

Financial Developments in Asia and the Pacific Rim

August 5, 2006

Banking Law Committee

Co-Chairs:

Michael Roster, Golden West Financial Corporation

Juliana S. O'Reilly, Fannie Mae

Panelists:

Daniel Fung, senior officer, Republic of China; former Solicitor General of Hong Kong

Dawn Haghghi, president, U.S. Hong Kong Business Association; former senior counsel, Charter One Bank

Nicholas Rockefeller, principal, Rockvest Group; former partner, Perkins Coie

David K.Y. Tang, partner, Preston Gates; chair, Federal Reserve Bank of San Francisco

Financial Developments in Asia and the Pacific Rim Speaker Biographies

Daniel Fung

Daniel Fung was the first person of Chinese extraction to serve as Solicitor-General of Hong Kong, doing so in the years 1994-98 and thus straddling Hong Kong's reversion to Chinese sovereignty. He is Senior Counsel of the Hong Kong Bar specializing in constitutional and commercial law and is the chairman of Des Voeux Chambers. Daniel also is currently chairman of the Broadcasting Authority, the government regulator of television and radio broadcasting in and out of Hong Kong, and is the founding chairman of the East-West Strategic Development Commission (Estradev), a non-profit, apolitical platform for conducting business-to-government dialogue to stimulate economic growth in emerging markets such as India, Kazakhstan, the Czech Republic, and other nations.

In addition, Daniel is a member of the World Bank International Advisory Council on Law & Justice, a national delegate to the Chinese People's Political Consultative Conference, chairman of the China Law Council, and president of the International Law Association Hong Kong Chapter. He has been a member of Middle Temple since 1974, and in 1990 he became the youngest member of the Hong Kong bar to be appointed Queen's Council. Daniel also was a Visiting Scholar to Harvard Law School (1998-99) and a Senior Visiting Fellow to Yale Law School (1999).

Daniel is a fellow of University College London, where he graduated with an LL.B. in 1974 and an LL.M in 1978.

Dawn Haghghi

Dawn Haghghi is former vice president, senior counsel and director of legal operations for Charter One Bank in Illinois and recently served as special counsel to Blue Cross and Blue Shield in Illinois. She has extensive experience in banking, corporate, health care and labor law.

After over a decade in law firm practice, Dawn previously served as corporate counsel at Interstate National Corporation, a subsidiary of Fireman's Fund and affiliate of the Allianz Group, and as Midwest labor counsel for Nordstrom's.

Dawn is a member of the board of directors of the Chinese American Service League and is past president of the Association of Corporate Counsel Chicago Chapter, of the National Hong Kong Business Association, and of the Hong Kong Business Association of the Midwest. She also was part of the delegation to the White House welcoming ceremony for Premier Wen Jia Boa of the PRC and has been an organizer and speaker for a wide range of conferences on China and the Pacific Rim.

Dawn is a graduate of The College of Wooster and of Case Western School of Law. She also has completed Chinese language programs in the U.S. and in Beijing.

Nicholas Rockefeller

Nicholas Rockefeller is vice chairman and chief legal officer of the RockVest Group of Investors and is involved in various banking and commercial projects in China and worldwide.

He is a member of the Council on Foreign Relations, the International Institute of Strategic Studies, the Advisory Board of RAND, the Corporate Advisory Board of the Pacific Council on International Relations, the Board of the Western Justice Center Foundation, and the Central China Development Council and has served as a participant in the World Economic Forum and the Aspen Institute. He also serves as a director of the Pacific Rim Cultural Foundation, and is a member of the boards of visitors of the law schools of the University of Oregon and of Pepperdine University.

Nicholas' China practice includes transactions with China's largest banks, energy companies, communications entities and real estate enterprises as well as with China's principal cities and leading provinces. He was chosen as a board member of the Central China Construction and Development Commission and as a director of the Xiwai International School of Shanghai International University. He has appeared numerous times on CCTV and other China media.

Nicholas is a graduate of Yale University and of Yale Law School.

David K.Y. Tang

David Tang is a partner at Preston Gates Ellis LLP and is based in the firm's Seattle and Hong Kong offices. He also currently is chairman of the Federal Reserve Bank of San Francisco and of the Greater Seattle Chamber of Commerce.

David's law practice is focused on international commercial transactions, venture and secured financings, and foreign investment matters. He has over 25 years of transactional experience in China, Hong Kong and Taiwan.

David is a graduate of Columbia University and of Harvard Law School.

Financial Developments in Asia and the Pacific Rim

These are among the key topics that will be taken up by the panel:

- What are the legal and business challenges facing financial services companies operating in China, Japan, and other parts of Asia and the Pacific Rim?
- Will Asian banks and central governments continue to purchase U.S. debt?
- What is the regulatory environment?
- What should counsel expect when representing clients in the region?

ABA Banking Law Committee Program

Honolulu, Hawaii

5 August 2006

Presented By

Dawn Haghighi

Nicholas Rockefeller

Economic Statistics

- Since 1978, it is estimated that per capita income has increased seven times.
- 400 Million people have risen from extreme poverty.
- A middle class of 100 million has developed.

Economic Statistics

- Over 800 million (60 percent of the population) live in rural areas.
- The World Bank reports that over 200 million people live on less than \$1.00 dollar per day.
- The *Economist* estimates that 150 million rural Chinese are unemployed.

Breaking Down The Statistics

- The Two Chinas
- Diamond Bracket

Big Changes in China's Banking

- WTO requires market access to foreign banks.
- Privatization of national, provincial and city banks.

The Big Four: The State Owned Commercial Banks

- The Bank of China
- The China Construction Bank
- The Agricultural Bank
- The Industrial and Commercial Bank

The Big Four

- The Big Four Banks manage over 60 percent of the deposits and loans.
- In 1994, the Big Four were restructured to operate on a profit-loss basis.
- In 1994, the government established one asset management corporation for each Big Four Bank to write off non-performing loans.

Big Four General Facts

- By the end of 2001, collectively the Big Four employed 1.4 million people and had 116,000 branches.
- In 2002, the Big Four had 68.3 percent share of total deposits.
- In 2003, the total deposits slightly declined to 64.9 percent share of total deposits.

The Bank of China (“BOC”)

- China’s main international banking institution.
- Its specialty is foreign exchange and trade finance.
- The BOC maintains approximately 59 % share of China’s trade finance business.

The Bank of China

- BOC Hong Kong Holdings was successfully listed on the Hong Kong Stock Exchange in 2002.
- The 2.8 billion dollar offering was oversubscribed by 7.5 times.

The China Construction Bank

- Medium to long term credit for specialized projects.
- Urban housing and other infrastructure projects.

China Construction Bank

- CCB is the second largest bank in China.
- CCB has 136 million active retail accounts.
- CCB has 14,000 branches across China.
- It is reported that in 2004, CCB sold 26 different mutual funds to investors with a sales volume of \$ 3.74 billion.

The Agricultural Bank

- Financing for the agricultural sector.
- Wholesale and retail banking services to farmers and village enterprises.

The Industrial and Commercial Bank

- The largest bank in China by total assets, employees and customers.
- Has over 28,000 branches.
- Second largest foreign exchange business.
- First RMB clearing business.

The Industrial and Commercial Bank of China

- Handles the local currency lending and deposit-taking for Chinese industrial and commercial enterprises.
- Provides trade related services such as letters of credit.
- Maintains an investment banking subsidiary in Hong Kong.

The Central Bank

- Why have a Central Bank?
- What are the functions of a Central Bank?

The difference between a Country's Treasury and a National Bank

- What decisions does each make?
- Who are the decision makers?
- How do the decisions affect the national economy?
- What actions do other National Banks, especially the Fed, make in response?

The Policy Banks

- Created in 1994 to take over the government directed –spending functions of the Big Four.
- Responsible for financing economic trade development and state-invested projects.

The Policy Banks

- **Agricultural Development Bank of China**

Agricultural development projects

- **China Development Bank**

Infrastructure financing projects

- **Export Import Bank of China**

Trade financing projects

Second Tier Commercial Banks

Shareholder Banks

- Bank of Communication
- China Everbright Bank
- CITIC Industrial Bank
- Shanghai Pudong Development Bank
- Mingshen Bank
- Hua Xia bank

Second Tier Commercial Banks

Shareholder Banks

- Better asset quality and profitability than the Big Four.
- Lower non-performing loan ratios than the Big Four.

Second Tier Commercial Banks

- The Shenzhen Development Bank, the Pudong Development Bank and the China Minsheng Bank were listed on the Shanghai Stock Exchange (A-share).
- China Mingshen Bank is the only Second Tier Bank without any government ownership.

Gray Market Banks

- Informal groups of lenders/investors.
- Annual interest rates made on their loans range from 8 to 20 percent, providing returns to investors substantially above the 2.25 percent official bank deposit.
- Gray Market Banks are outside the formal banking system but widespread.

Foreign Banks

- In 2004, there were 62 foreign banks with over 200 branches (restricted licenses).
- In 2005, foreign banks accounted for 3 percent of total assets held. A large increase from 2003.

Branches of Foreign Banks

- Foreign Banks operate under licenses that restrict them to specific clients and certain geographical areas.
- Foreign Banks are permitted to provide financial services in non-local currencies to foreign firms in 18 cities.
- In 2004, foreign banks had 18 percent market share of loans in foreign currency.

Foreign Banks

- By the end of 2005, 105 foreign branches had received local currency licenses.
- Of the 105 foreign branches with Renmibi licenses, 61 have been permitted to provide services to both Chinese and foreign firms.

Licensing: Geographical Restrictions

Until recently, foreign banks were required to wait one year between branch openings in a city and maintain a high capital requirement.

Foreign Joint Ventures

- To avoid the licensing restrictions, many foreign banks have purchased minority shares in domestic banks.
- The PRC Government permits up to total of 24.9 percent foreign stake in any one domestic bank.
- A foreign person can buy control of a provincial or city controlled bank by purchasing 10 to 20 percent of capital stock.
- The PRC Government also provides significant incentives to encourage minority interest.

Foreign Joint Ventures

- **HSBC** purchased a 19.9 percent holding of the Bank of Communications for \$ 2.25 billion.
- **Bank of America** purchased a 10 percent holding in the China Construction Bank for \$3 billion.
- **Royal Bank of Scotland** purchased 10 percent of the Bank of China for \$3.1 billion.
- **Tamasek** committed to purchase \$2.5 billion of the CCB.
- **Goldman Sachs** purchased a 10 percent holding in the Industrial & Commercial Bank of China for \$ 3 billion.
- **ING Bank and International Finance Corporation (World Bank)** together own 24.9 percent of the Bank of Beijing, the second largest of China's city commercial banks.

Foreign Bank Investment in China's Banks

- Assist China's Banks in meeting capital requirements.
- Assist in the development of the compliance function.

Principal Investment Banks Active in China

- China International Capital Corporation.
- Bear Sterns
- Goldman Sachs
- Merrill Lynch
- NatWest Markets (RBS)
- HSBC
- Barclays Capital

Co-Operative Banks

- There were originally 3,000 urban and 50,000 rural credit co-operatives. These co-operatives re-emerging into and becoming banks.
- They were created to provide funding for small and medium size businesses.

China Banking Regulatory Commission Website

- www.cbrc.gov.cn

Loan Statistics

- Standard & Poor's research indicates that in 2003, 45 percent of the loans made in China were non-performing.
- In 2005, as result of substantial government assistance, the estimate of non-performing loans was lowered to 31 percent.
- Non-performing loans are estimate to be \$700 Billion.

Asset Management Companies

- **Big Four** **AMC**
- China Construction Bank Cinda
- Industrial and Commercial Bank of China Huarong
- Agricultural Bank Great Wall
- Bank of China Orient

Asset Management Companies

- AMC were established to transfer the non-performing assets from the Big Four.
- The AMC acquires the loans and re-sale the loans.

Consumer Loans

- Consumer loans now constitute 10 percent of the outstanding bank loans.
- Auto loans are increasing. 50 percent of the auto loans on the books are overdue and 5 percent are in default.

Bank Cards

- The banking card system in China continues to develop.
- As of June 2004, there were
 - 476,000 POS machines
 - 64,000 ATMS
 - 300,000 Chinese merchants that accept banking cards
- It is estimated that since 1985, China has issued 714 million banking cards, a majority of which are debit cards.
- There are over 110 banking card issuers in China, including the Big Four and many second tier banks.

Credit Cards

- According to a 2003 VISA research study, average per transaction purchase with a card is \$253 USD, compared with \$350 USD in the U.S.
- The most common transactions on credit are houses, vehicles and home appliances.

Holdings of U.S. Debt

- Foreign Direct Investment (FDI)
- Trade Deficit with U.S.
- Net Petroleum Purchases
- Energy Usage

**The ABA
Banking Law Committee Program**

**Key Dates: The Development of The
Chinese Banking System**

**Presented by
Dawn Haghighi and Nicholas Rockefeller
Honolulu, Hawaii
5 August 2006**

Key Dates: The Development of The Chinese Banking System

1949 to 1978: Chairman Mao's Planned Economy

1950 -1978

- The PRC Government creates a banking system characterized as highly centralized and an all-inclusive mono-bank system.
- The People's Bank of China ("PBOC") is the main channel through which all banking activities is conducted.
- The PBOC operates as China's Central Bank.

1954

- The China Construction Bank is founded. to handle China's Capital construction investments.

1978 to 1989: Premier Deng Xiaoping's Economic Reforms

1979

- The PRC Government begins its process of modernizing the banking system.
- The PRC government spins off the four major state-owned banks (the "Big Four") from the PBOC:
 - Bank of China
 - The Industrial and Commercial Bank of China,
 - China Construction Bank
 - The Agricultural Bank of China.

1980

- China is accepted as a member of the World Bank.
- The China Investment Bank is created to manage the disbursements from the World Bank.
- Throughout the 1980s, the PRC Government slowly continues its banking reform process.
- Throughout most of the 1980s, the Chinese Banking System does not include many basic banking products or services. Interbank relations are nominal and interbank borrowing and lending does not exist. Very few individuals have checking accounts and bank credit cards do not exist.

- Throughout the 1980s, government agencies and provincial authorities create several investment banks referred to as International Trust and Investment Corporations (“ITIC”), such as China International Trust and Investment Trust Corporation. The ITICS focus on merchant and investment banking activities.

1983

- The State Council re-organizes the PBOC to act as a Central Bank rather than a National Bank.

1984

- The PBOC branch network is reorganized to create the Industrial and Commercial Bank of China.

1986

- China is accepted as a member of the Asian Development Bank. The China Investment Bank disburses funds from the Asia Development Bank.
- The Great Wall Card, the first Chinese credit card, is created for use in foreign exchange transactions.

1990 to 2001: The Third Generation, A Market Oriented Economy with Chinese Characteristics

1991/1992

- The Shanghai Stock Exchange and the Shenzhen Stock Exchange are established.
- Currently, there are approximately 1,300 companies, mostly state owned enterprises, listed with a combined total market value of \$ 400 billion.
- The PRC Government and not independent underwriters determine which companies are listed.

1994

- The PRC Government commercializes the Big Four into commercial banks to be operated on a profit-and- loss basis.
- The PRC Government creates three Policy Banks:
 - China Development Bank
 - Export Import Bank
 - The China Agricultural Development Bank
- The Policy Banks are created to manage and oversee the policy lending functions and finance the economic and trade development of state-invested projects.

1995

- The Commercial Banking Law (“CBL”) effective July 1995, standardizes the commercial activity of banks. The CBL sets out the general principles for lending, depositor relationships and bank management.
- The CBL limits the PBOC’s authority to act only as a Central Bank.
- In this capacity, the PBOC has full autonomy in applying the monetary instruments, including setting interest rates for commercial banks and trading in government. The PBOC no longer provides commercial banking functions.
- The State Council provides oversight of the PBOC policies.
- The Insurance Law of October 1995 sets forth the requirements for setting up an insurance company and for the formation of insurance contracts.
- The PBOC is entrusted with the regulatory and supervisory oversight of the insurance industry.

1996

- The Security Law of July 1999 is enacted and governs the issuing and trading of securities.
- China Securities Regulatory Commission provides regulatory and supervisory authority over security related activity.

1997

- An amendment to the Criminal Law is enacted, which criminalizes money laundering.

1998

- The Guandong International Trust and Investment Corporation (“GITIC”) files for bankruptcy.
- A majority of the 240 ITIC experience liquidity problems due to the bankruptcy of GITIC.
- China adopts a strategy of recapitalization of its state-owned banks. The PRC Government issued \$32 billion in bonds to recapitalize the Big Four.
- Responsibility for the regulatory oversight of the insurance industry is transferred to the China Insurance Regulatory Commission.

1999

- The PRC Government establishes four asset management companies (“AMC”) to transfer and sell the non-performing bank assets.
- Each of the Big Four has a relationship with one of the AMC.

- **Big Four** **AMC**

China Construction Bank	Cinda
Industrial and Commercial Bank of China	Huarong
Agricultural Bank	Great Wall
Bank of China:	Orient

- According to the Central Bank Report, in 2002, the non-performing loans accounted for 21.4 percent to 26.1 percent of the total non-performing assets.

2000

- A personal credit rating system was introduced in Shanghai. The system is launched to provide information to assess consumer credit risk and establish rating standards.
- The credit system was established to support the PBOC's efforts to encourage banks to diversify their portfolios by increasing services to the private sector.
- Interest rate reform begins.
- The PRC Government allows several small banks to increase capital through bond or stock issues. The Shenzhen Development Bank, the Pudong Development Bank and the China Minsheng Bank, the only bank in China without government ownership, are listed on the Shanghai Stock Exchange.

2001 to 2015: The Fourth Generation, Entry into the WTO and Establishing a Globally Integrated Rule-based Market Economy

2001

- China is accepted as a member of the World Trade Organization ("WTO"). The PRC Government begins the WTO implementation process.
- Under the WTO's commitments, the PRC Government agrees to open its banking sector to foreign banks by December 11, 2006.
- The Trust Law of 2001 is effective in October 2001, which sets forth the guidelines for establishing a legal trust in China.

2002

- As part of its WTO commitments, the PRC Government releases the Rules for Implementing the Regulations Governing Foreign Financial Institutions in the People's Republic of China.

- The foreign currency interest rate policies were unified for Chinese and foreign financial institutions in China.

2003

- China Banking Regulatory Commission (“CBRC”) is officially established with its primary function to take over the supervisory role of the PBOC.
- The CBRC is created to strengthen the efficiency of bank supervision and to assist the PBOC to continue to focus on the macro- economy and currency policy.
- The main mission of the CBRC is to “maintain a safe and sound banking system in China.” Its responsibilities include “the regulation and supervision of banks, asset management companies, trust and investment companies as well as other deposit-taking financial institutions.
- The PRC Government creates the Central Huijin Investment Co. Ltd. to transfer foreign exchange from the State Administration of Foreign Exchange to large state-owned enterprises.
- At the end of 2003, foreign equity stakes in Chinese Financial institutions are approximately 500 million or .3 percent of the total banking assets.
- In comparison, The Big Four plus banks Bank of Communications, manage over 60 percent of the country’s loans and deposits.

2004

- The banking card system in China continues to develop. As of June 2004, China had 476,000 POS machines, 64,000 ATMS and approximately 300,000 Chinese merchants accept banking cards.
- It is estimated that since 1985, China has issued 714 million banking cards, a majority of which are debit cards. There are over 110 banking card issuers in China, including the Big Four and many second tier banks.
- Commercial banking activity is the main focus for the Big Four.
- The China Bank Regulatory Commission permits banks to charge high risk borrowers up to 70 percent over benchmark lending.
- The PRC Government introduces rules permitting foreign banks to trade derivatives directly with Chinese businesses.

2005

- The China Construction Bank lists on the Hong Kong Stock Exchange, the largest initial public offering in the Stock Exchange’s history.
- Several international financial institutions purchase equity stakes in China’s banks.
 - a. HSBC purchased a 19.9 percent holding of the Bank of Communications for \$ 2.25 billion.

- b. Bank of America purchased a 10 percent holding in the China Construction Bank for \$3 billion.
 - c. RBS purchased 10 percent of the Bank of China for 3.1 billion.
 - d. Tamasek committed to purchase \$2.5 billion of the CCB.
 - e. Goldman Sachs purchased a 10 percent holding in the Industrial & Commercial Bank of China for \$3 billion.
 - f. ING Bank and International Finance Corporation (World Bank) together own 24.9 percent of the Bank of Beijing, the second largest of China's city commercial banks.
- The China Regulatory Banking Commission issues new Regulations requiring banks to monitor senior management and board members through internal monitoring and independent external auditors and requiring that the banks establish internationally accepted risk management controls.

2006

- Several large financial institutions (HSBS Holdings, Citigroup, American Express) have entered into credit card partnerships with Chinese banks.
- According to Visa International data, there are approximately 30 to 60 million credit card consumers in China.
- The PRC Government begins drafting Credit Card consumer laws.

2007

- According to the WTO provisions, foreign banks will be permitted to directly offer loans and other banking services to Chinese citizens.
- The CBRC is planning to consolidate the 35,000 rural credit cooperatives into approximately 2,000 institutions by the end of 2007.

2008

- Beijing Olympics. It is estimated that approximately 90 percent of the businesses will accept credit cards.

2010

- MasterCard estimates that by 2010, there will be 50 to 75 million Western-style credit cards issued in China.

