal. Oppenheim (NA, 4.1%)

reviewed by regulator)	Listed in Shanghai.
Huishang Bank \$5.65, NA	Bank of Montreal [1238] had previously been reported interested, but now Development Bank of Singapore is reported to be considering a 10%-20% stake. Pangaea Capital Management is also seeking a 5% stake.
Industrial and Commercial Bank of China <sup>4</sup> \$685, 4.69%	Goldman Sachs [1] (5.75%) American Express [9] Allianz [1238gc] (Collectively \$3,780, 10.0%)
Industrial Bank Co \$59.1, 2.33%	Hang Seng Bank [138] (62.14% owned by HSBC [1234689gcpr]) (\$209, 16%) Temasek Holdings (NA, 5%) IFC [148] (\$52, 4%) Seeking regulatory approval for a listing in Shanghai.
Jiangsu Bank \$9.97, NA	Forming in 2006 through merger of 10 city banks in Jiangsu Province, including Suzhou City Commercial Bank.
Jinan City Commercial Bank \$2.8, 7.1%	Commonwealth Bank of Australia [1] (\$17, 11%, with option to expand up to 20%) Listing expected in 2007.
Langfang City Commercial Bank <sup>6</sup> NA, NA	Planning to list in 2007.
Liaoning Rural Credit Cooperative Union NA, NA	Rabobank [1238gc] has signed an agreement to set up a joint venture bank with the cooperatives in 2007.
Nan Tung Bank	According to Banking Newslink (3 Oct 2006) Morgan Stanley [1] bought Nan Tung bank, the first time that a foreign shareholder has been allowed full ownership of a mainland bank. However, the Macau-based bank was technically already under foreign ownership.
Nanchong City Commercial Bank \$0.23, NA	German Investment and Development Bank (DEG) [1] (\$4, 10%) Sparkassen International Development Trust, Savings Bank Foundation for International Co-operation (\$1, 3.3%)
Nanjing City Commercial Bank \$5.52, 4.2%	BNP Paribas [1gcpr] (\$87, 19.2%) IFC [148] (\$27, 5%) Awaiting regulatory approval for a listing in Shanghai.

Ningbo Commercial Bank \$4.6, 1.2%	Overseas-Chinese Banking Corp (\$71, 12.2%) Employees own 20%
Ping An Bank \$32.7, NA	Ping An Insurance Group [56] (19.9% owned by HSBC [1234689gcpri]) (NA, 73%) HSBC [1234689gcpri] (\$18, 27%)
Quanzhou City Commercial Bank NA, NA	Reported to be in negotiations with National Australia Bank [28].
Rizhao City Commercial Bank \$1.14, NA	Nanjing City Commercial Bank (19.2% owned by BNP Paribas [1gcpri], 5% owned by IFC [148]) is reported to be buying a 20% stake for \$18.77 million, which would make it the largest shareholder.
Shanghai Pudong Development Bank \$56.8, 2.45%	Citigroup [13489] (\$70, 4.62%, with option to increase stake to 19.9%) Listed in Shanghai. Additional listing rumoured for Hong Kong.
Shanghai Rural Commercial Bank \$14.25, NA	ANZ [128] bought 19.9% stake in Nov 2006
Shaoxing County Rural Cooperative Bank NA, NA	American United Bank is reported to have "made a proposition".
Shenzhen Commercial Bank \$9.0, NA	Ping An Insurance Group [56] (19.9% owned by HSBC [1234689gcpri]) is to buy a 89% stake for \$614 million.
Shenzhen Development Bank \$26.2, 10.29% (NPL figure being reviewed by regulator)	Newbridge Capital (NA, 17.9%) GE Consumer Finance [16] (\$100, 7%) (pending shareholder approval of share reform plan; price may be renegotiated) Lehman Brothers [9] is reported to be close to securing a 1% stake for an investment of \$20 to \$30 Listed in Shenzhen.
Tianjin Bohai Bank NA, NA	Standard Chartered [123489gchk] (\$128, 20%)
Tianjin City Commercial Bank \$8.5, 7%	ANZ [128] (\$111.5, 20%)
Tianjin Rural Cooperative Bank NA, NA	Rabobank [1238gc] has signed a preliminary cooperation agreement, and is rumoured to be close to investing. Previously, ABN AMRO [12389gchk] was reported to be interested in taking a stake in the bank.
United Rural Cooperative Bank of Hangzhou	Rabobank [1238gc] (\$21.8, 10%)

(formerly Hangzhou Rural Credit Cooperative Union)	IFC [148] (\$10.9, 5%)
\$3.8, 1.5%	
Urumqi City Commercial Bank	Habib Bank is reported to be in talks to acquire 19.9 percent of UCCB.
\$2.16, NA	
Xiamen International Bank	ADB [14] 10%
Xi'an City Commercial Bank	IFC [148] (\$19.9, 12.5%)
NA, NA	Scotiabank [123] (\$3, 2.5% with regulatory approval for up to 12.4%)
Sources: Company websites and press reports	

### Key to corporate responsibility commitments:

<sup>1</sup> Company has published own social and/or environmental policies

<sup>2</sup> UNEP Finance Initiative signatory

<sup>3</sup> Equator Principles signatory

<sup>4</sup> Member of the Chinese Business Leaders Forum

<sup>5</sup> Member of the Chinese Association for Corporate Social Responsibility

<sup>6</sup> Member of the China Committee of Corporate Citizenship

<sup>7</sup> Member of the China Business Council for Sustainable Development

<sup>8</sup> Global Reporting Initiative reporter

<sup>9</sup> Member of the Global Business Coalition on HIV/AIDS

<sup>9c</sup> Member of the UN Global Compact

<sup>pri</sup> Asset management arm is a UN Principles for Responsible Investment signatory

<sup>hk</sup> Hong Kong Corporate Social Responsibility Charter signatory

## Appendix 3: Export-Import Bank of China Environmental Policy

### Original version for official use

#### 关于中国的环境保护政策

##### 一、环境管理政策

核心是采取防范措施和加强环境管理，力求不产生或少产生对环境的污染和破坏。主要措施是：

（一）将环境保护纳入国民经济与社会发展计划和年度计划，在经济发展中防治环境污染和生态破坏。

（二）严格对建设项目实行环境影响评价和“三同时”制度(建设项目的生产主体工程防治污染设施同时设计、同时建设、同时投产使用)。现在，全国建设项目环评执行率和“三同时”执行率都达到 95% 以上。

（三）健全环境保护法律、法规和规章，使环境管理沿着法制化和规范化轨道发展。

（四）健全环境管理机构。从中央到省、市、县四级政府建立了环境管理机构，这些机构依法行使环境管理权力。国务院有关部门和大中型企业也建立了相应的环境管理机构，管理本行业和本企业的环境问题。

##### 二、环境经济政策

主要包括资金投入和税收优惠政策：

（一）企业将防治污染所需资金纳入固定资产投资计划。

（二）列入国家重点污染防治和生态保护的项目，国家给予资金支持；城市政府将城市维护费用于环境保护设施建设；国家征收的排



污费用于污染防治。

### （三）国家实行税收优惠政策

——所得税优惠：对利用废水、废气、废渣等废弃物作为原料进行生产的，在 5 年内减征或免征所得税；

——投资方向税优惠：建设污水处理厂、资源综合利用等项目，其固定资产投资方向调节税实行零税率；

——增值税优惠：对以煤矸石、粉煤灰和其他废渣为原料生产的建材产品，以及利用废液、废渣提炼黄金、白银等免征增值税；

——建筑税优惠：建设污染源治理项目，在可以申请优惠贷款的同时，该项目免交建筑税；

——关税优惠：对城市污水和造纸废水部分处理设备等实行进口商品暂定税率，享受关税优惠；

——消费税优惠：对生产、销售达到低污染排放限值标准的小轿车、越野车和小客车减征 30% 的消费税。

——农业特产税优惠：西部地区退耕还林还草而产出的农业特产收入，在 10 年内免征农业特产税。

## 三、环境技术政策

目的在于提高能源和资源利用效率、减少污染物的排放，主要措施有：

（一）工业企业在进行技术改造时，采用先进的技术和清洁生产工艺，提高资源、能源的利用率；

（二）按照环保法律有关规定，对企业浪费能源和资源、严重污染环境的落后工艺和设备实行限期淘汰；

（三）企业在生产中应该采用无毒、无害或低毒、低害原料。

## 四、环境保护产业政策

在经济结构战略性调整中，促进环保产业结构优化，提高环保产品的科技含量；制定措施促进环保产业社会化、环保产业营运市场化、产品标准化等。

## 五、环境国际合作政策

中国一贯高度重视环境国际交流合作，强调在认真做好本国环境保护工作的同时，以积极的态度参与国际环境事务；以新的伙伴关系共同推进区域和全球环境合作，加快解决全球环境问题的进程；坚持环境国际合作应该尊重国家主权，处理环境问题应兼顾各国现实的实际利益和世界的长远利益。

## 六、中国进出口银行的环境保护政策

中国进出口银行在业务开展中高度重视所支持的项目对环境的影响，主要从事前、事中和事后三个环节加强对项目环境影响的监控和管理。

### （一）事前——项目评审环节

中国进出口银行将项目的环境影响评估作为项目评审的基本条件和要素之一，要求寻求进出口银行支持的项目，必须进行环境影响的可行性分析，得到所在地/国的环境管理部门的认可或批准，对不利于环境保护或得不到环境管理部门认可或批准的项目，一律不予提供支持。这一政策在中国进出口银行支持的国内外上千个项目中得到贯彻。

### （二）事中——项目检查环节

中国进出口银行对项目执行进行定期检查，检查内容包括所执行的项目对环境造成的影响。对那些在执行过程中对环境开始产生不可接受的负面影响的项目，中国进出口银行将要求执行单位及时采取补救或预防措施，否则，将停止提供支持。

### (三) 事后——项目后评价环节

项目中止或执行完毕后，中国进出口银行会对项目执行情况、完成情况及其影响进行后评价。环境评价是后评价的必须内容。根据后评价的情况，中国进出口银行会对类似项目的事前和事中环境要求将做出修正。必要时，全面修正有关的要求和政策。

## **Translated English-language version: not for official use**

### **About China's Environmental Protection Policy**

#### **1. Environmental Management Policy**

The core of the policy is to adopt preventive measures and enhance environmental management, in order to not produce and to produce less environmental pollution and destruction. The main measures include:

- (1) To include environmental protection into the national economic and social development plan and the annual plan. To deal with environmental pollution and ecological destruction amid economic development.
- (2) To strictly enact environmental impact assessment and the "three synchronized approach" for the construction projects, i.e. the design, construction and operation of the core project and pollution prevention facilities should be synchronized. Now, over 95% of construction projects comply with such requirements in China.
- (3) To improve the environmental legislation, law and regulations, so as to bring environmental management into a legal and regulatory framework.
- (4) To improve the environmental management institution. These institutions, which are formed at four levels of administrations, from central, provincial, municipal to county level, will implement environmental management according to law. State Council's departments and corporations can also building corresponding institutions to manage its own sector or corporations' environmental problems.

#### **2. Environmental Economic Policy**

It mainly includes capital investment and tax return or exemption policies:

(1) Corporations to include the expenditure incurred due to pollution abatement into the fixed assets investment plan.

(2) To give financial support to the national major pollution abatement and ecological protection projects; municipal government to spend the budget of municipal maintenance in the construction of environmental facilities; to levy the discharge treatment fee for pollution abatement.

(3) Tax return or exemption policies

-- Income Tax Incentives: those who make use of waste water, waste gas and waste residue as raw materials for production will have the partial or full tax return in five years;

-- Exemption for adjustment tax on directing investment: those who build sewage treatment plants and comprehensive resources utilization projects, the fixed assets adjustment tax on directing investment is set at zero;

-- Value-added tax exemption: those who use corollary waste, fly ash and other waste residue as raw materials for construction materials, and those who use waste liquid and waste residue to extract gold and platinum can have value-added tax exemption;

-- Construction tax exemption: the pollution abatement project at sources, when applying for premium loan, can have construction tax exemption;

-- Custom tax exemption: to impose fixed (lower) tax rate for the imported municipal and paper mill sewage treatment equipment;

-- Consumption tax reduction: to impose a 30% reduction of consumption tax for the production and sale of low emission cars, including sedan vehicles, sport utility vehicles and coach cars;

-- Tax return on specialised agricultural products: The specialised products due to the grain for green, restoration of forests and grassland policies will have 10 year specialized agricultural product tax exemption.

### **3. Environmental Technology Policy**

Its purpose is to raise the energy and resources utilization efficiency, and reduce the pollutant's discharge. The main measures include:

(1) When taking the technological improvement measures, the industries should adopt advanced technique and clean production technology so as to raise resources utilization and energy efficiency;

(2) to impose a phase-out plan for the backward technology and equipments in corporations that waste energy, resources and pollute environment, according to the environmental law,

(3) Corporations should use non-toxic, harmless or lowly toxic, lowly harm materials during production.

### **4. Environmental Industry Policy**

During the strategic adjustment of economic structure, we should promote the improvement of environmental industry, raise the

technological elements in the environmentally friendly products and implement measures to promote socialization of environmental industry, and make environmentally friendly products marketable and standardized.

## **5. International Cooperation on Environmental Protection**

China has been paying high level of attention to international cooperation on environmental protection. When seriously playing our part in environmental protection, China actively takes part in international environmental affairs. China aims at promoting regional and global cooperation together with a new partnership, so as to speed up the progress to resolve environmental problems. China emphasises the respect for national sovereignty amid international cooperation, and take the national interests of different countries and long-term interests of the world into consideration when handling environmental problems.

## **6. China Ex-im Bank's environmental protection policy**

China Ex-im Bank is paying a high level of attention to our funded projects' environmental impacts. We enhance environmental monitoring and management before, during and after the project implementation.

### **(1) Before – Project Review**

China Ex-im Bank considers projects' environmental impact assessment as one of the basic requirements and elements during the project review. We require the funded projects to conduct feasibility study of environmental impacts, and obtain endorsement or approval from the recipient country's environmental administration. Those projects that are harmful to environment or do not gain endorsement or approval from environmental administration will not be funded. This policy is enacted throughout over thousands of China Ex-im Bank's funded projects.

### **(2) During – Project Examination**

China Ex-im Bank conducts regular examination for project implementation, which includes the project's environmental impacts. Once any unacceptable negative environmental impacts result during the project implementation, China Ex-im Bank will require the implementation unit to take immediate remedial or preventive measures. Otherwise, they will discontinue financial support.

### **(3) After – Post-project review**

When the project is stopped or completed, China Ex-im Bank will conduct post-project review in project implementation and completion status, and its impacts. Environmental assessment is a necessity in the post-project review. According to the post-project review, China Ex-im Bank will revise the measures taken before and during the project implementation for similar projects. If necessary, the related requirements and policies will be fully revised.



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