



FINANCIAL SECTOR REFORM

In 2007, the PBC effectively implemented *the Requirements of the State Council on Further Enhancing Economic System Reform*, and achieved great improvements in many aspects. Further progress was made in financial institution reform. The shareholding reform of the Industrial and Commercial Bank of China (ICBC), the Bank of China (BOC), the China Construction Bank (CCB) and the Bank of Communications (BOCOM) (referred as the four reforming banks below) proceeded smoothly, and their financial performance continued to improve. The foundational reform of the Agricultural Bank of China (ABC) was pushed forward steadily. Policy bank reform achieved great progress. The reform of China Development Bank (CDB) made a great breakthrough with state capital injection of US\$20 billion. Major headway and strategic results were recorded in the reform of rural credit cooperatives (RCCs). Restructuring and reform of China Re-insurance Company (China Re) progressed stably. More progress was made in the pilot program of integrated financial services.

Further Progress Was Made in Financial Institution Reform

The shareholding reform of state-owned commercial banks (SOCBs) proceeded smoothly

The four reforming banks continued to promote internal reform to strengthen their risk management and internal control systems, to enhance self-discipline, to further transform their business models, and to improve asset quality. They also continued to promote the reform of branch networks, to enhance examination and evaluation on their risk management and internal control systems, and to ensure the effective operation of new mechanisms and regimes. Meanwhile, the BOCOM and the CCB were listed in Shanghai Stock Exchange on May 15 and September 25, 2007 respectively. Until then, the four reforming banks had all realized public listings in both the Hong Kong and Shanghai markets. The ABC foundational reform was pushed forward steadily, with great achievements in external audit and favorable progress in capital rating and verification, legal due diligence and the NPLs checking. At the same time, internal reform was further strengthened, and active research was conducted on ABC's policies and institutional arrangements in providing services for agriculture, farmers and rural areas as well as the county-level economic deve-

lopment. At present, relevant government departments are making efforts in conducting feasibility studies on the shareholding reform scheme of the ABC.

Policy bank reform achieved great progress

The CDB reform made a great breakthrough. With the approval of the State Council, the Central Huijin Investment Limited Company (referred as the Central Huijin Investment Co. below) injected US\$20 billion into the CDB on December 31, 2007. This capital injection will substantially increase the CDB's capital adequacy ratio (CAR) and enhance its risk prevention ability. It will also help to promote the CDB's comprehensive commercial-based operations and will be a fundamental achievement in the CDB reform, indicating an important step forward. Internal reform of the Export-Import Bank of China and the Agricultural Development Bank of China was also continuously enhanced, creating favorable conditions for their comprehensive reform.

Breakthroughs were made in the reform of the China Everbright Group In 2007, with the efforts and coordination of the PBC and related authorities, comprehensive restructuring and reform of the China Everbright Group were unfolded, including financial restructuring of the China Everbright Bank, and the establishment of the Everbright Industrial

Company and Everbright Financial Holding Company. In November, the Central Huijin Investment Co. made an investment in the China Everbright Bank with US dollars equivalent to RMB20 billion yuan, and preparations were made for IPO of the China Everbright Bank. The establishments of the Everbright Industrial Company and the Everbright Financial Holding Company were pushed ahead steadily.

Further progress was made in insurance sector reform Capital injection in and restructuring of the China Re made great progress. The restructuring of the state-owned insurance companies, which have the major shares in domestic insurance market, had been basically concluded. China Life, Ping An of China and China Pacific Insurance (Group) Co. Ltd. were successfully listed in the A-share market. As of the end of 2007, there had been 6 Chinese insurance companies that listed in public foreign and domestic capital markets. By means of going public, these insurance companies further improved their capital strength, and became more influential in the insurance sector.

Major headway was made in the RCCs reform In June 2003, the State Council decided to launch the pilot program of enhancing the RCCs reform. Since then, the RCCs reform had achieved great progress. First, the RCCs' historical burdens were effectively reduced. As of the end of 2007, after strict scrutiny, the PBC had cumulatively issued special bills to the RCCs in 2396 counties or county-level cities of 29 provinces with an amount of RMB165.6 billion yuan. The bills were used to buy the RCCs' NPLs amounting to RMB135.3 billion yuan, and to offset their accumulated losses of RMB30.3 billion yuan. At the same time, the PBC made payments for special bills of the RCCs with an amount of RMB80.7 billion yuan. The PBC also granted special loans of RMB1.2 billion yuan to the RCCs in Shannxi and Xinjiang. With all these supporting policies putting into place gradually, historical burdens of the RCCs had been basically resolved, and the policy of "Money for mechanisms"

began to produce its effects. Second, the RCCs' asset quality was improved further, and their function of serving agriculture, farmers and rural areas was strengthened. By the end of 2007, according to the four-category loan classification system, the RCCs' NPL ratio was 9.3 percent, a drop of about 28 percentage points over the end of 2002. The RCCs' CAR stood at 11.2 percent, an increase of about 20 percentage points over the end of 2002. Since 2004, the RCCs had made net profits for 3 successive years, with profits of 2007 being RMB44 billion yuan. As of the end of 2007, total outstanding rural loans of the RCCs nationwide reached RMB1.43 trillion yuan, accounting for 46 percent of their total loans, compared with the 40 percent at the end of 2002, and accounting for 93 percent of the total rural loans granted by all financial institutions, compared with the 81 percent at the end of 2002. Third, the ownership regime reform was pushed forward steadily. Following the principle of "reflecting localized characteristics and providing targeted guidance", The RCCs across the country actively probed new ownership regimes such as joint stock mode, shareholding cooperation mode and cooperation mode, etc.. They also chose new organizational forms such as rural commercial bank, rural cooperative bank and prefecture unified city-level legal entities or two-tier city-level legal entities. As of the end of 2007, 17 rural commercial banks, 113 rural cooperative banks, and 1 824 prefecture unified city-level legal entities had been founded nationwide. Meanwhile, the regulatory and supervisory framework for the RCCs had been generally established, and the responsibilities of and labor division among provincial governments, provincial rural cooperative unions and regulatory authorities had been basically clarified.

Integrated Financial Services Were Enhanced Steadily

The pilot program of integrated financial services had been progressing steadily, and mainly formed the



following three patterns. First, comprehensive integrated financial services pattern, in which case financial institutions provide cross-sector and cross-market financial products and services, such as RMB and foreign currency asset management products and Asset-Backed Securitization (ABS) products, etc.. Second, cross-shareholding of financial institutions, in which case commercial banks and insurance companies control shares in companies in another sector or hold shares in other financial institutions as investors. For example, commercial banks set up or invest in fund management companies, financial leasing companies and trust and investment companies. Insurance companies invest in non-listed bank equities and securities companies, and asset management companies set up securities companies, etc.. Third,

financial holding company pattern, including (a) pure financial holding companies, such as CITIC Holdings and Ping An Insurance (Group) Company; (b) mixed holding companies that are formed by large industrial enterprises with investment in various financial institutions; and (c) local state-owned asset investment and management companies that are founded by local governments and hold controlling interests in local banks, securities companies and other financial institutions. In addition, some foreign financial groups have penetrated into domestic banking, securities and insurance sectors by establishing branches, subsidiaries and joint-venture companies, or investing in domestic financial institutions, so as to achieve their cross-sector strategic deployment.

Box

Financial Service Innovation Pilot Program in Hunan Province

To further enhance central bank's financial service, satisfy multi-level and diversified financial service demands from local governments, enterprises and individuals, and accelerate balanced economic and financial development, the PBC and Hunan Provincial Government decided to launch financial service innovation pilot program on September 19, 2006. Until now, this program made remarkable results.

Pushed forward the building of social credit information system Breakthrough was made in information sharing between banks and tax agencies. Enterprises credit rating pilot project saw steady expansion. Small and medium enterprises and individual credit information system took shape. Individual credit report was used widely. A "Hunan Model" social credit information system, characterized by "government leadership, the PBC push, and non-independent local database", witnessed a significant progress.

Built payment system express way Small value payment system regular debit business saw wide coverage. The central bank accounting concentration electronic checking system was extended in Hunan province. National Cheque Image System (CIS) and cheque filing system was put into operation smoothly. Cross bank deposit and withdrawal business through small value payment system was successfully launched in Hunan. Breakthrough was made in fee collection and payment through the small value payment system. UnionPay corporate card pilot program had a successful extension. Bankcard tailored for migrant workers operated smoothly in Hunan province, with a total trading volume of 384 million yuan and transactions of 695.7 thousand.

Accelerated state treasury service Efforts were made to promote fiscal payment directly through the PBC state treasury department, which extended to 14 cities and counties in Hunan

province at end-2007. In June 2007, the PBC state treasury department in Hunan began direct redemption of bearer's government bonds. In November 2007, the Transversal Network Linking Fiscal, Taxation, Treasury and Banking Agencies began to cover the whole province. Expenditure nets linkage system was upgraded featuring launch of off-budget funds expenditure business in some cities and counties. Social welfare fund collection by the PBC state treasury department started in cities and counties on a trial basis.

Improved currency issuance service system more accessible by the public “Double shift model” started to operate in Changsha sub-branch banknote processing center. Until end-2007, 1.1103 million bundles of banknotes was sorted, a year-on-year growth of 106 percent. Booking system of banknote collection and deposit of commercial banks extended in Hunan. More efforts were given to anti-counterfeit publicity and attack on counterfeiting banknote. The building of anti-counterfeit publicity network was improved with anti-counterfeit publicity stations set up in one third of counties and towns.

Satisfied multi-level demands on statistical information Steady progress was made to push forward pilot program of statistical data concentrated collection, extend collection coverage on Hunan historical economic and financial fundamental data, expand information service pattern, contents, and coverage. Multi-level demands on statistical information from different agencies were satisfied.

Built convenient foreign exchange management service system Approval procedures for sources of overseas investment in foreign exchange funds were simplified. Hunan province took the lead in launching special pilot program of simplifying procedures for foreign exchange business market access of banking financial institutions and decentralizing approval rights of automatic checking and long-distance

checking. At the end of December, 2007, off-city foreign exchange payment business within Hunan province made by import enterprises was treated as intra-city business for those import enterprises in lists of Hunan foreign exchange payment enterprises. Internet processing pilot program for market access approval (filing) for bank selling/purchase foreign exchange started in Hunan.

Constructed efficient anti-money laundering system Anti-money laundering offsite monitor information collection system was launched in July 2007. Procedures and contents of large value and suspicious transaction reports on anti-money laundering were simplified. Pilot program was started on large value and suspicious transaction report for the securities and the insurance industry. Money laundering risk assessment and alarm indicator system was set up. Anti-money laundering information exchange platform was under construction.

Promoted financial institution credit products innovation *Guidance on Financial Industry Promoting Hunan Consumption Growth* was drawn up to promote consumption growth in Hunan by products innovation. Active steps were taken to guide financial institutions to further adjust and optimize credit structure, innovate financial products, support building of socialist countryside, support advantage industries, and help the financial industry to play the role in boosting local economic growth.

Opened two internet and intranet platforms In May 2007, financial service internet platform was opened on Hunan Provincial Government Website, a bridge to introduce financial knowledge, extend financial product, provide financial service, and explore financial innovation. In July 2007, intranet platform was put into use. On-line exchange of financial information was further strengthened.