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Contributors to This Report

Chief Editors:	XUAN Changneng	TAO Ling	JIN Luo
	LIANG Shidong	HUANG Xiaolong	
Editor:	TAO Ling	YANG Xiaojun	ZHANG Tiantian
Authors:			
Chapter I:	ZHANG Tiantian	XU Caixia	DING Kang
	FAN Shilei	LIU Liu	
Chapter II:	LI Da	REN Qiuyu	CHEN Ying
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	CHEN Jiming	ZHANG Xin	
Chapter III:	CHEN Jianxin	LIN Wenshun	ZHAO Min
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Chapter V:	WANG Shaoqun	CHEN Min	
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	SUN Yinhao	DONG Liang	
Special Topic II:	WANG Jin	GU Chenjie	LIU Liu

Special Topic III：	XIE Dan	LIU Jie	WANG Yu
Appendix：	ZHAO Min	LIU Liu	DIAO Yazhou
	CHEN Mian	CHEN Min	ZHANG Weihua

Other Contributors：

YU Mingxing	WANG Zunzhou	SHEN Liming
ZHANG Shuangchang	JI Jun	GUO Dayong
WEN Ruchun		

Contributors to English Edition[①]

Chief Editors: XUAN Changneng JIN Luo

Editor: YANG Xiaojun ZHANG Tiantian

Translators:

Executive Summary:	CAO Zhihong
Chapter I:	ZHANG Tiantian
Chapter II:	LIU Wenzhong
Chapter III:	ZHAO Bingzhe
Chapter IV:	LIU Qin
Chapter V:	WANG Xiao
Chapter VI:	FAN Shilei
Chapter VII:	WANG Beijie
Chapter VIII:	HU Ping
Special Topic I:	LI Da
Special Topic II:	CAO Zhihong
Special Topic III:	LU Leilei
Appendix:	LIU Liu

Other Contributors:

CHEN Min	LIU Jie
LV Yuan	MIAO Mengmeng

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Executive Summary

In 2013, growth of the world economy was low and the global financial system continued to undergo a series of transitions. The international financial markets saw large fluctuations, presenting many challenges to economic recovery and financial stability. The Chinese economy maintained good momentum and took a turn for the better. Reform of the financial sector continuously deepened, the financial institutions became stronger, the financial markets developed in a stable pace, the building of financial infrastructure made fresh progress, and the financial system as a whole remained sound.

In 2014, the Chinese economy still faces a very complex situation with both positive and negative factors. The decisions adopted at the 18^{th} CPC National Congress, the 2^{nd} and 3^{rd} Plenary Sessions of the 18^{th} CPC Central Committee will be implemented, and the general principle of seeking progress while maintaining stability will be followed, so that reform and innovation will be facilitated in all the fields of economic and social development. The stability and continuity of macroeconomic policies will be kept and the decisive role of market in resource allocation will be played to a fuller extent to promote sound and sustainable development of the real economy and financial sector.

The world economy was recovering slowly. Specifically, the growth in the U.S. was gaining strength, and the debt crisis in the Euro area entered a relatively calm period. Growth in Japan moderated after rebounding strongly as a result of policy stimulus. The emerging economies in general were slowing down. Due to the large fluctuations in the global financial markets, the currencies of some emerging economies experienced large depreciation. At the moment, the world economy still faces downward risks, given the uncertainties in the U.S. tapering, the persistence of long-term and structural problems in the euro zone, the lack of endogenous drivers in Japan, and the dual challenges facing emerging markets in the form of changing international financial environment and their own vulnerabilities.

The Chinese economy maintained a stable growth momentum and was taking a turn for the better. The proactive fiscal policy and sound monetary policy continued. The domestic demand expanded steadily while the overall price level was stable. The fiscal revenue kept growing, the level of government indebtedness was in general under control, and household income was rising. The monetary and financial environment was generally stable. At present, given the build-up of downward pressures and intertwined problems, the task of structural adjustment and transformation of growth pattern remains arduous. It is necessary to preserve the stability and continuity of macroeconomic policies, make macroeconomic management more forward-looking, targeted and coordinated, stimulate the vitality of the market, and accelerate the adjustment of economic structure and transformation of growth pattern, in order to improve the quality and efficiency of economic growth.

Performance of **the banking sector** was stable. The deposits and loans outstanding both were growing steadily, the quality of capital was relatively good, and the level of provisioning was sufficient. The growth of profit decelerated but various reform measures were being implemented smoothly, and the credit input for weak areas were increasing further. Financial services to the real sector produced positive results, and the effectiveness of financial regulation was increasing. However, risks have accumulated in certain industries, fields and regions, liquidity risk management is becoming increasingly difficult, potential risks in interbank, off-balance sheet and wealth management business should be watched closely and the risks in non-financial institutions with a financing function must not be neglected. Going forward, measures will be adopted to further deepen reform, encourage financial innovation, improve risk management, mitigate and address risks in key areas, enhance and improve banking sector regulation and supervision, and improve the efficiency and quality of services to the real sector.

The securities and futures industry developed in a sound manner and business innovation made fresh progress. The regulatory reform was furthered, the fundamental institutional design and building was improved, and the sector's opening-up was deepened. But the performance of some public companies slid and the debt level of some securities companies climbed rapidly. At the next stage, it is necessary to continue market-oriented reform and regulatory transformation, facilitate product and business innovation, work in real earnest to protect the legitimate rights and interests of investors, and achieve sound and sustainable development.

The insurance sector maintained the momentum of steady progress. Assets expanded further and growth of premium gradually recovered. The sector improved its operating efficiency and built up solvency capacity. Market-oriented reform of the sector continued, regulation improved, and the protection of consumer rights and interests was enhanced. However, the profit of the property insurance business decreased; the life insurance sector faced heightened liquidity pressure, whereas consumers lodged more complaints. Going forward, the market-oriented reform will be deepened, and the business and channel structures will be optimized. The effectiveness of insurance supervision will be enhanced to promote the healthy and sustainable development of the sector.

Performance of **the financial market** was generally stable. The market deepened and broadened while reform and innovation were advanced. The money market traded briskly, with interest rates fluctuating by a larger margin. Bond issuance expanded further and bond yield went higher. The stock market fluctuated and slumped, and the financing through the stock market declined. The transaction volume on the foreign exchange market expanded rapidly, and the yuan to dollar exchange rate appreciated slightly. The transactions of bill financing were frequent while the gold prices declined in a volatile market. At the next stage, measures will be adopted to build a centralized and open market system to support orderly competition, encourage financial innovation, add more layers and products on the financial markets and let the market play a decisive role in resource allocation.

The building of **financial infrastructure** made further progress. The payment, clearing and settlement system operated smoothly. The second generation payment system had been in smooth operation since its launch. Non-cash payment instruments mushroomed, and the rural payment environment saw much improvement. The system of laws and regulations governing the financial sector was further improved and became more in line with the reform, opening-up and development of the sector. Accounting standards were further improved with the implementation of various accounting rules. The *Administrative Provisions on Credit Information Industry* and the *Administrative Rules on Credit Information Institutions* were formally implemented, signaling a new stage in the development of institutional arrangements for the credit information industry. The anti-money laundering system was improved and its effectiveness enhanced. At the next period, efforts will be made to enhance the security and efficiency of financial infrastructure, and further improve the system of laws and regulations, accounting rules, credit information regulation and services, and the quality of anti-money laundering supervision.

The macro-prudential regulation was further advanced. The international community conducted more studies on making macro-prudential policies, facilitated the implementation of Basel III, strengthened regulation of the systemically important financial institutions and shadow banking system, made more moves towards building an effective resolution regime for financial institutions, and promoted the reform of OTC derivatives market. The major economies further deepened their financial regulatory reform and enhanced macro-prudential regulation. The final version of the Volcker Rule were adopted in the U.S, the Europeans made breakthroughs in building a banking union, and the new financial regulatory system was in operation in the UK. In China, efforts have been made to enhance the macro-prudential framework. A Joint Ministerial Conference on Financial Regulatory Coordination was established, led by the PBC, and regulatory coordination is becoming a regular rule-based practice. Efforts will be made to continue and improve counter-cyclical macroeconomic management, strengthen the systemic risk monitoring, assessment and resolution mechanism, and promote the establishment of the deposit insurance regime, for the purpose of effectively maintaining sound operation of financial system.

Abbreviations and Acronyms

ABC	Agricultural Bank of China
ADBC	Agricultural Development Bank of China
AML	Anti-money Laundering
APG	Asia/Pacific Group on Money Laundering
ASEAN	Association of Southeast Asian Nations
AVIC	Aviation Industry Corporation of China
BOC	Bank of China
BOCOM	Bank of Communications
BCBS	Basel Committee on Banking Supervision
CAGR	Compound Annual Growth Rate
CAR	Capital Adequacy Ratio
CBRC	China Banking Regulatory Commission
CCB	China Construction Bank
CCP	Central Counter Party
CDB	China Development Bank
CFETS	China Foreign Exchange Trade System
CPC	Communist Party of China
CPI	Consumer Price Index
CPSS	Committee on Payment and Settlement Systems
CIRC	China Insurance Regulatory Committee
CITIC	China International Trust and Investment Corporation
CSPFTZ	China (Shanghai) Pilot Free Trade Zone
CSRC	China Securities Regulatory Commission
CFTC	Commodity Futures Trading Commission
CFPB	Consumer Financial Protection Bureau
CTF	Counter-terrorist Financing
CMGs	Crisis Management Groups
DNFBPs	Designated Nonfinancial Businesses and Professions
DVP	Delivery Versus Payment

EUR	Euro
EBA	European Banking Authority
ECB	European Central Bank
EFSF	European Financial Stability Facility
EIOPA	European Insurance and Occupational Pensions Authority
EMEAP	Executives' Meeting of East Asia-Pacific Central Banks
ESM	European Stability Mechanism
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
ETF	Exchange-Traded Fund
EximBANK	Export-Import Bank of China
FATF	Financial Action Task Force on Money Laundering
FCA	Financial Conduct Authority
FDIC	Federal Deposit Insurance Corporation
FPC	Financial Policy Committee
FSA	Financial Service Authority
FSB	Financial Stability Board
FSOC	Financial Stability Oversight Council
FTA	Free Trade Area
FX	Foreign Exchange
G-SIBs	Global Systemically Important Banks
G-SIIs	Global Systemically Important Insurers
GBP	Great Britain Pound
GDP	Gross Domestic Product
G20	Group of Twenty
GEM	Growth Enterprise Market
G-SIBs	Global Systemically Important Banks
G-SIIs	Global Systemically Important Insurers
HICP	Harmonized Index of Consumer Prices
ICBC	Industrial and Commercial Bank of China
IPO	Initial Public Offering
IAIS	International Association of Insurance Supervisors
IMF	International Monetary Fund
IOSCO	International Organization of Securities Commissions
JPY	Japanese Yen
JSCBs	Joint-stock Commercial Banks

JOBS Act	Jumpstart Our Business Startups Act
LCB	Large commercial bank
LPR	Loan Prime Rate
LGFV	Local Government Funding Vehicle
MOU	Memorandum of Understanding
M&A	Mergers and Acquisitions
MOF	Ministry of Finance
MPC	Monetary Policy Committee
MMFs	Money Market Funds
MBS	Mortgage-Backed Securities
NBS	National Bureau of Statistics
NCUA	National Credit Union Administration
NPL	Non Performing Loan
NPO	Non-profit Organization
OCC	Office of the Comptroller of the Currency
OTC	Over the Counter
P2P	Peer to Peer
PBC	People's Bank of China
PICC	People's Insurance Company of China
PMI	Purchasing Managers Index
POS	Point of Sales
PPI	Producer Price Index
PPIRM	Purchasing Price Index of Raw Material
PRA	Prudential Regulation Authority
PSBC	Postal Savings Bank of China
PVP	Payment-versus-payment
QFII	Qualified Foreign Institutional Investors
QE	Quantitative Easing
RCAP	Regulatory Consistency Assessment Process
RCCs	Rural Credit Cooperatives
RMB	Renminbi
ROI	Return on Investment
R-QFII	RMB Qualified Foreign Institutional Investors
RRP	Recovery and Resolution Plan
SAFE	State Administration of Foreign Exchange
SEACEN	South East Asian Central Banks

SEC	Securities and Exchange Commission
Shibor	Shanghai Interbank Offered Rate
SME	Small and Medium-size Enterprises
SIFIs	Systemically Important Financial Institutions
SLF	Standing Lending Facility
SLO	Short-term Liquidity Operations
SSM	Single Supervisory Mechanism
TICs	Trust and Investment Corporations
TRs	Trade Repositories
UCCs	Urban Credit Cooperatives
UNSCRs	United Nations Security Council Resolutions
USD	US Dollar
EMEAP-WGPSS	Working Group on Payment and Settlement Systems under Executive Meetings of East Asia and Pacific Central Banks
y-o-y	year-on-year

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Chapter Ⅰ

International Economic and Financial Environment

In 2013, the global growth was in low gear. The global financial system continued to undergo a series of transitions, international financial markets experienced great fluctuations, and financial regulatory reforms were stepped up steadily. Both the advanced economies and emerging market economies may face certain policy risks with big challenges to economic growth and financial stability, and should hereby take active measures in response and strengthen mutual policy coordination, so as to guard against risks of economic slowdown and disorderly adjustment.

I. Economic Developments in the Major Economies

In 2013, the world economy continued to experience a slow recovery. The growth momentum in the U.S. continued to strengthen, while policy risks remained. The euro zone stepped out of recession, but the recovery was not solidly grounded. Although Japan waged a powerful rebound as a result of the policy stimulus, the growth slowed down afterwards and Japan still faced long-run challenges. In some emerging market economies, as growth slowed down and financial markets fluctuated, risks became more acute.

The U.S. recovery was gaining ground. GDP growth recorded 1.9 percent for the entire year of 2013, and the real GDP growth was 4.1 percent quarter on quarter during the third quarter, the highest since the first quarter of 2012. The unemployment rate dropped from 7.9 percent in January to 6.7 percent in December, the lowest level since November 2008. Inflation remained low throughout the year, with CPI registering 1.5 percent in December. The PMI compiled by the Institute for Supply Management (ISM) was above the threshold of 50 throughout the year except May. At the same time, the property market continued to recover, and stock indices hit record highs. Driven by the property-market recovery and the wealth effects from the bullish stock market, private consumption grew rapidly. In addition, the trade deficit narrowed substantially compared to the year 2012, recording USD 471.5 billion for the whole year, a y-o-y decline of 11.8 percent. On December 18, the Federal Reserve raised the projection for economic growth in 2014 from its previous projection in September of 2.9–3.1 percent to 2.8–3.2 percent.

The economy in **the euro zone** recovered tepidly. Beginning in 2013, with the European sovereign debt crisis in a relatively quiet period, the euro zone once again was on a recovery trajectory. In 2013, the euro zone GDP growth dropped by 0.4 percent y-o-y, recording -0.2 percent, 0.3 percent, 0.1 percent and 0.3 percent for each quarter respectively. The ZEW indicator of economic sentiment, which measures consumer and business confidence, edged up gradually for eight months, reaching 100 in December, the highest level in the recent two years. However, the unemployment rate was still elevated, remaining at 12.0 percent since Q4. Meanwhile, the price level in the euro zone remained low throughout the year, and in December, the HICP grew by only 0.8 percent y-o-y. On March 6, 2014, the ECB raised the projection for 2014 from its previous projection in December 2013 of 1.1 percent to 1.2 percent.

Growth in **Japan** moderated after rebounding strongly. Due to substantial yen depreciation and a massive fiscal stimulus, the Japanese economy grew by 0.7 percent for the whole year, with annualized quarterly growth rates recording 0.7 percent, with 4.5 percent, 4.1 percent, 0.9 percent and 0.7 percent respectively. The y-o-y core CPI became positive beginning in June, and reached 1.3 percent in December, hitting a new high, unseen in the past five years. Due to a stable labor market, the unemployment rate remained at about 4.0 percent for the whole year. Affected by rising import costs and other factors, the trade deficit recorded JPY 11.47 trillion in 2013, representing a y-o-y growth of 65.3 percent, a new historic high.

Table 1.1 Macro-economic and Financial Indices of the Major Economies

Country	Index	2013Q1			2013Q2			2013Q3			2013Q4		
		Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
United States	Real GDP Growth Rate (annualized quarterly rate, %)	1.1			2.5			4.1			2.6		
	Unemployment Rate （%）	7.9	7.7	7.5	7.5	7.5	7.5	7.3	7.2	7.2	7.2	7.0	6.7
	CPI（y-o-y, %）	1.7	2.0	1.5	1.1	1.4	1.8	2.0	1.5	1.2	1.0	1.2	1.5
	DJ Industrial Average (closing number)	13 861	14 054	14 579	14 840	15 116	14 910	15 500	14 810	15 192	15 237	16 086	16 577
Euro Zone	Real GDP Growth Rate (quarterly y-o-y, %)	-0.2			0.3			0.1			0.3		
	Unemployment Rate （%）	12.0	12.0	12.0	12.1	12.1	12.1	12.1	12.1	12.1	12.0	12.0	12.0
	HICP (y-o-y, %)	2.0	1.8	1.7	1.2	1.4	1.6	1.6	1.3	1.1	0.7	0.9	0.8
	EURO STOXX 50 (closing number)	2 641	2 647	2 698	2 725	2 662	2 605	2 699	2 671	2 789	2 774	2 901	2 919
Japan	Real GDP Growth Rate (annualized quarterly rate, %)	4.5			4.1			0.9			0.7		
	Unemployment Rate （%）	4.2	4.3	4.1	4.1	4.1	3.9	3.8	4.1	4.0	4.0	4.0	3.7
	Core CPI (y-o-y, %)	-0.2	-0.3	-0.5	-0.4	0.0	0.4	0.7	0.8	0.7	0.9	1.2	1.3
	NIKKEI225 (closing number)	11 139	11 559	12 398	13 861	13 775	13 677	13 668	13 389	14 456	14 328	15 662	16 291

Source: Statistical Bureaus and Central Banks of the Relevant Economies.

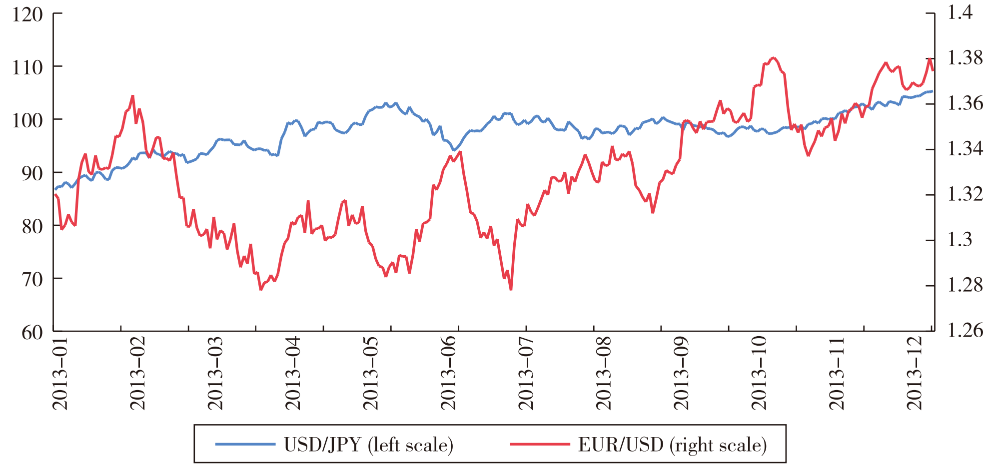
Growth in **emerging market economies** as a whole slowed down, with heightened risks in some economies. According to IMF statistics, growth of major emerging market and developing economies slowed down and registered 4.7 percent in 2013, and growth dynamics diverged in different countries. In particular, GDP growth of India and Brazil were up 1.2 and 1.3 percentage points respectively from the previous year, while growth of Russia and South Africa were down 1.9 and 0.7 percentage points. Some emerging market economies experienced a deteriorating balance of international payments, a drawdown of foreign exchange reserves, and grave fiscal and debt conditions. When the Federal Reserve signaled the tapering of QE in May, international capital flows reversed, causing large volatility in the financial markets of several emerging market economies. In general, the fundamentals in the emerging market economies were relatively weak, and short-term risks in some economies might increase.

II. International Financial Market Performance

In 2013, affected by uncertainties in the QE tapering process by the Federal Reserve and sluggish global economic recovery, the international financial markets fluctuated dramatically, with increased divergence between advanced and emerging market economies. Financial markets of most advanced economies gained strength, with stock markets rising sharply and hitting record highs, while some emerging market economies saw big volatility in their financial markets, including currency depreciations, stock market slumps, and rising yields of government bonds.

The euro appreciated slightly against the U.S. dollar, whereas the Japanese yen and the currencies in most emerging market economies continued to depreciate against the U.S. dollar. As of end-2013, the exchange rate of the USD/EUR closed at 1.3745 dollar per euro, an appreciation of 4.2 percent from end-2012, and the exchange rate of the JPY/USD closed at 105.30 yen per dollar, a depreciation of 17.6 percent from end-2012. Meanwhile, most of the emerging market currencies depreciated against the U.S. dollar, with the Brazilian real, Indian rupee, Indonesian rupiah, South African rand and Russian ruble depreciating by 13.3 percent, 11.0 percent, 20.8 percent, 19.1 percent and 7.1 percent respectively. In particular, after the Federal Reserve signaled a possible QE tapering in late May, major emerging market economies saw massive capital outflows. In late August, the Indian rupee, Indonesian rupiah, and Thai baht depreciated against the U.S. dollar by 18 percent, 15 percent, and 6 percent respectively from the end of May. Later in September, with the announcement by the Federal Reserve that the QE tapering would be postponed, financial markets in the emerging market economies rallied and volatility was eased, but the overall depreciation was still significant.

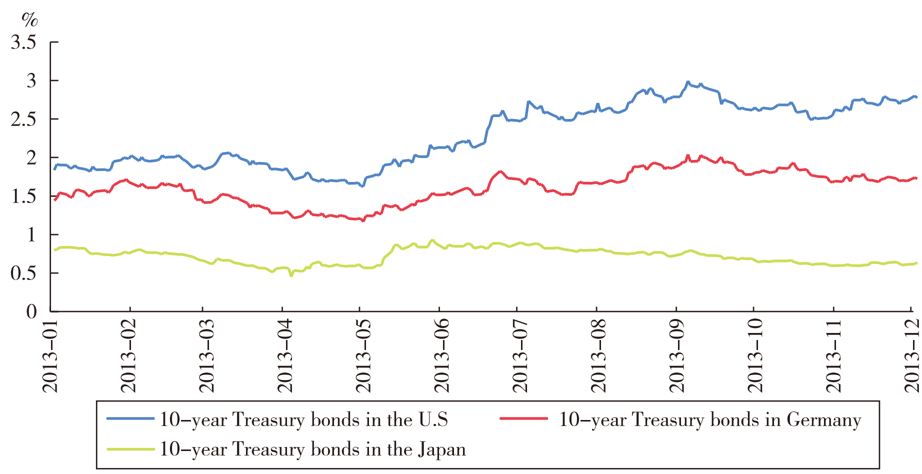
Figure 1.1 Exchange Rate Movements of Major Currencies



Source: Reuters.

Treasury bond yields in the U.S. and Germany rose, whereas yields decreased appreciably in Japan, and yields in some of the emerging market economies rose considerably. At end-2013, 10-year Treasury bond yields in the U.S. and Germany closed at 3.04 percent and 2.11 percent respectively, up 126 and 73 basis points compared with those of end-2012. The 10-year Treasury bond yield in Japan closed at 0.736 percent, down 6 basis points from the end of the last year. Since June, some emerging market economies experienced a reversal of capital inflows to outflows, and their 10-year Treasury bond yields continued to rise. In particular, yields in Brazil, Turkey, Indonesia, South Africa, and Russia rose dramatically, increasing 403, 372, 327, 153, and 86 basis points at end-2013 respectively from the end of the previous year.

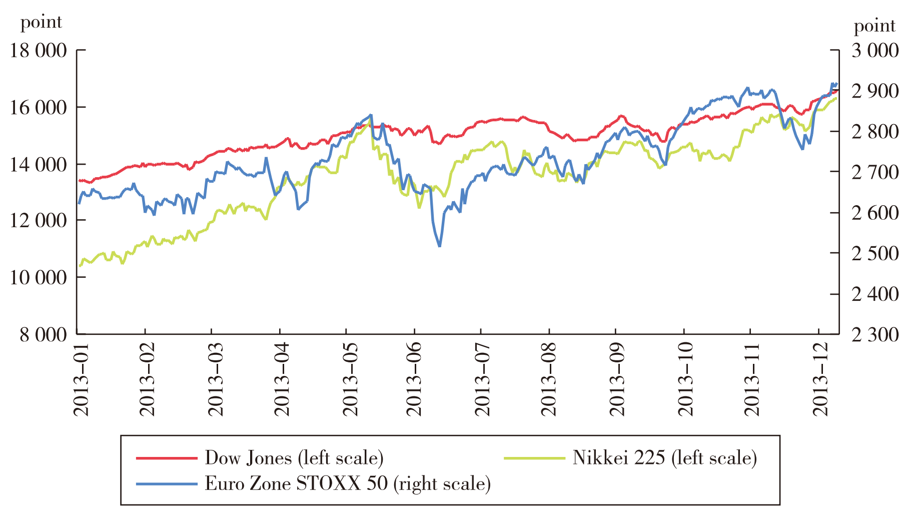
Figure 1.2 Yields of Treasury bonds in Major Economies



Source: Reuters.

Stock indices in the major advanced economies rallied, but they fluctuated wildly in most of the emerging market economies. Investor confidence in economic recovery of the U.S. and Europe strengthened, and risk appetite increased, pushing stock indices in the major advanced economies to record highs. At end-2013, the Dow Jones Industrial Average Index, the STOXX50 Index, and the Nikkei 225 Index closed at 16 576.66, 2 919.42, and 16 291.31 points respectively, up 26.5 percent, 13.3 percent, and 56.7 percent from the end of the last year. On the other hand, due to domestic imbalances in economic structure and affected by stronger expectation for a QE tapering by the Federal Reserve, the stock indices in a number of the emerging market economies fluctuated even more violently. From June to September, the stock indices in Indonesia, Turkey and India fluctuated by 20.4 percent, 23.0 percent and 15.3 percent respectively.

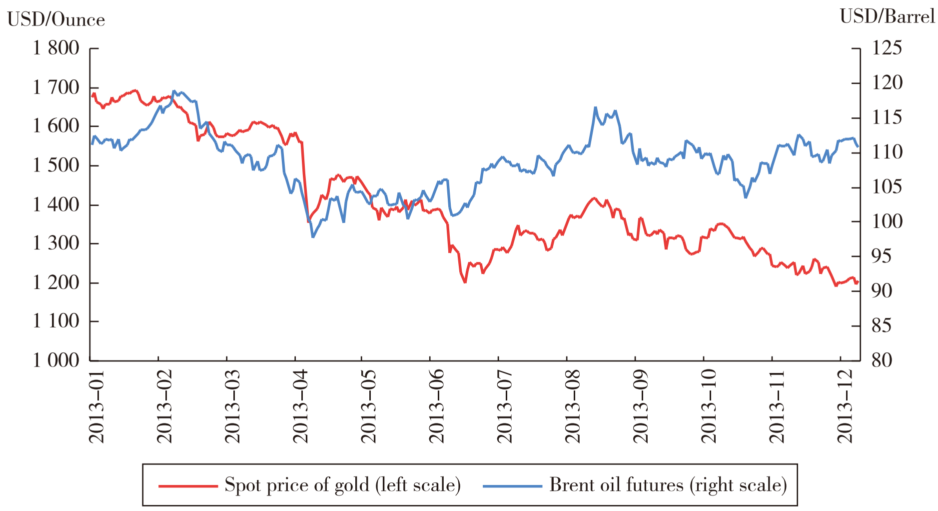
Figure 1.3 Major Stock Indices



Source: Reuters.

The commodity prices fluctuated at a subdued level, while the price of gold declined continuously. Generally speaking, the global commodity market was comparatively weak in 2013, and prices of major commodities were declining and adjusting. As of the end of the year, the U.S. Commodity Research Bureau Spot Index, which comprises of most commodities on the global market, closed at 456.36, a y-o-y decrease of 27.71. Meanwhile, the gold price declined continuously, and closed at USD 1 201.5 per Ounce by the year-end, falling by 27.8 percent y-o-y. Throughout the year, affected by the complex geopolitical situations and market speculation, international crude oil price fluctuated dramatically, with the New York light crude oil futures up 8.4 percent y-o-y and London Brent crude oil futures remaining stable by the end of the year.

Figure 1.4 Price Indices of Crude Oil and Gold on the International Market



Source: Reuters.

III. Monetary Policies of the Major Economies

In 2013, monetary policies of major central banks diverged greatly, with major advanced economies mainly clinging to easing policies and some emerging market economies tightening their policies.

The U.S. began to taper the QE policies. In 2013, the Federal Reserve kept the federal funds rate at the target range of 0-0.25 percent, and promised to maintain this exceptionally low level as long as the unemployment rate is above 6.5 percent, inflation rate between one and two years ahead does not exceed 2.5 percent and long-term inflation expectation is well-anchored. In December, in view of employment improvements, the Federal Reserve announced to decrease the size of monthly asset purchases from USD 85 billion to USD 75 billion, with mortgage-backed securities and long-term Treasury securities cutting USD 5 billion respectively. The Federal Reserve also reaffirmed its view that a highly accommodative stance of monetary policy would remain appropriate for a considerable time after the asset purchase program completely ends, and the federal funds rate would remain at the target range of 0-0.25 percent.

The ECB reinforced its easing monetary policies. In May 2013, the ECB decided to lower the major refinancing rate from 0.75 percent to 0.5 percent, and the interest rate on the marginal lending facility from 1.5 percent to 1 percent in order to stimulate economic recovery and activate credit activities. In July, the ECB announced that it would maintain the current low interest rate or even adopt a lower level for a prolonged period of time, which was regarded as its first forward guidance in terms of interest rate policies. In November, the ECB decided to lower the major refinancing rate again from 0.5 percent to 0.25 percent, and the interest rate on the marginal lending facility from 1 percent to 0.75 percent, to respond to the unexpected drop of inflation rate and depressed loan underwriting.

The Bank of England maintained its easing monetary policies. In 2013, the Bank of England kept the benchmark interest rate unchanged at the record low of 0.5 percent, and maintained the size of its asset purchases of GBP 375 billion. In August, the Bank of England introduced the forward monetary policy guidance, intending not to raise the benchmark interest rate until the unemployment rate falls to a threshold of 7 percent.

The Bank of Japan introduced new easing policies. In April, the Bank of Japan decided to implement the Quantitative and Qualitative Monetary Easing policy (QQE), doubling the monetary base and the outstanding amounts of Japanese government bonds (JGBs) as well as ETFs, and more than doubling the average remaining maturity of JGB purchases, with the objective of raising the inflation rate to 2 percent. By means of this policy, the Japanese monetary base by the end of next two years is expected to reach JPY 270 trillion or USD 2.78 trillion, accounting for 56 percent of nominal GDP.

Monetary policies in the emerging market economies continued to diverge. A number of countries further eased monetary policies to mitigate the economic downside risks, and some others tightened their policy stance in response to inflation, capital outflows and depreciation pressure of local currencies. The central bank of Hungary cut the benchmark interest rate on 12 occasions by 275 basis points altogether to 3 percent. The Central Bank of Chile lowered the benchmark interest rate on 2 occasions by 25 basis points respectively to 4.5 percent, the lowest level since April 2011. The Reserve Bank of India cut the benchmark interest rate for 3 times in the first half of the year to 7.25 percent, and later raised the rate to the current 7.75 percent on 2 occasions, in order to curb the intensified inflationary pressure. For the same reason, the Central Bank of Brazil raised the benchmark interest rate for 6 times to 10 percent, and the Bank of Indonesia raised the benchmark interest rate for 5 times to 7.5 percent. In addition, the central banks of Russia and South Africa announced to maintain the current benchmark interest rates unchanged in response to inflationary pressure.

Box 1 The U.S. QE Monetary Policies and the Implications for China's Financial Stability

In response to the international financial crisis since 2008 and to stimulate economic growth, the U.S. adopted several rounds of accommodative monetary policies. Both the implementation and unwinding of these policies have a significant influence on the global financial system, and its implications on China's economic and financial situations also warrant attention.

Main contents of the U.S. QE monetary policies. The first round of QE monetary policies (QE1) was introduced after the outbreak of the subprime crisis. On November 25, 2008, the Federal Reserve announced for the first time that it would purchase agency debts and mortgage-backed securities (MBS), marking the launch of the first round of QE policies, which concluded in March 2010. During this period, the Federal Reserve purchased assets with the accumulative total of USD 1.725 trillion, comprising MBS of USD 1.25 trillion, Treasury securities of USD 300 billion and agency debts of USD 175 billion. The second round of QE monetary policies (QE2) was adopted when the U.S. economy slowed down amid its recovery. In the third quarter of 2010, the growth rate of U.S. GDP had declined for 3 consecutive quarters, with the unemployment rate clinging to 9.5 percent for several consecutive months and the European sovereign debt crisis worsening constantly. The Federal Reserve announced to launch the QE2, which resulted in total purchases of long-term Treasury securities of USD 600 billion from November 2010 to June 2011 at a pace of USD 75 billion per month. The Operation Twist was implemented during the sluggish recovery period. The Federal Reserve declared, since September 14, 2012, to purchase MBS at a pace of USD 40 billion per month with no prearranged deadline, and implement the Operation Twist of selling Treasury securities with shorter maturities and purchasing the ones with longer maturities, which brought the monetary policies into the open-ended commitments. The third round of QE monetary policies (QE3) was announced in the "fiscal cliff" period. The Federal Reserve started from December 2012 on to purchase USD 45 billion Treasury securities per month, to replace the Operation Twist which concluded by the end of December 2012. This round continued to authorize up to USD 40 billion worth of MBS per month, and the total asset purchases of the Federal Reserve per month amounted to USD 85 billion.

Implementation of the U.S. QE policies boosted the cross-border capital inflows into China. First, the QE policies increased capital inflows to China, and funding by domestic enterprises from the HongKong stock and bond markets also expanded dramatically. Second, the QE policies directly led to lowered federal funds rate and widened spreads between foreign and domestic interest rates in China, giving arbitrage impetus to cross-border capital. Third, adequate liquidity in the U.S. helped to shape weak dollar and strong RMB, and reinforced the exchange arbitrage incentives of cross-border capital. Forth, the QE policies strengthened recovery confidence and reduced investor risk aversion, hereby inducing capital to flow from low-risk assets in advanced economies to emerging market assets with higher risks.

Implications of U.S. QE tapering on China. In light of continuous improvements in macro economy, in December 2013, the Federal Reserve announced to gradually taper its asset purchases since January 2014, initiating the exit process of the QE policies, 5 years after its launching. Thanks to its cumulative current account surplus, low external debts, high savings rate, capital control and tremendous foreign exchange reserves, China is unlikely to go through significant shocks by the U.S. QE tapering. At the same time, unwinding of the QE policies may strengthen market expectation on dollar appreciation, which on the one hand could add to the price advantage of Chinese export goods, and on the other, could bring down commodities prices and relax the economic operation costs and imported inflationary pressure in China. But this tapering may increase uncertainties in domestic capital flows, and result in market fluctuations. In addition, with increasing complexity in global and domestic economic and financial situations, the U.S. QE tapering will pose new challenges to Chinese monetary policies, and complicate the management of foreign exchange reserves.

To address the above issues, effective measures should be taken to draw on advantages and avoid disadvantages, maintaining economic and financial stability. First, taking the strategic opportunities to deepen economic and financial reforms. Spontaneous innovation and industrial structure upgrading should be encouraged to enhance the independent and endogenetic impetus of economic growth. In accordance with the requirement of leveraging the decisive role of the market in resource allocation, domestic financial markets should be further developed to expand market depth and breadth. Macroeconomic management should be more scientific and forward-looking and reform of the fiscal and taxation system should be promoted to enhance the resilience to external risks. Second, efforts should be made to further improve the RMB exchange-rate regime, expand breadth and depth of the foreign exchange market, and enhance the flexibility of the RMB exchange rate in an orderly way, so as to allow market demand and supply to play a fundamental role in market balancing and reduce cross-border capital arbitrage. Third, the management mechanism of external debts and capital flows should be strengthened under the framework of macro-prudential management to improve monitoring and oversight of cross-border capital flows. RMB convertibility under the capital account should be promoted in a gradual, steady and orderly way, trying to achieve a two-way and dynamic equilibrium of outflows and inflows.

Forth, communications and coordination in terms of macroeconomic policies should be improved, and multilateral trade cooperation should be forcefully reinforced by means of multilateral platforms. China should strengthen its policy dialogue with advanced economies, and promote cooperation among emerging market economies, including signing currency swap agreements to fend off risks together.

IV. Risks and Challenges

In 2013, the world economic recovery was still slow and sluggish. Most advanced economies continued fighting an uphill battle of economic recovery, and a number of emerging market economies encountered twin challenges from both changes in the international financial environment and domestic economic structural adjustment.

Whether the U.S. Federal Reserve could achieve smooth unwinding of the QE policies emerges as one prominent challenge to the world economy. The authority may face such a dilemma that a premature and too rapid unwinding may give rise to an overshooting of long-term interest rates and global financial turmoil, which may hinder economic recovery; while a delayed unwinding could risk creating financial bubbles and making later exit even harder. In this regard, the timing and pace of the unwinding are crucial. A bumpy exit may lead to a number of problems, including a sharper-than-anticipated surge in long-term interest rates, significant market fluctuations, flowing back of massive international capital, appreciation of the U.S. dollar and continuous declining of commodity prices, which may weigh on international trade and world economy to a certain extent and add to financial market risks.

A number of emerging market economies encountered twin challenges from both changes in the international financial environment and domestic economic structural adjustment. On the one hand, shocks from U.S. QE tapering may persist for a certain period of time, which may lead to market turmoil and even economic hard landings in emerging economies with large current-account deficits and weak fiscal positions. For example, declining of capital inflows in mid-2013 resulted in the sharp currency depreciations in Brazil, India, Indonesia, Turkey and South Africa. **On the other hand**, under the weak external demand prospect, growth impetus in emerging economies is yet to improve, with some countries facing the pressure of inflation and fiscal deficits. Moreover, some of the structural vulnerabilities that hinder sustainable economic developments may go beyond the reach of short-term fiscal and monetary policies, calling for institutional reforms and tough tradeoffs by policymakers amid a confluence of different macroeconomic policies.

The European debt crisis subsided comparatively, but considerable long-term and structural problems remain in the euro zone. First, prospects for economic recovery are still clouded. Despite the economic improvements in later half of 2013, total demand is still weak and unemployment rate remains worrisomely high, with Greece and Spain facing high unemployment rates of above 25 percent. In addition, issues of fragmented financial markets and structural imbalance in the labor market remain unresolved. Second, heavy government debt loads remain challenging, with government debt ratio continuously climbing. While government budget deficit ratios improved compared with the previous year, essential breakthrough is yet to come. Third, the adverse feedback loop among banks, corporates and sovereigns continued in some member countries. Some banks with weak balance sheets were less willing and able to provide funding for the real economy, keeping the interest rates on private loans at high levels. Sovereign spreads remained differentiated, raising funding costs for banks in stressed economies. Weak profitability of corporates created debt-servicing difficulties, and thereby, worsened the balance sheets of some banks.

Internal growth impetus in Japan is insufficient. Accommodative monetary policies boosted domestic financial markets and the banking system. But substantial risks to financial stability may arise if planned fiscal and structural reforms are not fully implemented, which may lead to resurfacing of deflation and downside risks in economic recovery. Meanwhile, the consumption tax increase, which will be brought into effect in April 2014, may weigh heavily on the Japanese economy, warranting close attention.

Trade and investment protectionism might pose certain risks, and the geopolitical situation is unoptimistic. Unemployment rates in a number of advanced economies remain worrisomely high and social welfare worsens, while governments have limited policy tools and space in stimulating economic growth. All these aspects may result in internal political polarization and regional trade frictions, thereby suppressing prospects for global economic recovery. Moreover, geopolitical tensions in the Western Asia and North Africa might increase volatility of global commodity prices, and curb world economic recovery.

V. Outlook

In 2014, the world economy may still grow at a low pace. According to the World Economic Outlook: Update released by IMF in January 2014, global growth is projected to be 3.7 percent and 3.9 percent for 2014 and 2015, respectively. Meanwhile, downside risks still remain. It will be essential for maintaining global economic and financial stability for major advanced economies to achieve successful normalization of their monetary policies and for some emerging market economies to engineer soft landings.

In the U.S., the budget agreement reached at the end of 2013 and the debt ceiling bill signed in early 2014 will help to ease the spending cut pressure over the next two years, and underpin economic recovery. The real estate and labor markets will also continue to improve. IMF projected the U.S. growth to rise from 1.9 percent in 2013 to 2.8 percent in 2014. Stronger growth is setting the stage for monetary normalization, but the U.S. still needs to take flexible measures to achieve a smooth transition, so as to avoid shocks to domestic and even global economic and financial stability. First, a clearer and well-timed communication strategy and better forward guidance are crucial for a smooth exit of the QE monetary policies. Second, policies should be made to carefully manage market fluctuations and portfolio adjustments, address structural reductions in market liquidity, and guard against the risk of excessive leverage in the shadow banking system, especially in the mortgage real estate investment trusts. Third, in the event of adverse shocks, contingency plans should be ready to mitigate significant market fluctuations.

The euro zone is moving from recession to recovery, and according to IMF, the growth rate for this region in 2014 was projected to be 1 percent. The euro area should take active measures further to promote production growth and increase market confidence. **First**, reforms should be enhanced to create a fair competition environment for the labor market, and to reduce entry obstacles to the products and services markets. **Second**, it is important to conduct a thorough and transparent balance sheet assessment and stress test, and to make reliable plans for capital replenishment, so as to regain investor confidence in the banking system. **Third**, normal loans to the real economy, in particular to small- and medium-sized enterprises should be restored, guiding credits to effectively flow to sectors that contribute more to economic growth. At the same time, comprehensive approaches should be taken to address the heavy debt loads of the corporate sector, clean up corporate debts, and improve the bankruptcy framework. **Forth**, further efforts towards the full banking union should be made to establish the single resolution mechanism and the single deposit insurance scheme. In addition, **the UK** will benefit from the easing credit conditions and strengthened market confidence, and IMF expected its growth rate for 2014 to be 2.4 percent.

In Japan, the temporary fiscal stimulus measures introduced by the government could accommodate to some extent the negative impacts of the higher consumption tax in early 2014, and IMF projected its growth in 2014 to be 1.7 percent. The policymakers should follow through on the fiscal and structural reform commitments, to avoid downside risks. **First,** in order to compensate for the impacts of the hike of the consumption tax rate, comprehensive economic growth strategies should be put in place to relax policy controls in certain sectors, strengthen investment willingness of the corporate sector, reform the labor market and boost growth prospects. **Second**, medium-term fiscal plan and reliable fiscal consolidation should be pushed forward to contain sharp rises in government bond risk premiums and fend off sovereign debt risks. **Third**, the authorities should encourage banks to increase their credit support to the corporate sector, and reduce the over-reliance on government bond assets, lowering the exposures of banks especially regional banks to interest rate risks.

The emerging market economies were projected to grow as a whole by IMF at the rate of 5.1 percent in 2014, thanks to strengthened demands from advanced economies and on-going domestic structural reforms. But the domestic demands in a number of countries may be weaker than anticipated, and economic growth may slow down. The appropriate policy mix will differ across economies in view of differences in output gaps, inflationary pressure and room for policy adjustments, but should at least involve the following measures. **First**, a general priority should be given to measures to strengthen economic fundamentals and a new round of structural reforms, including social security, income distribution, fiscal system, taxation, energy, transportation, education and health care, so as to enhance long-term growth potentials. **Second**, in the event of significant capital outflows, policymakers can take effective actions to mitigate potential risks. Exchange rates should be allowed to fluctuate based on market demand and supply, currency swap lines may be established among central banks in response to market fluctuation, and some intervention to smooth market volatility may be appropriate in countries with adequate reserves. **Third**, flexibility and credibility of monetary policies should be further reinforced, and fiscal consolidation should be implemented. **Forth**, policymakers should carefully monitor and contain the rapid growth of corporate leverage, and enhance the resilience of the banking system to external shocks.

Policymakers across economies should strengthen international policy coordination. As issuers of major international reserve currencies, central banks of major advanced economies should articulate their policy stance and action plans to other countries, to stabilize market liquidity expectations. All countries should promote cooperation with each other in terms of regulatory and macro-prudential policies, to add to the stability of the global financial system. International organizations, including G20, FSB and IMF, should carry through their important role in risk monitoring and international policy coordination, and help all the countries to tackle different policy challenges.

Chapter II

China's Economic and Financial Performance

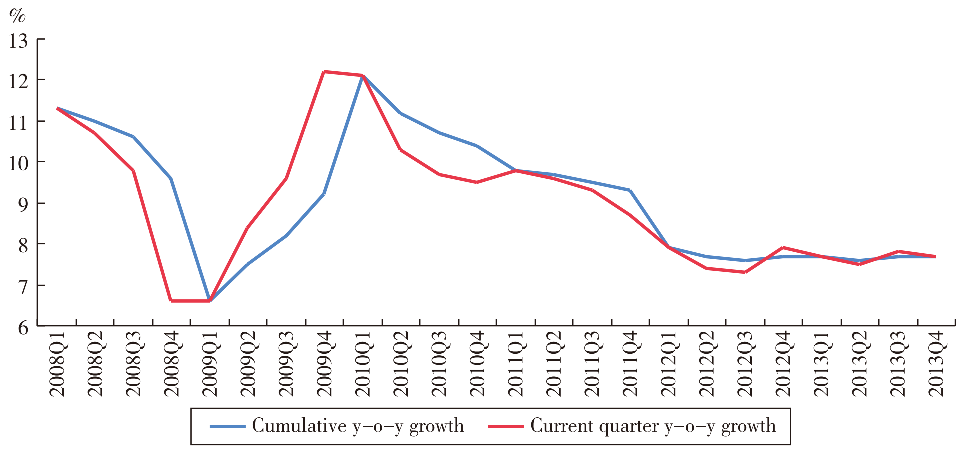
In 2013, facing a very complex domestic and international economic situation, the China government stroke a balance among preserving stable economic growth, adjusting economic structure, and promoting reform. Continued efforts were made to implement an active fiscal policy and a sound monetary policy, while the market dynamism was released on an on-going basis. As a result, economic progress was made while stability was maintained, laying a solid foundation for comprehensively implementing the reform blueprint envisaged in the 3rd Plenary Session of the 18th Communist Party of China (CPC) Central Committee.

I. Macro-economic Performance

1. Stable and improving economic growth was exhibited with industrial structure optimizing

According to preliminary statistics of the NBS, China's nominal GDP totaled 56.88 trillion yuan in 2013, up 7.7% y-o-y. GDP growth in the four quarters registered 7.7%, 7.5%, 7.8% and 7.7% respectively, showing a stable and improving trend. From industry perspective, the value-added of the primary industry was 5.70 trillion yuan, up 4% y -o-y, in particular the output of grain reached 602 million tons, marking the tenth consecutive year of bumper harvest; the value-added of the secondary industry was 24.97 trillion yuan, up 7.8% y-o-y, and that of statistically large enterprises increased 9.7% , representing a deceleration of 3.1 percentage points from the previous year; the value-added of the tertiary industry was 26.22 trillion yuan, up 8.3% y-o-y. The shares of the three industries in GDP were 10.0%, 43.9%, and 46.1% respectively, down 0.1 percentage point, down 1.4 percentage points, and up 1.5 percentage points from the previous year. The share of tertiary industry exceeded that of the secondary industry for the first time. The rapid development of the tertiary industry helped offer more jobs, maintain a stable employment market, and create favorable conditions for social and economic reforms in the next stage.

Figure 2.1 Y-o-y Growth of Cumulative and Current Quarter GDP

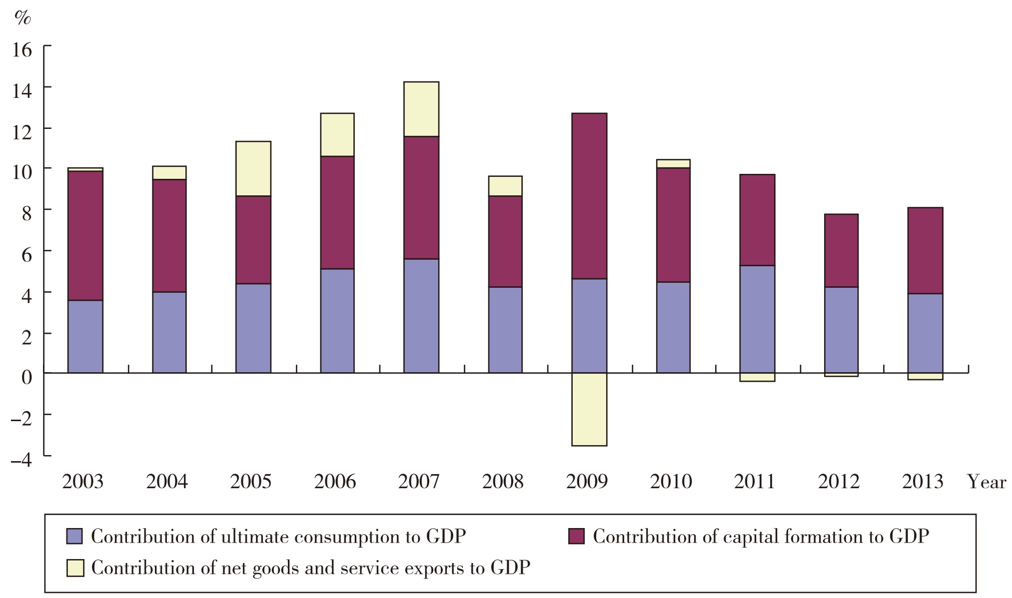


Source: The NBS.

2. Domestic demand increased steadily and growth of imports and exports recovered

In 2013, investments in fixed assets totaled 44.71 trillion yuan, up 19.3% in nominal terms and 18.9% in real terms y-o-y. Retail sales of consumer goods totaled 23.44 trillion yuan, up 13.1% in nominal terms and 11.5% in real terms y-o-y. Total imports and exports posted 25.83 billion yuan and increased 7.6% y-o-y after excluding the impact of exchange rate fluctuations. The growth was 1.4 percentage points higher than that in the previous year, with exports rising 7.9% to 13.72 trillion yuan and imports rising 7.3% to 12.11 trillion yuan. China has become the largest trading partner in the world. The trade surplus rose 12.8% y-o-y to 1.61 trillion yuan. In 2013, the contribution of ultimate consumption, capital formation, and net goods and service exports to GDP growth was 3.9, 4.2 and -0.3 percentage points respectively, down 0.2 percentage points, up 0.3 percentage points, and down 0.1 percentage point from the previous year (Figure 2.2). The endogenous driver of economic growth was yet to be enhanced.

Figure 2.2 Contribution of Consumption, Investments and Net Exports to GDP Growth



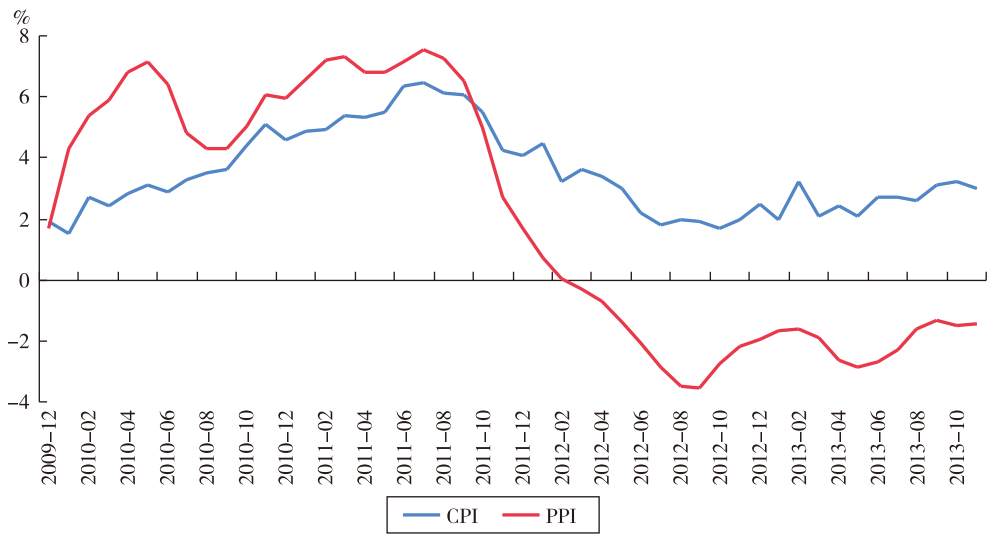
Source: The NBS.

The balance of payments remained in surplus. According to the statistics of the State Administration of Foreign Exchange (SAFE), the overall balance of payments in 2013 registered USD 431.3 billion, representing an increase of 144.6% y-o-y, among which the current account surplus declined 2.3% from the previous year to USD 188.6 billion, accounting for 2.1% of the GDP, and the capital and financial account witnessed a surplus of USD 242.7 billion. The stock of foreign-exchange reserves in the balance of payments statistics (excluding the impact of non-trading valuation changes such as exchange rates and prices) grew USD 432.7 billion, representing an acceleration of 338.5% y-o-y.

3. The general price level was basically stable

In 2013, growth of consumer prices was the same as that in the last year with the Consumer Price Index (CPI) rising 2.6% y-o-y. In terms of food and non-food items, food prices rose by 4.7%, a deceleration of 0.1 percentage point from those in the last year, and prices of non-food items rose 1.6%, which was the same as those in the last year. In terms of consumer goods and services, in 2013 the prices of consumer goods grew 2.5% y-o-y, and the prices of services increased by 2.9%. In 2013 Producer Price Index (PPI) fell 1.9% y-o-y. In particular, the prices of production materials fell 2.6% y-o-y, while those of consumer products edged up by 0.2%. PPI of the coal, non-ferrous metals, chemical fibre, and paper production fell by 11.3%, 5.4%, 4.4% and 2.3% y-o-y respectively, among the largest decline. The Purchasing Price Index of Raw Material (PPIRM) fell 2.0% y-o-y.

Figure 2.3 Movements of Major Price Indicators



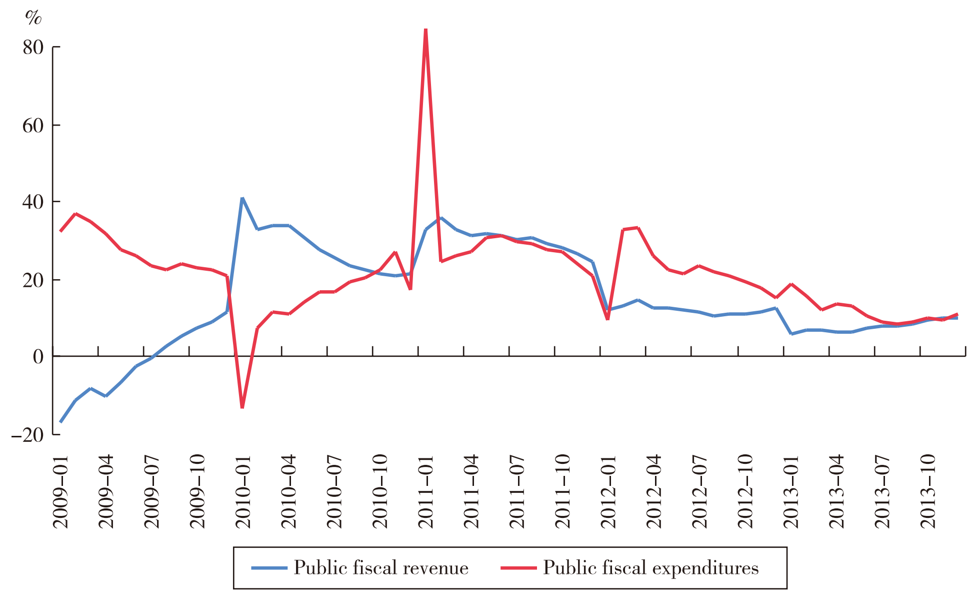
Source: The NBS.

4. Fiscal revenue and expenditures were basically balanced, and the government's debt risk was controllable in an overall manner

In 2013 fiscal revenue posted 12.91 trillion yuan, up 10.1% y-o-y, which was 1.19 trillion yuan more than that in the last year and represented a deceleration of 2.8 percentage points. Among this total, fiscal revenue of the central government posted 6.02 trillion yuan, accounting for 46.6% of the total revenue and representing a y-o-y growth of 7.1%, and fiscal revenue of local governments posted 6.9 trillion yuan, representing a y-o-y growth of 12.9%. In terms of the structure of fiscal revenue, tax revenue registered 11.05 trillion yuan, accounting for 85.6% of the total, and non-tax revenue registered 1.86 trillion yuan, up 12.1% y-o-y, representing a deceleration of 5.6 percentage points from the previous year.

Fiscal expenditures in 2013 reached 13.97 trillion yuan, an increase of 1.38 trillion yuan y-o-y. This represented a growth of 10.9% and a deceleration of 4.4 percentage points from the previous year (Figure 2.4). Fiscal deficit posted 1.2 trillion yuan, accounting for 2.1% of the GDP, lower than the international norm, i.e. 3%.

Figure 2.4 Growth of Fiscal Revenue and Expenditures



Source: The NBS.

The overall level of government debt was controllable. According to the data on government debts published by the National Audit Office on December 30, 2013, at end-June 2013 the amount of debts which the governments at all levels were liable for repayment amounted to 20.7 trillion yuan; the amount of debts partially or solely guaranteed by the governments amounted to 2.9 trillion yuan; and the amount of debts which the governments were probably liable for rescue responsibility amounted to 6.65 trillion yuan. At end-2012, the overall debt ratio of the government was 39.43%, lower than 60%, the internationally recognized standard. Most of the government debts were invested in the infrastructure and public welfare projects, many of which used operating income as the source for debt repayment, and the overall debt risk was controllable. However, some localities and industries are burdened with heavy debts, and they had relatively large pressures for debt repayment.

5. Profits of industrial enterprises continued to rise, and the liability/asset ratio was relatively high

The growth of main business revenue and profits of industrial enterprises picked up. In 2013 corporate sales of main business of statistically large enterprises increased 11.2% y-o-y, up 0.4 percentage points from the last year[①]. Realized profits rose 13.2% y-o-y, up 10.2 percentage points from the last year. Sales of main business of 5 000 industrial enterprises which the People's Bank of China (PBC) monitors (hereinafter referred to as 5 000 industrial enterprises) increased by 4.1%[②], down 0.7 percentage points from the last year[③]. In 2013, profits of statistically large enterprises increased 13.2% y-o-y, up 10.2 percentage points from the last year. Total profits of 5 000 industrial enterprises increased 2%, up 18.8 percentage points from the last year.

Asset turnover declined slightly, and the operating cycle was lengthened somewhat. In 2013, the inventory turnover of 5 000 industrial enterprises was 5.4 times. In particular, finished product turnover was 20.9 times, down 0.6 times y-o-y; raw material turnover was 14.9 times, down 0.7 times y-o-y; total asset turnover was 0.9 times. The operating cycle of 5 000 industrial enterprises was 131.7 days, 5.1 days more than that of the previous year.

Liability/asset ratio was relatively high, and the debt-servicing capacity declined somewhat. At the end of 2013, the liability/asset ratio of 5 000 industrial enterprises rose by 0.4 percentage points from the last year to 62.2%. The current ratio of 5 000 industrial enterprises was 104.1%, down 1.3 percentage points y-o-y; the quick ratio was 75%, down 1 percentage point y-o-y (Figure 2.5); the interest coverage multiplier was 4.4 times, down 0.1 times.

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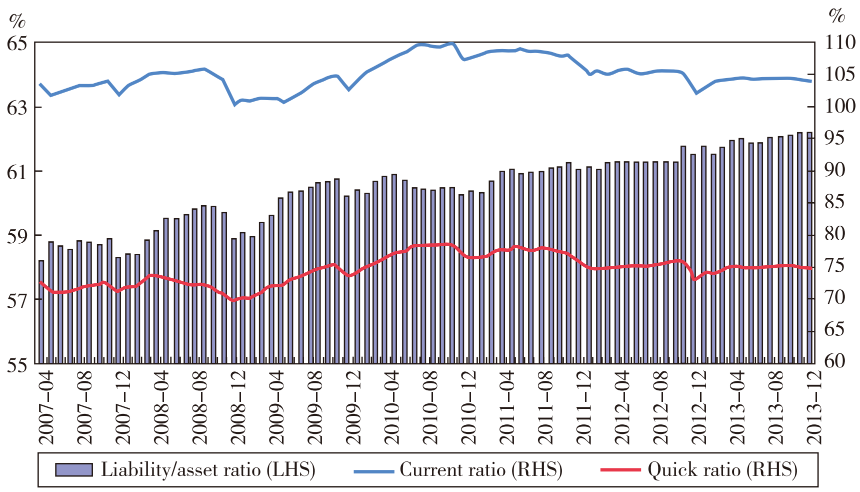
① As to the total profitability data for statistically large enterprises, the NBS only complied data from January to February, from January to May, from January to August, from January to November. As to data of other months and the whole-year data, there were only data of 22 provinces and municipalities, therefore, the business performance for statistically large enterprises in 2013 can only be explained with data from January to November in 2013, and it is also true for other parts of the report.

② Due to adjustment of sample enterprises and inconsistency of reporting time by different enterprises, the end-November 2013 data was used in lieu of end-2013 data. This is consistent with the practice of the NBS, and the same has been done in other areas of this report.

③ Due to adjustment of sample enterprises, inconsistency of reporting time by different enterprises, and continuous updating of financial data reported by 5 000 industrial enterprises, data for end-2012 in this report are newly published and adjusted, and there may be some differences between these data and those used in the previous year report.

Figure 2.5 Liability/asset Ratio, Current Ratio and Quick Ratio of 5 000 Industrial Enterprises

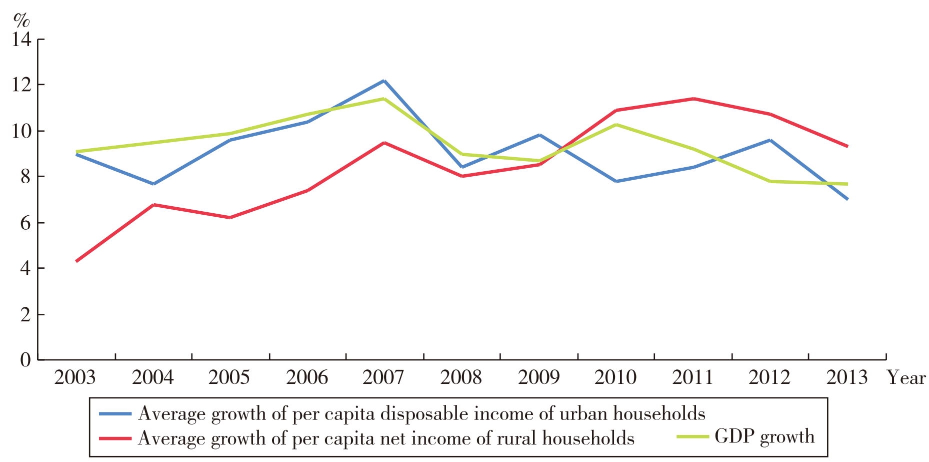


Source: The PBC.

6. Employment remained stable and household income continued to increase

In 2013, newly employed population in the urban areas reached 13.1 million, 440,000 more than that of the previous year. Per capita disposable income of urban households posted 26,955 yuan, representing a price-adjusted y-o-y real growth of 7%, a deceleration of 2.6 percentage points from the previous year, and 0.7 percentage points lower than the GDP growth. The per capita net income of rural households registered 8,896 yuan, representing a price-adjusted y-o-y real growth of 9.3%. That growth was 1.4 percentage points lower than that registered in the previous year, and 1.6 percentage points higher than the GDP growth (Figure 2.6).

Figure 2.6 Growth of Per Capita Income of Urban and Rural Households and GDP



Source: The NBS.

The overall debt level of the household sector was relatively low, while the saving rate of the household sector remained relatively high. At end-2013, outstanding deposits of the household sector stood at 44.5 trillion yuan, up 8.5% y-o-y, a deceleration of 8.1 percentage points from the previous year. It has become increasingly evident that people tended to withdraw deposits from their bank accounts and invest them in their wealth management accounts. Outstanding wealth management funds deposited in banks posted 9.5 trillion yuan, up 41.8% y-o-y; outstanding funds deposited in trust schemes posted 10.91 trillion yuan, up 46% y-o-y; funds entrusted in securities companies posted 5.2 trillion yuan, up 175.1% y-o-y; public placement funds and funds put in special wealth management accounts of fund management companies posted 3.53 trillion yuan, and market capitalization of the A-share market held by individual investors reached 5.58 trillion yuan. Outstanding nonperforming loans (NPL) of individual loans increased slightly, while the NPL ratio continued to decline. At end-2013, outstanding NPL of individual loans① (including both non-business loans and business loans) posted 320.36 billion yuan, 43.25 billion yuan more than that at the beginning of the year, and the NPL ratio was 1.6%, down 0.1 percentage point from the beginning of the year. Outstanding non-performance loans in areas of individual mortgage loans, individual credit card loans and individual auto loans posted 23.2 billion yuan, 26.24 billion yuan and 3.97 billion yuan respectively, representing an increase of 2.11 billion yuan, 10.75 billion yuan and 600 million yuan from the beginning of the year. At end-2013, the NPL ratio of individual mortgage loans, individual credit loans and individual auto loans posted 0.3%, 1.3% and 1.2% respectively.

Box 2 Performance of the Real Estate Market

In 2013, the real estate market was basically stable, with both the transaction volume and housing prices increasing. There was a significant differentiation among different regions. Investment in the real estate sector tended to be stable, and loans to the real

① The NPL data was derived from the CBRC. Some data for 2007-2008 covered policy banks, state-owned commercial banks, joint-stock commercial banks, city commercial banks, rural commercial banks, rural cooperative banks, foreign-funded financial institutions with legal person status and their branch offices, branches of foreign-funded banks, urban credit cooperatives (including newly-established urban credit cooperatives with single legal-person status and pre-existing urban credit cooperatives with retained legal-person status), rural credit cooperatives, finance companies of group companies, trust investment companies, financial leasing companies and auto financing companies. Postal Savings Bank was added after 2009.

estate sector increased steadily.

Both housing prices and transaction volume of the real estate market increased, with regional differentiation becoming more prominent. In 2013, sold areas of commercial housing nationwide amounted to 1.31 billion square meters on cumulative basis, up 17.3% y-o-y, and an acceleration of 15.5 percentage points from the previous year. The sale values of commercial housing nationwide posted 8.1 trillion yuan, up 26.3% y-o-y, and an acceleration of 16.3 percentage points from the previous year. Among this total, the growth of sale values in the eastern and central regions both exceeded 25%, outpacing that in the western region obviously . More cities reported y-o-y increases in housing prices. In December 2013, out of 70 large and medium-sized cities, the prices of newly-built commercial residential housing increased y-o-y in 69 cities, 16 more than in January. The number of cities whose housing prices growth reached or exceeded 10% increased month by month, and posted 28 in December, and growth of housing prices in some cities had exceeded 20% for four consecutive month.

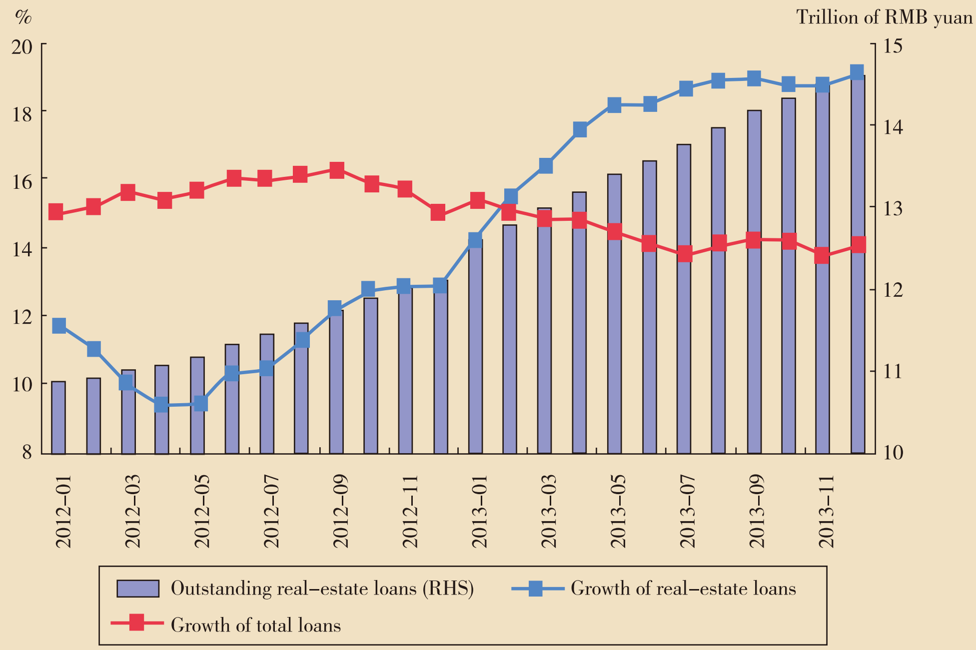
Growth of investments in real-estate development was stable. In 2013 investments in real-estate development totaled 8.6 trillion yuan, up 19.8% y-o-y and representing an acceleration of 3.6 percentage points from the last year. The floor area of newly-built housing rose 13.5% y-o-y to 2.01 billion square meters, while that in 2012 registered a y-o-y decline of 7.3%. The construction of welfare housing projects was beyond the plan set in the beginning of the year. Completed units of all kinds of welfare housing posted 5.44 million, and 6.66 million units of welfare housing were newly started to build.

Growth of real-estate loans increased steadily. By the end of 2013, outstanding real-estate loans of major financial institutions[①] (including foreign-funded financial institutions, the same hereinafter) posted 14.6 trillion yuan, an increase of 19.1% (Figure 2.7) y-o-y and an acceleration of 6.3 percentage points over the last year. Outstanding real-estate loans accounted for 21% of total outstanding loans, which was 1.2 percentage points higher than that at the end of the last year. In 2013 new real-estate loans reached 2.3 trillion yuan, which was 998.7 billion yuan more than that in the last year. New real-estate loans accounted for 28.1% of total new loans, which was 10.7 percentage points higher than that at the end of last

① Major financial institutions (including foreign-funded financial institutions) include Chinese-funded banks (excluding village and township banks), urban credit cooperatives, rural credit cooperatives, and foreign-funded banks.

year. Growth of individual mortgage loans stabilized at an elevated level, and at end-2013 outstanding individual mortgage loans posted 9.0 trillion yuan, an increase of 21.0% y-o-y and an acceleration of 8.0 percentage points from the end of the previous year. At the end of 2013, outstanding loans for welfare housing rose 26.7% y-o-y to 726 billion yuan. That was 11.5 times of outstanding welfare housing loans in 2009 (62.9 billion yuan), and the growth was 10.9 percentage points higher than that of residential real-estate development loans.

Figure 2.7 Outstanding Amount and Growth of Real-estate Loans of Major Financial Institutions



Source: The PBC.

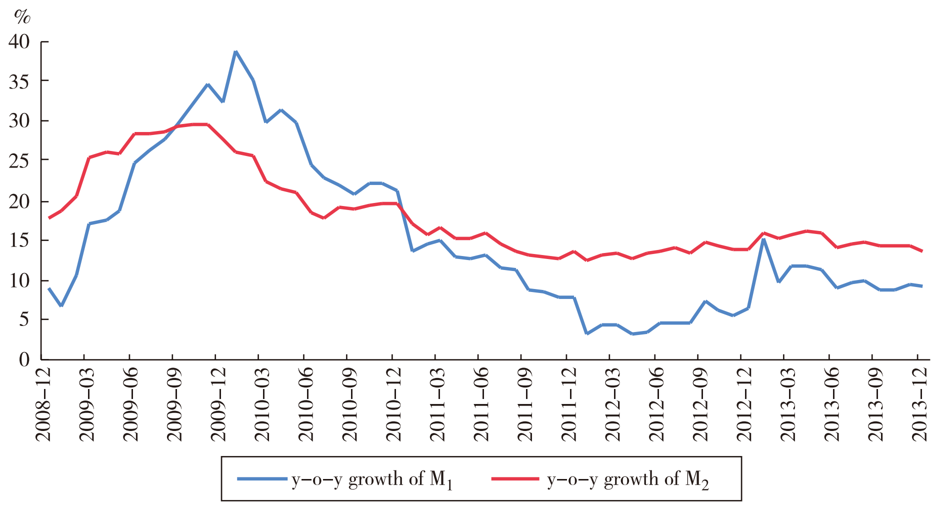
II. Monetary and Financial Performance

In 2013, the PBC continued to implement a sound monetary policy, improved the framework of macro-prudential management, strengthened window guidance and guidance on monetary and credit policies, advanced the market-based interest-rate reform, and further improved the RMB exchange-rate regime. In 2013, the growth of money, credit, and all-system financing aggregates moved toward the yearly targets, the financing and credit structure continued to optimize, and the monetary and financial environment was generally stable.

1. Money supply and credit extension registered stable growth

The growth of money supply approached the annual targets. At the end of 2013, outstanding broad money (M_2) stood at 110.7 trillion yuan, up 13.6% y-o-y, representing a deceleration of 2.5 percentage points from the highest level during the year and a deceleration of 0.2 percentage points from end-2012. The broad money maintained an appropriate growth trend. Outstanding broad money (M_1) stood at 33.73 trillion yuan, up 9.3% y-o-y, an acceleration of 2.8 percentage points over end-2012. Currency in circulation (M_0) stood at 5.86 trillion yuan, up 7.1% y-o-y. The central bank injected 389.9 billion yuan of cash on a net basis in 2013, at par with that in the previous year.

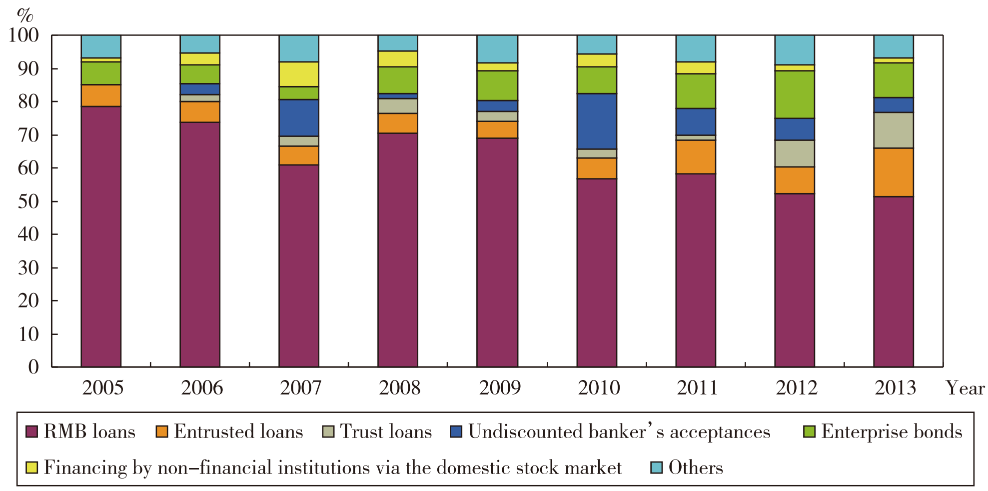
Figure 2.8 Growth of Money Supplies



Source: The PBC.

The amount of all-system financing aggregates increased somewhat and the financing structure was diversified. According to preliminary statistics, in 2013 all-system financing aggregates reached 17.29 trillion yuan, representing an increase of 1.53 trillion yuan y-o-y, and the financial sector stepped up its support to the real economy. In terms of the financing structure, all-system financing aggregates in 2013 displayed the following characteristics: first, the share of new RMB loans in all-system financing aggregates posted 51.4%, a historic low, and down 0.6 percentage points from the previous year; second, new foreign currency-denominated loans registered a larger deceleration from the previous year, mainly due to the deceleration of 634 billion yuan in the second half of the year; third, net financing via enterprise bonds decreased from the previous year and equity financing continued to remain at a subdued level; fourth, entrusted loans and trust loans registered larger y-o-y growth, resulting in a larger share of off-balance-sheet financing activities. In 2013 the combined share of entrusted loans, trust loans and undiscounted banker's acceptances in all-system financing aggregates was 29.9%, up 7.0 percentage points from the previous year.

Figure 2.9 Shares of Different Financing Modes in All-system Financing Aggregates



Source: The PBC.

Deposits and loans of financial institutions grew at a stable and relatively rapid pace, and deposit and lending rates fluctuated within small margins. At the end of 2013, outstanding deposits of domestic and foreign currencies in all financial institutions posted 107.1 trillion yuan, up 13.5% y-o-y; outstanding loans in domestic and foreign currencies by all financial institutions registered 76.6 trillion yuan, up 13.9% y-o-y. Deposit and lending rates of financial institutions fluctuated with small margins. In December 2013, the weighted average lending rate offered to non-financial institutions and other sectors was 7.20%, up 0.42 percentage points from the beginning of the year.

2. Monetary Policy Operations

Innovation was made in monetary policy operation tools and means in a timely manner to keep liquidity at reasonable and appropriate level. In 2013, with policy expectations of major economies changing and China's financial development and innovation accelerating, there were more short-term factors influencing the liquidity in the market. Facing a complex liquidity situation, the PBC further improved the liquidity adjustment mechanism, launched the Short-term Liquidity Operations (SLO) and Standby Lending Facility (SLF), used a combination of instruments to manage liquidity, and conducted fine-tunings and preemptive adjustments. In the meantime, the PBC strengthened information communication with the financial market, and urged commercial banks to strengthen liquidity management. The PBC rolled over part of the matured 3-year central bank bills to provide short-term liquidity while appropriately freezing up some long-term liquidity. In January 2014, some PBC branch offices conducted the SLF operations on a pilot basis in some provinces and municipalities to provide liquidity to support small and medium-sized financial institutions that complied with prescribed requirements. The channel for the central bank to provide normal liquidity support to small and medium-sized financial institutions was improved.

The macro-prudential policies played a role in counter-cyclical management and guiding structural adjustment. Based on the domestic and global economic and financial development, the soundness of financial institutions, and the implementation of credit policy, the PBC calibrated the parameters of the differentiated reserve requirement dynamic adjustment mechanism, made full use of counter-cyclical management measures, preemptive measures and fine tunings, and guided credit grew in a stable and reasonable way. The PBC further encouraged and guided financial institutions to increase credit support to weak links in the economy, such as small and micro enterprises, the agricultural sector, rural areas, and farmers, and less-developed areas in the central and western regions. The combination of dynamic adjustment mechanism of the differentiated required reserve ratio with conventional monetary tools such as the open market operations, deposit reserve requirement, and interest rate adjustment, as well as a mix of quantity-based, price-based and macro-prudential policy measures, contributed to implementation of the monetary policy and financial stability.

The window guidance and credit policy guidance were strengthened to step up financial services to the real economy. Efforts were made to improve the assessment of effectiveness of credit policy guidance, strengthen coordination of credit policy with industrial policy and regional development policy, consolidate financial resources to encourage and guide financial institutions to beef up support to key sectors and weak links in the economy, such as the agricultural sector, rural areas and farmers, small and micro enterprises, on-going and follow-up national key projects, the modern service sector, science and technology innovations, strategic emerging industries, improve financial services and step up support for job creation, students in need, poverty alleviation and poor area development for better livelihood of the people, and resolve the overcapacity problem. The differentiated housing mortgage policies were strictly implemented. The pilot program of credit asset securitization was advanced to better manage the stock of credit assets. The changed credit structure better supported economic structure adjustment, transformation and upgrading.

The market-based interest rate reform made new progress. First, controls on lending interest rates were completely removed. On July 20, 2013 the PBC removed the floor for the lending rates of financial institutions, controls on the interest rates for bill discounting, and the ceiling on the lending rates of rural credit cooperatives. Second, the self-regulatory pricing mechanism for market interest rates was established and improved. A self-regulatory management mechanism was established over interest rates that are independently determined by the financial institutions on the money, credit, and other financial markets, under the precondition that they comply with the relevant interest-rate regulations. Third, the Loan Prime Rate (LPR) centralized quote and release mechanism was established and formally put into operation. The LPR represents an expansion of the market-based interest rate quotation from the money market to the credit market, and provides an important reference to financial institutions forpricing credit products. Fourth, the issuance and trading of interbank certificates of deposit were promoted steadily, and the coverage of pricing liability products was expanded. The *Provisional Rules on the Management of Interbank Certificates of Deposit* was promulgated and released. During the year, ten financial institutions issued the first batch of interbank certificates of deposit.

Further improved the RMB exchange-rate regime, and deepened the reform of foreign-exchange administration. Since the beginning of 2013, the two–way flexibility of the RMB exchange rate was enhanced, market expectations for the RMB exchange rate were generally stable, and China's balance of payments continued to improve. At end-December, the central parity of the RMB against the US dollar was 6.0969 yuan per dollar, an appreciation of 3.09% from end-2012. In 2013 the ratio of current account surplus to GDP was 2.1%, an internationally recognized sustainable level. The administration over cross-border RMB business improved on a continuous basis, bilateral monetary cooperation was further expanded, and the use of RMB in cross-border transactions further increased. The reform of foreign-exchange administration was pushed ahead. The RMB convertibility under the capital account made steady progress, and efforts were made to continually improve the monitoring of cross-border capital flows. The PBC took a decisive action to initiate a contingency plan to prevent inflow of abnormal cross-border foreign-exchange funds, and mainly made use of macro-prudential policy tools and market-oriented means to effectively prevent abnormal cross-border capital inflow, and the balance of payments gradually moved to a balanced position.

III. Outlook

China is still in an important period of strategic development, and fundamentals that support its long-term growth remain unchanged. The industrialization and urbanization continue to press ahead, and there are huge potentials for regional development, therefore, there are solid bases and favorable conditions for maintaining high-or medium-speed growth rate in the coming years. But it is noteworthy that the international economic situations remain very complex, the foundation for stable and higher domestic growth is not solidly based, the Chinese economy still faces downward pressures, some economic problems remain unresolved, and we should remain aware that China's economic development is not yet on a balanced, coordinated and sustainable path. Dependence on investment and borrowing has become stronger, and endogenous growth drivers are to be enhanced. The issue of excess capacity in some industries is severe, complicating the rational allocation of production factors. The social financing structure is still not optimal, with the amount of indirect financing comprising a larger share in all-system financing aggregates. Potential risks in the real economy and financial sector merit attention, and the task of making structural adjustments and transforming the growth pattern remains arduous.

The year 2014 will be the first year to implement the decisions adopted at the 3rd Plenary Session of the 18th CPC Central Committee and to comprehensively deepen reforms, and also a crucial year in undertaking the tasks set in the 12th Five-year Plan. Continued efforts should be made to follow the principle of making progress while maintaining stability, keep stability and continuity of policies, make macro-economic policy more forward-looking, well-targeted, and coordinated, promote reform and innovation in every aspect of social and economic development, stimulate dynamism in the economy, accelerate transformation of the development mode and structural adjustment, improve the quality and efficiency of economic development, and promote the sustained and sound development of the economy.

Endeavoring to transform the role of government, and letting the market play a decisive role in resource allocation. Efforts will be made to transform the government's functions, deepen administrative reform, make innovation in administration and management, and strengthen the credibility and execution power of the government. Efforts will be made to accelerate the formation of a modern market system featuring firms' independent operation and fair competition, consumers' freedom of choice and consumption, free movement of goods and factors, and equal exchange. Efforts will be made to remove market barriers and improve the efficiency of resource allocation and fairness. Efforts will be made to build a unified, open, competitive and orderly market system, and improve the production factor and resource price formation mechanism which reflects market demand and supply, resource scarcity, and environmental costs. Efforts will be made to advance the market-based interest-rate reform, and the self-regulatory market interest-rate pricing mechanism will be improved to build the capacity of financial institutions for independent pricing. The RMB exchange-rate regime will be improved, convertibility of the RMB under the capital account will be accelerated, and efforts will be made to prevent risks of abnormal cross-border capital movement. A financing mechanism for local governments featuring standardized management, long-term operative effectiveness and controllable risks will be built, so as to resolve local government debt problem via market-oriented means.

Improving the macroeconomic management system and continuing to implement an active fiscal policy and a sound monetary policy. The macroeconomic management system guided by national development strategy and plans and using the fiscal policy and monetary policy as main tools will be improved. Efforts will be made to promote the mechanism of macroeconomic management, strengthen the coordination of fiscal policy, monetary policy, and policy measures such as industrial policy and price adjustment measures, and increase the level of discretionary policy. In light of changing situations, a combination of quantitative, price-based monetary policy tools will be used in a flexible way and the toolkits will be improved. Total volumes of liquidity will be controlled, so as to maintain a stable money market and ensure that money, credit, and all-system financing aggregates increase in a stable and appropriate manner. The macro-prudential policy framework will be improved, and the various parameters will be adjusted when necessary based on changes of economic performance, the soundness of financial institutions, and implementation of the credit policy. The macro-prudential policy will continue to play a role in counter-cyclical and structural adjustment.

Stepping up financial support to structural adjustment, transformation and upgrading. Efforts will be made to deepen reform, revitalize the credit stock, make the best use of incremental credit, and improve capital efficiency. Coordination of credit policy and industrial policy will be strengthened, and the structure of key industries will be promoted. Financial institutions will be guided to step up financial support to ongoing and follow-up national key projects, the agricultural sector, rural areas, and farmers, small and micro enterprises, the modern service sector, emerging industries, and other important areas and industries. New loans to new projects of industries marked by overcapacity and to ongoing projects which are against the rules and environmental protection will be strictly controlled. The differentiated housing mortgage policy will be strictly implemented. Inclusive finance will be promoted in an active manner, so as to improve financial service to small and micro enterprises and to encourage financial institutions to beef up support to weak links in the economy. Efforts will be made to support the development of private-owned financial institutions, to encourage and guide private capital to enter into the financial service realm, to provide competitive financial service for the real economy, and to address the problem of insufficient supply of financial services in some grass-root areas and small and micro enterprises.

Accelerating financial innovation and optimizing financing structure. To enhance the capacity of the financial sector to serve the real economy, efforts will be made to accelerate financial innovation. First, efforts will be made to build a multi-tier capital market. The development of the bond market will be standardized, the market-based reform of new stock issue system will be deepened, the return mechanism to shareholders of listed companies will be improved, the exit system will be improved, and the quality of listed companies will be enhanced. Second, continued efforts will be made to improve the direct financing instruments. Building on the expansion of the pilot of asset securitization scheme, efforts will be made to normalize the development of asset securitization and create regular channels for financial institutions to make liability and asset adjustment, and guide financial institutions to stay alert to potential systemic risk while meeting the financing requirement of the real economy. Third, the diversified shareholding of financial institutions will be gradually enhanced, corporate governance of financial institutions will be improved, and the conditions for private capital to enter into the financial sector will be effectively relaxed, so as to gradually form a financial system featuring diversified shareholding, sufficient competition, and differentiated operation. Fourth, efforts will be made to promote differentiated operation of large banks, small and medium banks, and rural financial institutions. Small and medium financial institutions will be guided to build on local resources and characteristics and extend more support to small and micro enterprises, the agricultural sector, rural areas, and farmers.

Safeguarding the stability of the financial system. Efforts will be made to improve the modern financial enterprise system, improve the macro-prudential management, strengthen financial regulation and supervision, guide the sound operation of financial institutions, continue to strengthen regulatory coordination and cooperation, and prevent the spread of cross-industry and cross-market risks. Efforts will be made to strengthen the construction of risk resolution mechanism of financial institutions, establish a deposit insurance scheme, and improve the market exit mechanism of financial institutions, so as to build a long-term mechanism for maintaining financial stability.

Box 3 Financial Measures to Support China (Shanghai) Pilot Free Trade Zone

On August 22, 2013, the State Council formally approved the establishment of China (Shanghai) Pilot Free Trade Zone. The core objectives of the Free Trade zone are to create a regulatory system on cross border investment and trade that is in line with international practices and legal requirements, cultivate a business environment that is in line with international practices and legal requirements, and build a pilot free trade zone, as measured by international standards, with convenient investment and trade procedure, full convertibility of currencies, effective and efficient supervision, and standard legal environment.

On December 2, 2013, the PBC issued the *Opinions of the PBC on Financial Measures to Support China (Shanghai) Pilot Free Trade Zone* (the Opinions, hereinafter). In line with the *Framework Plan for the China (Shanghai) Free Trade Zon*e, the Opinions followed the principles of “financial sector serving the real economy to facilitate cross-border trade and investment”, continuing opening-up and innovation, leading the way in experiment, facilitating exchange and remittance for investment and financing, expanding the use of RMB in cross-border transactions, steadily promoting the market-based interest-rate reform and the foreign exchange administration reform. The financial support measures are aimed at expanding the growth scope for the real economy in the free trade zone, nurturing their competitiveness, and promoting their participation in global cooperation and competition at a higher level.

Financial measures to support the development of the real economy and facilitate cross border trade and investment in the pilot free trade zone include the followings. The first is to make explorations on facilitating exchange and remittance for investment and financing, to promote the process of capital account convertibility, to promote further opening-up of the pilot free trade zone, and to support "going global" of the corporate sector. The second is to expand the use of RMB in cross-border transactions, and to facilitate the use of RMB in a more flexible way by enterprises and individuals located in the pilot free trade zone for their cross-border transactions, so as to reduce exchange and remittance costs and exchange rate risks. The third is to steadily promote the market-based interest-rate reform, accelerate the reform process, and support the development of the real economy. The fourth is to deepen the reform of foreign exchange administration, further reduce administrative examination and approval, and gradually establish a market-based system of foreign exchange administration.

On implementation and risk management, the Opinions followed the principles of keeping risks within controllable ranges,making steady progress and organizing pilot implemention orderly. Operational guidance for the reform articles of the Opinions will be made step by step whenever the conditions are mature,to ensure that experiments are organized in an orderly manner. The Opinions focus on macro-prudential management, develop a series of risk prevention measures, and implement a whole process of risk management. Efforts will be made to strengthen management of authenticity and integrity of enterprises located in the pilot free trade zone, effectively prevent the use of false trade information for illegal arbitrage activities, strengthen monitoring of money laundering, terrorism financing, and tax evasion, pay close attention to the abnormal cross-border capital flows, and strengthen the regulation and supervision of short-term speculative capital in the pilot free trade zone.

The establishment of China (Shanghai) Pilot Free Trade Zone is a significant step taken by the CPC Central Committee and the State Council to promote comprehensive reform and opening-up under the new situation. As the experiment field to promote reform and opening-up of the economy, the pilot free trade zone, shouldered with the important mission of accumulating new experiences by exploring innovative businesses and management models that can be copied and spreaded to other areas, can serve as a model for the entire economy.

Chapter III

Banking Sector

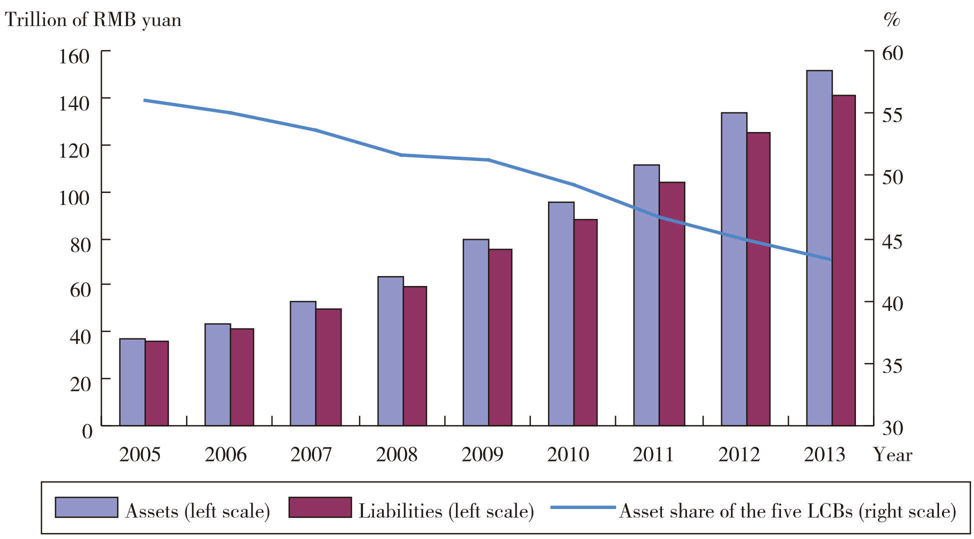
In 2013, China's banking sector actively implemented the national macroeconomic policies and continuously improved financial services. Overall, the industry has maintained sound development momentum, and made remarkable achievements in fostering real economy and promoting economic transformation. However, risks were accumulating in some industries and regions. Further reforms, financial innovations, reinforced risk management and risk resistance capacity became imperative.

I. Recent Developments

1. Growth of total assets and liabilities slowed down, and competition of the sector became intense.

Total assets and liabilities expanded at a slowing pace. At end-2013, total assets of banking institutions increased by RMB 17.73 trillion yuan to RMB 151.35 trillion yuan. The growth rate was 13.27 percent on a y-o-y basis, 4.63 percentage points down from last year. Total liabilities amounted to RMB 141.18 trillion yuan, a y-o-y growth of 12.99 percent or an increase of RMB 16.23 trillion yuan from late 2012 (Figure 3.1). The growth rate was 4.8 percentage points down compared to that of last year. Collectively, the five large commercial banks (LCBs) accounted for 43.34 percent of total commercial bank assets, 1.59 percentage points down from 2012. The asset shares of joint-stock commercial banks (JSCBs), city commercial banks and rural financial institutions (including rural commercial banks, rural cooperative banks and rural credit cooperatives) increased by 0.19, 0.79 and 0.51 percentage point respectively.

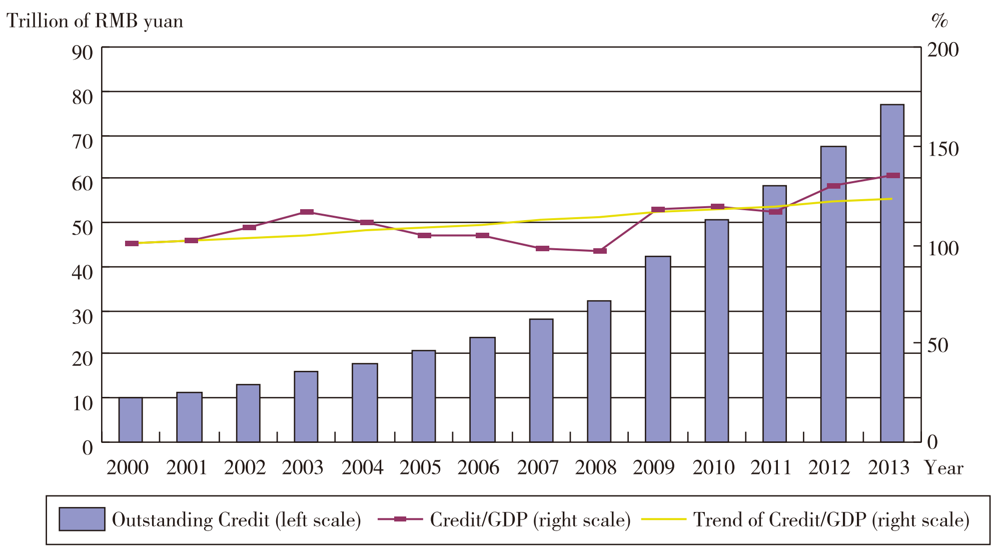
Figure 3.1 Total Assets and Liabilities of Banking Institutions



Source: The CBRC.

Total deposits and loans sustained a steady growth. At end-2013, the outstanding bank deposits denominated in both domestic and foreign currencies increased by RMB 12.7 trillion yuan or 13.5 percent y-o-y to RMB 107.1 trillion yuan. The growth pace slowed down by 0.56 percentage point compared to that of 2012. The outstanding loans were up by RMB 9.3 trillion yuan to RMB 76.6 trillion yuan. The growth rate is 13.8 percent y-o-y, 1.76 percentage points down from 2012 (Figure 3.2). In terms of maturity, the increment of medium and long-term loans climbed up by RMB 4.6 trillion yuan, 1.7 trillion more than the increase in 2012. The medium and long-term loans accounted for 51.6 percent of the new loans, a 16.5 percentage points up from 2012. The increment of short-term loans and bill financing demonstrated a steady increase, RMB 4.1 trillion yuan more than the previous year. In terms of institutions, LCBs, city commercial banks and rural financial institutions experienced greater loan acceleration. In terms of credit orientation, both fixed asset loans that are extended to project investments and operating loans achieved an upswing by RMB 1.58 trillion and 2.96 trillion yuan respectively.

Figure 3.2 Credit Structure Change of Banking Institutions



Source: The PBC and the NBS.

Banking structure was optimized. With the soar of small and medium-sized banking institutions, both the number and market share showed continuous expansion, leading to a lower level of market concentration and more intense competition. At end-2013, there were 145 city commercial banks, 468 rural commercial banks, 122 rural cooperative banks, 1803 rural credit cooperatives and 987 village banks. The market share of small and medium-sized banking institutions reached 22.57%, with 1.39 percentage point increase.

Box 4 China Is Loosening Reins on Private Capital's Entry into Banking Sector

As a competitive industry, the financial sector should involve various qualified investors and promote fair competition. Subsequent to a number of policies to encourage private investments in recent years, in 2013, Chinese government published a statement entitled *Guidances on Financial Support for Economic Restructuring and Upgrading, and 3rd Plenary Session of 18th CPC Central Committee formulated the Decision on Major Issues Concerning Comprehensively Deepening Reforms.* Both the statements pledged to allow qualified private capital to set up financial institutions such as small- and medium-sized banks. The channel for private capital to enter the financial industry is broadened.

Allowing private capital to set up banks is of great importance to promote the opening-up of financial system. Private capital is vigorous, with advantage of flexibility and high capability of innovation. A push into banking sector will expand investment channels for private capital, promote competition in banking industry and shore up the non-public sector of the economy. Compared to the dominant large and medium-sized banks in the banking sector, private banks usually benefit from their smaller sizes, and enjoy funding cost advantages and information advantages. By extending footprints to SMEs and agriculture-related industries, private banks could promote financial support to real economy and enrich the banking sector.

Supplementary reform measures are prerequisites for allowing qualified private capital to set up banks. First, efforts should be made to strengthen the decisive role of the market mechanism, in accordance with the risk-return principle, and to establish an effective mechanism of corporate governance and operation. Second, strengthen financial supervision, solidify the corporate governance of private banks, improve internal controls, take precautious against risks of connected transactions, refine information disclosure mechanism and reduce unnecessary administrative interventions. Third, the launch of a deposit insurance system should be accelerated. All these measures will contribute to the credit level of private banks, optimize the financial structure, establish a sound resolution mechanism, and promote the formation of a financial system characterized by effective competition and sustainable development.

2. Credit support to fragile industries was intensified, and the real economy was strengthed.

Strategies were launched to bolster economic restructuring. The State Council published guidelines on financial support to economic restructuring, transformation and upgrading. Orientated by the guidelines, China's banking institutions played an active role to make full use of both the stock and the incremental credit. State Council's strategy to promote new industries was positively implemented. Banking institutions endeavored to facilitate the combination of technology and finance, and allocated more credit conducive to newly emerged industries such as energy conservative industry, new-tech industry, bio-industry, high-end equipment manufacturing, new energy and new materials industry. Banking institutions also made commitment to impel technological transformation projects which conformed to national industrial policies. Incentives were cultivated to promote energy conservation and emission control; credit extension to high polluting, energy-intensive and over-capacity industries was highly controlled and squeezed.

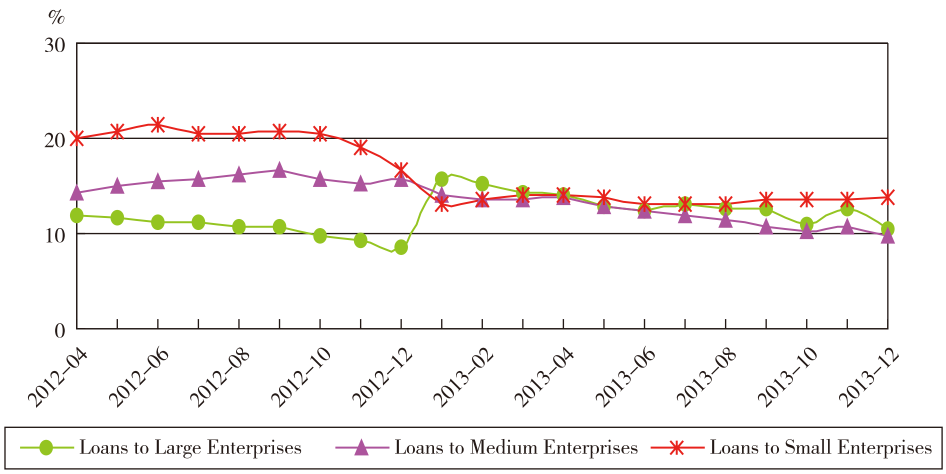
Capacity to foster agriculture, rural areas and farmers was built up. At end-2013, the outstanding agriculture-related loans (excluding bill financing) reached RMB 20.88 trillion yuan, with a y-o-y growth of 18.4 percent, 4.5 percentage points higher than the average loan growth rate during 2013 (Figure 3.3). With improved capital capacity and financial performance, rural credit cooperatives achieved a 9-year consecutive substantial growth in profit; capabilities to foster agriculture were greatly enhanced. The prosperity of three new rural financial institutions-village banks, loan companies and rural mutual credit cooperatives, enhanced competition of the rural financial market. At end-2013, the outstanding loans of the three new rural financial institutions amounted to RMB 365.1 billion yuan, with a y-o-y growth of 56 percent. Banking services marked footprints in all villages and towns nationwide, and all provinces achieved coverage of banking services.

Figure 3.3 Outstanding Agriculture-related Loans

Source: The PBC.

Financial services to Small & Micro Enterprises (SMEs) were significantly improved. Guided by national policies to boost SMEs financing, China's banking institutions continuously scaled up financial innovations, streamlined lending process, and promoted service efficiency. Loans to SMEs maintained a comparatively high increase. At end-2013, the outstanding SMEs loans reached RMB 13.5 trillion yuan, 17.62 percent of total outstanding loans, up by 13.7% compared to the previous year. The y-o-y growth was 3.3 and 3.9 percentage points higher than the loan growth to large enterprises and medium enterprises respectively (Figure 3.4). In 2013, newly extended loans to SMEs registered RMB 2 trillion yuan, accounting for 43.5 percent of new corporate loans and 21.51 percent of total new loans. At end-2013, there were 7839 micro-lending companies in total, with an increase of 1759. Total lending balance reached RMB 819.1 billion yuan, with new lending of RMB 226.8 billion yuan. The prosperity of micro-lending companies played a positive role to alleviate funding stress of SMEs.

Figure 3.4 Loan Growth Rates of Large Enterprises, Medium Enterprises and SMEs



Source: The PBC.

3. Reforms were launched steadily, and soundness of banking sector was improved.

Reforms of the financial institutions were advanced. The reforms of ICBC, ABC, BOC, CCB and BOCOM were progressing well. Corporate governance became more efficient, capabilities of self-pricing and risk management began to solidify, business maintained a steady momentum and banks' competitiveness became more intense. At end-2013, CAR of the 5 LCBs stood at 13.15 percent, 11.87 percent, 12.38 percent, 13.02 percent and 11.91 percent respectively. NPL ratio recorded 0.95 percent, 1.16 percent, 1.05 percent, 0.88 percent and 1.05 percent respectively. The whole year net profit registered RMB 253.23 billion yuan, RMB 165.84 billion yuan, RMB 146.3

billion yuan, RMB 212.59 billion yuan and RMB 60.28 billion yuan, with a y-o-y growth of 8.5 percent, 14.28 percent, 12.88 percent, 10.32 percent and 12.12 percent respectively. Moreover, reforms of other financial institutions were launched steadily. In December, Cinda Asset Management Company successfully went public in HK stock market, as a pilot among all the national asset management companies. Cinda's success stood as a milestone on the restructuring march of China's asset management companies.

Pilot reform of ABC's Rural Area Banking Division extended its coverage. By the end of October, the pilot reform was further expanded to 538 county-level areas in Jiangsu, Zhejiang, Hunan, Yunnan, Jiangxi, Shaanxi and Guangdong province. Preferential policies, including differentiated deposit reserve requirement, exemption of supervisory charges and sales tax, were still in place. Following the expansion, the business share of ABC county-level branches involved in the pilot reform increased from 40 percent to 80 percent of the total.

Reforms and openness were sequenced at an appropriate pace. Strategy of opening-up both domestically and internationally was enforced adamantly. Domestically, channels were broadened to introduce private capital into the banking industry. At end-2013, private capital accounted for over 50 percent in more than 100 small and medium-sized banks; 3 of them were solely private owned. Proportion of private capital registered over 90 percent in small and medium-sized rural financial institutions, and 73 percent in village banks. External opening-up of China's banking industry made remarkable achievements. The number of foreign banking institutions reached 930, with assets CAGR of 20 percent. For foreign banks, the market entry barriers, qualification of engagement in RMB business, working capital requirement for branches were gradually loosened up; foreign banks were commencing business with more convenience.

4. The effectiveness of supervision was intensified and full participation in international banking supervisory reform was committed.

Effectiveness of banking regulation was further enhanced. The PBC made broader efforts to enrich macro-prudential toolkit. In 2013, the PBC launched short-term liquidity operation by releasing the Standing Lending Facility (SLF), so as to ensure adequate liquidity in the banking sector. The PBC also led an Inter-ministerial Joint Conference of Financial Regulatory Coordination. Responsibilities of this new system included coordination on financial information sharing, internet finance, inter-banking business, supervisory division between central government and local governments, etc. The CBRC made strides in filling in the regulatory framework, promoting the implementation of Administrative Measures on the Capital of Commercial Banks (Trial), defining shadow banking system, and strengthening differentiated supervision on LGFVs, real estate sector and over-capacity industry. For the purpose of standardizing wealth management business, the CBRC issued rules on the allocation of wealth management fund and the risk provision.

Relevant authorities continued to actively participate in international banking supervisory reforms. Relevant authorities, including the PBC, MOF and CBRC, were actively involved in the reforms led by FSB and BCBS, and took great efforts to bring national regulatory framework in line with international standards. China took the FSB Thematic Peer Review on Resolution Regimes and Reform Progress. The CMG of BOC was established on FSB request, and started to draft RRP. Some oversea branches of Chinese banks submitted resolution plans on the request of host supervisors. In 2013, the BCBS released full text of *Basel III: the Liquidity Coverage Ratio and Liquidity Risk Monitoring Tools and Global systemically important banks: Assessment methodology and the additional loss absorbency requirement*, issued consultative documents regarding securitization and fundamental review of trading book, and launched jurisdictional Regulatory Consistency Assessment Programme (RCAP). China underwent the RCAP review in 2013. It turned out that the overall capital regulatory regime was assessed to be compliant under BASEL III capital requirement.

Box 5 BCBS Published Regulatory Consistency Assessment Programme Assessment of Basel III Capital Regulations-China

With the 2010 publication of the final Basel III rules text, the Committee's focus is shifting from policy drafting to implementation of the new regulatory framework. To promote timely and consistent implementation of Basel III, the Committee put in place a comprehensive and robust review process covering all aspects of Basel Accords. The assessment approach comprises three levels; Level 2 review is to ensure consistency of jurisdictions legislation or regulations with Basel Accords. The Committee published *Basel III Regulatory Consistency Assessment Programme (RCAP)* in April 2012, which described the scope and approach of Level 2 review programme. Per the RCAP methodology, the outcome of the assessment is summarized using a four-grade scale, both at the level of 14 key individual components of the Basel capital framework and overall assessment of compliance by a jurisdiction: compliant, largely compliant, materially non-compliant and non-compliant. The Committee planned to finalize the first round of jurisdictional assessments by 2015.

The RCAP assessment of China began in January 2013. China is the sixth Basel Committee member jurisdiction to undergo RCAP assessment, following EU, Japan, US, Switzerland and Singapore. In September 2013, The Committee published *Regulatory Consistency Assessment Programme (RCAP) Assessment of Basel III Capital Regulations-China.* The feedback is generally positive with overall grading assigned to China is "Compliant". At a detailed level, 12 out of 14 components are assessed as "Compliant", including scope of application, transitional arrangements, definition of capital, capital buffers, credit risk-IRB, securitization framework, counterparty credit risk rules, market risk-standardized measurement method, market risk-internal models approach, operational risk-basic indicator approach and standardized approach, operational risk-advanced measurement approaches and supervisory review process.

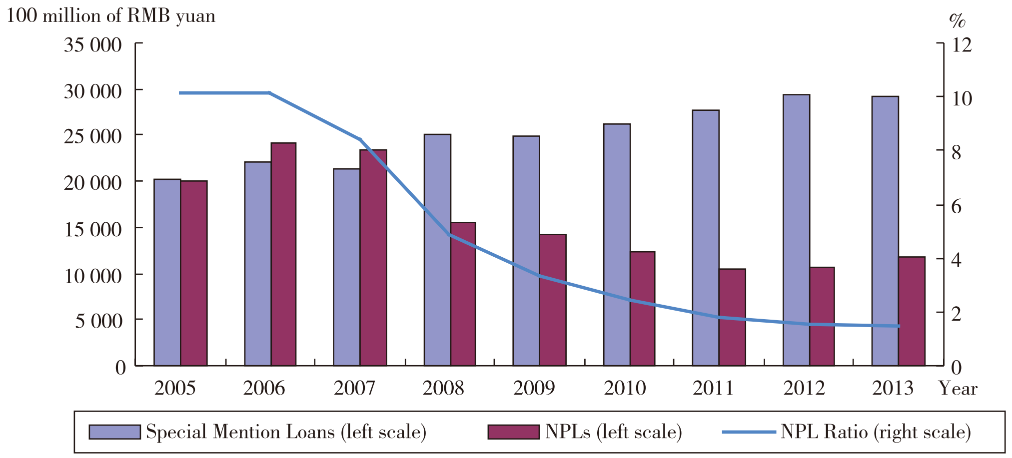
Credit risk standardized approach and Pillar 3 are assessed as "Largely Compliant". The main differences vis-à-vis Basel standards identified are: First, China's Capital Rules specify that exposures to the domestic sovereign, banks and public sector entities are assigned fixed risk weights and do not employ the Basel risk weighting options that linked to external credit assessments. The latter reflects change in the event of a rating downgrade of the sovereign. Second, the Pillar 3 disclosure requirements are incomplete in certain areas, such as credit quality and securitization. In particular, regarding credit quality, a breakdown of impaired loans and loan loss provisions by industries or counterparties is not required by domestic regulation.

Overall, the RCAP assessment of China is considered to be objective, and has brought about valuable recommendations to improve the implementation of international standards. The assessment will be highly beneficial to foster a consistent adoption of international regulatory standards, improve banks' risk management and enhance the effectiveness of supervision.

II. Soundness Assessment

The banking sector showed slight deterioration in asset quality, while loss provisions were still sufficient. At end-2013, the total outstanding NPLs recorded RMB 1.18 trillion yuan, and NPL ratio registered at 1.49 percent. Commercial banks' NPLs climbed up by RMB 99.2 billion yuan to RMB 592.1 billion yuan, which continued an upward trend of 9 consecutive quarters. NPL ratio of commercial banks was 1 percent. Special-mention loans of banking institutions were RMB 2.91 trillion yuan while special-mention loan ratio was 3.69 percent. Past due loans increased by RMB 203.9 billion yuan to RMB 1.14 trillion yuan. Loan loss provision continued to stand at a high level. At end-2013, the provision coverage ratio of commercial banks declined by 12.81 percentage points to 282.7 percent, while the loan loss provision adequacy ratio dropped by 10.33 percentage points to 321.21 percent. The provision to loan ratio recorded 2.83 percent, up by 0.01 percentage point than that of one year earlier.

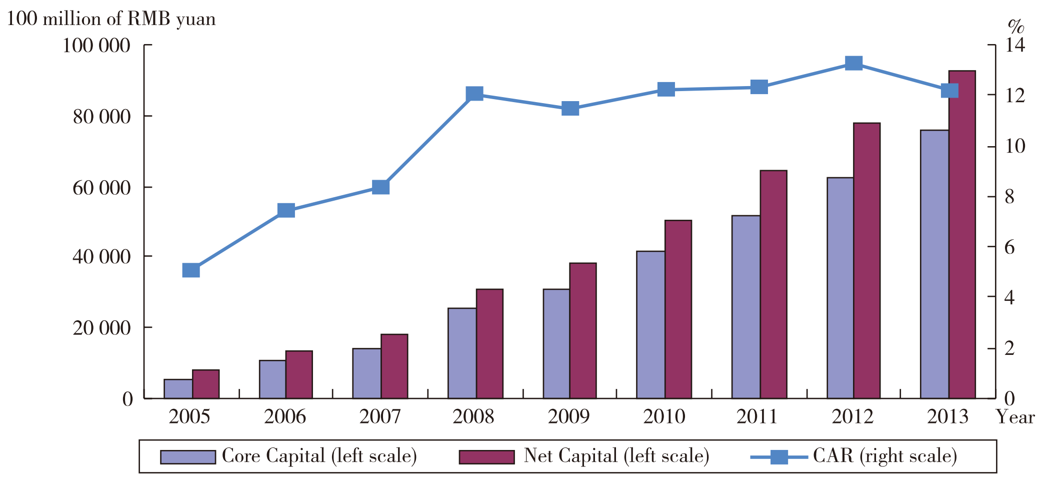
Figure 3.5 Changes of Special Mention Loans and NPLs



Source: The CBRC.

Banks' capital adequacy and capital quality remained relatively high. In 2013, the banking institutions achieved additional capital replenishment of RMB 1.48 trillion yuan, composed of retained earnings of RMB 1.18 trillion yuan, equity financing of RMB 248.8 billion yuan, and hybrid bonds of RMB 10.142 billion yuan. On January 1, 2013, The Capital Rules for Commercial Banks (provisional) was implemented, which set a more stringent capital adequacy ratio standard. Under the new approach, at end-2013, the CAR of commercial banks registered at 12.21 percent, with a y-o-y drop of 0.29 percentage point (Figure 3.6). total core Tier 1 capital recorded RMB 7.58 trillion yuan, which was 81.62% of core capital, demonstrating a high quality.

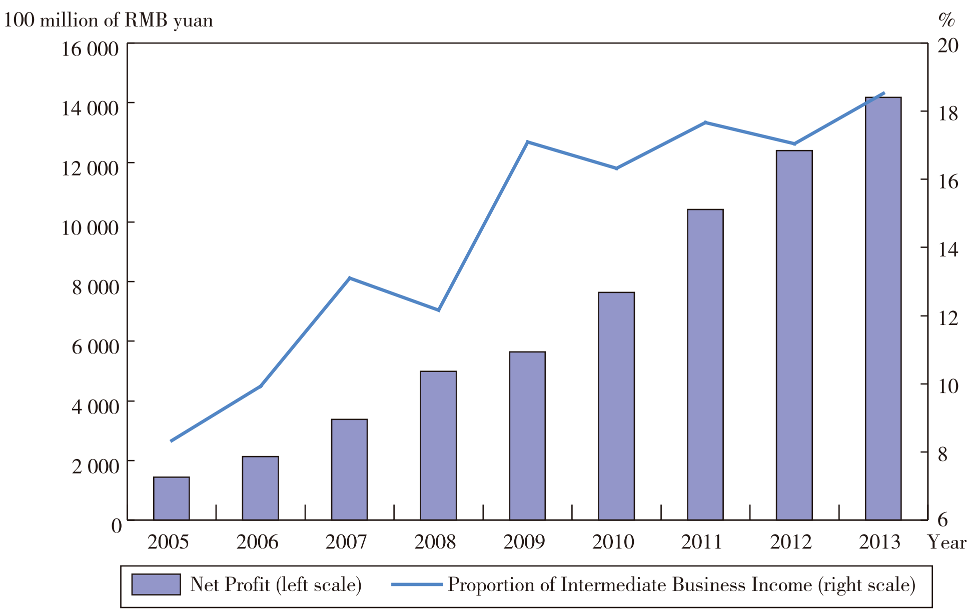
Figure 3.6 CAR and Capital Structure of Banking Institutions in Recent Years



Source: The CBRC.

Growth of profitability slowed down, and restructuring pressure increased. In 2013, the whole year net profit of the banking institutions was RMB 1.74 trillion yuan. The y-o-y growth was 15.23 percent, a decrease of 5.47 percentage points over the previous year. The ROA stood at 1.22 percent, same level with 2013, while ROE dropped 0.52 percentage point to 18.52 percent. Net interest spread of banking institutions declined by 0.08 percentage point y-o-y to 2.75 percent. Intermediate businesses income accounted for 15.87 percent, up by 1.28 percentage points y-o-y (Figure 3.7). Currently, the market mechanism and business environment were undergoing significant changes; the traditional profit model, which mainly relied on interest spread and credit expansion, became unsustainable. The whole banking industry was confronting an urge to accelerate transformation.

Figure 3.7 Profitability and Proportion of Intermediate Business Income

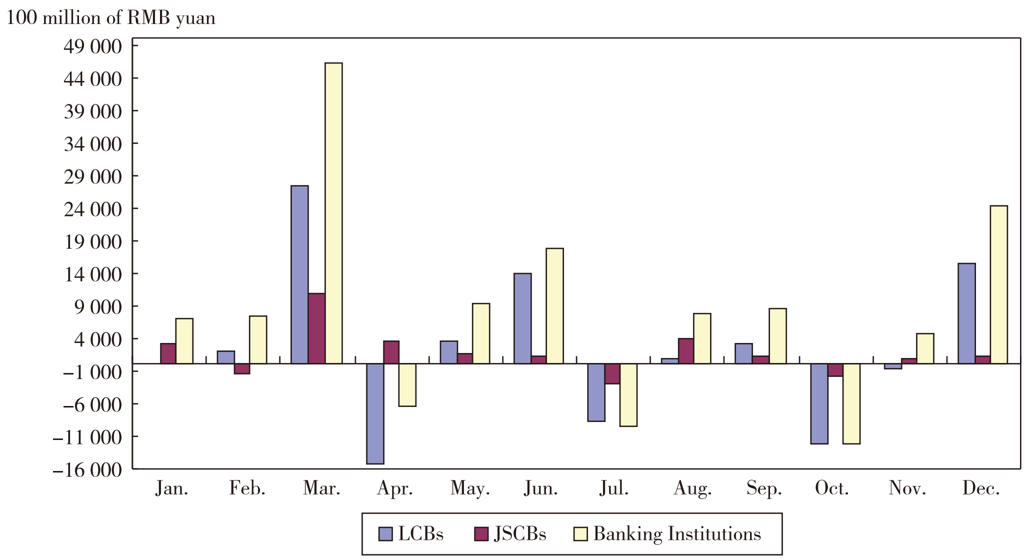


Source: The CBRC.

Overall credit risk was controllable while default risks increased in some key areas. For the year of 2013, in spite of low NPL ratio, credit risks embedded in LGFVs, real estate sector, and over-capacity industry could not afford to neglect. LGFVs loans was reaching peak of debt payment stress, since approximately 37.5 percent of the outstanding loans would come due between 2013 and 2015. Real estate loans rebounded in 2013. The assets quality of banking sector will be affected by the market fluctuation in the real estate industry. Moreover, the rebound of NPLs flagged in industries saddled with excessive capacity, such as PV, steel, shipping, plate glass, etc.

Liquidity management was under pressure due to complex factors. Firstly, volatility in banks' deposits threatened the stability of bank funding resources. In 2013, the cross-quarter fluctuation of banking deposits amounted to over RMB 5 trillion yuan, while the annual volatility was nearly RMB 6 trillion yuan (Figure 3.8). Deposit to total liability ratio declined from 87.2 percent in 2006 to 81.9 percent in 2013. Secondly, expansion of banks' balance sheets and variety of off-balance-sheet financial innovations further amplified the demand for liquidity. Driven by earning pressure and regulatory arbitrage, banking institutions funded long-term lending with short-term funding from interbank market or wealth management products. Balance sheet structure became extra sensitive to interest rate volatility, and more reliance on the money market amplified the fluctuation in the market liquidity. Meanwhile, a seasonal peak in tax collection coincided with the liquidity seasonality. Thirdly, uncertainty of US's withdrawal of quantitative easing might change the cross-border liquidity environment and bring more fluctuation to the domestic market.

Figure 3.8 Monthly Deposit of Banking Institutions in 2013



Source: The PBOC, the CBRC.

Interbank businesses soared, and great attention should be attached to potential risks. In recent years, as the financial market was maturing, financial institutions became more diversified, banking institutions accelerated business transformation, and the interbank business expanded rapidly in China. From 2009 to 2013, interbank assets of the banking institutions soared from RMB 6.21 trillion yuan to RMB 21.47 trillion yuan. The growth rate marked 246 percent, 1.79 times of the asset growth and 1.73 times of the loan growth over the same period. Interbank liabilities increased from RMB 5.32 trillion yuan to RMB 17.87 trillion yuan. The growth rate reached 260.9 percent, 1.74 times of the liability growth and 1.87 times of the deposit growth over the same period. The excessive expansion of the interbank business raised concerns to potential systemic risk.

Box 6 Regulate Interbank Business

Normally, interbank business is defined as investment and financing activities between financial institutions. Primary business types include interbank lending, interbank deposit, interbank loans, interbank financing and payment, redemptory monetary capital for sale (financial assets sold for repurchase), interbank investment, etc.

The surge in interbank business is impelled by appetency for practical needs; however, risks are latent due to misbehaviors, bypassing regulations, maturity mismatch or lack of transparency , etc. To some extent, the rapid expansion of interbank business has undermined the effectiveness of macro-control and financial supervision. Firstly, interbank business normally has mutual benefit to counterparties, since it may be off constraint of reserve requirement or loan-to-deposit ratio, or it may save capital and loss provisions for banks. Consequently, some banking institutions rely on interbank business to bypass macro-control and regulatory disciplines. Secondly, many financial institutions finance long-term, high-yielding projects through short-term low-cost interbank funding to achieve excess returns. The maturity mismatch is significant that may lead to liquidity risks. Thirdly, a lack of transparency and the irregularity accounting of interbank business increase regulatory difficulties. Fourthly, contagion risks are growing. Some interbank businesses are conducted through "multi-channels" , leading to complex structures and frequent fund transfers, which result in an inflated asset size in the financial system. A noticeable repercussion may be expected for a wider segment of the financial sector if severe credit losses hit one link of the channels.

Enhanced regulation is the inherent requirement to ensure the soundness of interbank business and mitigate relevant risks. It is also an important act to boost real economy and promote economic restructuring. In order to develop the interbank business soundly, it is necessary to standardize interbank market operations, define the business types and accounting requirements of the business clearly, strengthen internal management and external regulation, promote eligible interbank innovative business, and strive for high transparency of the interbank business.

The off-balance sheet business experienced rapid growth, and potential risks should not be neglected. At end-2013, outstanding balance of entrusted loans and investments on the off-balance sheet of banking institutions registered RMB 57.7 trillion yuan, an increase of RMB 9.05 trillion yuan or a y-o-y growth of 18.6 percent. The outstanding balance accounted for 38.12 percent of the total size of on-balance sheet, up by 1.71 percentage point from the end of 2012. Among the off-balance sheet items, entrusted loans was RMB 8.2 trillion yuan, entrusted investment was RMB 3.67 trillion yuan, acceptance bills was RMB 8.94 trillion yuan. It was worth noting that some commercial banks were trying to bypass financial regulations through off-balance sheet business. Credit risks turned to be more opaque, since bank funding was directed to industries explicitly restricted by the government and NPLs were erased from balance sheet.

Risks were latent in the booming wealth management business and trust products. Total assets under management at China's 67 trust companies jumped 46% to RMB 10.9 trillion yuan at the end of 2013. A lack of scrutiny and effective risk control set the stage for potential defaults in China's trust sector. At end-2013, the total balance of wealth management products recorded RMB 9.5 trillion yuan, an increase of RMB 2.8 trillion yuan from 2012. Sales of wealth management products satisfied partial financing needs of the real economy; however, the correlated risks should be aware. Firstly, the rigid payment in wealth management market eroded market discipline, fueled moral hazard risks, elevated price of risk-free capital, and caused misallocation of funding among different markets. Secondly, some of the wealth management products were dedicated to fund activities or industries explicitly restricted by the government, aiming to bypass macro-control or financial supervision. Thirdly, a lack of uniform regulatory rules on wealth management products among different financial sectors would induce regulatory arbitrage.

Some non-financial institutions with financial functions surged, while internal management and supervision lagged behind. At end-2013, there were 7839 micro-credit companies, 8185 credit guarantee institutions, and 6833 pawn houses. Rural mutual fund organizations and internet finance like Ren Ren Dai emerged in multitude. Due to weakness in internal management and external supervision, some institutions were prone to illegal fund-raising, usury or fraud behaviors. These misbehaviors seriously disrupted market discipline and might invoke unexpected risk events.

III. Outlook

Looking forward into 2014, banking institutions will strive to implement the spirit of the 18th National Congress of the CPC and the spirits of the 2nd and 3rd Plenary Sessions of 18th Central Committee of the CPC, pledge to let markets play a decisive role in allocating resources, adhere to polices of opening-up, continuously drive financial reforms, encourage financial innovations, actively address risks and challenges, and effectively enhance the capacity and efficiency to serve real economy.

Be ready for new opportunities and challenges, and promote sustainable development of the banking sector. In recent years, the economic environment, macro-policies and market mechanism faced by the banking sector have undergone profound changes. Along with the accelerated marketization of interest rate and foreign exchange rate, the traditional business model, which mainly relies on high interest spread and asset expansion, becomes unsustainable. Meanwhile, financial innovations, such as interbank businesses, wealth management products and private lending, are booming. The diversification trend of the financing channels appears evident. The burgeoning internet finance, represented by internet payment, Yu'E Bao, P2P lending services and crowd financing, is spreading shock waves to conventional banking services. To this end, banking institutions should continue to deepen reforms, optimize business models and strategies, strengthen risk management, improve financial services and construct competitive advantages, so as to achieve sustainable development.

Ensure the implementation of prudent monetary policies, and shore up economic restructuring and transformation. In 2014, under the premise of a reasonable credit limit, banking institutions should revitalize the stock of credit, make good use of increment credit, improve the financial services, and maximize the capital efficiency. Banking institutions should pursue favorable credit policies to key areas in the economy, including major infrastructures, strategic emerging industries, SMEs, agriculture-related industries and urbanization, etc. Differentiated housing credit policy will be strictly implemented, with a tendency to support the construction of affordable housing and small-to-medium commercial housing units, as well as first-time buyers. Guided by the central government's decisions, banking institutions will make unswerving efforts to tackle overcapacity issue. Differentiated credit policies will be implemented following the approach of "digestion, transfer, integration and phasing out". The pilot reform of asset securitization should be solidified, so as to improve the liquidity situations of the medium and long-term credit assets.

Deepen the reform and opening-up of the banking sector, and construct a more competitive and inclusive financial system. On the condition of strengthened supervision, China will open up the banking sector wider by allowing qualified private capital to set up small and medium-sized banks. Measures will be taken to establish the modern enterprise system, deepen the reform of large financial institutions, improve corporate governance, and build up an effective mechanism of decision-making, implementation, check and balance. Requirements of corporate governance should be strictly carried out in daily operations and risk management, and an effective application of incentive and restraint mechanism should be explored. Reforms of Exim Bank and ADBC will be accelerated, with an aim to maintain the main policy-directed functions while prudently develop the proprietary business. The financial accounting for policy-directed business and proprietary business should be separated. Efforts should be made to establish capital constraint mechanism, consummate corporate governance, improve preferential fiscal policies, and build up a sustainable environment for policy institutions. Adapted to requirements of economic development and financial reforms, CDB's reform should be deepened, to ensure proper resolutions of the issues, such as bond credit ratings, funding sources, etc. Efforts will be made to promote inclusive finance that is characterized by acquirable financial services, reasonable prices, moderate competition, sustainable development and wide coverage.

Enrich the financial market with financial innovations. Accelerate the transformation of government functions, further simplify administrative approval procedures, give market a decisive role in allocating resources, explore innovations of management system, release reform bonus, and stimulate the exuberant vitality of market players. Financial innovations that are of benefit to real economy should be encouraged, with close attention paid to asset securitizations and new capital innovation. Explore the applicability of large and medium-sized agriculture machinery, contractual management right of rural land and use right of rural home land as mortgage collaterals. Bring forth new ways to revitalize specialized small and medium-sized financial institutions, so as to reduce homogeneous risks.

Take strict precautions against financial risks in key areas, and further enhance the soundness of banking sector. Banking institutions should embed risk awareness and accurately understand the risk profiles. Financial risks associated with industrial restructuring should be actively mitigated. Efforts should be made to control the size of incremental LGFVs loans and optimize the structure of stock loans, so that risks associated with LGFVs loans could be mitigated prudently. Banking institutions will continue to implement the real estate control policies, especially the differentiated housing credit policy. Moreover, banking institutions are required to establish a name list management system and conduct stress tests for real estate loans. To address funding stress, banking institutions should take proper measures to strengthen liquidity risk monitoring and early warning analysis. More efforts are required to enrich liquidity management toolkit, optimize maturity structure of the balance sheet, improve contingency plans, and effectively upgrade the capacity to manage liquidity risk.

Deploy resources against risks embedded in interbank business and wealth management products, and stay cautious of risk contagion. Improve the interbank business management, and constantly enhance transparency in the business. Balance should be sought between limiting unreasonable interbank businesses and promoting normative innovations. Develop a comprehensive and systematic approach to regulate wealth management products, urge banks to establish a separate management system dedicated to wealth management business, and ensure separate booking and settlement for each product. With regard to interbank business and wealth management business, banking institutions should adopt strategies that adapt to internal risk management capability, and refine the related internal control system and operational process.

Improve the banking regulatory framework by drawing on the international regulatory reforms. Refresh the supervisory framework in line with international standards. Within the framework, banking institutions will be incentivized to steadily implement new capital regulatory standards in accordance with the fixed schedule. Counter-cyclical capital buffer requirement will come in force, a more efficient capital constraint mechanism will be in place, and the liquidity management framework will be improved. The classification criteria of financial institutions should be refined based upon the characteristics of China's financial market. Regulatory policies should be unified to reduce regulatory arbitrage, fill in the supervisory gap, and enhance the pertinence and effectiveness of the supervision.

Chapter IV

Securities and Futures Sector

In 2013, the securities and futures companies operated soundly and achieved positive progress in business innovation. Reforms in the regulatory framework were pushed forward, the openness of the sector was strengthened, and the institutional infrastructure was enhanced. Going forward, efforts should be made to further improve the business model of securities and futures companies and to continuously lift the sector's risk management capacity.

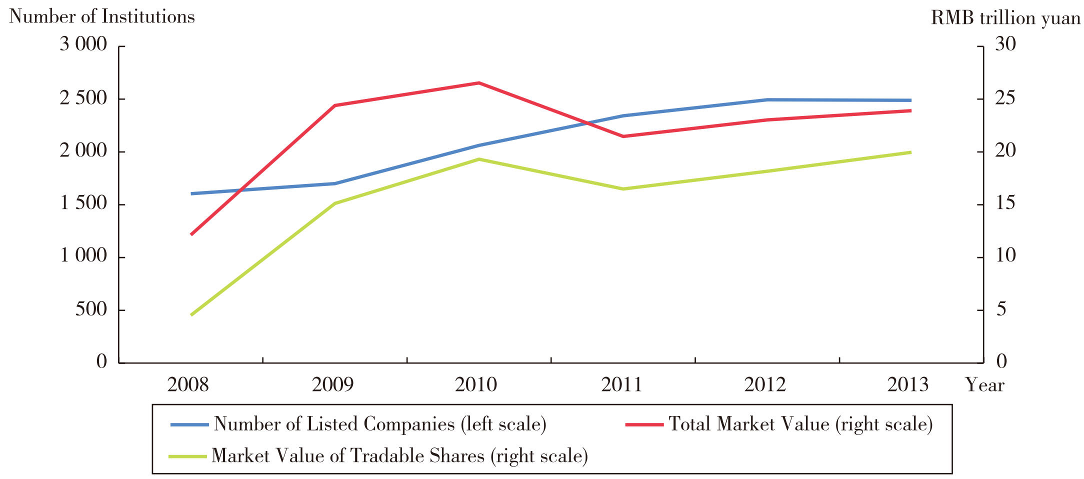
I. Recent Developments

1. The market entities operated soundly.

Listed companies exhibited stable performance.

By the end of 2013, there were 2489 listed companies on Shanghai Stock Exchange and Shenzhen Stock Exchange altogether, reduced by 5, which were delisted during the year. The total market value reached RMB 23.91 trillion yuan, an increase of 3.79 percent y-o-y; the market value of tradable shares reached RMB 19.96 trillion yuan, an increase of 9.87 percent y-o-y. Though a decline in number, listed companies exhibited sound performance in general(Figure 4.1), reflecting the rule of "survival of the fittest".

Figure 4.1 Number and Market Value of Listed Companies, 2008–2013



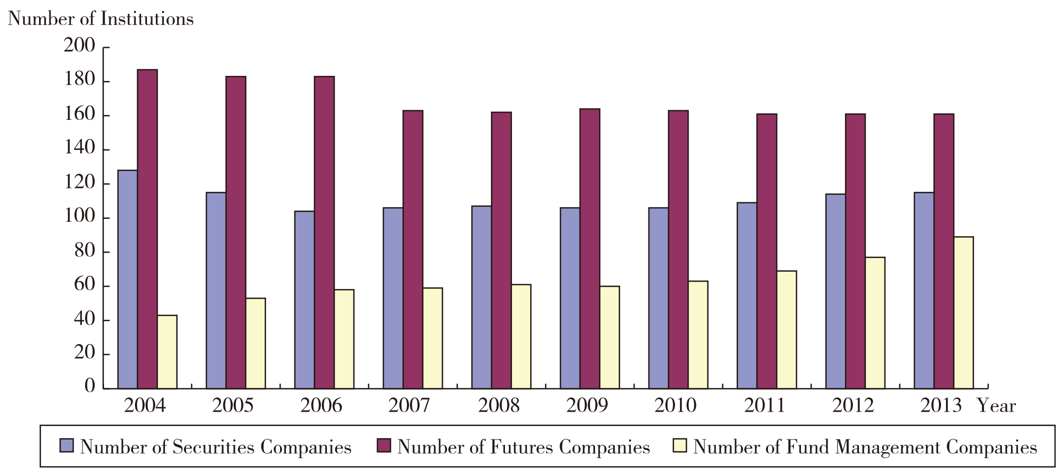
Source: The CSRC.

The Number of Companies listed on the national OTC market increased significantly. The National Equities Exchange and Quotations System for Small and Medium Enterprises began its operation on January 16, 2013. With the release of *Decisions on Issues Regarding National Equities Exchange and Quotations* by the State Council, the National Equities Exchange and Quotations system extended its coverage from the pilot project of Gao Xin Yuan Qu to nationwide. By the end of 2013, 355 companies had been listed on the

National Equities Exchange and Quotations System, an increase of 155 compared to the last year. The total shares and total market value reached 9.639 billion shares and RMB 55.2 billion yuan, up 74.4 percent and 36.57 percent compared to the last year, respectively. The market witnessed significant expansion and smooth operation.

The number of securities and futures companies increased slightly. By the end of 2013, there were 115 securities companies, up by 1 y-o-y, of which 20 firms were listed securities companies, up by 1 y-o-y. There were 156 futures firms, down by 5 y-o-y. The number of fund management companies was 89, a significant increase of 12(Figure 4.2).

Figure 4.2 Number of Institutions Operating in Securities and Futures Sector, 2004–2013



Source: The CSRC.

The assets of securities and futures companies grew. By the end of 2013, the total assets of securities companies (excluding customers' assets) amounted to RMB 1.52 trillion yuan, up by RMB 410 billion yuan and 36.79 percent y-o-y. The futures companies' assets (excluding customers' assets) totaled RMB 62.989 billion yuan, up RMB 7.85 billion yuan and 14.24 percent y-o-y. There were 1553 mutual funds managed by fund management companies, with 3.12 trillion units and RMB 3 trillion yuan in balance, down 1.66 percent and up 4.76 percent y-o-y, respectively.

Product innovation by securities companies was pushed forward steadily. With the release of *the Guidelines on Setting up Branches and Subsidiaries of Securities Companies*, restrictions placed on securities companies when setting up branches and subsidiaries, including geography, qualification and number were relaxed. More securities companies were engaged in the financing and securities lending business, bringing to the fast growth of the business. By the end of 2013, 84 securities companies had reported to conduct the financing and securities lending business, making the balance of which reach RMB 346.547 billion yuan, an increase of 287.07 percent y-o-y. The launch of the pilot project of securities relending business helped further improve the market infrastructure for the financing and securities lending business. As far as the stock pledged repurchase business was concerned, by the end of 2013, 86 securities companies had undertaken the business. 15 securities firms had been involved in the pilot program of OTC market after filing to the Securities Association of China, offering innovative trading tools such as investment return swaps and OTC stock options. The asset management business of securities companies witnessed fast growth during the year, with the total value of entrusted assets amounting to RMB 5.2 trillion yuan, an increase of 175 percent y-o-y. With the release of *Administration of the Asset Securitization Business of Securities Companies,* the pilot project of asset securitization business was soon turned into a common line of business for securities companies, with lowerqualification requirements and expanded scope of underlying assets. The innovation initiated by securities companies was also accelerated, among which were the pilot programs of the custody of privately offered funds, payment service of clients' funds and the execution of stock options of listed companies, and study on the pilot projects of the service of spot agency contract for expensive metals and spot proprietary contract for gold.

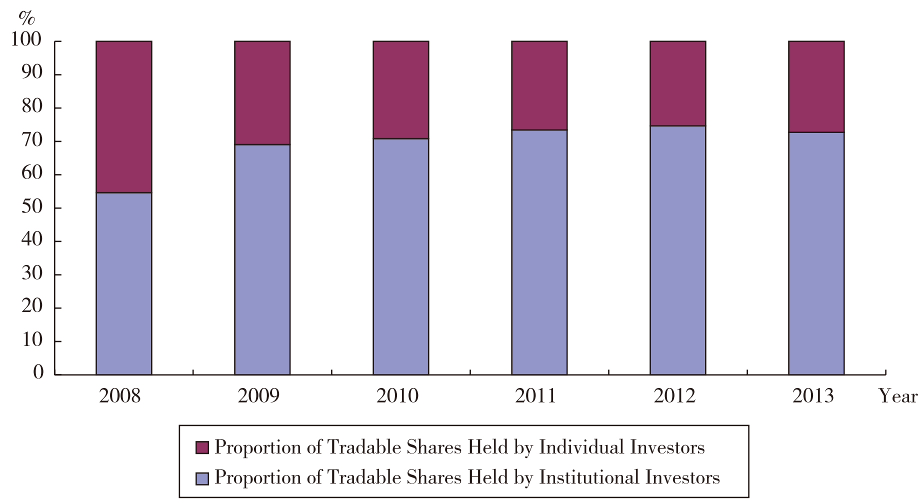
Progress has been achieved in the innovation by fund management companies. By the end of 2013, the total value of asset management business operated by the 62 subsidiaries of the fund management companies reached RMB 941.4 billion yuan, accounting for 44 percent of the non-public placement asset management business and 18 percent of the industry's total balance. The money market fund collaborated with the internet to offer more innovative products. For example, in June 2013, the Tianhong Fund management and the Alipay Co. jointly offered the product of Yu E Bao, or "leftover treasure", which was combined with Tianhong's Zeng Li Bao money market fund and had gained the largest customer base and balance in the domestic market. Moreover, a number of innovative products were introduced to the market, like the open-ended exchange-traded index fund for bonds, ETF for gold, floating charge fund, target return fund, term fund and absolute return fund.

The business of futures companies became more diversified. The innovation by futures companies accelerated in 2013. The pilot projects in the futures investment advisory service, asset management business and setting up special risk-management subsidiaries were extended and started to work. By the end of the year, 93 futures companies had been qualified for offering the futures investment advisory services and 29 companies were qualified for the asset management business, among which 28 companies had engaged in the business and the balance of entrusted assets managed by futures companies reached RMB 1.26 billion yuan. With the implementation of *the*

Guidelines on Setting up Subsidiaries for Risk Management Service by Futures Firms, the pilot program of setting up the subsidiaries to conduct risk management service by futures companies was launched.

Types of institutional investor increased. In 2013, with the extended pilot program of setting up asset management subsidiaries by commercial banks, 5 commercial banks completed setting up such subsidiaries, further helping funds flow from the banking sector to the capital market. With the release of *Provisional Administrative Rules Regarding Public Securities Investment Fund Business of Asset Management Companies*, more and more market entities can apply for the public fund management business, including the securities companies, insurance companies' asset management subsidiaries, private securities investment fund management companies, equity investment companies and venture capital companies. By the end of 2013, the market value for tradable shares had represented 72.74 percent of total market value, marking a slight decrease of 1.93 percent y-o-y and the 4th consecutive year above 70 percent(Figure 4.3).

Figure 4.3 Comparison of Proportion of Tradable Shares Held by Institution and Individual in Tradable A-Share Market, 2008–2013



Source: The CSRC.

2. The institutional infrastructure was improved.

The reform of IPO system was pushed forward. The *Opinions on Further Promoting IPO system Reform* as well as supportive administrative rules and regulations, such as the *Measures for the Administration of Securities Offering and Underwriting* were released by the authorities. The new share offering system will place the emphasis on the information disclosure arrangement, enable relevant parties of the market fulfill their necessary responsibilities, and make the whole process of offering, pricing and distribution more effective. The new offering mechanism, including the transfer of old shares and the combination of shares and debt, was introduced and the integrity requirements for the issuers and the controlling shareholders were strengthened. Following the principle of early disclosure and issuing responsibility, the early investigation system was put in place to improve the supervision and law enforcement system, intensify the supervision during and after new share offering and strengthen the punishment for illegal issuance. The regulatory authority also launched special examination on the financial information of IPO companies, and restarted the IPO steadily.

The regulatory framework for the OTC market was put in place initially. The regulatory framework for the OTC market is mainly based on *the Securities Law of the People's Republic of China and Decisions on Issues Regarding National Equities Exchange and Quotations System for SMEs*. Detailed regulatory arrangements could be found in a series of guidelines and administrative rules, including the *Measures for the Supervision and Administration of Unlisted Public Companies and the Provisional Administrative Rules of National Equities Exchange and Quotations System*. The regulatory framework covered a number of issues, including entry qualification, information disclosure, financing for share issuing, share trading, investor entry, market regulation,etc.

The market-oriented mergers and acquisitions of listed companies accelerated. The approval system for mergers and acquisitions of listed companies was much more streamlined. During the year, the approved significant asset restructuring amounted to RMB 314.26 billion yuan, an increase of 35 percent y-o-y.

The investor protection program was strengthened step by step. The release of *Opinions on Further Enhancing the Protection of Small and Medium-sized Investors' Rights and Interests* by the State Council focused on issues regarding the protection of the medium and small investors and put forward 9 proposals concerning improving investor suitability, optimizing investment return mechanism and ensuring the investors' access to information. The authority's efforts aimed to strengthen the policy arrangement of investor protection, boost the market confidence and promote the long-term healthy development of the capital market.

Products offered by the securities and futures sector were more diversified. In November, the State Council released the *Guiding Opinions on the Pilot Program of Preferred Shares*, in order to boost the development of direct financing and M&A of listed companies, provide diversified investment channels for investors and ensure a stable development of the capital market. In September, the Treasury bond futures were launched smoothly, which was regarded as an important step forward to improve the issuing system of Treasury bonds. The launch of Treasury bond futures was conductive to pushing forward the interest rate liberalization, optimizing resource allocation mechanism and lifting the financial sector's capacity to better serve real economy. 4 strategic energy futures, including steam coal and iron ore, were introduced to the market. 4 agricultural futures, including egg and veneer were introduced to the market as well. The pilot programs of continuous trading for gold futures, silver futures, and nonferrous metal futures, like copper, aluminum, zinc and lead futures, etc., were launched.

Box 7　Launch Treasury Bond Futures

Treasury bond futures are the interest rate futures in nature, with the underlying assets being treasury bonds. The seller and the buyer agree to make the transaction in the organized exchange with standardized contracts according to the pre-determined price and settlement timing in the future. As an important step to develop the multi-layered capital market, the launch of the treasury bond futures helps to push forward the market-oriented reform and boost innovation. China has prepared itself well for the introduction of Treasury bond futures. First, the issuing system of Treasury bonds has been improved with the issuance size increasing significantly. The issuing system managed by the Ministry of Finance works in a market-oriented way, and the key types of Treasury bonds are issued according to regularly rolling issuing system, a common international practice. The total amount of Treasury bonds issued kept increasing and reached over RMB 1.3 trillion yuan by the end of 2012. Second, the secondary market has been matured with considerable market depth. The bond market is mainly based on the OTC market, with the exchange playing a supplementary role. The book-entry treasury bonds transacted in the interbank market had been amounted over RMB 7 trillion yuan by the end of 2012, about 60 times the balance when the pilot project of Treasury bond futures was initially introduced in 1995. The active trading in Treasury bonds helps to strengthen the market liquidity. The data indicated that the transaction turnover of Treasury bonds in the interbank market reported to be RMB 9.1 trillion yuan by the end of 2012 with an annual turnover rate of 133 percent. If not including the bonds of the held-to-maturity accounts, the turnover rate for the bonds of the available-for-sale accounts reported to be 600-700 percent. Third, the investors of the market have became more diversified. Financial institutions play a major role in the market, represented by commercial banks for their essential share and supplemented by other active institutional investors, making the interbank market an efficient financing platform. Fourth, the registration and custody arrangement of Treasury bonds can give a solid support to the introduction of Treasury bond futures. Fifth, the successful introduction of stock index futures helped introduction of Treasury bond futures in experience.

On September 6, 2013, with the approval of State Council, the 5-year Treasury bond futures began being transacted in the China Financial Futures Exchange. The Treasury bond futures have the following characteristics: First, the underlying assets are standardized treasury bonds based on nominal value with remaining maturity of 4-7 years, which is convenient for delivery. Second, the rolling delivery system which requires raising hands simultaneously by the seller and buyer and the collective delivery system were adopted. The arrangement will help reflect the true willingness of the seller and buyer, extend the delivery period, and significantly lower the default risk. Third, with the collaboration of the inter-ministerial regime, the China Financial Futures Exchange Co. is able to set up delivery accounts in both the interbank market and the exchange, and therefore meets investors' need for different treasury bond markets. The move would help remove the limits faced by investors in the delivery and ensure successful custody and delivery of Treasury bonds across markets. Fourth, the Ministry of Finance adjusted the bidding time for 5-year and 7-year book-entry Treasury bonds so that all the investors can only learn the bidding result when the Treasury bond futures are transacted and any insider trading that takes advantage of information obtained during the bidding process could be avoided effectively.

In December 2013, after successful delivery of Treasury bond futures TF1312, the first Treasury bond futures contract completed its entire life of being offered, transacted and delivered. The market operated stably and began playing its function step by step. First, the price discovery and risk hedging function of the Treasury bond futures helps to strengthen the efficiency of Treasury bond issuing system. The gap between the bidding price and the yield on Treasury bond futures was only 2 basis points in December. Second, the liquidity of spot market for Treasury bonds was improved and the transactions on stocks of Treasury bonds became more active. After the introduction of Treasury bond futures, the daily transaction turnover of the cheapest deliverable Treasury bonds, "13 Treasury bonds 15", reached RMB 2.018 billion yuan, an increase of 19.59 percent compared to the period before the introduction. Third, the cross-market custody arrangement of Treasury bonds helps to strengthen the market base for Treasury bonds' yield curve. Fourth, the introduction of Treasury bond futures helps to reflect monetary policy information and enhance the transmission efficiency of policy. Fifth, the innovation by financial institutions could be further boosted with the introduction of Treasury bond futures, strengthening the decisive role of the market in resource allocation. As of the end of 2013, 87 innovative financial products had been offered by financial institutions for Treasury bond futures transactions.

3. The regulatory transformation was pushed forward steadily.

The administrative approval and filing system were streamlined and the regulatory transparency was increased. Following the State Council's requirement of transforming the government's function and streamlining the administrative process, China Security Regulatory Commission (CSRC) has put forward specific plans to streamline the administrative work, according to which 2 administrative items were cancelled in 2013 and 19 items would be envisioned to be streamlined or cancelled during 2014-2016. In the meantime, the spokesman arrangement was put in place by the CSRC and the regular press release system was formed.

The legal system and the enforcement were enhanced. Progress has been achieved in amending *the Securities Law of the People's Republic of China and the Futures Law of the People's Republic of China. Drawing up Rules on Regulation of Listed Companies and the Interim Regulations for the Administration of Private Investment Funds* also went smoothly. A series of rules regarding the management, sale and custody arrangement of public funds were put in place. The regulator delt with a number of typical illegal cases, including the fraudulent issuing of Wan Fu Sheng Ke and insider trading by Everbright Securitis Corporation. By the end of 2013, the authorities had completed rectifing the transaction platforms nationwide, and 200 platforms were closed.

The supervisory cooperation among relevant authorities was strengthened. According to the *MOU between the PBC and CSRC on Strengthening Supervisory Cooperation in the Securities and Futures Sector and Jointly Safeguarding Financial Stability*, regional offices of CSRC have signed MOU with 32 branches of the central bank to commit joint efforts in information communication and sharing, cracking down illegal behaviors in the securities and futures sector, collaborating in standardizing the local transaction platforms, and promoting risk monitoring, consumer education and investor protection.

4. The openness of the sector was further promoted.

During the year, 8 companies completed IPO and 10 companies completed additional offering overseas, raising USD 17.4 billion. The *Notice on Some Issues Relating to Investment by Qualified Foreign Institutional Investors in the Interbank Bond Market* released in March, allowed QFII, with qualification approved by the CSRC and investment limit approved by the State Administration of Foreign Exchange (SAFE), to apply to the PBC to enter the interbank bond market. The move aimed at expanding the investment channels for QFII and standardizing the investment practice. The development of both QFII and RQFII accelerated, the investment limits for QFII were lifted to USD 150 billion and the pilot projects of R-QFII were extended to the London and Singapore market. Moreover, the CSRC approved the establishment of national energy trading center by the Shanghai Futures Exchange in the Shanghai free trade zone.

II. Soundness Assessment

1. Some listed companies reported having lower performance and the funds have shown signs of fleeing from the real economy.

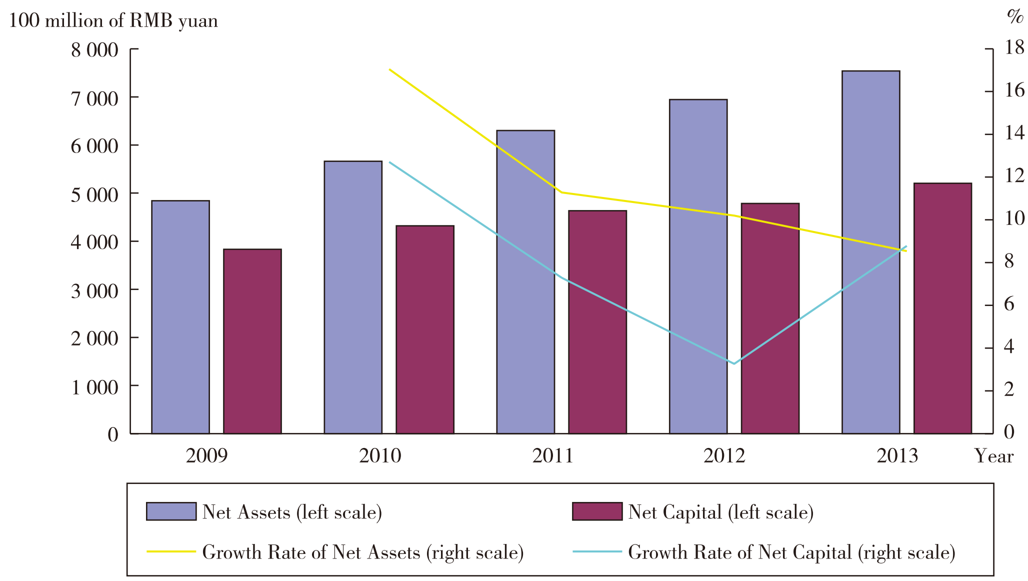
Affected by the slowing economic growth and the rising operation cost for enterprises, listed companies faced more difficulties during the year. By the end of this February, 1750 listed companies gave performance prediction, accounting for 69.64 percent of all the listed companies. 198 listed companies predicted loss, about 11.31 percent of all reporting companies, among which 162 companies reported the loss for the first time and 26 companies reported continued loss. The proportion of listed companies reporting loss increased by 2.24 percentage points, compared to the year of 2012. The listed companies reporting loss were mainly from the "chemical industry", "the computer, communication and other electronic equipment manufacturing industry", and "the specific equipment manufacturing industry".

The business of entrusted wealth management and entrusted lending by listed companies increased significantly in 2013. The statistics indicated that there were 204 and 397 announcements concerning entrusted wealth management and entrusted lending by listed companies, respectively, up 168.4 percent and 42.8 percent compared to the last year. Some listed companies were observed with unsound practice, like injecting the funds into areas restricted by economic policy or making use of funds from the bank sector improperly.

2. The liabilities of securities companies grew fast and the overall performance was sound.

By the end of the year, the total assets and liabilities of securities companies amounted to RMB 2078.8 billion yuan and RMB 1325 billion yuan, up 20.8 percent and 29.1 percent y-o-y, respectively. The net assets and net capital of securities companies amounted to RMB 753.9 billlion yuan and RMB 520.5 billion yuan, up 8.54 percent and 8.78 percent y-o-y, respectively (Figure 4.4).On average, the ratio of net capital to total risk-based capital provision reached 612.35 percent, ratio of net capital to net assets reached 69.04 percent, ratio of net capital to liabilities reached 65.18 percent, and ratio of net assets to liabilities reached 94.41 percent, slightly lower compared to the last year. Though the liabilities of securities companies grew faster than assets, all the risk control indicators met regulatory requirements and the overall performance of the sector was sound.

Figure 4.4 Changes of Net Assets and Net Capital of Securitits Companies, 2009–2013

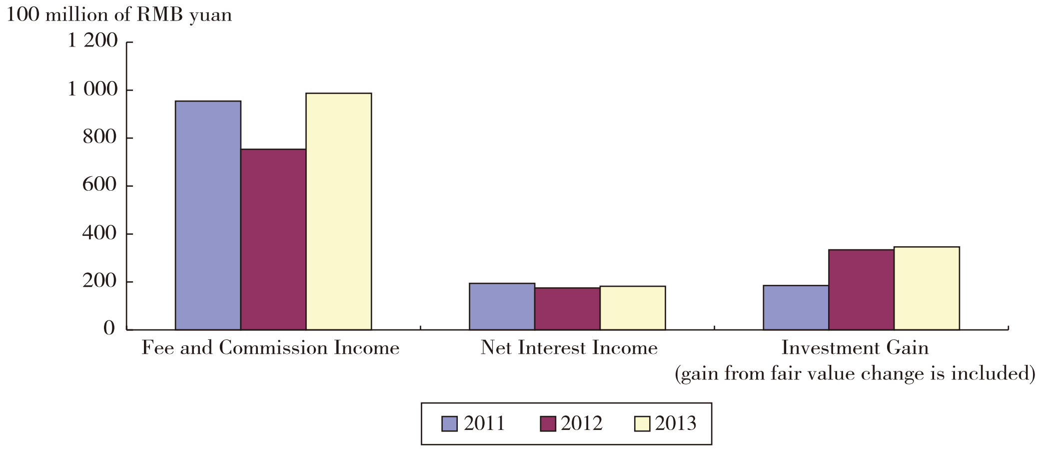


Source: The CSRC.

3. The profitability capability of securities companies was strengthened, yet the profiting model need to be further improved.

In 2013, the operating income of securities sector amounted to RMB 159.2 billion yuan in total, up 22.37 percent y-o-y, among which, RMB 98.7 billion yuan from fees and commissions with a y-o-y increase of 30.9 percent; RMB 30.6 billion yuan from the securities investment gains (including investment income and the fair market value adjustments) with a y-o-y increase of 5.52 percent; RMB 18.2 billion yuan from net interest income with a y-o-y increase of 4 percent (Figure 4.5). The net profits of 2013 accumulated to RMB 44 billion yuan, increasing 32.93 percent y-o-y. Breakdown analysis showed that, fees and commissions were still the main income source of securities companies, the proportion of which rose from 57.96 percent in 2012 to 62 percent in 2013. The fast development of innovation by securities companies, like the financing and securities lending and asset management business, would help securities get rid of over reliance on broker business. It was important for securities companies to strike the balance between innovation and risk management, as has been illustrated by the 8.16 abnormal transaction accident of Everbright Securities Co. Efforts should be made to strengthen internal control system, lift risk management capacity and make innovation meeting the real economy's needs.

Figure 4.5 Comparison of Securities Companies' Income Structure, 2011–2013



Source: The CSRC.

Box 8 Pay Close Attention to the Fast Growth of Targeted Asset Management Business of Securities Companies

There are 3 types of asset management business offered by securities companies: the targeted asset management business, the collective asset management business, and the specific asset management business. The asset management business of securities companies witnessed a fast growth in recent years, and especially, the targeted asset management business grew explosively due to its wide investment channels. As of the end of 2013, the total balance of targeted asset management business amounted to RMB 4.83 trillion yuan, up 186 percent y-o-y and accounting for 93 percent of the asset management business of the sector.

The business model of the targeted asset management business worked as follows. With funds raised by banks, securities companies acted like the manager of funds and were responsible for executing banks' investment orders, and the securities companies get management fees from the service. The business was based on the following banks' needs: First, using the funds to perchase discounted commercial papers, trust assets, and other types of assets to help the banks transfer the assets off the balance sheet. Second, investing the funds in undiscounted commercial papers, claims on accounts receivables, and claims on stock investments; using the funds to make entrusted loans, trust loans, etc. to help banks lend off the balance sheet. Third, if the funds were used to purchase the wealth management products of insurance companies and were then returned to the banks as deposits of financial institutions, the business would help banks balance its funding structure.

Fourth, the business would help banks turn the deposits and lending business into the intermediary business and improve its revenue composition, through such channel services as between banks and trust companies, securities companies or fund management companies. For securities companies, the business model would be helpful to make use of the resources of banks, strengthen the cooperation with banks, and provide more revenue channels.

However, given the cross-market and cross-sector nature of the targeted asset management business, the authorities have kept close monitoring on the risks of the business and intensified inspection and enforcement measures. With the release of Circular on Standardizing the Targeted Asset Management Business between Secusities Companies and Banks and the Supplementary Opinions on Further Standardizing the Asset Management Business of Securities Companies by the Securities Association of China, the securities companies were required to strengthen internal control system and be vigilant on risk monitoring and management. Currently, the internal control system and management of the targeted asset management business have been improved. Most securities companies were cautious when investigating the financial conditions of cooperating banks. The asset management contracts were further clarified regarding the relevant parties' responsibilities and risk information disclosure.

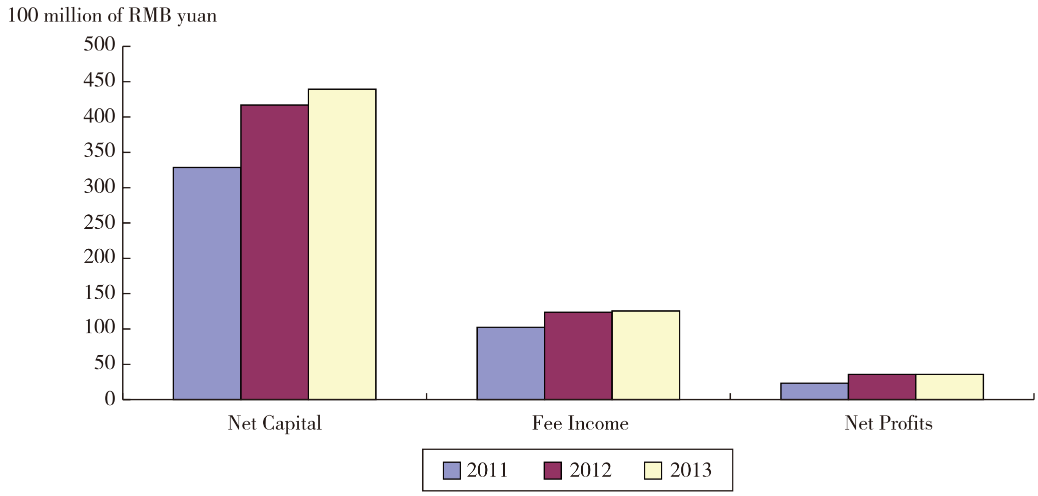
As the next step, the top-level design and strategic development plan of the sector should be further improved. First, the legal system should be enhanced to create an equitable market environment to encourage transformation of business models by securities companies. Second, the financial regulatory coordination regime, which was composed of the central bank and the sectoral regulators, should play a leading role in building consolidated statistics and risk monitoring system for wealth management products as well as other products and businesses across the markets, the sectors, and the regions. Third, the communication and coordination among different regulators should be strengthened to ensure the channel businesses be regulated properly.

4.The futures companies grew yet with declining profits and the overall strength need to be enhanced.

By the end of 2013, the total assets of futures companies (excluding entrusted assets from customers) amounted to RMB 62.99 billion yuan, the net assets reached RMB 52.21 billion yuan and net capital reached RMB 43.94billion yuan, up by 14.24 percent, 14.34 percent and 5.38 percent y-o-y, respectively. The total client margin reported to be RMB 193.92 billion yuan, a y-o-y increase of 9.74 percent; the operating income reached RMB

18.304 billion yuan in 2013, an increase of 7.3 percent y-o-y; and the net profits totaled RMB 3.549 billion yuan, a drop of 0.5 percent y-o-y (Figure 4.6).

Figure 4.6 Changes of Major Indicators for Futures Companies, 2011–2013



Source: The CSRC.

Yet, compared to other financial institutions, the operating strength of futures companies need to be further enhanced. By the end of 2013, the average net capital of futures companies reported to be RMB 282 million yuan. The innovation by futures companies accelerated, however, the income still mainly relied on fees and commissions from clients and interest income on clients' margin. The income from fees and commissions totaled RMB 12.55 billion yuan and the income from the interest on clients' margin totaled RMB 5.4 billion yuan in 2013, accounting for 68.57 percent and 29.5 percent of total operating income of futures companies, respectively.

5. The fund management sector operated soundly and the innovation in money market funds accelerated

By the end of 2013, the value of securities investment funds reached RMB 3 trillion yuan, up 4.53 percent y-o-y, among which stock-oriented funds and mixed funds accounted for 38.47 percent and 18.88 percent, down 1.57 and 0.82 percentage points y-o-y, respectively, while the bond market funds and money market funds accounted for 15.78 percent and 24.9 percent, up 2.6 and 4.95 percentage points y-o-y, respectively. Affected by the declining stock market and the volatile bond market, the development of stock market funds and bond market funds slowed. However, the money market funds developed quickly because it adeptly made use of the internet to boost innovation in products, services and sales, which could better satisfy the liquidity and investment needs of individuals and enterprises.

Box 9 Innovation by Money Market Funds and the Impacts

The money market fund is an open-ended fund that makes investments in cash, agreement deposits, termed deposits within 1 year, bonds with remaining maturity less than 397 days (including 397 days), the bond repos and central bank bills with remaining maturity less than 1 year (including 1 year) as well as other high liquid money market products approved by the PBC and CSRC. The innovation by money market funds accelerated in recent years, with more convenience in redemption, payment, money transfer and investment. The major characteristics of innovation were as follows: First, the "T+0" mechanism was introduced for some money market funds, enabling investors redeem the fund on the day of buying. Second, the payment and repayment fuctions, realized by the third-party payment platform, were added to further strengthen the utility of products for investors. The money market funds may be connected to multiple bank repayment accounts or designated website shops. Third, the customer adhesion was increased by connecting the money market funds to specific bank accounts.

The innovation by money market funds has posed important influences over the industry and the stability of financial market. First, the innovation could better satisfy investors' needs for liquidity while ensuring the safety and profitability and actually act like the water pool for cash and intermediary for investment by providing all-around services in the market. Second, the connection between money market funds and the on-line payment services made the funds an important platform for internet finance yet posed weaknesses in insufficient information disclosure and payment safety. Third, with the introduction of the "T+0" mechanism and quick money transfer between banks and fund accounts, the money market funds work like saving institutions, which will challenge the banking funding business with increased funding costs and funding adjustment pressure. Fourth, the money market funds may face the risk of runs by investors when a lot of them got redeemed collectively and shocked the entire market, and the multi-layered systemic risk prevention and resolution regime should be further improved.

Overall speaking, the innovation by the money market funds would help to increase the competitiveness of the sector and satisfy the diversified investment and financing needs. However, the issues of deposit dislocation, market volatility and regulatory gaps arising from its fast development were worthy of closer monitoring by the authorities. As the next step, the coordination of supervision should be enhanced, with clarified division of responsibilities, to ensure strengthening the risk monitoring and preventing potential systemic risks effectively.

III. Outlook

Going forward, with the aim of lifting the capital market's capacity to better serve the real economy, efforts should be made to push forward the market-oriented financial reform, promote regulation, encourage the innovation initiated by sound market entities and based on sound practice, protect the investors, and ensure the long-term healthy development of the capital market.

1. Develop the multi-layered capital market and streamline the administrative approval system.

The authorities should continuously push forward the development of a multi-layered capital market, through strengthening the main board, reforming the Growth Enterprise Board, and encouraging SMEs enter the National Equities Exchange and Quotations system. Efforts should be made to introduce more commodities and financial futures, such as crude oil futures, to encourage innovation in new transaction tools, including options, commercial indexes, carbon emissions, etc., and to promote the continuous trading and bonded delivery for mature futures products. The authorities should stick to the principle of market-oriented reform, further streamline the administrative approval and filing system, simplify the approval process, increase the transparency of approval criteria and procedures, and activate the market.

2. Push forward the registration-based reform of the new share offering system and intensify the regulation of listed companies.

According to the *Opinions on Further Pushing Forward the Reform of New Share Offering System*, efforts should be made to strengthen the efficiency of the approval system of new share offering under current legal framework, including optimizing the administrative procedures, increasing the transparency of approval process, and creating a favorable basis for the market to transfer to the registration-based new share offering system. In collaboration with relevant authorities, the regulator should further push ahead the proposal of introducing the registration-based new share offering system as well as the amendment to *the Securities Law of the People's Republic of China*. The investigation system should be enhanced and the market-oriented M& A reform should be continuously promoted. The delisting system of listed companies should be improved and the contingency plans for high-risk listed companies should be put in place. Efforts should also be made to establish a regulatory framework for non-listed public companies, which should put emphasis on information disclosure and strengthen the discipline of National Equities Exchange and Quotations Co..

3. Encourage innovation and protect investors' legitimate rights and interests.

The asset securitization business by securities and futures companies should be encouraged and efforts should be made to standardize the financing and OTC market business of securities companies. Innovation by fund management companies should be pushed forward, where eligible asset management entities should be encouraged to engage in public fund management business. The subsidiaries of fund management companies and futures companies should be encouraged to engage in asset management business as well. The openness of the capital market should be further strengthened. Measures should be taken to actively support the development of Shanghai pilot free trade zone, allow foreign investors' access to mature futures products and allow domestic securities and futures companies enter the overseas market by setting up subsidiaries or acquiring foreign companies. The authority should continuously intensify crack-down on illegal securities practice like false statement, market manipulation and insider trading, etc. The market discipline and integrity requirements for market entities, including listed companies and intermediaries, should be strengthened to enable these entities fulfill relevant responsibilities. The criteria for investor suitability should be clarified, the diversified investment return system for listed companies should be established and the dispute resolution mechanism for small investors should be built up to improve investors' protection.

4. Improve the legal system and enhance infrastructure construction.

The efforts to improve the legal system should focus on the amendment to *the Securities Law of the People's Republic of China, drawing up the Futures Law of the People's Republic of China*, promoting the release of a series of rules and administrative measures, such as the Rules on Regulation of Listed Companies and the Provisional Rules on the Administration of Private Securities Investment Funds, consolidating and streamlining the existing rules and regulations. The authorities should also push ahead the establishment of the central supervision information platform, achieving the uniform reporting and sharing system of supervision information. Moreover, efforts should be made to build the uniform reporting system and the central database, which would help strengthen the monitoring, assessment, and contingency resolution of systemic risks of the capital market.

Chapter V

Insurance Sector

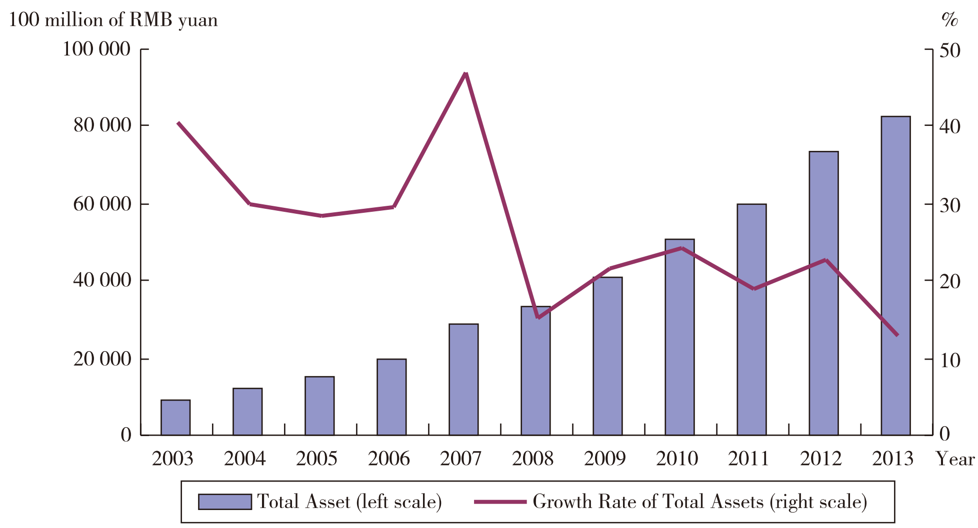
In 2013, China's insurance sector continuously registered steady growth and made progress. Further growth had been embedded in the size of assets. Premium growth gradually picked up. Operational efficiency experienced a substantial surge. Market-oriented reforms continued to advance. The current insurance sector is at the critical stage of transformation and upgrading, whereas the risk prevention task is still critical. The next step will be continuing with comprehensively deepen reforms, promotion of product and service innovation and capacity enhancement of sustainable development.

I. Recent Developments

1. Asset Size Continued to Grow and Premium Growth Rate Increased Gradually

By the end of 2013, total assets of the insurance sector had registered RMB 8.3 trillion yuan, increasing at 12.7 percent year on year (Figure 5.1), including RMB 1.1 trillion yuan, RMB 6.8 trillion yuan, RMB 210.39 billion yuan and RMB 19.08 billion yuan of property insurance companies, personal insurance companies, reinsurance companies and asset management companies respectively, increasing at 11.9 percent, 15.4 percent, 14 percent and 29.9 percent year on year respectively. Premium growth accelerated, and premium income nationwide amounted to RMB 1.72 trillion yuan, increasing at 11.2 percent year on year, 3.2 percentage points higher than last year, wherein premium income from property insurance, life insurance, health insurance and accident insurance were RMB 621.2 billion yuan, RMB 942.5 billion yuan, RMB 112.35 billion yuan and RMB 46.13 billion yuan, up 16.5 percent, 5.8 percent, 30.2 percent and 19.5 percent respectively.

Figure 5.1 Total Assets and Growth Rate of Insurance Sector



Source: The CIRC.

2. Number and Variety of Institutions Increased and Innovation Made Progress

In 2013, the number of insurance institutions was 174, increasing by 10 compared to the previous year, including 10 insurance groups and shareholding companies, 63 property insurance companies, 71 personal insurance companies, 8 reinsurance companies, 18 asset management companies, 1 export credit insurance company and 3 others. The restructuring of China Taiping Insurance Group Co. had got periodical achievement, and the founding meeting of the new company which is restructured as a limited liability company, was held in June. CNPC Captive Insurance Company was approved. Ningbo rural insurance cooperative pilot expanded. ZhongAn Online Property Insurance Co. Ltd, the first online insurance company, was established. China Life E-Commerce Co. Ltd. was established which significantly expanded its online sales channels. Insurance institutions were allowed to enter into public funding market. China Life AMP Asset Management Co. Ltd., the first domestic fund company controlled by insurance companies, was set up in November. In July, Ping An Insurance (Group) Company of China. Ltd was identified as one of the first nine global systemically important insurers by Financial Stability Board (FSB) and the International Association of Insurance Supervisors (IAIS).

3. Market-Oriented Reform was Actively Pushed Forward and Sector Development Power was Strengthened

Ordinary personal insurance rate reform was officially launched. Liberalization was implemented to lift 2.5 percent assumed interest rate limit which had been in place for more than a decade, while it reduced capital requirement for protection-type insurance products. Market-oriented reform of fund utilization had continuously promoted. Administrative examination and approval process had been simplified. Supervision on investment capacity of insurance institutions had improved. Investment channels of insurance funds had been broadening. Insurance asset management companies had been allowed to set up asset management products, investing in stocks, bonds, securities investment funds, infrastructure and real estate investment plans, etc. Insurance funds had been allowed to invest in ChiNext shares, and qualified insurance companies had been allowed to invest in blue chips for the policies sold before 1999. Deepening reform of market access and exit mechanisms was conducted. Business scope management of insurance companies was implemented in terms of grade and classification. The proportion of investment by a single shareholder in an insurance company was moderately liberalized. Administrative rule for the management of M&As of insurance companies was developed. Mechanism of market exit and risk disposition was further improved.

Box 10 Introduce Market-Oriented Reform on Ordinary Personal Insurance Interest Rate

In the early 1990s, the personal insurance industry introduced a great many of insurance policies with an assumed interest rate above 8 percent whereas a change of the macro-economic environment caused the return on investment far below the assumed interest rate, so interest spread loss was to occur. To mitigate the risk, in 1999, insurance regulatory authorities adjusted the annual compound interest rate of life insurance policies to be below 2.5 percent. This measure played a positive role in guiding reasonable operation and effective risk control of insurance companies, but also brought about some problems with the continuous development of the insurance sector. The attraction of ordinary personal insurance products is severely hampered, causing the personal insurance industry to turn to saving alternative products (such as participating insurance) for profit, which deprived the guarantee function of personal insurance products. With low return on investment over the past two years, saving alternative products faced with a weaker momentum of growth. Under such circumstances, it was urgently imperative that upper limit of assumed interest rate for ordinary personal insurance policies should be appropriately lifted.

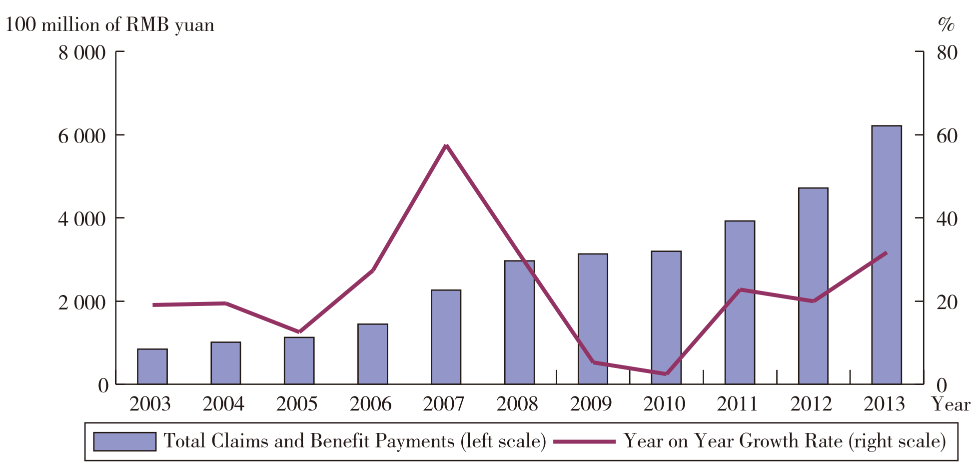
In August 2013, the Notice on Policy Reform of Ordinary Personal Insurance Premium Rate was released to set the basic reform strategy of "freeing the market while strengthening regulation". The new strategy allowed the assumed interest rate to be determined independently by market supply and demand, and removed the upper limit of 2.5 percent. On the other hand, the regulatory authority should guide the reasonable pricing of insurance companies by setting the statutory reserve requirement assessment ratio of ordinary personal insurance products. After the reform, the reserve requirement assessment ratio for new issued ordinary personal insurance policies shall be no higher than the smaller value of either the assumed interest rate or 3.5 percent. In the meantime, the new strategy will appropriately reduce the minimum capital requirement of net amount at risk for long-term personal insurance business, and aims to encourage and support the risk protection business, and tighten regulatory controls over solvency.

The rate reform transferred the pricing right to the market and enterprises, and mobilized the enthusiasm of the market. Insurance companies accelerated the development of relevant products and the insurance sector quickly regained its protection function. As of end-September 2013, a total of 82 new products were designed by personal insurance companies after the rate reform, wherein protection products accounted for 70 percent and the assumed interest rate of some products raised to 4 percent. Since the reform was initiated, the premium income of new ordinary personal insurance policies has increased by 520 percent year-on-year, reaching a record high in 13 years and reserving the downward trend of the new business, which lasted for over two years. But one thing worth noting is that the rate reform may bring about the risks of policy surrender and spread loss, which poses higher requirement for insurance companies in terms of product design, pricing, asset liability management and risk prevention.

4. Agro-Insurance, Critical Illness Insurance and Liability Insurance made breakthroughs

In 2013, insurance claims and benefits amounted to RMB 621.29 billion yuan, increasing by 31.7 percent year on year (Figure 5.2), which is higher than the premium growth rate by 20.5 percentage points. The service capacity of the industry to community had been improved. On 1 March, *The Regulation on Agricultural Insurance* officially took effect. The annual agricultural insurance premium income was RMB 30.66 billion yuan, increasing by 27.4 percent year on year. The total payment to 31.77 million affected farmers was RMB 20.86 billion yuan, increasing by 41 percent year on year. The insured crops area was over 1 billion Chinese acres and the value of risk coverage exceeded RMB 1 trillion yuan. Deployment of the State Council to develop pension services and health care, to enhance positive interaction among pension, health care and insurance sector, to extend commercial health insurance products, and to develop diversified health insurance services, had been promoted. Critical illness insurance pilot was in an orderly way, in 144 co-ordinating regions of 25 provinces nationally, covering 360 million populations. The Ministry of Finance, Ministry of Human Resources and Social Security and the State Administration of Taxation jointly issued the preferential deferred tax policy on enterprise annuity and occupational pension, promoting multi-layer pension insurance system. Pilot of compulsory pollution liability insurance on those industries with high environmental risks was launched in Guangzhou and several other places. Catastrophe insurance mechanism was explored by some provinces and cities.

Figure 5.2 Insurance Claims and Benefit Payments and Its Growth Rate



Source: The CIRC.

Box 11 Fully Advance the Development of Agricultural Insurance

Agricultural insurance is an effective policy tool that aims to establish and improve the agricultural protection system and support agricultural development. Starting from 2007, the Ministry of Finance has initiated the premium subsidy policy for agricultural insurance. The policy ushered the agricultural business of China into a new era of development. In 2013, the Regulation on Agricultural Insurance officially took effect to exert another push to the development of the agricultural insurance industry.

China's agricultural insurance business adheres to the principle of "governmental guidance, market-oriented operation, autonomy and collaboration", and has formed a variety of models in different regions. One of them is that the government selects qualified insurance companies through bid invitation, and the insurance companies undertaking agricultural insurance business conduct independent operation and are responsible for their own gains and losses. The second model is for a number of insurance companies to form a mutual association, and each company takes certain proportion of the premium income and risks. The third model is for the government and insurance companies to set up a mutual association, and the premium income is transferred to the agricultural insurance fund account set up by the government and the account of insurance companies respectively according to a pre-agreed proportion. The two sides also take risks according to such proportion. The fourth model is for the government to nominate a qualified insurance company as an agent for the agricultural insurance business, the insurance company only obtains certain agent fee while premium income is owned by the government, and the government hence takes all the risks for that model. At present, the first two models are most popular among most regions where the fiscal support from the government has played a vital role in the development of agricultural insurance. In the total premium income of agricultural insurance of 2013, above 97 percent belongs to agricultural insurance with a fiscal subsidy. China's agricultural insurance is confronted with several problems. The protection level is relatively low. There are few benefit-type insurance products. The pricing mechanism adopted by some regions for food grain crops, economic crops and livestock should be improved. The diversification system for disaster risks needs to be further improved.

In the future, we need to thoroughly implement the spirit of the 3rd Plenary Session of the 18th CPC Central Committee, give full play to the role of the market mechanism, reduce governmental interference and provide even better support to the development of agricultural insurance. First, we need to strengthen the accumulation and analysis of experiences and data of the insurance sector, and improve scientific pricing for agricultural insurance business. We should advance product innovation, expand the scope of insurance coverage and offer more product options for farmers with different affordability and protection demand. Second, we should enhance the support for agricultural insurance, and increase the coverage and risk protection of the three major grain crops. We should encourage the development of agricultural insurance with local characteristics, and establish a disaster risk diversification mechanism of agricultural insurance under fiscal support. Third, we should reduce administrative control and give insurance companies a better say in terms of insurance terms, pricing and claims, etc. On the other hand, we should strengthen the coordination among different government departments, and increase support to departments of agriculture, forestry, water conservancy and meteorology in terms of disaster warning and loss assessment so as to jointly advance the development of the agricultural insurance.

5. Regulation Continued to Improve and Consumer Protection was strengthened

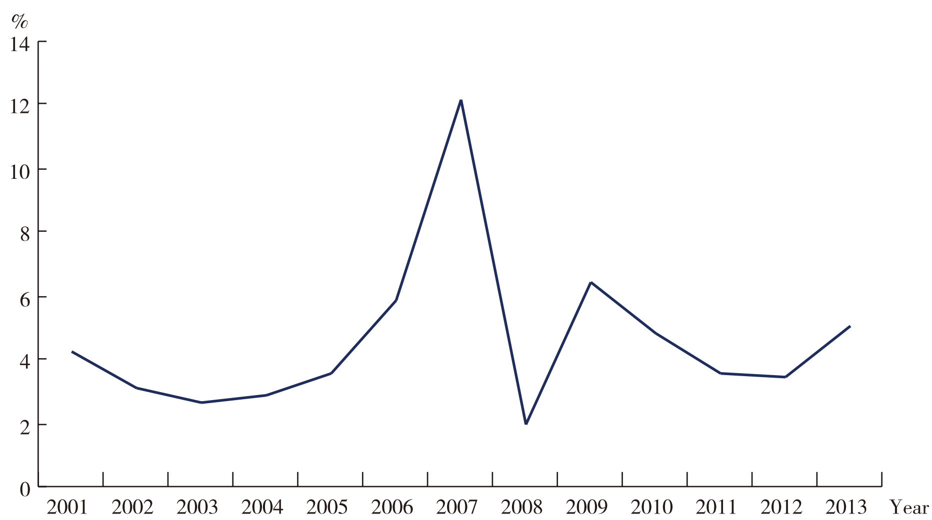
Based on the notion of "Service focus, Strict supervision, Risk prevention, and Development promotion", the insurance regulatory authority put forth efforts on investigation and inspection, and concentrated on insurance companies and agencies, focusing on corporate governance, internal control, data authenticity, difficulties in auto insurance claims, etc. It made the regulatory approach to telemarketing and bancassurance sales behavior, in order to regulate the basic service standards of specialized insurance intermediaries and strengthen practice management of insurance salesmen, brokers, surveyors and adjusters. Efforts were made to strengthen solvency regulation, to finish the framework of the second-generation solvency supervision system, develop the framework to set up top-level design, and establish the tri-pillar regulatory system of quantitative regulation, qualitative regulation and market discipline. Risk measurement and assessment criteria on insurers' solvency were developed and quantitative tests were carried out. Innovative capital replenishment channels, issuance of subordinated debt by insurance groups, and multi-channel capital strength enhancement were promoted. Mature payments and abnormal surrender risks were investigated, and regulation on fund utilization risk was strengthened. Further efforts focused on improving public image of insurance sector, setting the National Insurance Publicity Day, enhancing the level of insurance consumer protection, improving the evaluation mechanism of management of life insurance misleading sale activities, establishing evaluation indices regime of auto insurance claim services, introducing the administrative rules for handling insurance consumer complaints, and promoting the insurance dispute mediation mechanism.

II. Soundness Assessment

1. Increased Return on Investment and Larger Scale of Alternative Investment

In 2013, the insurance sector fully seized the opportunity on the marketization reform of fund utilization, adjusted investment strategy based on market shift and optimized asset allocation. Demand deposit was reduced, large agreement deposit was increased, government bonds and financial bonds were declined, high-yield corporate bonds were increased, and the strength of alternative investment was enhanced over infrastructure, real estate, asset-backed plans, equity plans, etc. Investment proportion of deposit and bonds were down by 4.7 and 1.1 percentage points respectively, while alternative investment proportion was up by 6.3 percentage points compared to the beginning of this year. Return on investment was RMB 365.8 billion yuan throughout the year, making the return on investment ratio at 5.04 percent, increasing by 1.65 percentage points compared to last year (Figure 5.3). Yield on alternative investment exceeded 6.5 percent which had played an important role in better yield on insurance fund utilization, however, the insurers should also prevent investment risks and avoid funds being invested in limited sections by macro-economic management.

Figure 5.3 Average ROI of Insurance Funds

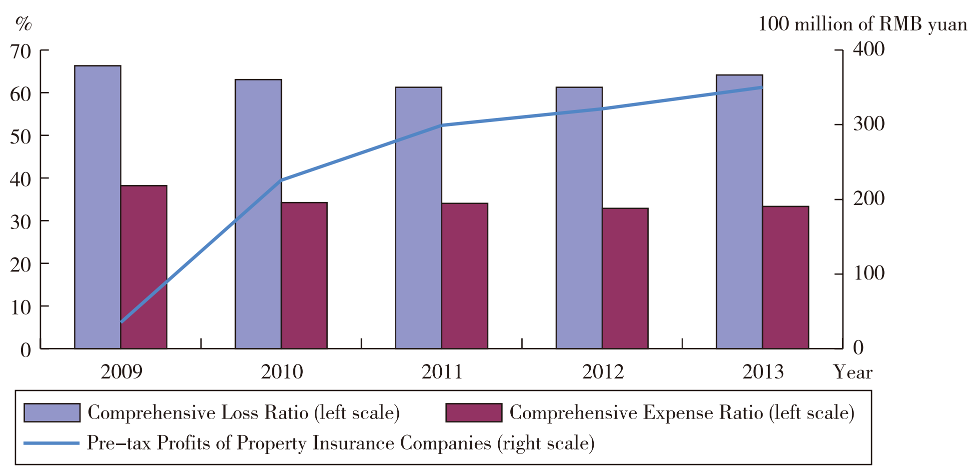


Source: The CIRC.

2. Contracting Underwriting Profits in Property Insurance and Slight Increase in Profits

In 2013, China's automobile production and sales firstly topped 20 million record, leading strong growth in auto insurance business, whereas auto premiums grew by 17.9 percent. The Regulation on Agricultural Insurance was formally taken effect, further promoting the development of agricultural insurance. Meanwhile, liability insurance and enterprise property insurance maintained the growth momentum. The annual premium income of property insurance companies reached RMB 648.1 billion yuan, up by 17.2 percent year on year, which is 1.5 percentage points higher than the previous year. Nonetheless, due to natural disasters namely "Feite", "Tiantu", "Haiyan" Typhoon and flood in the Northeast, the increased vehicle maintenance costs and other factors, the loss ratio of property insurance companies surged significantly, while the combined ratio came to 99.5 percent, up by 5.4 percentage points. There was a sharp drop in underwriting profits, but under good investment performance, property insurance companies realized RMB 35 billion yuan of profits, increasing by RMB 2.86 billion yuan year on year (Figure 5.4).

Figure 5.4 The Combined Ratio of Property Insurance Sector and Pre-tax Profits



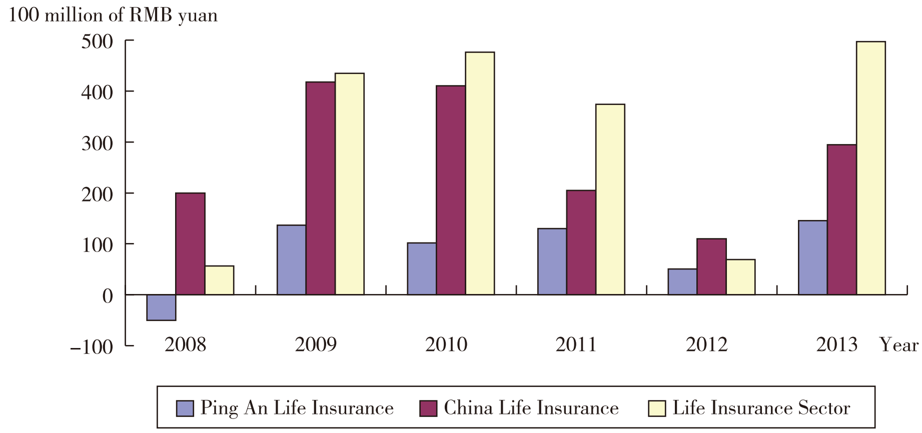
Source: The CIRC.

3. Rebounded Premium Growth in Life Insurance Industry and Sharp Profit Growth

Bancassurance premiums continued with a declining trend, but premiums through sales representatives grew. In 2013, participating insurance, investment-linked insurance and universal insurance premium income grew by 3.5 percent, 1.6 percent and 9.9 percent year on year, respectively. Ordinary life insurance premiums had rapid growth, at 23.8 percent year on year, accounting for 12.7 percent of overall life insurance premiums.

In August 2012, the Guidance on Critical Illness Insurance in Urban and Rural Areas was released, and health insurance premiums experienced rapid growth. The annual premium income of life insurance companies came to RMB 1.07 trillion yuan in 2013, increasing at 7.9 percent year on year, up by 3.8 percentage points over the previous year, while the product structure was improved. Since the investment income rose significantly, annual profits of the life insurance sector reached RMB 49.69 billion yuan, by a significant increase of RMB 42.81 billion yuan than the previous year (Figure 5.5).

Figure 5.5 Pre-tax Profits of China Life Insurance, Ping An Life Insurance and the Life Insurance Sector



Source: The CIRC.

4. Rapid Growth in Mature Payments and Surrenders and Greater Liquidity Pressure on Life Insurance Industry

2013 is the peak year of life insurance maturity payments, amounting to RMB 174.2 billion yuan, representing an increase of 70 percent year on year. Due to the lower than expected yield on insurance products such as participating insurance, the annual surrenders grew to RMB 190.7 billion yuan, increasing 59 percent year on year, at 3.8 percent surrender rate which is 1.0 percentage point higher than the previous year. In the case of significant growth in mature payments and surrenders, the insurance sector developed contingency plans, strengthened main responsibility for effective risk prevention of insurance companies, promoted product innovation, increased premiums, and eased liquidity pressure in order to maintain market stability. 2014 is considered another peak year of mature payments, superimposed with surrender risk. Liquidity management of life insurance sector is still facing challenges.

5. Lower Market Concentration and Significant Insurance Company Differentiation

In 2013, the Herfindahl index of China's property insurance and personal insurance were 0.174 and 0.141 respectively, decreasing by 0.003 and 0.010 respectively over the previous year. The market share of premiums of the largest property insurance and life insurance companies were 34.4 percent and 30.4 percent, which were 0.5 and 2 percentage points lower than the year before respectively. Listed companies had done relatively well than other property insurance companies, small and medium companies showed poor operating results, and few companies suffered serious losses. For life insurance companies, listed ones ran smoothly with sharp increase in investment income. Surrenders at small and medium companies were prominent. The 4 specialized health insurance companies were at loss all. However, companies with banking background could take the advantage of bancassurance, so as to experience preferential premium increase. The premium growth at ICBC-AXA Life, BoCommLife, ABC Life, and China Post Life were 117 percent, 86.4 percent, 74.4 percent and 58.4 percent respectively.

6. Capital Replenishment from Multi-Channels and Relatively Adequate Solvency

Capital replenishment channel for insurance companies is broadening. In 2013, the capital was efficiently replenished and the whole industry solvency adequacy was shown, through shareholder funding, subordinated debt, subordinated convertible bonds, etc (Table 5.1). In particular, 5 companies issued RMB 26 billion yuan of subordinated debt, 1 company issued RMB 26 billion yuan of convertible bonds, and 44 companies raised RMB 64.6 billion yuan through registered capital, including 19 life insurance companies, 3 health insurance companies, 2 pension insurance companies, 4 asset management companies, 11 property insurance companies, 2 insurance groups and 3 reinsurance companies, wherein mostly were small and medium insurance companies.

Table 5.1 Solvency Adequacy Ratio of Listed Insurance Companies

	China Life Insurance	Ping An Life Insurance	CPIC Life Insurance	New China Life	PICC Life	PICC P&C	Ping An Property Insurance	CPIC Property Insurance
2013	226%	172%	191%	170%	202%	180%	167%	162%
2012	236%	191%	211%	193%	130%	175%	178%	188%

Source: Listed Companies’ Annual Reports.

7. Increased Insurance Complaints and Triggered Strengthened Consumer Protection

In 2013, valid complaints received by the insurance regulator amounted to 22 673, up by 30.6 percent year on year, of which complains concerning property insurance companies and life insurance companies were 9 055 and 12 228 respectively, which were 1.4 and 1.14 per 100 million premiums respectively. For property insurance complains, claims / payment disputes in the category of service quality and dissatisfaction in damage assessment prices accounted for 75.1 percent. For life insurance complains, illegal complaints reflecting insurance company fraud and misleading sales occupied 34 percent, while surrender disputes registered 26.1 percent for those who did not agree with low cash value of insurance policies nor surrender charges.

III. Outlook

The 3rd Plenary Session of the 18th CPC Central Committee set the comprehensive strategic plan to deepen the reform. The Central Economic Work Conference established the general tone of seeking progress amidst stability and promoting reform and innovation. The insurance sector, as an important part of the financial industry, will fully execute the spirit of the meetings, implement the role and function of insurance, continue to promote market-oriented reform and advance healthy and sustainable industry development.

1. Adapt to Situation Changes and Adjust Development Strategy of the Insurance Sector

In 2014, the international economic situation remains complex, the foundation for domestic economic recovery is not yet solid, and there is still mounting downward pressure for the Chinese economy. The financial industry is undergoing profound structural changes with accelerated development of integrated financial services and the abrupt emergence of internet financing, causing an increasingly competitive market environment. All these will pose obvious impacts to the development of the insurance sector through multiple channels such as the real economy and the financial market. At present, the insurance sector has entered into a stage of moderate growth from the previous mode of rapid growth. The usual growth rate of 20 percent or even 30 percent is unlikely to be sustained in the future. Under such circumstances when both the internal and external environments are undergoing profound changes, the existing development model, product structure and sales model which have been in place for quite a long period of time are in urgent need of adjustment. The insurance sector should vigorously reverse its traditional extensive development model which features high investment, high cost, high consumption and low efficiency, and step on a course of intensive operation and value increase. Insurance companies should take diversified development routes, strengthen innovation in products and services, intensify the development of long-term savings insurance and risk protection insurance products, further optimize the business and channel structures, and promote the balanced development of the insurance market.

2. Accelerate Development of Key Businesses and Better Serve the Real Economy

The insurance sector will focus on overall social economic development, seeking policy support and legislation protection, more product and service innovation, and active promotion on the development of agricultural insurance, catastrophe insurance, commercial pension and health insurance, liability insurance, etc., so as to support the real economy. On the basis of existing policy implementation, it will continue to expand the category and coverage of agricultural insurance, promote the development of agricultural insurance with local agro characteristics, develop and promote agricultural price indices insurance. With fulfillment of the functions of government and market, it will gradually establish catastrophe insurance system in line with China's national conditions, develop an implementation plan, and promote the exploration of the catastrophe insurance pilot locally whereas condition allows. Vigorous development of commercial pension and health insurance, continuous promotion of the pilot program of individual tax-deferred pension insurance, encouragement on insurers' participation in construction on pension services, expansion of pilot scope, promotion of critical illness insurance in urban and rural areas and participation in entrusted management on medical protection services, would be followed. It is considered to enhance the in-depth development of liability insurance, such as medical and environmental pollution, in addition to promoting compulsory liability insurance on food safety legislation.

3. Further Promote Market-Oriented Reform and Improve Competitiveness of the Insurance Sector

Efforts will be made to deepen market-oriented reform, clarify the relationship among regulator, market and industry, pass real responsibility and investment right to market entities, and enhance market vitality and competitiveness. Establishing the market-oriented pricing mechanism, initiating rate formation mechanism and actuarial system reform of participating insurance and universal insurance, actively and steadily undertaking reform of clause and rate management system on commercial auto insurance, and considering the reform of compulsory liability insurance for vehicles are to be pushed forward. Adhering to market-oriented reform of fund utilization, reform would be in all aspects of proportional regulation on insurance fund utilization, broader investment scope and stronger risk management. Further efforts are making to accelerate market access and exit mechanism reform, improve market exit and risk resolution mechanism, optimize access standards and approving process, carry out comprehensive research on pre-disclosure system of market access, and regulate merger and acquisition activities. Product management reform will be market-oriented, the product innovation identification and protection system will be explored, and the product approval and filling process will be simplified. Additional efforts will be made on promoting the reform of the insurance sales representative management mechanism and professional bancassurance.

4. Focus on Insurance Sector Long-Term Development and Management of Asset Liability Matching

Efforts should be made to Guide insurance institutions to adopt the asset-liability matching concept, under considering factors of the country's economic and financial environment and related regulations, asset and liability management mechanism will be established and improved, and coordination mechanism between product development and investment will be set, aiming at maintaining consistency of products, actuarial services, investment and sales, which will effectively prevent pricing risk and spread loss risk. In terms of product design, it will need to consider investment ability and market conditions to realize positive interaction between either sides of the balance sheet. In terms of fund utilization, asset allocation strategy will be made based on characteristics of liabilities and financial market conditions, through rational and prudent investment to gain long-term and stable return. Vigorous development of financial market, long-term bond products and orderly innovative derivatives including futures and options related to interest rate and exchange rate will be put forward to provide more asset allocation vehicles for insurance companies.

5. Improve Scientific and Effective Regulation and Strengthen Regulatory Coordination

The insurance sector should continue to advance the establishment of the second-generation solvency regulation regime, strengthen solvency regulation and tighten solvency restrictions, formulate management measures and expand channels for capital replenishment. The sector should also earnestly reform its regulatory approach, strengthen regulation over business processes, enhance categorized regulation and off-site monitoring, and improve requirements on information disclosure and internal control. Measures should be taken to regulate market order and strengthen market behavior regulation, including intensified investigation, stronger punishment over illegal conducts, cleaning up of the insurance intermediary market and stricter regulation on new sales channels such as the internet. Meantime, regulatory authorities in China should continue to comprehensively manage difficulties in claims payments and sales misleading, further elaborate the settlement mechanism for insurance disputes, improve the efficiency in handling customer complaints and earnestly protect the rights of customers. In addition, authorities should strengthen regulatory coordination and cooperation, implement the joint ministerial conference on financial regulatory coordination, and closely follow and actively participate in international insurance regulatory reforms. Efforts should be put to improve regulation on the global systemically important insurance institution, and effectively control cross-market and cross-border financial risks.

6. Promote Risk Early-warning and Resolution Mechanism and Firmly Hold the Bottom Line for Risks

Regulatory authorities should improve the risk early-warning system, establish the mechanism for risk monitoring, assessment and warning, and enhance the ability of risk contingency resolution. Various contingency plans should be improved and the rescue and financing mechanisms of the insurance guarantee fund should be perfected to specify triggering conditions of risk resolution, empower the tool box for risk resolution and hold firmly the bottom line for risks. We should effectively prevent and mitigate mature payment and surrender risks. We should also identify risks in light of the characteristics of main companies and businesses, and urge insurance companies to actively and properly handle emergencies. We should prevent and mitigate the insolvency risk, intensify solvency stress testing and take swift precautious measures. Meanwhile, we should establish a capital rating system and implement the total custodian system of insurance fund utilization. The insurance market should take effective measures to mitigate liquidity risks, regulate the high cash-value business and advance product innovation on the basis of controllable risks. We should also prevent and mitigate risks in insurance fund utilization, and establish a new regulatory framework. On the basis of an intensified off-site monitoring and on-site investigation, we should strengthen regulation vehicles including information disclosure, internal control, categorized supervision, asset accreditation, etc., to enhance the territorial supervision pilot of fund utilization.

Box 12 Regulate the Professional Insurance Intermediary Market

Professional insurance intermediaries play an important role in promoting professional operation of insurance companies, reducing transaction cost, improving the market structure and promoting sound development for the insurance sector. The professional insurance intermediary market is of great significance for countries and regions with a developed insurance sector. In Britain, 40 percent of the premium income of property insurance is realized through insurance brokers, and the insurance intermediary market accounts for 1 percent of the national GDP. Similarly, in the United States, most of the insurance business is undertaken and realized by insurance agents and brokers.

China's professional insurance intermediary market has experienced rapid development in recent years. The premium income from 2004 to 2012 grew at an annual average rate of 25.8 percent, but there is still a large gap as compared to countries with a developed insurance sector. The unauthorized sales of self-developed wealth management products by Shanghai Fanxin Insurance Agency Company in 2013 caused severe break of its capital chains and the “runaway” incident of its general manager, which revealed that the professional insurance intermediary market is faced with the following problems. First, corporate governance is incomplete and some institutions have very weak internal control, causing false business and sales misleading. Second, capacity is insufficient. Some institutions are in lack of operation management talents and professional talents, and have weak capital strength and low level of professionalism whose competition relies largely on monopoly of customer resources and lifting of insurance fees and commissions. Third, the compensation mechanism needs improving. Professional insurance intermediaries deal with disputes or compensate policyholders in case of bankruptcy mainly through professional liability insurance or the guarantee money, and may appear inadequate in compensation capital. Fourth, there are still vulnerable links in regulation, and the regulatory tools cannot meet the need of industrial development. All the problems mentioned above have severely hampered the development of the professional insurance intermediary market, and have also brought about serious negative impacts to the development and reputation of the insurance sector.

In the next step, we should draw upon international experiences and standardize the development of the professional insurance intermediary market. First, we should carry out comprehensive researches on the positioning and the role of insurance companies and professional insurance intermediaries, guide insurance companies to set up specialized sales companies and support professional intermediaries in their efforts of market reorganization, merger, acquisition and public financing, and establish and improve the nationwide service network. Second, we should guide professional insurance intermediaries to strengthen corporate governance and internal control, raise their awareness of compliance operation, improve the qualification of the intermediary market, enhance their capacity on products sales, service and risk management, and improve their professionalism in operation. Third, we should strengthen regulation, improve relevant rules and regulations, tighten market access, adopt a prudential market exit approach, straighten investigation and punishment, accelerate the construction of industrial self-regulatory organizations and build up a system of integrity operation.

Chapter VI

Financial Market

Chinese financial market continued its sound development in 2013. The economic structural adjustment and upgrading were promoted by smooth market operation, expanding scale and enhanced innovation, as well as the steadily advanced reform.

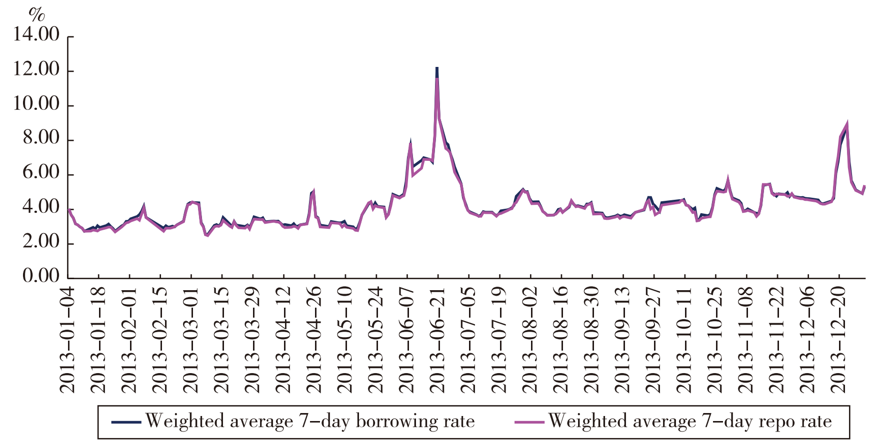
I. Market Overview

1. Repo and Interbank Borrowing Market

The trading in repo and interbank borrowing market was active and short-term maturity dominated. In 2013, the accumulated trading volume of interbank borrowings reached RMB 35.5 trillion yuan, declining 23.9 percent compared with the last year; the accumulated trading volume of bond repos reached RMB 158.2 trillion yuan, increasing 11.6 percent compared with the last year. The trading maturity was mainly short-term, and the interbank borrowings matured no longer than 7 days totaled RMB 33.4 trillion yuan, accounting for 94 percent of the total trading volume, 1 percentage point lower than the last year; the trading volume of pledged repos within 7 days totaled RMB 139.8 trillion yuan, accounting for 92 percent of total pledged repos, 2 percentage points lower than the last year.

The volatility of market rate increased, and the benchmark interest rates shifted upwards significantly. In December 2013, the weighted average pledged repo rate was 4.28 percent, 203 basis points higher than the beginning of the year, 166 basis points higher than the last year. The annual trend was low at first and high in the end, divided by the middle of the year. Taking the 7-day pledged repo rate as an example, the average rate was 3.9 percent in the first half of the year, and rose to 4.4 percent in the second half. There were two major fluctuations within the year. On June 20, the 7-day pledged repo rate reached the historic high of 11.62 percent; in late December, the money market interest rate fluctuated again, and on December 23, 7-day repo rate rose to 8.94 percent, hitting the new high in the second half of the year (Figure 6.1).

Figure 6.1 Interest rate movements on the interbank borrowing and repo markets in 2013



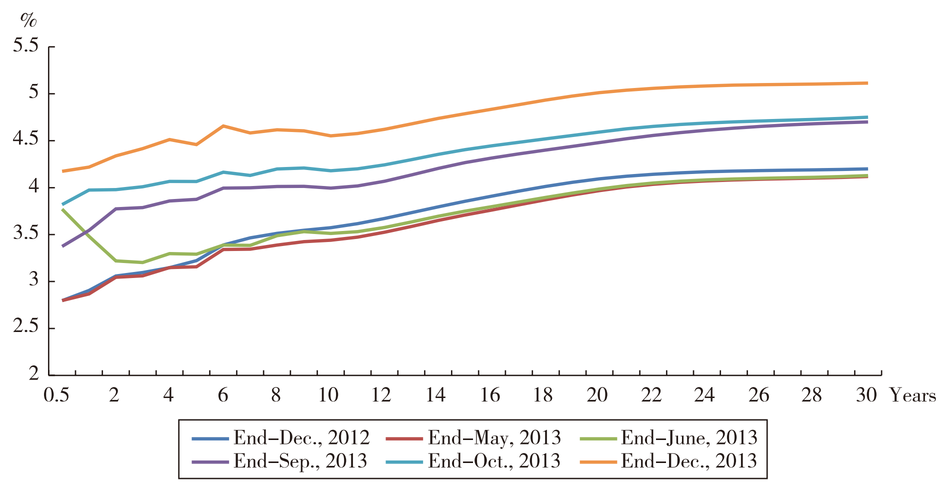
Source: National Interbank Funding Center.

2. Bond Market

The issuance amount continued expanding. In 2013, the accumulated issuance of RMB-nominated bonds totaled RMB 9.0 trillion yuan, increasing 12.5 percent y-o-y, in which the accumulated issuance of RMB-nominated bonds in interbank bond market totaled RMB 8.2 trillion yuan, increasing 9.9 percent y-o-y. By the year-end, the bonds deposited on the bond market totaled RMB 29.6 trillion yuan, of which RMB 27.7 trillion on the interbank market, increasing 10.7 percent y-o-y.

The trading volume decreased and the government bond yield curve shifted upwards. In 2013, the trading volume of cash bond in the interbank market totaled RMB 41.6 trillion yuan, down 44.7 percent y-o-y. Interbank market bond index dropped from 144.65 points at the beginning of the year to 143.93 points at the year-end, down 0.72 points or 0.49 percent y-o-y; exchange market government bond index rose from 135.84 points at the beginning of the year to 139.52 points at the year-end, up 3.68 points, nearly 2.7 percent. Compared with the end of last year, the interbank market government bond yield curve moved upwards with a flatting trend. At the end of December, the yield of 1-year, 3-year, 5-year, 7-year and 10-year government bond were 131, 132, 124, 112 and 98 basis points higher than the end of the last year, respectively.

Figure 6.2 The movement of government bond yield curve in 2013



Source: The PBC

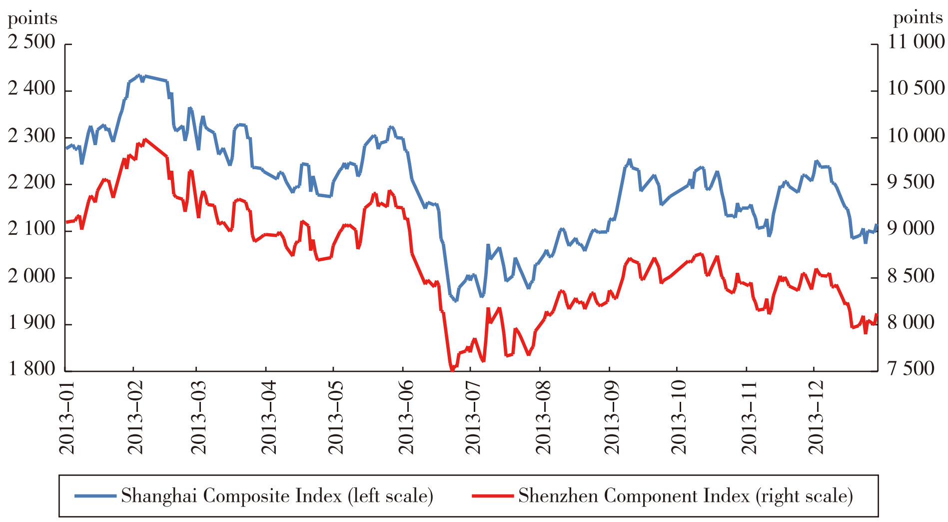
The market participants were diversified while the investor structure was optimized. By the end of 2013, there had been 4883 market participants on the interbank bond market, 6404 less than the end of last year. Among them, there were 1358 direct participants, 63 more than the last year; 3525 indirect participants, 6457 less than last year. The reduced institution are mainly non-financial institutions, 5992 less than last year. Currently the bond issuing institutions on the interbank bond market include the Ministry of

Finance, policy banks, Ministry of Railways, commercial banks, non-bank financial institutions, international development organizations and non-financial enterprises, etc. The multi-layered investor structure has been established, with the core being the market makers, the majority being the financial institutions and joint participation of other institutional investors. By the end of 2013, there had been already 138 foreign institutions, including foreign central banks, international financial institutions, sovereign wealth funds, Hong Kong and Macau clearing banks, foreign banks, foreign insurance institutions, RQFII and QFII, allowed for access to the interbank bond market. With the introduction of innovational products and improvement of infrastructure, the interbank market was enriched in market layers and enhanced in operation efficiency, and has already become the important investment and financing platform for market participants.

3. Stock market went down with fluctuations

In 2013, the stock markets of both Shanghai and Shenzhen exhibited an overall trend of downwards with fluctuations (Figure 6.3). The Shanghai Composite Index once hit the highest of 2444.80 on Feb. 18th, hit the lowest of 1849.65 points on Jun 25, then stabilized and closed at 2115.98 in the end of the year, down 6.75 percent y-o-y. The Shenzhen Component Index closed at 8121.79 points in the year end, down 10.91 percent y-o-y. The total domestic market value was RMB 23.90 trillion yuan; and the tradable market value was RMB 19.96 trillion yuan, rising 3.79 percent and 9.87 percent y-o-y, respectively. The daily average turnover of both markets in 2013 was RMB 196.945 billion yuan, increasing by RMB 67.452 billion yuan than last year.

Figure 6.3 The movements of Shanghai Composite Index and Shenzhen Component Index



Source: Wind data.

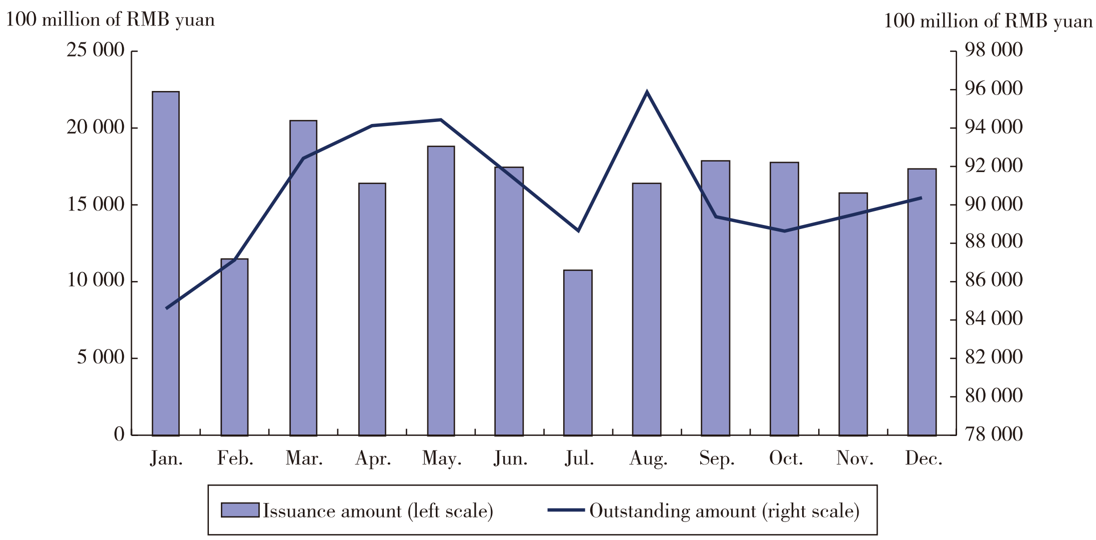
4. The RMB interest rate derivatives trading was less active.

There were 24409 transactions in RMB interest rate swap market in 2013, with nominal principal of RMB 2.7 trillion yuan, and a y-o-y drop of 6.01 percent. In terms of maturity, the trading of products with maturity no more than 1 year was most active, with nominal principal of RMB 2.1 trillion yuan and the proportion of 75.55 percent of the total. In terms of reference interest rate, the floating ends of RMB interest rate swap were mainly 7-day fixing repo rate and Shanghai Interbank Offered Rate (Shibor), and the nominal principal of interest rate swap trading linked with the above two rates accounted for 65.32 percent and 33.28 percent of the total nominal principal, respectively. In 2013, there was one forward interest rate agreement in total, with nominal principal of RMB 50 million yuan; one bond forward in total, with nominal principal of RMB101 million yuan.

5. The bill market trading was brisk

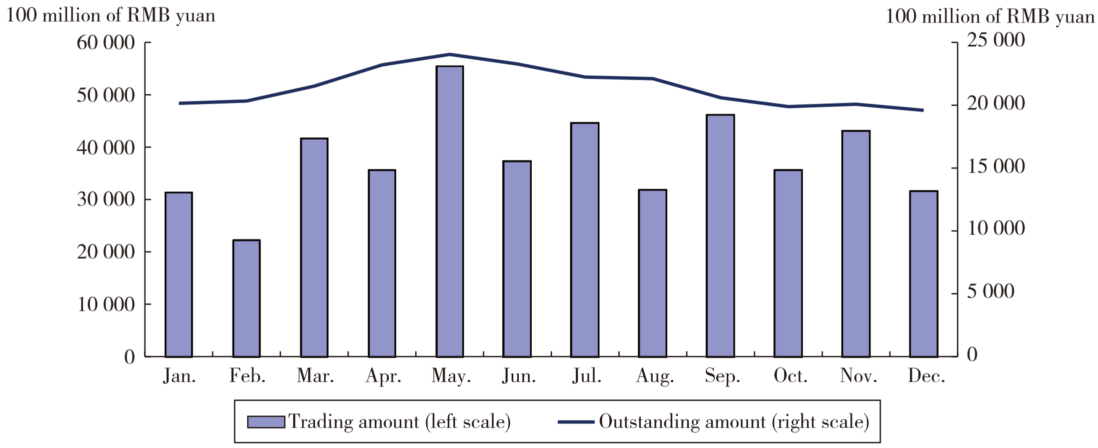
In 2013, the growth of bill acceptances lowed down, and the accumulated issuance of commercial bills totaled RMB 20.26 trillion yuan, increasing 13.3 percent y-o-y, down 5.51 percentage points (Figure 6.4). At the end of 2013, the outstanding balance of commercial bills totaled RMB 9.03 trillion yuan, increasing 8.29 percent y-o-y, down 17.08 percentage points. Bill financing traded briskly. In 2013, the cumulative amount of commercial bills discounted by financial institutions posted RMB 45.65 trillion yuan, a y-o-y growth of 44.2 percent (Figure 6.5); the year-end balance of discounted bills totaled RMB 1.95 trillion yuan, down 4.07 percent y-o-y.

Figure 6.4 The issuance of commercial bills in 2013



Source: The PBC.

Figure 6.5 The discount of commercial bills in 2013



Source: The PBC.

6. Gold price tumbled down

In 2013, the international gold price peaked at USD 1693.75 per ounce, bottomed at USD 1180.10 per ounce, and closed at USD 1201.50 per ounce at the year-end, dropping by USD 462.50 per ounce compared with last year or 27.80 percent. The domestic price kept the same pace with international price in overall movement. The price of AU9999 on the Shanghai Gold Exchange peaked at RMB 340.80 yuan per gram, bottomed at RMB 236.36 yuan per gram, and closed at RMB 236.46 yuan per gram, dropping by RMB 98.04 yuan per gram y-o-y or 29.30 percent. The annual weighted average price was RMB 278.60 yuan per gram, 17.76 percent lower than the average price of last year. The trading volume on the Shanghai Gold Exchange grew substantially and hit a record high. In 2013, the accumulated trading volume of gold was 11614.45 tons, increasing 82.90 percent y-o-y; the turnover was RMB 3.213trillion yuan, increasing 49.42 percent y- o-y.

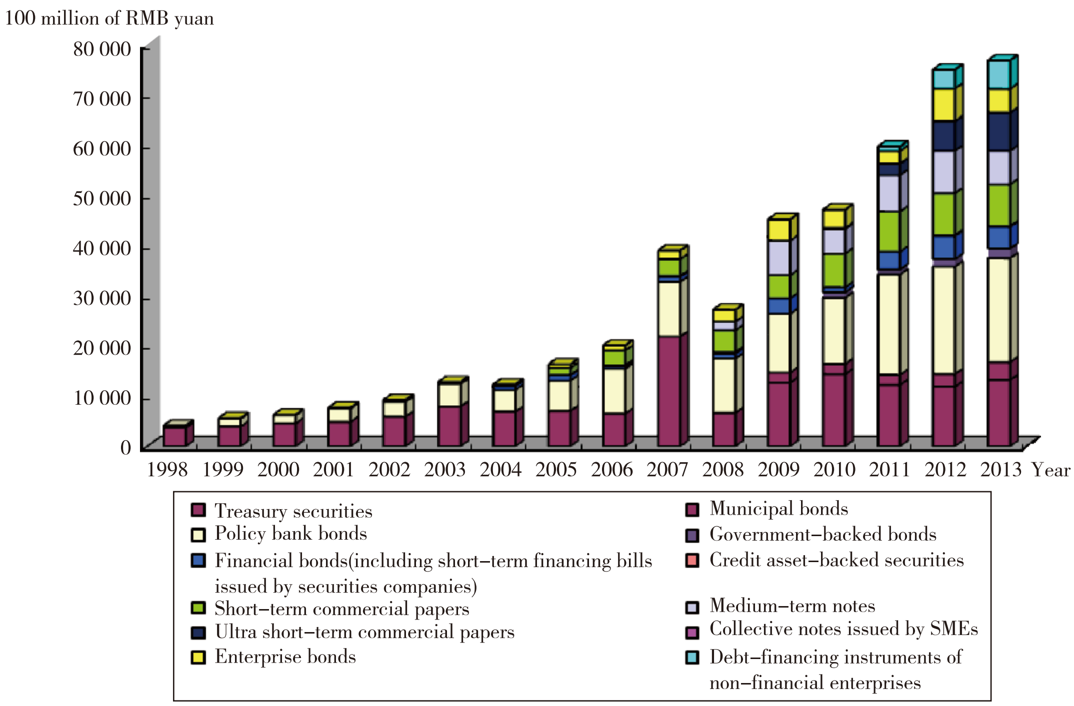
7. The foreign exchange market grew rapidly

The RMB exchange rate was strengthened in 2013, the central parity of RMB against USD rose with volatility, and hit the highest 6.0969 in the year end, with an annual increase of 3.1 percent. The trading on the RMB foreign exchange market was active. The annual turnover of interbank foreign exchange market was USD 7.6 trillion, up 25.4n percent, and the turnover of RMB foreign exchange market was USD 7.5 trillion, up 26.1 percent. The turnover of foreign currency pair transactions was USD 64.23 billion, down 25.1 percent y-o-y, among which the USD/Euro transactionsranked first in trading volume, accounting for 44.2 percent of the total, up 15.1 percentage points y-o-y. The number of participants on the foreign exchange market expanded further. The members on the spot market totaled 405, and the members were 88, 87, 80 and 33 on the forward, foreign exchange swap, currency swap and option markets, respectively. There were 31 market makers on the spot market and 27 market makers on the forward and swap markets.

II. Overview of Market Financing

The bond financing grew continuously. The accumulated issuance of RMB-nominated bonds (including central bank bills) was nearly RMB 9 trillion yuan, increasing 12.5 percent y-o-y. By the year-end, the outstanding balance of domestic bonds was nearly RMB 30 trillion yuan, rising 12.3 percent y-o-y. The pilot of government bond pre-issuance was launched to improve the efficiency of pricing of government bond issuance. The cross-market issuance of financial bonds further enhanced the interconnection and interaction between the exchange market and OTC market. The first batch of CDB's RMB 12 billion yuan financial bonds was successfully issued on the Shanghai Stock Exchange on December 27, 2013.

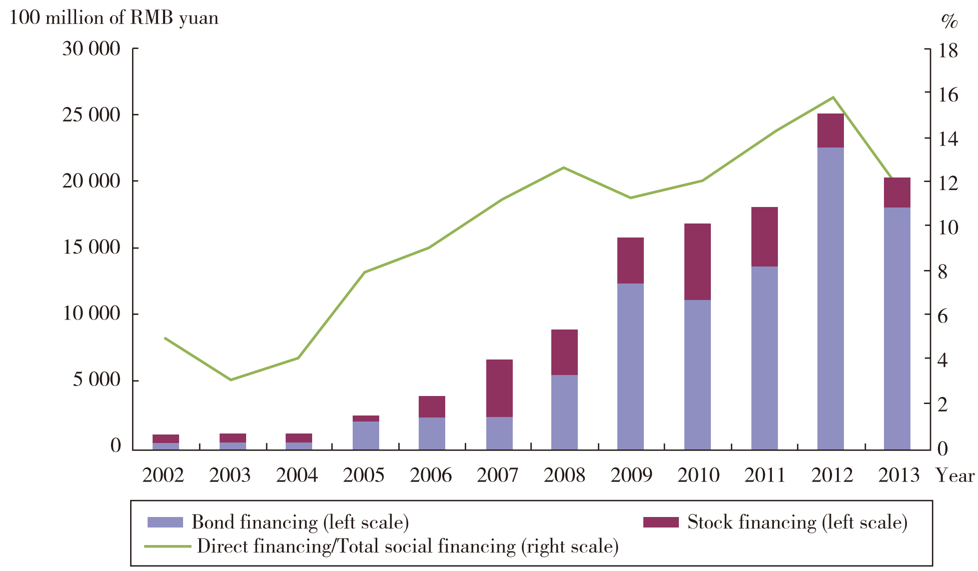
Figure 6.6 The issuance of major bonds on the interbank bond market in recent years



Source: China Central Depository and Clearing Corporation Limited, Shanghai Clearing House.

The stock financing declined slightly. In 2013, IPO on the A share market was paused, and domestic stock financing (in cash)totaled RMB 280.276 billion yuan, down 10.38 percent y-o-y, among which the financing through IPO was zero, financing through secondary offering totaled RMB 232.701 billion yuan, up 17.99 percent y-o-y, and financing through allotment totaled RMB 47.575 billion yuan, up 293.18 percenty-o-y.

Figure 6.7 The direct financing by non-financial enterprises and its proportion in the total social financing in 2002-2013



Source: The PBC.

III. Infrastructure Building

Further improving bond issuance mechanism and requirements. In September2013, the PBC further regulated the financial bonds issued to targeted investors, clarifying their definition and features, as well as the qualification requirements on subscribers, and supported the diversification of financial bond issuance. In December, the Shanghai Clearing House was allowed to put the bond bidding system online, providing bidding and issuance service for the bonds registered there. After the official launch of the system, the capacity of the bond bidding system in the interbank bond market would be expanded several times, so as to provide effective safeguards for encouraging bond bidding and issuance. The PBC jointly with the Ministry of Finance and CSRC issued the notice on carrying out a pre-issuance pilot of government bonds and promoted the 7-year government bonds as the first batch of pre-issuance pilot, improving the market pricing mechanism.

Regulating the interbank bond market. First, measures were taken to regulate transaction settlement in the interbank bond market, requiring that all transactions should be made through the system of National Interbank Funding System, and cannot be revocable and changeable. The National Interbank Funding System and the depository and clearing institution should improve the information verification mechanism and information exchange and sharing mechanism. Second, the interbank bond market DVP requirement was further strengthened to guard against market risk and enhance market efficiency.

Intensifying the opening-up of the interbank bond market. To broaden the investment channels of qualified foreign institutional investors and regulate their investment, the PBC issued the *Notice on Some Issues Relating to Investment by Qualified Foreign Institutional Investors in the Interbank Bond Market* in March 2013, allowing the qualified foreign institutional investors (QFII) holding the licenses issued by CSRC and investment quotas approved by the State Administration of Foreign Exchange (SAFE) to apply to PBC for entry into the interbank bond market.

Guiding and launching central clearing of RMB interest rate swaps. In December 2013, the PBC approved the Shanghai Clearing House to carry out the central clearing for RMB interest rate swaps, and issued the *Rules on Central Clearing for RMB Interest Rate Swaps*. The launch of central clearing for RMB interest rate swaps was beneficial for further activating market transactions and enhancing market efficiency, and also of positive significance for establishment of the overall central clearing framework for Chinese OTC financial derivatives as well as safe and efficient operation and sound development of the OTC financial derivatives market.

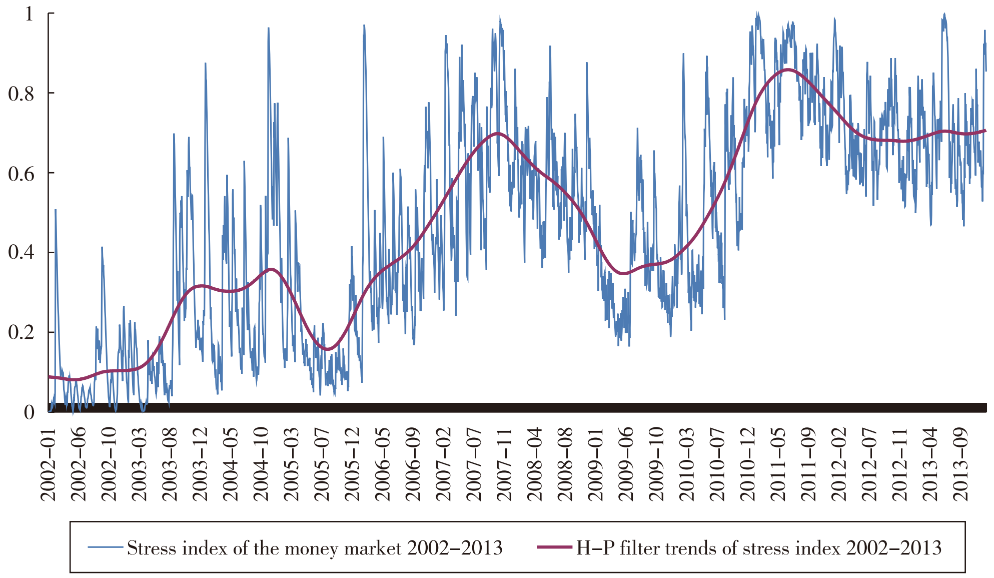
Developing the multi-layered capital market system. In June 2013, the State Council decided to expand the pilot scheme of National Equities Exchange and Quotations system For SMEs ("the New Third Board") to nationwide. In December, the State Council published the *Decisions on Issues Regarding the National Equities Exchange and Quotations System For SMEs*, setting out rules in terms of functional positioning of the New Third Board, establishment of the rotation system of different boards, simplification of administrative licensing system, investor appropriateness management and regulatory collaboration. Afterwards, the development of the New Third Board accelerated obviously. Its introductionwould help the capital market play a better role in supporting economic transformation and upgrading, representing the new progress made in development of a multi-layered capital market in China.

IV. Soundness Assessment

In 2013, the financial market operated smoothly, but the market volatility increased under the influence from both domestic and foreign complicated economic and financial situations.

The interest rate in the money market rose with volatility, while stress in the market remained relatively high. By the end of 2013, the overnight and 7-day pledged repo weighted average interest rates and 3-month Shibor interest rate were 3.2 percent, 5.4 percent and 5.56 percent, dropping 66 basis points, and rose 89 and 166 basis points, respectively. Annually, the money market interest rate showed a fluctuating upward trend, and was significantly influenced by the timing factors. The market stress kept high throughout the whole year, and hit the highest in the middle of June.

Figure 6.8 Money market stress index, 2002-2013



Source: Calculation based on Wind data.

Box 13 The Money Market Fluctuations in June 2013

Since 2013, China's banking system liquidity has been at a moderate level, and the money market has also operated smoothly. But affected by a series of factors, there was once significant fluctuations in the money market in June, and the weighted average interest rates of interbank borrowing and pledged repos were 6.58 percent and 6.82 percent, 366 and 381 basis points higher than May, respectively.

There were two direct factors for the fluctuations. First, the expectations for US QE policy tapering were significantly enhanced, which once resulted in changes of the global capital flow and international financial market fluctuations, and affected China's money market as well. Second, the temporal factors including tax payments by enterprises, holiday cash injection and reserve payments, combined with the emotional factors like market expectation changes led by pessimistic external noise for China. Analyzed at the deeper level, the upward trend in financial market interest rate was the result of the balancing between total liquidity and micro entities' capital demands. Currently, since the previous investment-driven growth mode has not changed, the industrial structure adjustment would occupy two sets of funds; meanwhile, some economic entities are not sensitive to interest rate because of soft budget restraints, and their funding demand is rather high. The commercial banks' strong expansion motivation, rapid expansion of interbank business and increasing maturity mismatches also increased the funding pressure.

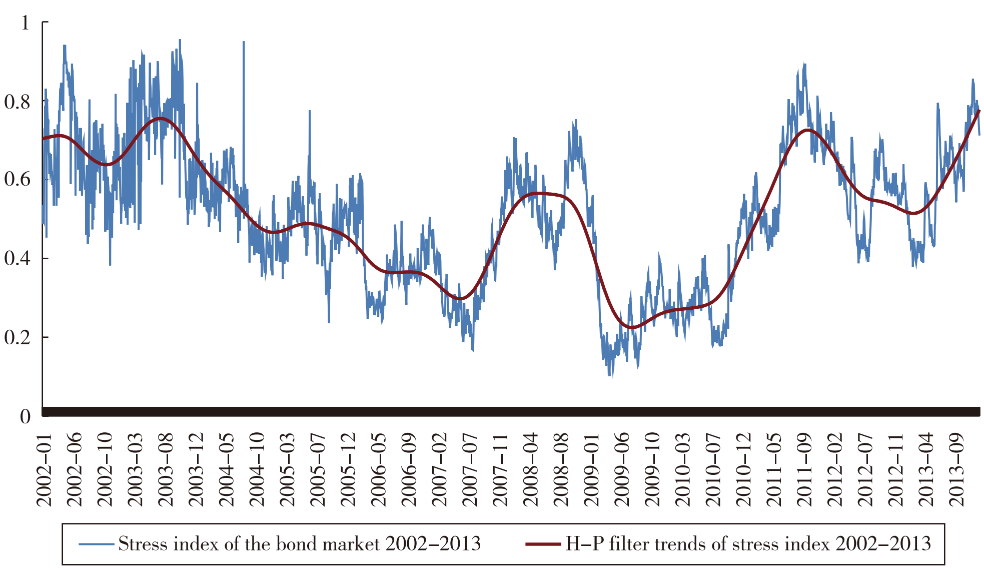
In short, the short-term interest rate fluctuations mainly reflected the influence from economic events, while the medium and long-term interest rate fluctuations would be connected more with fundamentals like economic growth, inflation, economic structure, etc., and also affected by the spillover of international environment. The interest rate liberalization reform might visualize some implicit or artificially low costs. As the price of funding, interest rates fluctuate with the change of economic situations and market demand and supply relationship, which is just a reflection of the decisive role which market played in resource allocation, and could facilitate the economic structure adjustment and transitional upgrading. The financial market fluctuations were also helpful to detect problems, and enable the market to self-modify and self-repair.

Confronting with the money market fluctuations, the PBC timely supplied liquidity support through open market operations and the Standing Lending Facility (SLF), and published the notice to enhance communication with the public, smoothing down the market interest rate. Since the second half of 2013, the PBC took a series of measures to keep moderate liquidity in the banking system and soundness of the money market. First, the PBC comprehensively implemented various liquidity instruments like open market operations, short-term liquidity adjustment tools, Standing Lending Facility, etc., to adjust liquidity in a timely and proper manner. In particular, the PBC intensified the short-term liquidity injection on some specific occasions like season end and cash injection peaks. Second, the PBC strengthened communication with market and financial institutions, conveyed the monetary policy intentions by various ways, and actively guided market expectations. Third, the PBC urged commercial banks to strengthen liquidity and asset-liability management, properly arrange the size and term structure of assets and liabilities, and effectively control the liquidity risk. Under the combined effect of a variety of liquidity management measures, the market kept a moderate liquidity level and operated soundly, which was not only conducive to promoting the moderate growth of money and credit aggregates, but providing a better liquidity environment for financial institutions to modify their asset and liability structure and reduce the maturity mismatch risk.

Influenced by the complicated internal and external environment as well as the seasonal changes of treasury money and cash injection, China's banking system liquidity would still be complex in the next stage. The PBC shall enhance the research on liquidity situation, make good use of various liquidity management tools, strengthen fine-tuning policy instruments in a forward-looking manner, control the total liquidity, carry out the sound monetary policy, and create a stable monetary environment for steady economic growth, deepening reform and structural adjustment.

The bond market stress index was rather high. During the whole year, the average bond market stress index was higher than 2012. By the year-end, first, the interest rate risk featured by the government bond yield saw a rise. The yield to maturity of 1-year, 5-year and 10-year fixed interest rate government bonds on the interbank market closed at 4.22 percent, 4.46 percent and 4.55 percent, up 130, 115 and 95 basis points respectively than last year. Second, the spread between 1-year and 10-year government bond yield was 33 basis points, 35 basis points lower than the beginning of the year. Third, corporate credit bond yield went upward. In the interbank market, the yield of 1-year and 5-year AA grade medium-term notes were 7.06 percent and 7.45 percent, up 213 and 155 basis points higher than the beginning of 2013, respectively ; the spread between 1-year, 5-year AA grade medium-term notes and government bonds were 284 and 299 basis points, 86 and 37 basis points higher than the beginning of 2013, respectively, which showed a rise in credit risk.

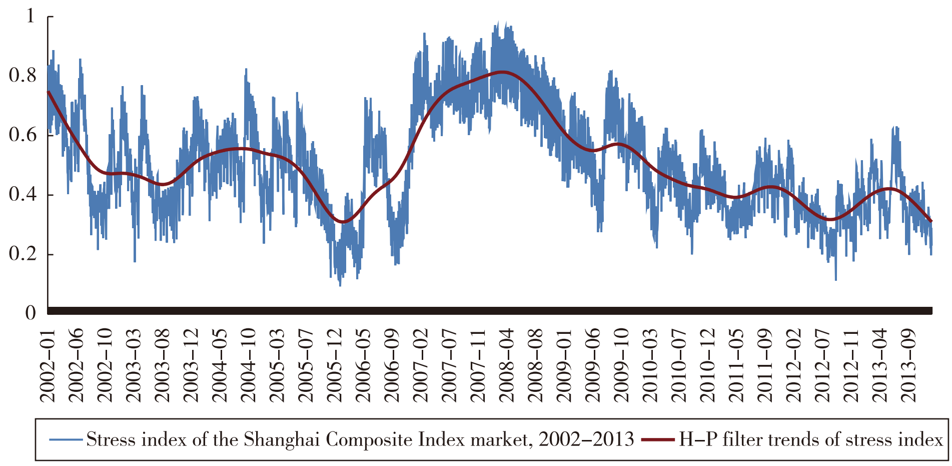
Figure 6.9 Stress index of the bond market, 2002-2013



Source: Calculation based on Wind data.

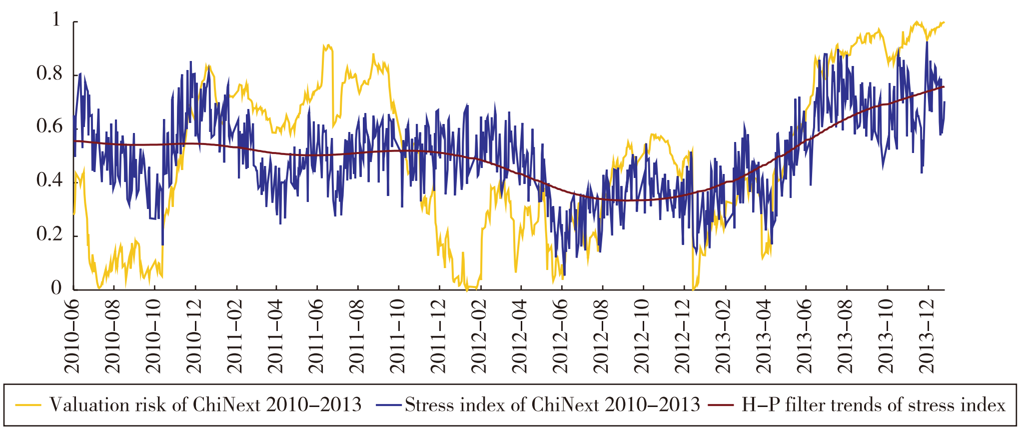
The large-cap and blue-chip stock market was in soundness; while the stress in the ChiNext market rose to a relatively high level. The large-cap and blue-chip stock market differentiated significantly with the SME board and ChiNext market. By the end of 2013, the overall rolling PriceEarnings ratios (P/E ratios) of AB shares, SHSZ 300 shares, SME board and ChiNext were 13.99, 9.55, 36.73 and 60.3, dropping 8.32 percent, 19.48 percent and rising 29.79 percent, 74.03 percent y-o-y respectively; the price to book ratios (P/B ratios) of AB shares, SHSZ 300 shares, SME board and ChiNextwere 1.84, 1.48, 3.35 and 4.55, dropping 8.91 percent, 20 percent and rising 13.45 percent, 47.25 percent y-o-y, respectively. The market valuation of Shanghai Composite Index was at the historical low level, and of higher volatility and overall robust operation, and the stress index was at a relatively moderate level, equivalent with the last year, which rose shortly in the middle of the year and then declined. The ChiNext valuation risk rose rapidly, and the volatility and market stress index also rose.

Figure 6.10 Shanghai Composite Index market stress index, 2002-2013



Source: Calculation based on Wind data.

Figure 6.11 The valuation risk and stress index of ChiNext, 2010-2013



Source: Calculation based on Wind data.

Box 14 Treat the "T+0" Trading Prudently

The so-called "T+0" trading in China refers to the trading mechanism of selling the shares bought on the same day. In the history of Chinese stock market, "T+0" was once applied in the Shanghai A share market during 1992-1995, the B share market before 2001 and the warrants market after 2005, etc. But due to the speculation brought by "T+0" trading and the correspondingly exacerbated stock price volatility, "T+0" trading was called off. Currently "T+0" trading has not yet been applied in A share market.

Recently, some people argue that the subscribers of Exchange-Traded Funds (ETFs) are allowed to sell the fund shares on the same day of purchase, and could thereby achieve de facto "T+0". Since there is minimum quota requirement in ETF purchase (generally 1 million units), the small and medium-sized investors could not hedge the risk by intra-day trading through "T+0" as institutional or large investors do, thus cannot evade risks by selling the shares in a timely manner after the blind purchase. Therefore, these people believe that "T+0" tradingshould be put in place steadily from the perspective of protecting small and medium-sized investors and maintaining market fairness.

Seemingly "T+0" trading could indeed help investors adjust their investment strategies according to market changes and fix the income or avoid further loss; also it could activate the market, and increase the commission income of securities companies. However, there are some potential risks that merit attentions.

First, "T+0" trading might induce settlement risk. On one hand, the dealing could be frequent since securities can be sold and bought several times on the same day. On the other hand, there is certain time lag (usually more than 1 day) in the process of securities clearing and settlement. After buying securities, the investors can only sell on the same day securities receivable which are not in their accounts yet. Therefore, "T+0" trading essentially turns out to be credit trading. Driven by pursuit of large trading volume and more commission fees, securities companies might allow investors to make large amount of overdraft. In case the risk goes out of control and results in delivery default, the securities settlement system might be in danger.

Second, "T+0" trading might exacerbate the market fluctuations. "T+0" trading might encourage investors to trade more frequently, the same batch of funds can be flowing in and out several times on the same day, which could inflate the money supply while increasing the market trading volume, fuel the securities price fluctuations, and exacerbate the market volatility.

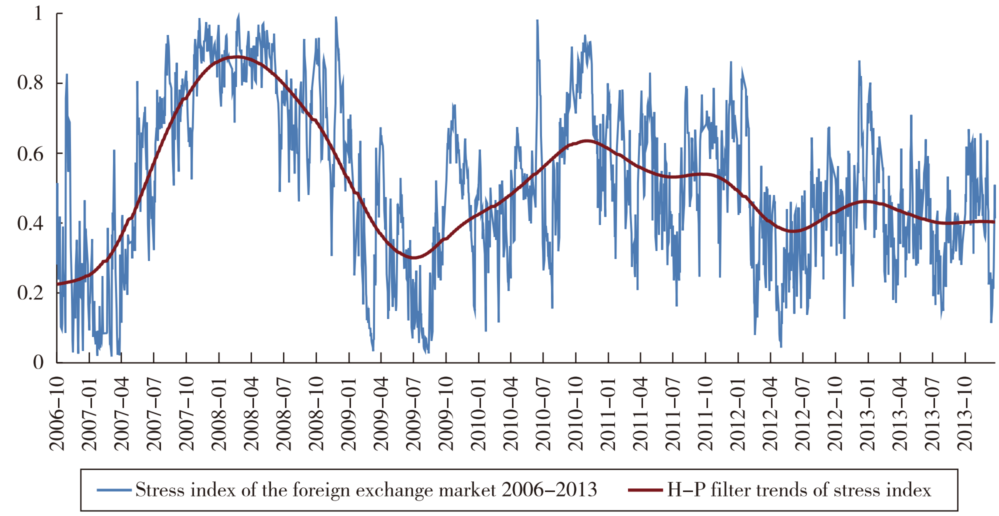
Third, "T+0"might increase the risk of market manipulation. "T+0" trading might facilitate the illegal behaviors like insider trading, market manipulation, etc. For example, investors with fund advantage might sell shares just after pulling up the price, and large investors who manipulate the market could leverage by buying several times more shares than their affordable amount, or make fake transactions by conspiracy in frequent mutual trading, to induce small investors to follow them. These behaviors make it harder to regulate and supervise the market, and call for a higher capability for securities regulation.

Drawing from the international experiences, due to the potential risks, "T+0" trading can only be applied when certain preconditions, like investor maturity and securities regulatory level, have been met. Otherwise, there might emerge risks. The application process of "T+0" trading in certain emerging markets is similar to that of the A share market. In Taiwan, China "T+0" trading was once allowed before 1985, but was banned in July, 1985 due to huge risks. Until 1994 when relevant conditions and the environment are mature, it was gradually introduced. In the advanced markets like U.S., although "T+0" trading is allowed, there are still some relatively high access thresholds to keep incapable investors away from such kind of credit trading as well as keep the securities companies and even the settlement system away from the risk resulted from huge loss brought by over-frequent trading. There are also corresponding measures in terms of daily supervision and ex-post punishment for the behavior of over-frequent trading which might impact the market or harm other investors.

After years of development, China's stock market has achieved remarkable progress, but in overall, it's still in a stage of "emerging and transitional". Therefore, it still needs comprehensive research and prudential treatment to decide whether the "T+0" trading could be applied in A share market currently.

RMB appreciated slightly against USD, and the foreign exchange market stress was at a moderate level. By the year-end, the bidding price of USD against RMB was RMB 6.0543 per dollar in on-shore market, and RMB 6.0568 per dollar in Hong Kong market, dropping 176 and 167 basis points y-o-y, respectively. RMB appreciated by 2.82 percent (on-shore market) and 2.69 percent (Hong Kong market) respectively; and the forward premium of 1-year USD against RMB in on-shore market and Hong Kong market were 450 and 470 basis points, dropping 885 and 930 basis points y-o-y, respectively. The expectation on RMB appreciation was weakened.

Figure 6.12 Stress index of the foreign exchange rate market, 2006-2013



Source: Calculation based on Wind data.

V. Outlook

In accordance with the request of the Third Plenary Session of the the 18th CPC Central Committee, we shall build a unified, open, competitive and orderly market system, to make the market play a decisive role in allocating resources. Further measures should be made to establish and improve a multi-layered capital market system, intensify direct financing, encourage financial innovation, and enrich the layers and products of financial markets.

Develop and regulate the bond market. Continue to regulate the development of the interbank market, enlarge the bond issuance amount, further improve bond issuance pricing mechanism, promote bond product innovation and diversification, improve the information disclosure standards in bond market, strengthen market discipline and risk sharing mechanism, further enhance market transparency, steadily push forward the opening-up of bond market, make the ministerial coordination mechanism of corporate credit bonds work well, promote regulatory coordination, and reinforce the market infrastructures.

Continue to improve the stock market. Further make the main board market stronger by enriching the products and layers, completing trading mechanism and reducing trading costs. Properly reduce the threshold of financial standards for access to the ChiNext, establish refinancing mechanism, and allow the listing in ChiNext of the internet and innovative technical companies which have no positive profits yet but meet certain conditions. Accelerate the setting-up of the National Equities Exchange and Quotations system for SMEs, broaden the channels for private investments, and ease the financing difficulties of small and micro enterprises. Integrate qualified regional equity share transfer markets into the multi-layered capital market system. Develop the OTC market for brokerage, gradually establish the brokers' network or coalition, and carry out a variety of OTC transactions and business. Simultaneously, establish a sound rotation system of different boards, and reform, improve and strictly implement the delisting mechanism.

Regulate the development of private placement market. Encourage the development of private equity funds and venture capital funds, supply equity financing for innovative SMEs at different life stages, and achieve innovation support, M&A promotion and employment improvement. Implement moderate regulation and industrial self-regulation, establish the investor appropriateness management system, standardize funding and marketing campaign, and crack down on illegal fund-raising activities.

Steadily develop the money, derivatives, foreign exchange and gold markets. Encourage instruments innovation in the money market, and enhance their liquidity management function. Further improve commodity futures and financial derivatives market, improve price formation mechanism, introduce advanced financial futures derivatives and improve OTC derivatives market system to meet the diversified needs of risk management from financial institutions, wealth management from households and regional economic development. Strengthen institutional arrangement and infrastructures in the foreign exchange market, further promote RMB exchange rate formation mechanism, and push forward the innovation of exchange rate risk management tools. Continue to enrich participants in the gold market, encourage product innovation, strengthen monitoring, early warning and risk prevention, and promote the steady and sound development of the market.

Box 15 Accelerate the Setting-up of the Multi-layered Capital Market System

The Third Plenary Session of the 18th CPC Central Committee pointed out clearly that we must "promote the multi-layered capital market system, push forward the registration reform of the new share offering system, and promote equity financing through various channels". The continuous improvement of the main board, SME board and ChiNext, acceleration of national OTC market building, as well as promotion of equity financing at various levels and through various channels, are of great significance for better serving the real economy growth, and promoting the economic structural adjustment and industrial transformation and upgrading.

Deeply understand the connotation of the multi-layered capital market system. Capital market should serve the real economy. The enterprises of different types and at different development stages differentiate greatly from each other, thus their investment and financing demands are diversified, which calls for a differentiated design in issuance, trading and regulation in the capital market. Therefore, the construction of a multi-layered capital market system need to keep two key elements in mind: first, the multi-layered capital market is a dynamic concept instead of a static one, whose core is to serve the real economy; second, the multi-layered feature of the capital market is derived from the multi-layered and diversified nature of real economy, and the fundamental precondition of capital market construction should be the need of real economy.

Continue to improve the main board, SME board and ChiNext construction. The Third Plenary Session of the 18th CPC Central Committee clarified the orientation of registration regime reform of the new share offering system, which is an essential step to improve the main board, SME board and ChiNext construction. The registration regime reform requires that the regulation of new share offering should take full information disclosure as the core, reduce the securities supervisor's substantial review and value judgment of issuers' qualification, lessen administrative approval, lower stock issuance cost, and enhance financing efficiency. Meanwhile, the delisting regime for listed companies should be further improved, to enhance the quality of listed companies by survival of the fittest. The crackdown on illegal behaviors including false statement, market manipulation and insider trading, etc., should be intensified to strengthen market discipline and integrity constraint for market participants including listed companies and intermediaries, promote the market participants to take their own responsibility, faithfully protect investors' interests, and maintain the fairness, justice and openness of the securities market.

Continue to develop the OTC market. The OTC market includes national OTC market and regional equity share transfer markets. China is a country with a vast territory and great regional differences, and a large number of SMEs have diversified demands, which makes it necessary for developing the multi-layered OTC market system. Besides national OTC market, the regional equity transfer markets would be helpful to mobilize the enthusiasm of both central and local governments, and inspire the reforming impetus of the grassroots. In December 2013, the State Council published the Decisions on Issues Regarding National Equities Exchange and Quotations System for SMEs, making a breakthrough in national OTC market construction. The next step would be incorporating the regional equity transfer markets into the multi-layered capital market system on the basis of rectifications of various trading venues, giving full play to the regional equity transfer markets in capital formation and equity circulation, actively developing and regulating regional equity transfer markets, and under the unified rules, allowing the regional equity transfer markets to have differentiated institutional arrangements commensurate with local circumstances, so as to provide differentiated services for companies of different size and types and at different development stages.

Chapter VII

Financial Infrastructure

In 2013, China continued to develop its financial infrastructure, with major achievements in the building of payment system, gradually upgraded financial laws and regulations, further improved accounting rules and standards, breakthroughs in the development of credit information system and social credit system, increased effectiveness of anti-money laundering, and generally enhanced financial services and management. All of those contributed to the stable performance of the financial system.

I. Payment, clearing and settlement system

1. Institutional building funther enhanced

The institutional set-up made new progress. First, the *Administrative Rules for Bankcard Acquiring Business* was published which laid the basis for the supervisory system on bankcard acquiring business; second, the *Measures for the Custody of Clients' Reserves of Payment Institutions* was issued to carry out an across-the-board regulation over deposit, gathering, use, transfer and other custodian activities of clients' reserves; third, the *Rules on Bill Printing* was released to specify various links in the printing process, including change of plate, plate making, order, shipment, detection of counterfeit bills and regulatory and management responsibilities; fourth, the prevailing RMB bank account management rules underwent a major reform, and the *Administrative Rules on RMB Bank Settlement Accounts* and its detailed implementation rules were drafted. Besides, researches were made on the design of market access rules for bankcard clearing business, and efforts were dedicated to facilitate work on administrative permission and approval of bankcard clearing institutions. And in order to implement the dispute settlement by WTO on the case of China's electronic payment raised by the United States, some case-related measures were abolished or amended.

Financial infrastructure performed soundly. In 2013, the function of financial infrastructure including payment system, securities settlement system, central counterparty and transaction database was further enhanced. Those systems have been processing an increasingly large amount of transactions, and the management and operation of such systems have been further improved. First, the launch of the 2nd generation of National Advanced Payment System and pilot programs for the Accounting Data Centralized System went smoothly. Second, various payment systems nationwide performed soundly, and the transactions processed by those systems increased rapidly. The total volume and value of payment transactions processed by the above-mentioned payment systems stood at 23.58 billion and RMB 2939.57 trillion yuan, increasing by 23.38 percent and 17.19 percent y-o-y respectively. Third, clearing agencies including China Union Pay, clearing centers of city commercial banks and rural credit banks processed a greater variety and larger size of business. The interbank payment system of China Union Pay successfully processed 15.12 billion transactions[①], involving a total value of RMB 32.3 trillion yuan, an increase of 21.3 percent and 48.4 percent compared with last year. The volume and value of transactions processed by the payment and clearing system of rural credit banks stood at 121 million and RMB 2.46 trillion yuan, up 40.23 percent and 22.55 percent respectively from last year. Fourth, transaction systems of China Government Securities Depository Trust and Clearing Co., Ltd, Shanghai Clearing House and China Securities Depository and Clearing Company delivered sound performance, with a rapid growth in the value of securities depository trust and clearing transactions. The total value of securities deposited posted RMB 29.48 trillion yuan, up 13.39 percent y-o-y, indicating a steady growth. The systems cleared a total of RMB 270.82 trillion yuan of cash bond and repo transactions in 2013, up 1.15 percent y-o-y. However, the growth slowed by 31.52 percent compared with year 2012, indicating reduced trading activities. Fifth, the central counterparty clearing business through Shanghai Clearing House has expanded to cover 56 members for net-clearing of cash bond transactions, 249 members for clearing of FX anonymous transactions and 26 members for clearing of FX bilateral transactions. And the preparation for centralized clearing of RMB interest rate swaps was successfully completed. Sixth, management of interbank trading data was further enhanced. Data from the interbank database of China Foreign Exchange Trading System was becoming more indicative and accurate, and the database could now cover a wider range of information from both RMB and foreign exchange markets.

Box 16 Successfuly Launch the Second Generation of National Advanced Payment System

To meet the growing demand for diversified interbank payment methods by banking institutions, financial markets, corporations, public sector institutions and the general public, adapt to commercial banks’ changeing business and management model, and follow the life cycle of information system, since 2009, great efforts have been made to steadily develop the second-generation of payment system based on various functions of the current system, including: introducing cutting-edge payment concepts and technologies, expanding the functions of the system, improving clearing efficiency, enlarging service categories, enhancing operational

① Including bankcard deposits, cash withdrawal, consumption, transfer and inquiry through traditional channels such as ATM, POS terminals and mobile POS terminals, and emerging channels such as telephone and internet.

control, and upgrading disaster recovery system. With careful planning, hard work and tireless efforts by the People's Bank of China (PBC), banking institutions and relevant organizations, the second-generation of payment system was successfully launched in October 2013.

The design of the second-generation payment system takes full consideration of the prevailing condition of China's payment system and draws experiences from advanced international practices. Major upgrades are reflected in:

First, a commercial bank could access the system from one entry point as one legal person. Payments made by its headquarter and branches could now be processed through a single account. Under the first-generation payment system, branches of commercial banks have to open accounts at provincial levels to get access to the payment system. In contrast, commercial banks could realize higher business efficiency, face with less liquidity requirement and make a better utilization of capital with the second-generation payment system. It also allows the cash management department in a commercial bank's headquarter to conveniently monitor the liquidity conditions of the entire bank and flexibly make adjustments.

Second, the system features more liquidity management functions. Liquidity risk is the major risk faced by the payment system. Failure of in-time payment by one institution might ripple through the system and impede the payment capacity of another institution. The second-generation payment system is equipped with many new functions like large-value payment queuing matching, "capital pool" management, "one-stop" real time inquiry of liquidity condition and so on. All those new functions will improve the efficiency of clearing.

Third, the system supports interbank process of online payment. Within ten minutes after an interbank transfer through online banking or an ATM, a client could check the settlement condition of this transfer. Thus, the second-generation payment system helps to improve the online payment experience of a client and facilitates the development of e-commerce.

Fourth, operational maintenance of the system is more efficient. With tremendously enhanced risk-alert capacity and more efficient monitoring, the second-generation system is safer and more stable.

Fifth, the system has enhanced backup features. The backup and recovery structure of the second-generation is composed of the generation center, long-distance backup center and local data center, which ensures continuous processing of payment and intactness of data during emergencies.

Sixth, the system uses international

standards for financial messages. The second-generation system implements the internationally accepted ISO 20022 message format, enabling the connection between different systems. For example, the second-generation payment system will be connected with relevant foreign exchange payment systems to realize payment-versus-payment (PVP) settlement in RMB and foreign exchange transactions, so as to facilitate the settlement efficiency and prevent settlement risks in such transactions.

Non-cash payment instruments underwent flouring development. Wide application of information technologies in retail payment leads to rapid innovations in this area. As a result, payment and settlement efficiency have been remarkably boosted and cost has been reduced, providing more convenience for the general public. In 2013, the volume of transactions processed by non-cash payment instruments continued to grow. The volume and value of payment transactions processed by means of non-cash payment instruments nationwide reached 50.158 billion and RMB 1607. 56 trillion yuan, up 21.92 percent and 24.97 percent y-o-y respectively. The ratio of M_0 in GDP in domestic China dropped all the way from 12.8 percent in 2006 to 10.3 percent in 2013. By the end of the year, the cumulative bankcard issuance in China registered 4.214 billion, increasing by 19.23 percent y-o-y. Among the total, 593 million was financial IC cards. The penetration rate of bankcards reached 47.45 percent. In terms of credit cards, the outstanding amount payable at the end of the period was RMB 1.84 trillion yuan, up 61.8 percent y-o-y. Electronic payment including online payment, telephone payment and mobile payment developed very fast. In particular, the volum and value of online payment registered 23.674 billion and RMB 1060.78 trillion yuan, a y-o-y increase of 23.06 percent and 28.89 percent respectively. The coverage and size of mobile payment pilot program in rural areas continued to grow. Some bank branches at provincial or city level provide mobile cash withdrawal service.

Supervision and management were further improved. First, the supervision and management framework over the payment system was reinforced. The *Provisions on Payment and Settlement Inspection Procedures*, and the *Administrative Measures on Rural Credit Banks Funds Clearing Center* and the *Manual for Onsite Inspection of the Payment and Settlement by Banking Institutions* were published to clarify the supervisory and management rules and procedures. Second, supervision and management over payment institutions were strengthened. By end-2013, a total number of 250 institutions acquired payment licenses. The combination of onsite inspections and offsite supervisory working mechanisms composed of important issues reporting and annual supervisory reporting helped to foster risk control and compliance awareness in payment institutions. Third, nationwide enforcement inspections on bankcard acquiring business and on the banking accounts of budget units were carried out. Management rules on bankcard acquiring business and custody of clients' reserves by payment institutions were reinforced. Fourth, authenticity of users' personal information of all existing bank accounts was verified, which contributed to the implementation of the real-name bank account system.

The *Principles for Financial Market Infrastructure* was implemented. In April 2012, the Committee on Payment and Settlement Systems (CPSS) and the International Orgnization of Securities Commissions (IOSCO) jointly released the *Principles on Financial Market Infrastructure* (referred to as the Principles hereinafter), which comprehensively enhanced the supervision and risk management of financial market infrastructure. In 2013, CPSS and IOSCO carried out first Level 1 assessment[①] and planned for another in 2014 to evaluate whether members meet the requirements of Level 1 assessment. As a member, China has committed to implement the *Principles*. In May and August 2013, the PBC and CSRC respectively issued the *Notice on Relevant Matters Concerning Implementing the Principles for Financial Market Infrastructures*, to elaborate on China's implementation plan. In December 2013, the PBC and CSRC jointed published the *Notice on Carrying out Assessment of Financial Market Infrastructure*, making unified arrangements for self-assessment and external assessment of the financial market infrastructure in China.

Payment environment in rural areas improved remarkably. In recent years, payment services and environment in rural areas have been improved. Agricultural subsidies are paid directly to individual households, payment channels have been expanded, special bankcard services for farmers have been launched, and retail payment services to help farmers have been promoted. All those measures facilitate the coordinative development of financial services in both urban and rural areas and the comprehensive development of payment business. By the end of 2013, the volume of cash withdrawal transactions under the migrant worker bankcard project exceeded 14 million, generating a transaction value of RMB 21 billion yuan. Meanwhile, financial institutions operating in rural areas were encouraged to do all kinds of transactions via the payment system based on their conditions and business needs. By end-2013, more than 80 thousand rural financial institutions and their branches have gain access to the payment system of the PBC, which greatly facilitated the channels for fund transfers in rural areas.

Cross-border exchange and cooperation were further deepened. By taking an active part in

① There are three levels of assessment. Level 1 assessment investigates whether members have established regulatory framework in the implementation of the Principles; level 2 assessment investigates whether the regulatory framework is complete and in line with relevant principles; level 3 assessment investigates whether the regulatory authorities and financial market infrastructure satisfy the requirements of the Principles.

international organizations such as the CPSS, the Working Group on Payment and Settlement Systems under the Executives' Meeting of East Asia-Pacific Central Banks (EMEAP-WGPSS), the South East Asian Central Banks (SEACEN), and ASEAN+3, the PBC continued to increase its international presence in the payment industry, enhance its cooperation with members of those organizations in the area of payment, clearing and settlement, and gain more say over regional payment and settlement matters. In order to boost international communication, the PBC also improved the mechanism for cooperating with other central banks and published the *China Payment System Development Report*.

2. Prospect for development

In the next step, in line with the *Guiding Opinion to the Development of China's Payment System (2011-2015)*, the PBC will coordinate the development of the payment, clearing and settlement systems, and enhance the safety and efficiency of the financial market infrastructure and retail payment market. First, efforts will be made to maintain the safe and stable operation of the payment system. Second, continued efforts will be made to promote and standardize the use of non-cash payment instruments. To avoid restraining market participants' innovation, supervisory focus will gradually switch from transaction methods and media towards risk control and settlement and clearing of non-cash payment instruments. Third, the PBC will reinforce supervision and management of the payment service market. Fourth, the PBC will accelerate the implementation of the *Principles for Financial Market Infrastructure* and put in place the risk management of financial market infrastructure. Fifth, according to the guidelines of the 18th National Congress of the CPC to strengthen agriculture, benefit farmers, and enrich rural areas and to integrate urban and rural development, the PBC will gradually build a multi-layer, low-cost and sustainable rural payment service system, which will serve as a sound base for the integration of financial services in both urban and rural areas. Sixth, the PBC will continue to deepen international exchange and cooperation on payment system.

Box 17 Bitcoin

Since its inception in 2009, Bitcoin has been developing rampantly. Price for one Bitcoin soared from only USD 13 at the beginning of 2013 to USD 100 in April and to the all-round peak of more than USD 1 000 in December. Fast growth of Bitcoin triggered discussion about whether virtual currency is true money. Some believes Bitcoin posts a large challenge towards the prevailing money system, and some even calls it future gold.

Judging by its nature, Bitcoin is not true money. First, not backed by state credit, Bitcoin is not a legal tender and there is no decree to be honored for it. The circulation of Bitcoin is limited and unstable, making it unsuitable as means of payment. Second, there is a ceiling for the total number of coins in existence, which means bitcoin cannot grow in line with the economy. If Bitcoin becomes real money, it might lead to deflation and hinder economic development. Third, the lack of a centralized adjustment mechanism makes Bitcoin prone to speculation and high price volatility. Thus, it is disqualified for a unit of account and a medium of exchange. Currently, most goods that accept Bitcoin as a means of payment are still denominated in their domestic currencies. Fourth, Bitcoin is highly substitutable, and it is difficult for Bitcoin to serve as a general equivalence. Any digital "currency" in line with P2P protocols with its own mining algorithm, limited quantity and no central authority could replace Bitcoin. Nowadays, Bitcoin is used more as a speculation instrument than a payment instrument in real economy. Those who own Bitcoins are more willing to collect them than to trade them for other merchandises.

The general public does not have adequate knowledge of Bitcoins. Holding, using and trading of Bitcoins purely out of speculation purpose might bring about the following risks. First, online trading platform, process and rules of Bitcoins are not protected by regulations or laws, resulting in the possibility of price manipulation and fraud. Besides, there are also concerns for the safety of fund in the account, settlement and clearing of Bitcoins' trading. Second, because the price of Bitcoins is not backed by true value, the movement of the price depends mainly on holders' confidence and expectation, or even on the assumption that Bitcoin might become a "universal currency". Consequently, they are likely to become targets for speculation. Any sign of changes in the market or in policies might make the bubble burst. Third, Bitcoin transactions are highly concealed, anonymous and have no territorial restraints. Therefore, it is very difficult to monitor the flow of funds in such transactions, which might be taken advantages of by criminals in drug and gun deals and money-laundering.

In December 2013, the PBC and another four government authorities in China released the *Notice on the Prevention of Risks Associated with Bitcoin*, requiring that financial and payment institutions should not conduct business associated with Bitcoin; internet websites providing bitcoin-related services such as registration and transaction should record with the telecommunications regulatory agencies and be sure to fulfill anti-money laundering obligations, identify users, and promptly report suspicious transactions; relevant agencies, financial institutions and payment institutions should help disseminate knowledge of currency and guide the general public to establish a proper understanding of the concept of currency and practise rational investment.

II. Legal Environment

1. The legal system governing the financial sector further improved

In 2013, China speeded up reform of the administrative approval system and the transformation of government functions. Relevant laws and regulations were stipulated or amended and some administrative approvals were handed down to government departments at lower levels, so as to promote market innovation and internal impetus for economic growth.

Laws and regulations were amended and legal system was improved. The Standing Committee of the National People's Congress revised the *Securities Law of the People's Republic of China*, relaxing restrictions on securities companies' adjustment of registered capital or changing the form of corporations; the *Company Law of the People's Republic of China* was amended, allowing entrepreneurs to register their companies by agreeing upon registered capital instead of actual contributions, loosening conditions for capital registration and simplifying the registration items and documents. The State Council released the revised version of the *Administrative Regulations of the People's Republic of China on Foreign-funded Insurance Companies*. According to the regulation, foreign-invested insurance companies could make capital contributions by using RMB-denominated income for opening insurance companies jointly operated or wholly owned by foreign insurance companies. Revisions were made to the *Measures for the Reporting of Statistics on Balance of International Payments*, which changed the statistics coverage, reporting persons, reporting contents, etc. Amendments were also made to the Administrative Regulations on Futures Trading, abolishing the requirement to verify the types of commodities in overseas futures trading by entities or individuals in China.

More judicial interpretations were released and financial judicial system was improved. The Supreme People's Court published the *Interpretation on Several Issues Concerning Application of the Insurance Law of the People's Republic of China II*, which standardized the insurance coverage of insurance companies, specified the insurers' duty to remind applicants of and explicitly explain the insurance clauses, regulated the interpretation of the content of insurance contracts and defined the inception of insurance liability. The *Official Reply of the Supreme People's Court on Issues Concerning Application of Laws in the Trial of Cases Involving Disputes over Export Credit Insurance Contracts* was enacted to clarify the application of laws to export credit insurance contracts. The Supreme Court also promulgated the *Provisions on the Network Inquiry and Freeze of the Deposits of the Persons Subject to Enforcement*, regulating activities of people's courts in making network inquiries and freezing deposits and other assets of the persons subject to law enforcement.

Regulatory provisions and measures were made to keep market order. The PBC released regulatory documents to clarify the supervision and management on credit information institutions, explain issues concerning account opening and interbank market bond investment by RQFIIs, improve management on the settlement of interbank bond transactions, elaborate on the trading, registration, custody and settlement of interbank negotiable certificates of deposits, and standardize custody of clients' reserves and the bankcard acquiring business by payment institutions. Relevant regulators also released regulations and regulatory documents on administrative licensing of commercial banks, pilot administrative measures for consumer finance companies, consumer protection in banking industries, issuance and underwriting of securities, management of clients' assets by securities companies, sale and custody of securities investment funds, pilot domestic securities investment made by RQFIIs, and the National Equities Exchange and Quotations System. Documents issued by regulatory authorities also strengthened handling of insurance consumer complaints, and supervision over insurance brokerage institutions, insurance salespersons and brokerage practitioners.

2. Prospect in law-making

In 2014, further efforts and researches will be dedicated to the revision of the *Law on the People's Bank of China*. The current version of the law came into effect in 1995 and was amended in 2003. Over the past several years, China has experienced rapid economic and financial development. Amidst the background of continuous financial system reform and innovation and the deepening of financial opening up, there are rising demands for the adjustment and improvement of the responsibilities of the PBC. In the aftermath of global financial crisis, consensus has been reached that macro prudential management and financial stability roles of central banks should be enhanced. Major advanced economies including the United States and the Britain carried out comprehensive reform of their financial supervisory system, which provided us with experiences and references for improving China's financial management system. Under such circumstances, revisions should be made to the prevailing *Law on the People's Bank of China* from a strategic perspective of deepening financial system reform and facilitating development of the financial industry. The revision should put more emphasis on market orientation, follow market mechanism, encourage financial innovation, improve financial services as well as the supervisory system, employ laws and administrative measures to provide stimulus to market development. And a sound legal basis shall be laid for the PBC to fulfill its duties and for the growth of the financial industry over a long period of time. The amendments shall underline macro adjustment and macro prudential roles of the PBC, detail methods and tools for safeguarding financial stability and improve regulations on financial market management, financial statistics and RMB management.

To match the reform of the financial industry in China, the formulation of the *Futures Law* and amendments of the *Securities Law* and *the Insurance Law* will be accelerated, and revision of the *Interim Regulations on*

Cash Management, the *Regulations on the Administration of Foreign-invested Banks and the Regulations on Compulsory Traffic Accident Liability Insurance for Motor Vehicles* will be promoted. The PBC will actively undertake researches on drafting of the *Rules on Deposit Insurance*, the *Rules on Non-deposit Taking Lending Institutions*, the *Administrative Measures on RMB Banking Accounts, the Rules for Implementing Risk Disposal Measures in the Bankruptcy of Commercial Banks*, the *Administrative Measures on Financing Guarantee Companies, the Interim Administrative Measures on Private Equity Funds* and the *Administrative Measures on the Supervision of Listed Companies*.

III. Accounting Standards

1. Progress has been achieved in establishing accounting rules and standards

In 2013, accounting rules and standards continued to be improved. First, steady progress has been made in making and revamping accounting rules and standards. The issuance of the *Enterprise Product Cost Accounting System (Trial)* and the *Standards of Accounting Informatization of Enterprises* consolidated requirements for product cost, which used to scatter in various accounting rules, and standardized the accounting informatization of enterprises. Accounting rules for public institutions have been revised to be in line with the real conditions of reform and development. The *Accounting Standards for Administrative Institutions* was released, so as to tailor accounting methods to the budget management and financial management of administrative institutions. Second, information disclosure is improved. Rules for listed companies' semi-annual and quarterly information disclosure have been revamped, enhancing the purposefulness and effectiveness of reporting while reasonably reducing the cost of information disclosure. Format and contents of securities companies' annual reports have been unified and improved. Third, the *Rules on Preparation and Reporting of the General Purpose Taxonomy of the Accounting Standards for Business Enterprises* was amended to meet the requirements for the extended implementation of the general purpose taxonomy in the oil and gas industry and the banking industry.

2. Prospect for development

In the next step, continued efforts will be made to promote the convergence between domestic accounting standards and international rules, release and prepare for the implementation of fair value accounting, make researches on supplementary accounting rules suitable for financial instrument innovation and capital market development, and further improve the accounting system for enterprises in the financial industry. Active efforts will be made to facilitate the implementation of accounting rules and standards for public institutions, elementary and middle schools and public scientific research institutions. Publicity campaigns will be carried out to introduce the *Standards of Accounting Informatization*. And the usage of general purpose taxonomy in corporate accounting will be further expanded. China will take an active part in the stipulation and revision of international accounting rules and standards, increase its presence in international organizations such as the newly established Accounting Standard Advisory Forum and devote more energy to international communication and cooperation.

IV. Credit Environment

1. Marked progress has been made in building credit information and social credit system

Legal system related to credit information advanced to a new height. On March 15, 2013, the *Administrative Provisions on Credit Information Industry* came into effect, providing the development of credit information industry with a legal basis. The PBC also issued the *Administrative Measures on Credit Information Agencies*, which took effect on December 20, 2013, to regulate the establishing and exit procedures for credit information agencies, and clarify daily supervision requirements.

Box 18 Release of the Administrative Measures on Credit Information Agencies

In order to implement the decision of "establishing and improving a social credit system" adopted at the Third Plenary Session of the18th CPC Central Committee, the PBC issued the *Administrative Measures on Credit Information Agencies* (referred to as the Measures hereinafter) on November 15, 2013.

The *Measures* is an important supplement to the *Administrative Provisions on Credit Information Industry*. It adheres to the concepts of strict supervision over personal credit information agencies and loose supervision over enterprises' credit information agencies, equal emphasis on market operations and supervision, and the combination of administrative supervision and social supervision. It specifies the establishment, changes and termination of the credit information agencies, and reinforces corporate governance and risk control of those agencies. Together with the *Administrative Provisions on Credit Information Industry* and other relevant laws and regulations, the Measures will play an important part in facilitating regulated operations of credit information agencies and protecting the legitimate rights and interests of information parties.

In order to fully protect the legitimate rights and interests of information parties, the Measures improves the requirements for establishing personal credit information agencies and clarifies that entities applying to establish a personal credit information agency should have a sound organizational structure, complete business operation and an internal control system including security management, compliance management system and so on. Besides, the credit information system must reach level 2 or above of the national information security and protection standards. Meanwhile, the Measures also improves the market exit procedures for personal credit information agencies and solves the transition problems occurring in the database disposal process and credit information agency exit procedures.

In terms of supervision, the *Measures* not only clarifies the reporting requirements for credit information agencies, but also establishes an enhanced surveillance mechanism. When an agency involves in serious illegal activities or unlawful practices, shows signs of possible data leakage, has major financial difficulties or has been the subject of numerous complaints, the PBC could list it as a subject of enhanced surveillance by increasing the frequency of its business operation reporting and information system security appraisal as necessary and taking relevant surveillance measures. In addition, the Measures also makes detailed requirements for the competency and qualifications of senior management of credit information agencies.

Pursuant to the *Administrative Provisions on Credit Information Industry* and the *Administrative Measures on Credit Information Agencies*, the PBC will effectively perform its supervisory duty over credit information agencies, urge various credit information agencies to regulate their own business behaviors, step up protection of information parties' legitimate rights and interests, and promote the rapid and healthy development of China's credit information industry.

The credit information market developed steadily. Financial credit information database functioned smoothly, with continuously increasing access, fast expanding data, gradually improved data quality and substantially rising number of inquiries. By end-2013, the personal and corporate information databases had collected information of nearly 840 million natural persons and nearly 19.2 million corporates and other organizations, and met inquiries of 340 million and 100 million respectively in the year. A multi-layer credit reporting market has just been formed. A large variety of credit information service products have appeared and credit information agencies are mushrooming. According to a preliminary survey, there are more than 150 credit information agencies in China, involving a total revenue of more than RMB 2 billion yuan. There are various credit information products, including corporate credit report, individual credit report, credit investigation report, bond issuer rating report, facility rating report, borrower rating report, guarantor credit rating report and follow-up rating report.

Standards for credit information management have been improved. The PBC released the *Notice on Promoting the Reform of Management over Credit Market Rating* to change the management methods of credit market rating from focusing on ex-ante management to in-process and ex-post monitoring and information disclosure. Efforts were devoted to encourage micro-credit companies and financing guarantee companies to get access to the financial credit information database and participate in credit rating pilot programs. Currently, 816 small institutions have been approved access to the database. The phase one of credit information management system was put into trial operation, which symbolized the informatization management of credit rating and credit information management. The PBC organized commercial banks and the operational institutes of financial credit information database to carry out self-reviews and special inspections on their compliance with the *Administrative Provisions on Credit Information Industry*. To gradually exercise management over private credit information agencies, the PBC carried out surveys on, monitored and analyzed those agencies and their business pattern, and guided them to improve their business procedures in line with the Provisions. The *Development Report of China Credit Information Industry (2003-2013)* was published, which summarized the work and achievements of the past ten years and pointed out the development strategies of the following five years.

Steady progress has been made in the building of a social credit system. The *Social Credit System Construction Plan (2014-2020)* was drafted and the *Several Opinions on the Use of Credit Records and Credit Reports in Administrative Matters* was released to promote the building and using of credit records and the development of credit information market. The small and micro enterprises and rural credit system is developing steadily. The *Guidance on Basic Data Items for Building the Small and Micro Enterprises and Rural Credit System* was issued to standardize credit record building of small and micro enterprises and farm households. In order to facilitate the building of small and micro enterprises and rural credit system, the PBC organized surveys on development of the pilot areas with small and micro enterprises and rural credit system. By end-2013, credit records for 2.43 million small and micro enterprise and 151 million farm households had been set up, and a total of 350 thousand small and micro enterprises and 87.46 million farm households had obtained credit support.

Outreach and education programs on credit information were continuously carried out. Under the organization of the PBC, the PBC local branches and sub-branches, financial institutions and credit information agencies conducted various outreach and education programs across the country, including regular programs like "6.14 Care About Credit Record Day" and "Credit Information Month", as well as the special campaign featuring the theme of "Fully Implement the *Administrative Provisions on Credit Information Industry* and Facilitate the Healthy Development of the Credit Information Industry" . Public credit awareness and consciousness of safeguarding credit information have greatly enhanced. In 2013, a total of 8.16 million inquires were made by individuals voluntarily for their own credit reports.

2. Prospect for development

In the next stage, further efforts will be made to reinforce the credit information system. The draft of the *Administrative Measures on the Financial Credit Information Database* will be put onto agenda. And the PBC will accelerate the launch of the *Administrative Rules on the Users of the Financial Credit Information Database* and the *Administrative Rules on the Information Security of Credit Information Agencies*. The PBC will also enhance the classified management over credit information agencies, upgrade financial credit information database, reinforce the registration and management system of credit rating agencies via strengthened rating process monitoring and information disclosure requirements, and extend the application of micro credit company rating and financing guarantee company rating in China. The PBC will fully implement the *Social Credit System Construction Plan (2014-2020)*, promote the building of credit information system of various departments, and realize information sharing with other agencies through data exchange and system link. Vigorous efforts will be dedicated to push forward the building of small and micro enterprises and rural credit system, especially in the pilot areas. More outreach and education programs on credit information will be carried out in order to disseminate relevant information.

V. Anti-Money Laundering

1. Steady improvements were made in the system of preventing and controlling money laundering

In February 2013, the Financial Action Task Force on Money Laudering (FATF) published the *Methodology for Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems*, which put anti-money laundering (AML) and counter-terrorist financing (CFT) as top policy goals and listed eleven immediate outcomes for the assessment. With the main goal of boosting effectiveness, the PBC fully implemented the risk-based approaches and gradually improved domestic money laundering prevention and control system.

The anti-money laundering and counter-terrorist financing system was improved. Within the framework of Anti-Money Laundering Joint Ministerial Conference, the PBC completed the preliminary work for drafting the *Administrative Measures on Freezing of Assets Relating to Terrorist Activities*, participated in the researches on methods for identifying name lists of terrorism organizations and terrorists, and released the *Guidelines on Assessment of Money Laundering and Terrorist Financing Risks and Categorized Management of Customers of Financial Institutions*.

Quality of large-sum and suspicious transaction reports has been boosted. The PBC guided ICBC and other 36 financial institutions to successfully carry out trials on setting technical indicators, building systems, making analyses, and establishing rules by themselves. Those trials tested the viability of using suspicious transaction reporting based on reasonable doubts in China and provided impetus for a large group of financial institutions to independently develop indicators for unusual transactions with reference to methods used in the trials, thus enhancing the initiative and effectiveness of financial institutions in combating money laundering.

The risk early-warning mechanism of money laundering has been established. Analysis reports of money laundering pattern were regularly compiled and issued by the PBC branches and 18 national banking institutions. The results of those reports were shared with financial institutions and relevant government agencies. Against the high incidence of illegal activities such as new types of internet fraud and money laundering and unlawful selling and buying of bankcards, three *Money Laundering Risk Warnings* were issued.

International cooperation on anti-money laundering was further deepened. As the current co-chair of Asia/Pacific Group on Money Laundering (APG), China successfully held the 16th APG Annual Meeting in Shanghai. Meanwhile, by participating in various multi-lateral cooperation mechanisms, China actively involved in the stipulation of international anti-money laundering rules and regulations and in the internal governance of those organizations. China also took part in the compliance review of the United Nations' *Convention against Corruption*, and intensified basic researches in domestic application of international anti-money laundering standards.

2. Prospect for development

Going forward, the PBC, jointly with other relevant agencies, will set up national money laundering risk assessment mechanism, and form a national working group on assessing money laundering risks within the framework of Anti-Money Laundering Joint Ministerial Conference. Efforts will be dedicated to complete the amendment of the *Administrative Measures on Managing Large-sum and Suspicious Transactions* and to accelerate the formulation of anti-money laundering rules for designated nonfinancial businesses and professions (DNFBPs). Top on the working agenda will be strengthening monitoring and surveillance of terrorist financing, cross-border money laundering and network crimes. Preparations for next round of international anti-money laundering assessment of China will kick off.

Box 19 Methodology for Assessing Technical Compliance with FATF Recommendations and the Effectiveness of AML/CFT Systems

On February 2013, the FATF published the *Methodology for Assessing Technical Compliance with the FATF Recommendations and the Effectiveness of AML/CFT Systems*, which listed effectiveness as an assessment item for the first time and clarified 11 immediate outcomes for evaluating the effectiveness of a country's AML/CFT systems, as follows. First, money laundering and terrorist financing risks are understood and, where appropriate, actions coordinated domestically to combat money laundering and the financing of terrorism and proliferation. Second, international cooperation delivers appropriate information, financial intelligence and evidence, and facilitates action against criminals and their assets. Third, supervisors appropriately supervise, monitor and regulate financial institutions and DNFBPs for compliance with AML/CFT requirements commensurate with their risks. Fourth, financial institutions and DNFBPs adequately apply AML/CFT preventive measures commensurate with their risks, and report suspicious transactions. Fifth, legal persons and arrangements are prevented from misuse for money laundering or terrorist financing, and information on their beneficial ownership is available to competent authorities without impediments. Sixth, financial intelligence and all other relevant information are appropriately used by competent authorities for money laundering and terrorist financing investigations. Seventh, money laundering offences and activities are investigated and offenders are prosecuted and subject to effective, proportionate and dissuasive sanctions. Eighth, proceeds and instrumentalities of crime are confiscated. Ninth, terrorist financing offences and activities are investigated and persons who finance terrorism are prosecuted and subject to effective, proportionate and dissuasive sanctions. Tenth, terrorists, terrorist organizations and terrorist financiers are prevented from raising, moving and using funds, and from abusing the non-profit organization (NPO) sector. Eleventh, persons and entities involved in the proliferation of weapons of mass destruction are prevented from raising, moving and using funds, consistent with the relevant United Nations Security Council Resolutions (UNSCRs).

Effectiveness and compliance will serve as two pillars for the FATF's next round of international mutual assessment. And risk-based approaches are the fundamentals for improving the effectiveness of AML/CFT systems of a country. With the introduction of the effectiveness standard, an entire set of statistic indicators should be designed by various countries to keep abreast of the distribution and development trend of money laundering and terrorist financing, understand the policy transmission channels, and realize aimed improvement of current anti-money laundering and counter-terrorist financing systems.

In order to conform to the effectiveness standard, China has already formulated an outline for assessing national money laundering risks, carried out pilot programs on voluntary reporting of suspicious transactions, and promulgated measures for freezing assets relating to terrorism. All those measures will gradually enhance the overall effectiveness of China's anti-money laundering and counter-terrorist financing systems.

Chapter Ⅷ

Macro-prudential Regulation

In 2013, the international community further strengthened the research and formulation of macro-prudential policies, and major economies continuously improved macro-prudential framework. China continued to enhance macro-prudential regulation, established and improved the financial regulatory coordination mechanism, enriched counter-cyclical macro control measures, strengthened assessment and monitoring of systemic risks and resolution regime construction as well, and effectively safeguarded the sound operation of financial system.

I. International Developments on Macro-prudential Regulation

1. Improving macro-prudential policy on the banking sector

Promoting the implementation of Basel III. The BCBS conducted a comprehensive assessment on implementation of Basel III, with the aim of promoting members to adopt Basel III in a timely, comprehensive and consistent way. There are 3 levels of assessments: **Level 1** focuses on the timely implementation of Basel III. Out of 27 members, except for Indonesia, 26 members have released the new capital rules based on Basel III. The U.S. and EU issued regulations in July and June respectively, which came into effect in January 2014. A few of members have introduced the liquidity and leverage ratio requirements. **Level 2** is the assessment on consistency of national regulations with the Basel III. Since the Regulatory Consistency Assessment Process (RCAP) was launched in April 2012, BCBS has carried out assessments on EU, Japan, Singapore, Switzerland, U.S. and China. The result of assessment on China is "Compliance", and the assessment report was published in September 2013. **Level 3** is the assessment on consistency of outcomes of implementation of regulations. BCBS researched on the banks' calculation of risk-weighted assets in both banking account and trading account and found that substantial differences existed in calculation of risk-weighted assets in different banks. BCBS is working on feasible policy framework to improve comparability of different measurements.

Enhancing the leverage ratio requirements. As the complement to the minimum capital requirements, the 3% leverage ratio, i.e. regulatory capital/total risk exposures was introduced by BCBS. In June 2013, BCBS published the *Revised Basel III Leverage Ratio Framework and Disclosure Requirements - Consultative Document*, improving the risk exposure measure, specifying the treatment of investees, written credit derivatives, collaterals and securities financing transactions inside and outside the scope of regulatory or accounting consolidation, and requiring banks to disclose their leverage ratio information, including a summary comparison table which compares total accounting assets and total leverage ratio exposures, and a breakdown of the main leverage ratio regulatory elements.

Improving risk management standards. In

March 2013, BCBS published *Supervisory Framework for Measuring and Controlling Large Exposures - Consultative Document*, enhancing concentration risk management. It expanded the scope of large exposures to lending corporates, all the third parties comprising banks, securities, funds and trusts, and intra-group exposures, set the exposure limits on OTC derivatives transactions, securities financing transactions, funds, securitization and other structural financial products on banking account and trading account, and proposed the large exposure limit to be 25% of common equity tie 1 or tier 1 capital, ensuring the loss could be contained in case of defaults of counterparties.

2. Strengthening supervision on SIFIs

Revising assessment methodology of G-SIBs. For the recent three years, BCBS had continuously collected, analyzed and compared data submitted by large banks, fine-tuned and solved the problems in application of the original assessment methodology, and issued the *Global Systemically Important Banks: Updated Assessment Methodology and the Higher Loss Absorbency Requirement* in July 2013, revising the assessment methodology, disclosure requirements, and additional loss absorbency capacity requirements. **First**, set the methodology for determining the sample of banks. The 75 largest global banks in terms of total assets, banks that were designated as G-SIBs in the previous year, or banks that have been added to the sample by national supervisors using supervisory judgment can be included in the sample. **Second**, change the indicator definition. A cap of 500 basis points will be applied on the substitutability category score. Once the score exceeds 500 basis points, the total score wouldn't change although the systemic importance increases. The Wholesale Funding Ratio in the interconnectedness category will be replaced with the Securities Outstanding. **Third**, create the new empty buckets. Each new bucket will be equal in size to each of the initial buckets and the minimum higher loss absorbency requirement for the new buckets will increase in increments of 1% of risk-weighted assets.

Updating the list of G-SIBs. In November 2013, FSB updated the list of G-SIBs, using end-2012 data and the revised assessment methodology. One bank has been added to the list, increasing the overall number from 28 in 2012 to 29 (Table 8.1). ICBC was included in the list of G-SIBs for the first time, which was allocated in the Bucket I, same with the BOC; corresponding loss absorbency requirement is 1%.

Table 8.1 Updated List of G-SIBs

Bucket (Higher Loss Absorbency Requirement)	G-SIBs in alphabetical order within each bucket
5 (3.5%)	Empty
4 (2.5%)	HSBC
	JP Morgan Chase

(concluded)

Bucket (Higher Loss Absorbency Requirement)	G-SIBs in alphabetical order within each bucket
3 (2.0%)	Barclays
	BNP Paribas
	Citigroup
	Deutsche Bank
2 (1.5%)	Bank of America
	Credit Suisse
	Goldman Sachs
	Group Crédit Agricole
	Mitsubishi UFJ FG
	Morgan Stanley
	Royal Bank of Scotland
	UBS
1 (1.0%)	Bank of China
	Bank of New York Mellon
	BBVA
	Groupe BPCE
	Industrial and Commercial Bank of China Limited
	ING Bank
	Mizuho FG
	Nordea
	Santander
	Société Générale
	Standard Chartered
	State Street
	Sumitomo Mitsui FG
	Unicredit Group
	Wells Fargo

Source: 2013 Update of Group of Global Systemically Important Banks by FSB, Nov. 2013.

Issuing assessment methodology and policy measures for G-SIIs. In July 2013, the International Association of Insurance Supervisors (IAIS) released the *Global Systemically Important Insurers: Initial Assessment Methodology* and *Global Systemically Important Insurers: Policy Measures*. FSB published the initial list of 9 G-SIIs using the end-2011 data, in which Ping An Insurance (Group) Company of China was included. G-SIIs will be subject to Basic Capital Requirements (BCR) and Systemic Risk Management Plan (SRMP). They also need to establish CMGs, and develop recovery and resolution plans as well.

Developing methodologies for indentifying NBNI G-SIFIs. At the request of G20 Summit, FSB has been developing, in consultation with the International Organization of Securities Commissions (IOSCO), the methodologies for identifying non-bank non-insurance global systemically important financial institutions (NBNI G-SIFIs). The basic set of impact factors includes size, interconnectedness, substitutability, complexity and global activities. Based on different business models and risk profiles, NBNI G-SIFIs are categorized into 3 types: finance companies, market intermediaries, and asset management entities including investment funds, and each specific entity type would be applied to different sector-specific indicators.

Box 20 Assessment Methodology and Supervision on G-SIIs

In July 2013, IAIS released the assessment methodology and policy measures for G-SIIs. FSB published the initial list of 9 G-SIIs, which includes Allianz SE, American International Group, Inc., Assicurazioni Generali S.p.A., Aviva plc, Axa S.A., MetLife, Inc., Ping An Insurance (Group) Company of China, Ltd., Prudential Financial, Inc. and Prudential plc.[①]

Assessment methodology. Consistent with the G-SIBs, the assessment approach of G-SIIs is indicator-based. Indicators include size, global activity, interconnectedness, non-traditional non-insurance (NTNI) activities and substitutability, which reflect the characteristics of insurance companies. Since the NTNI activities are major resources of systemic risks, they are given higher weights (Table 8.2). IAIS recognized that using the indicator-based assessment on its own may not be sufficient to determine whether the candidates are in fact systemically important. Additional quantitative and qualitative analyses may be required. Insurance and Financial Stability (IFS) approach is one supplemental quantitative assessment methodology, which segments the insurance business portfolio into traditional insurance, semi-traditional insurance, non-traditional insurance, non-insurance financial activities and industrial activities, and applies to them risk weights of 2.5%/20%, 12.5%/50%, 22.5%/75%, 100% and 0% respectively. If there are obvious differences between the results of indicator-based approach and the IFS approach, then the supervisory judgment is needed.

① Different from the G-SIBs, all G-SIIs are arranged in the alphabetical order.

Table 8.2 Assessment indicators for G-SIIs

Category (and weighting)	Individual indicators	Indicator weighting
Size (5%)	Total assets	2.5%
	Total revenues	2.5%
Global activity (5%)	Revenues derived outside of home country	2.5%
	Number of countries	2.5%
Interconnectedness (40%)	Intra-financial assets	5.7%
	Intra-financial liabilities	5.7%
	Reinsurance	5.7%
	Derivatives	5.7%
	Large exposures	5.7%
	Turnover	5.7%
	Level 3 assets	5.7%
NBNI activities (45%)	Non-policy holder liabilities and non-insurance revenues	6.4%
	Derivatives	6.4%
	Short term funding	6.4%
	Financial guarantees	6.4%
	Minimum guarantee on variable insurance products	6.4%
	Intra-group commitments	6.4%
	Liability liquidity	6.4%
Substitutability (5%)	Premiums for specific business lines	5%

Source: Global Systemically Important Insurers: Initial Assessment Methodology by IAIS, July 2013.

Policy measures. First, enhanced supervision. G-SIIs are required to manage liquidity risk, and to reduce systemic importance. They are also required to establish and implement SRMP, including separating systemically important NTNI business from traditional business or prohibiting certain systemically important business. **Second, effective resolution.** In line with the FSB's *Key Attributes for Effective Resolution Regimes for Financial Institutions (hereinafter referred to as"Key Attributes")*, IAIS set out the effective resolution measures for G-SIIs, including establishing CMGs, developing recovery and resolution plans, conducting resolvability assessment process, and reaching cross-border cooperation agreements. **Third, higher loss absorption capacity.** IAIS will set the capital requirement applicable to all group activities including non-insurance subsidiaries. Based on this, IAIS will set the higher loss absorption (HLA) capacity requirement on the NTNI activities. The insurance group should hold adequate high-quality capital to meet HLA. The method of calculating the amount of required HLA may take into account whether the insurance group has demonstrated effective separation. Wherever the G-SII can demonstrate effective separation of NTNI activities from traditional insurance activities, the targeted HLA may be calculated based on the base capital requirements for the NTNI activities conducted. Where NTNI is not effectively separated, then the targeted HLA may be calculated according to the base capital requirements of NTNI activities in the combined insurance entities and the interconnectedness score.

3. Promoting effective resolution regime

Putting the effective resolution regimes of G-SIFIs in place. Home and host authorities of G-SIFIs should establish CMGs, develop recovery and resolution plans (RRPs) and undertake resolvability assessment process as the FSB required. In 2013, the survey conducted by FSB showed that all G-SIBs have established CMGs, and made remarkable progress in developing resolution strategies and operational resolution measures. But there was still a long way to go in endowing resolution authorities adequate power and coordination in cross-border resolution of financial conglomerates. Most CMGs intended to employ "Single point of entry" strategy which is applied at the group level. FSB asked all G-SIBs to have CMGs in place before July 2014, and complete RRPs by the end of 2014.

Guiding development of RRPs. In order to assist home and host authorities in meeting the resolution planning requirements under the FSB *Key Attributes*, in July 2013, FSB issued 3 guidance documents on developing effective resolution strategies, indentifying critical functions and shared services, and recovery triggers and stress scenarios by approval of G20 Summit. The guidance set out two resolution strategies: "single point of entry resolution (SPE)", in which resolution powers are applied to the top of a group by a single national resolution authority, and "multiple point of entry resolution (MPE)" in which resolution tools are applied to different parts of the group by two or more resolution authorities acting in a coordinated way. It also proposed the preconditions and process of the above two approaches. The guidance also suggested that critical functions are activities performed for third parties where failure would lead to the disruption of services that are vital for the functioning of the real economy and for financial stability. Examples include payments, custody, certain lending and deposit-taking activities, clearing and settling and limited segments of wholesale markets, etc. Critical shared services are activities performed within the firm or outsourced to third parties where failure would lead to the inability to perform critical functions. Examples include the provision for banks of information technology and other services such as facility management and administrative services. Recovery triggers and stress scenarios should comprise but not depend on quantitative indicators, which should not only take into account the financial and economic conditions but also are commensurate with characteristics of financial institutions.

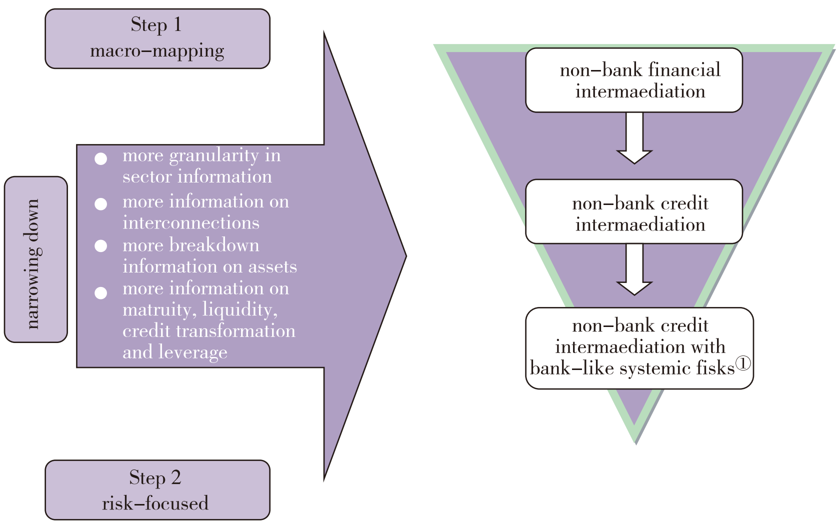
Putting forward the implementation of Key Attributes in non-bank financial institutions. Aiming to resolve the problem revealed in 2012 thematic peer review that resolution regimes were less progressive for insurers, securities or investment firms, and financial market infrastructures (FMIs), FSB made great efforts in 2013 to assist national authorities to establish resolution regimes for FMIs, insurers and financial institutions holding client assets. In August 2013, FSB issued the guidance on application of *Key Attributes* to non-bank financial institutions for consultation, which set out that resolution regimes for FMIs, including payment systems, central securities depositories, securities settlement systems, central counterparties and depositories, need to give priority to maintaining continuity of the critical functions that FMIs perform in financial markets and take account of the loss allocation arrangements; the resolution regimes for insurers need to protect policy holder interests; and the resolution regimes for the financial institutions directly or indirectly holding client assets like funds, financial instruments, collaterals and assets, which include dealers, asset managers, brokers, custodians etc., need to interact effectively with client asset protection rules, so that client assets can be rapidly transferred or returned in the resolution of a firm holding client assets. FSB, working with Committee on Payment and Settlement Systems (CPSS) and IOSCO, has preliminarily developed the guidance on recovery and resolution planning of FMIs.

Revising Core Principles for Effective Deposit Insurance Systems. BCBS and International Association of Deposit Insurers (IADI) published *Core Principles for Effective Deposit Insurance Systems (hereinafter referred to as "Core Principles")* in June 2009, and the assessment methodology in December 2010. In February 2013, IADI launched the review on the *Core Principles* and assessment methodology, focusing on the use of deposit insurance funds, funding arrangements in resolution, early intervene mechanism, bail-in tools, cross-border resolution, public awareness and moral hazard etc. Such review tended to reflect the experiences of national deposit insurance authorities in implementing *Core Principles*, and also address the issues flag in the FSB peer review and FSAP. IADI plans to submit revised *Core Principles* and assessment methodology to FSB in July 2014 .

4. Strengthening supervision on shadow banking system

Continuously monitoring shadow banking system. In November 2013, FSB published the third monitoring report on global shadow banking system based on the end-2012 data from 25 jurisdictions. The report still followed the "two-step" approach set out in 2011. First, authorities should cast the net wide, looking at all non-bank credit intermediation to ensure that data gathering cover all areas where shadow banking-related risks might potentially arise. Second, authorities should narrow the focus to the specific non-bank credit intermediation which may induce systemic risk or regulatory arbitrage (Figure 8.1). The report showed that global shadow banking grew by USD 5 trillion in 2012 to USD 71 trillion, representing about 117% of monitored jurisdictions' GDP, lower than the peak level of 125% in 2007, increasing by 6 percentage points y-o-y. The shadow baking's share in total financial intermediation has declined to 24% at the end of 2012, which is 0.7 percentage points up from 2011 and below the peak level of 27% in 2007. Shadow banking of advanced economies still is the main components, with the share of shadow banking in U.S., EU, UK and Japan registering 85.9%. Emerging economies saw a rapid growth in shadow banking, and potential risks warrant attention.

Figure 8.1 "Two-step" approach to monitor shadow banking



Source: Global Shadow Banking Monitoring Report 2013 by FSB, November 2013.

Promoting policy implementation in MMFs, securitization and other shadow banking entities. In 2013, FSB continued to strengthen the oversight and regulation of shadow banking in five areas. In August, FSB published the final policy recommendations on MMFs, securitization and other shadow banking entities, and after then FSB started to monitor the implementation of these recommendations. With regard to the MMFs, FSB required the MMFs that offer stable or constant net asset value (NAV) to their investors should be converted into floating NAV where workable, or the safeguards like capital, liquidity, and

① Bank-like systemic risks include maturity transformation, liquidity transformation, imperfect risk transfer, and leverage.

other prudential requirements should be introduced to reinforce stable NAV MMFs' resilience to runs. U.S. and EU authorities both issued regulatory proposals to enhance the supervision on operation of MMFs. With regard to securitization, based on the IOSCO's recommendations, FSB set out the retention requirements, measures that enhance transparency and standardization of securitization products. And the FSB, in collaboration with other standard-setting bodies, has been promoting the resumption of orderly securitization markets. With regard to the other shadow banking entities, FSB developed a policy framework to guide national authorities to indentify and assess non-bank financial intermediations' shadow banking-related risks. This policy framework consists of the following three elements: (i) Risk assessment should depend on economic functions or activities rather than the entities' legal form, ensuring to identify the potential sources of shadow banking risks in a forward-looking way. (ii) Adoption of policy tools should consider the economic functions, the structure of the markets in which they operate, and the degree of financial stability risks posed by entities on the markets. (iii) Authorities should share information on entity types, economic functions, risk factors etc., in order to maintain consistency across jurisdictions in applying the policy framework.

Accelerating policy development in banks' interactions with shadow banking entities, and securities financing transactions. To reduce the spillover of risks from the shadow banking system to the core banking system, policy recommendations are being developed by the BCBS in the following three areas: (i) specifying the scope of consolidation to ensure that all banks' activities, including their interaction with the shadow banking system, are captured within the prudential regime; (ii) revising the large exposure requirements, enhancing the risk management of banks facing the default of single private sector counterparties, and controlling the risk contagion rising from the banks' interactions with the shadow banking system; (iii) setting more prudential capital requirement on banks' investment in equity of funds, including fund engaged in shadow banking activities. To reduce the over-reliance of the shadow banking system on the securities financing and other short-term wholesale funding, FSB suggested to enhance the standards and processes for data aggregation at the global level, set requirements on re-hypothecation, and reinforce the minimum regulatory standards for collateral valuation and management. To dampen pro-cyclicality and fire-sale risks, FSB published in August 2013 proposals on the "haircuts (margins)", setting out the methodologies for calculating haircuts, and a minimum numerical haircut requirement on some specific securities financing transactions.

5. Promoting OTC derivatives market reforms

The remarkable progress has been achieved in OTC derivatives market reforms in 2013. **With regard to the legislation and regulations**, the majority of jurisdictions have legislation in place to require reporting of OTC derivatives contracts to trade repositories (TRs) and about half of the jurisdictions have legislation in place that set out the specific trade reporting requirements and Basel III capital requirements. Only few jurisdictions have put in force the mandatory clearing obligations and requirements to trade on organized trading platforms. **With regard to the cross-border supervision**, at request of G20 leaders, a working group of OTC derivatives market regulators from jurisdictions with large OTC derivatives markets has been working on addressing inconsistencies in the application of rules in a cross-border context. In August 2013, this group published a report which provided a feasible solution of cross-border conflicts, inconsistencies, gaps and duplication. It also proposed a flexible and outcome-based approach that should be the basis for the assessment of equivalence or substituted compliance, and urged jurisdictions to remove barriers to reporting to trade repositories by market participants with particular attention to removing barriers to reporting counterparty data and to access to trade repository data by authorities. **With regard to the international standards and guidance**, BCBS and IOSCO published a finalized framework for margin requirements for non-centrally cleared derivatives in September 2013, with jurisdictions expected to incorporate these into their regulatory regimes and begin phasing in from December 2015. CPSS and IOSCO published the final report on authorities' access to trade repository data in August 2013. BCBS, in cooperation with the CPSS and IOSCO, is revising the capital treatment of banks' exposures to CCPs, with final guidance expected to be published in 2014.

6. Reducing reliance on credit rating agencies

In 2013, FSB launched a thematic peer review on reducing reliance on credit rating agencies (CRA) to urge jurisdictions to fulfill their commitments under the roadmap endorsed by the G20 Leaders Summit in 2012. The peer review was undertaken in two stages. The first stage of the peer review was finished in August 2013, the findings include that both the U.S. and the EU have taken significant steps to remove the hard-wiring of CRA ratings from their rules and regulations. The Dodd-Frank Act in U.S. sets a more absolute standard than the FSB Principles since it requires the complete removal of references to CRA ratings. The CRA III Regulation adopted in EU represents the most comprehensive requirements to give effect to the FSB Principles. The extent of reliance on CRA ratings varies across financial sectors. CRA ratings still play a significant role in banking regulations, although they play a less prominent role in the supervision of insurance companies and other non-bank financial intermediaries. The BCBS published in December 2013 a consultative paper on revisions to the Basel securitization framework, setting out recommendations to address the mechanistic reliance on external ratings and cliff effect in capital requirements. The BCBS is also researching the substitutes for credit ratings in standardized approach of capital calculation. The second stage of the peer review commenced in October 2013, and all FSB members including China have submitted the action plans to promote financial institutions to develop their own internal credit rating models.

7. Others

Implementing the Data Gaps Initiatives. In order to improve the data collection and sharing for G-SIBs, FSB planed to carry out the "data gaps and systemic linkage" project in three phases. Phase I was put in place in March 2013, and G-SIBs need to report their largest 50 counterparties' credit exposures data to the Data Hub in BIS. Except China and Sweden, all G-SIB home jurisdictions have joined this project. The Data Hub shared the data with participating home authorities in June 2013. Phase II and Phase III will begin in force in 2014 and 2015 respectively.

Establishing the LEI system. FSB continued to implement the global "Legal Entity Identifier (LEI)" system, making unique identification codes for all global financial transactions' participants. This system has a three-tier structure which is not-for-profit and independent from the FSB. The Regulatory Oversight Committee (ROC), which is constituted by representatives from national regulatory authorities, is responsible for the governance of the global LEI system. Below the ROC, there is the Central Operating Unit (COU) responsible for collection and processing of global data. Local Operating Units (LOU) are set by jurisdictions, responsible for the registration, validation and maintenance of local LEIs. Each financial institution would get a unique 20-digit code comprising numbers and alphabets; the first four digits represent the country codes allocated to LOUs, the fifth to eighteenth digits are configured by the LOUs, and the last two digits are check digits. At present, U.S., Germany, Ireland and Palestine have applied and got the LEI country codes.

II. Major jurisdictions' progress in Macro-prudential Policy

1. United States

Financial Stability Oversight Council (FSOC) identified and prevented systemic risks. In 2013, FSOC undertook the following missions: (i) publishing the annual report, stocktaking macro-economic and financial situation and financial markets developments as well, sorting out the progress in financial regulatory reform, analyzing the potential risks to financial stability, and proposing the policy recommendations in the future; (ii) identifying the systemically important non-bank financial institutions. AIG Group, GE Capital and Prudential Financial, Inc. were identified as systemically important non-bank financial institutions in accordance with the assessment indicators set by Dodd-Frank Act and methodology of FSOC, which would be subject to more prudential supervision of the Federal Reserve Board.

Regulatory standards were improved. First, tightening the capital requirements in accordance with the Basel III. The Federal Reserve Board, FDIC and Office of the

Comptroller of the Currency (OCC) jointly issued a series of new rules and regulations, setting 4.5% common equity tier 1 capital adequacy ratio (common equity tie 1 capital/ risk-weighted assets), 6% tier 1 capital adequacy ratio, and 2.5% capital conservation, as well as an additional minimum leverage ratio of 3% for banks applying the advanced approach. Second, setting up a regulatory framework on liquidity, releasing rules on strengthening liquidity risk management, which apply to banking holding companies and savings and loans holding companies with the total assets exceeding USD 50 billion as well as the non-bank financial institutions with the total assets more than 250 billion or foreign balance sheet assets exceeding USD 10 billion, and giving details on application and minimum requirement of liquidity coverage ratio, measure of high quality liquidity assets and net cash outflow. Third, enhancing supervision on MMFs. As the world's largest MMF market, FSOC proposed the structural reform to reduce vulnerability of MMFs in November 2012, and the Securities and Exchange Commission (SEC) also issued the proposed rules that would change the way that MMFs operate in order to make them less susceptible to runs, including transferring institutional MMFs to floating NAV, using liquidity fees and redemption thresholds on non-government MMFs, etc.

Final version of the Volker rule was issued. In December 2013, five federal agencies including the Federal Reserve Board, Commodity Futures Trading Commission (CFTC), FDIC, OCC and SEC jointly issued the final version of the Volker Rule. The final rules prohibit banking entities from engaging in high-risk proprietary trading of certain securities, derivatives and commodity futures, and impose limits on banking entities' investment in hedge funds or private equity funds. Also the final rules provide exemptions for certain activities, such as permitting banking entities to engage in foreign sovereign debt transactions. The final rules set the compliance, recording and reporting requirements based on the asset size of banking entities. The implementation of the Volker rule would push the large banks employing sounder development strategies and business models, and reduce the impact of speculation business on the traditional banking system, to restore the market confidence in the banking system.

2. United Kingdom

The new financial regulatory system was in place. On April 1 2013, the Financial Service Act came into effect, representing the new financial regulatory system was in place. Under the new framework, the Bank of England was in charge of monetary policy, macro-prudential regulation and macro-prudential regulation. The Financial Policy Committee (FPC) established within the Bank of England is responsible for micro-prudential regulation, and the Prudential Regulation Authority (PRA), as the subsidiary of the Bank of England, together with the Financial Conduct Authority (FCA) are jointly responsible for micro-prudential regulation, replacing the original Financial Service Agency (FSA). On December 18, the *Financial Service Banking Reform Act* was approved, making the legal foundation for the banking structural reform in UK. The act set out that the banking conglomerates should set up separate entities for retail banking and investment banking respectively, enhance the loss-absorbency capacity, and it also provided measures on promoting an orderly competition of banking sector, improving supervision on payment and settlement system.

FPC carried out macro-prudential mandate. FPC undertook the following work since its establishment in 2013: first, publishing the *Financial Stability Report* biannually, analyzing and assessing systemic risk of the financial system, and identifying the three priorities including enhancing banks' capital adequacy, addressing the issue of "too-big-to-fail" and shadow banking. Second, providing policy recommendations to the HM, Bank of England, PRA and FCA periodically, covering the draft of guidance on stress test, revision of rules on liquidity requirements, assessment on vulnerability caused by the rise of long-term interest rates, improving the capacity of responding to the internet attacks, and requiring real estate mortgage institutions to conduct interest rate stress test, etc. Third, assuming FPC two new mandates including development of counter-cyclical capital buffer and capital requirement applicable to the whole financial sector. In January, FPC published a policy report, clarifying how to implement the above mentioned two macro-prudential instruments, and the potential impact on financial stability and economic development. It also identified a series of core indicators including balance sheet data, leverage of the real economy and market condition as references to decision-making.

Bank of England analyzed the implication of monetary policy on financial stability. The *Financial Stability Report* published by Bank of England in 2013 stated that monetary policy can influence financial stability through demand and financial channels. The first one is demand channel. Easing monetary policy could encourage households and corporate increase consumption and investment, thus increasing the demand for the new credits. Once the interest rate rise in the future, the current debt scale would incur higher debt servicing costs. The second one is financial channel. Monetary policy can affect banks' capital replenishment capacity through the impact on the bank profitability. Also it can change the balance sheet liquidity through affecting the ability of financial institutions to attract funding. Meanwhile, monetary policy would change the risk perceptions and risk tolerance of banks and non-bank financial institutions. Financial institutions and market participants would take more risk when the nominal interest rate decline. Low interest rate could lead to rapid credit growth, which makes macro adjustment more difficult. Moreover, for the insurance companies and pension funds, a fall in long-term rates could increase the value of liabilities by more than the value of its assets, possibly creating a deficit for the fund.

Bank of England was designated as the resolution authority. The Special Resolution Regime (SRR) for the banking institutions was established after the crisis. In this regime, the Bank of England was designated as the resolution authority, in charge of the orderly resolution and exit of failed financial institutions. Alongside the push forward of financial regulatory reform in UK, the application of SRR has extended to all financial institutions supervised by the PRA and FCA, including deposit-taking institutions, investment firms, financial holding companies, central counterparties etc. The *Financial Service Act* specifies that the Bank of England and the subsidized PRA are responsible for the implementation of crisis management. In particular, PRA judges whether the resolution procedure is needed to be launched, and once entering into the resolution procedure, it would be the Special Resolution Unit （SRU）within the Bank of England which would implement the resolution instruments as well as coordinate with other agencies. The crisis also made the UK authorities reflect on the deposit insurance system, and improve some institutional arrangements of the Financial Services Compensation Scheme (FSCS). First, every deposit-taking institution needs to go through the “Single Customer View”, which is to collect information of every single insured depositor’s accounts, so as to provide depositor information to the FSCS in a short time in case that the compensation occurs. Second, the rule that the compensation must be triggered by the application of depositors is removed. The FSCS automatically enters into the compensation procedure as soon as banks failed. Third, the term of compensation is specified that the FSCS has to compensate within 7 days after banks’ failure.

3. European Union

The Banking Union achieved substantial progress. First, the European Parliament approved the new banking regulatory rules, urging EU nations to implement the financial regulatory reform by legal means. On September 12, the European Parliament approved the Single Supervisory Mechanism (SSM), which was the first step marching for the Banking Union. European Central Bank (ECB) will supervise directly significant credit institutions within the euro-zone and those with total assets exceeding EUR 30 billion or more than 20% of the GDP in the nations beyond the euro-zone but voluntarily entering into the SSM, as well as the credit institutions in the euro area which have requested or received financial assistance from the European Stability Mechanism (ESM) or the European Financial Stability Facility (EFSF). And in the initial stage, ECB would conduct a comprehensive stress test on European large banks to get the real risk profiles of them. Members’ authorities would supervise domestic medium and small-sized banks under the guidance of the ECB, and continue their key role in consumer protection, anti-money laundering, and payment services. The ECB has the right to take over some troubled medium and small-sized banks and take intervention measures if necessary. The European Banking Authority (EBA) is responsible for making regulations and rules, and carrying out the banking stress test on a regular basis. Second, the European Council reviewed and approved the framework of the Single Resolution Mechanism (SRM) on December 19, which was another important step towards the Banking Union. SRM aims to make a uniform rule on banking resolution, addressing the inconsistencies in resolution measures of member authorities, reducing the resolution cost and ensuring soundness of the financial system. The ECB, European Council and national resolution authorities would jointly set up a Single Resolution Board, to analyze and decide on the types of resolution tools as well as the operation of the European resolution fund. If the resolution decision made by the Single Resolution Board was not taken by member authorities, the Board had right to directly resolve troubled banks.

Shadow banking supervision was enhanced. The European Council issued a proposal on supervising shadow banking on September 4, 2013, after publishing the green paper on shadow banking supervision in March 2012. The proposal set up a series of rules in terms of liquidity standards, information disclosure requirements and transparency in the operation etc. The European Council was also considering making new rules on MMFs in order to enhance their soundness. In December 2012, the ESRB published the regulatory recommendations on MMFs, including mandatory transfer to floating NAV MMFs, additional liquidity and disclosure requirements, and more detailed reporting requirements.

Assessment and monitoring of systemic risk were strengthened. ESRB continued to publish the risk dashboard, monitoring the inter-linkages and systemic risk, macro risk, credit risk, funding and liquidity, market risk etc. Taking into account the circumstances of member nations, ESRB suggested different macro-prudential tools for risks in banking, insurance and financial market infrastructures, and conducted assessment on the results of implementation of different tools. ESRB also proposed a set of measures to address the systemic risk in foreign debt held by non-financial private sector, and ensure the effective adoption of the European capital rule by using appropriate macro-prudential instruments.

4. Russia

New financial regulatory system was in shape. In July 2013, Russia enacted a law to abolish the Federal Financial Markets Service and establish the Financial Supervision Committee belonged to the Central Bank of Russia, taking the responsibility of supervising and oversight financial market, and conducting uniform supervision on securities, insurers, small-sized financial organizations and pension funds. The central bank needs to submit once every three years to the Duma the draft of development and sound operation of key financial areas. This reform strengthened the macro-prudential mandate of the central bank, brought both monetary policy and financial supervision to a single institution, ensured the uniform and consistency of financial policies, and further reinforced the central bank's capacity in preventing and mitigating systemic risk.

III. China's Practices in Macro-prudential Regulation

1. The Joint Ministerial Conference on Financial Regulatory Coordination was set up.

The CPC Committee and the State Council

have always paid high attention to the establishment of the financial regulatory coordination mechanism. The *Law on People's Bank of China* amended in December 2003 stipulated that the State Council should set up a financial regulatory coordination framework, while the detailed measures are promulgated by the State Council. The rules on main mandates, internal organisation structure and the staffing of the PBC released in 2008 required that under the leadership of the State Council, the PBC, together with the CBRC, CSRC and CIRC, establish the financial regulatory coordination mechanism. According to aforementioned rules, the PBC, CBRC, CSRC and CIRC strived to improve communication and coordination of financial regulation policies in various ways.

Since 2013, China's economic and social development has presented new features characterized by the development phase. The pace of structural adjustment of economy has accelerated, the reforms of interest rate and exchange rate regime are pushed steadily forward, financial innovations and innovative business models emerge, and the external environment and internal operational mechanism have undergone profound changes, which urge to improve the financial regulatory coordination mechanism. In August, the State Council approved the establishment of a joint ministerial conference on financial regulatory coordination , to be led by the PBC and participated by the CBRC, CSRC and CIRC. The office of the joint ministerial conference is located within the PBC, assuming the relevant administrative affairs. The joint ministerial conference has regular quarterly meetings or occasional meetings to perform its mandate, enhancing the coordination between monetary policy and financial regulation as well as between regulatory policies and laws, promoting the coordination between safeguarding financial stability and mitigating systemic and regional financial risks, reinforcing the policy coordination with regards to cross-sector financial products and cross-market financial innovations, and strengthening the coordination in areas like financial information exchange and the comprehensive financial statistics system, which marks that the financial regulatory coordination in China has been institutionalized and rule-based.

The establishment of the Joint Ministerial Conference on Financial Regulatory Coordination is a significant decision made by the State Council with considerations of domestic and foreign economic and financial conditions, and is a crucial measure to improve China's financial regulatory system. First, it's conducive to filling up the supervisory gaps and absence due to over-fast development of financial innovation, unifying the supervisory parameters and standards, and meeting the internal demands of maintaining soundness and effectiveness of the financial sector under the separate supervisory system. Second, It's beneficial to promote the coordination among macro-adjustment and financial supervision as well as regulatory policies in different sectors, and forge the common force, effectively safeguarding the development of financial market and servicing the real economy. Third, It's favorable to view the financial system as a whole, strengthen the overall coordination of development and policy implementation concerning money market, credit market, capital market and insurance market, enhance macro-prudential regulation and prevent systemic risk.

Since the establishment of the financial regulatory coordination regime, relevant authorities have made great efforts to set up financial regulatory information sharing and comprehensive financial statistics mechanism, normalize the development and supervision of internet-based finance, regulate inter-bank business, and improve local financial regulation system. In the next step, the joint ministerial conference will perform its duties under the leadership of the State Council, and enhance the standardization and institutionalization of regulatory coordination.

2. Implementing the counter-cyclical macro-adjustment policies

In recent years, the PBC has adopted a macro adjustment approach featured with combination of quantitative, price-based and macro-prudential instruments, giving full play to different adjustment measures, coordinating the use of different instruments and forging the common force. After the international financial crisis, drawing lessons from the advanced economies, the PBC introduced the dynamic adjustment framework on differentiated reserve ratio on the basis of refinement on macro-prudential policy framework and toolkit. In accordance with the changing economic and financial condition, soundness of financial institutions as well as the implementation of credit policy, in 2013, the PBC continued to implement and improve the dynamic adjustment system on differentiated reserve ratio, calibrate some of the parameters, guide financial institutions to fulfill the sound monetary policy, maintain the sound operation, extend credit supply in an appropriate and reasonable way, and optimize the credit structure. In the beginning of 2013, the PBC guided the rural financial institutions to provide funding for the preparation of spring plowing, and thoroughly fulfill the credit demand of the rural areas, farmers and agricultures. During the third quarter of 2013, the PBC further adjusted the parameters, in order to encourage and incentivize financial institutions to increase credit extension to small and micro enterprises, the rural areas, farmers, agricultures as well as the underdeveloped regions like middle and western China. In general, dynamic adjustment system on differentiated reserve ratio, combined with the traditional monetary policy instruments including open market operation, adjustment of interest rate and reserve ratio etc., have played a crucial role in maintaining stable gross volume of credit, optimizing credit structure, and enhancing resilience of financial institutions. In the next stage, the PBC will adjust timely the parameters of dynamic adjustment system as the situation develops, and continue to give full play to the dynamic adjustment on differentiated reserve ratio as a counter-cyclical instrument. In the meanwhile, the PBC would consider bringing more credit creation activities into the macro-prudential framework alongside the financial deepening, financial innovation and development. The PBC and CBRC will continue to stipulate rules on counter-cyclical capital buffer, and set up and improve a mechanism which can achieve the smooth coordination and complement between macro-prudential regulation and micro-prudential supervision.

3. Strengthening assessment and monitoring of systemic risk

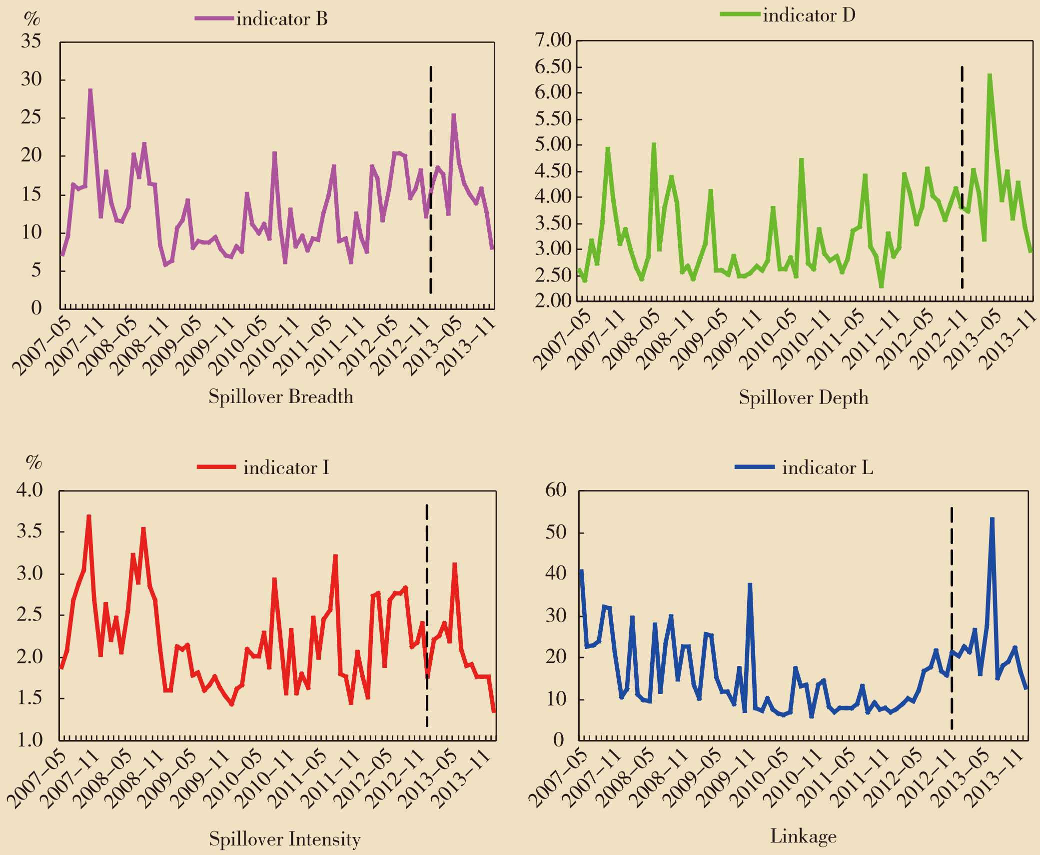
In 2013, the PBC strengthened judgment and assessment on foreign and domestic macro-economic performance from the overall and macro perspective, made in-depth analysis on the implications of changing global financial and economic condition as well as the cross-border capital flow on the liquidity and price level in China. With thorough understanding of the institutional characteristics of China as a transitional economy, focus was put on the analysis on risks related to transitional economy, and the potential risks arising from local government financing platforms, real estate loans, overcapacity industries, cross-sector financial products and cross-market financial innovations etc. The PBC continued to conduct financial stability stress test, according to the development of international and domestic economy and the deployment of financial reform, reasonably set the scenarios, refined the methodology, and enriched stress indicators. The regular risk monitoring and assessment system of banking, securities and insurance sectors was improved, and the on-site assessment on soundness of financial institutions was also enhanced. The PBC also enhanced reporting system of important matters and risk events of financial institutions, well prepared response plans, and resolved risks in a timely manner. Establishment of the deposit insurance system was also promoted to improve the market-based exit mechanism.

Box 21 Analysis on Contagion Risk of Banking Institutions

We made a further dynamic mapping and update on overall stability of the entire financial network by using data from inter-bank payment and settlement system from 2007 to 2013.

The major indicators on financial network stability of China experienced an obvious fluctuation during January to December 2013. Breadth (B), depth (D) and intensity (I) indicators all experienced downward after upward trend, and the peaks were in May and June. Moreover, a new indicator L was introduced to measure the degree of financial institutions' dependence on the network (Figure 8.2).

Figure 8.2 Movement of Financial Network Stability Indicators in 2007-2012①



Source: The PBC.

Linkage indicator (L) is measured by the proportion of inflow/outflow funds in the total position, reflecting the dependence of financial institutions on the whole financial network in terms of liquidity supply and demand. On the whole, indicator L has always been in the rather low level since 2010, then eventually rose since the second half of 2012, and declined sharply after reaching the peak in June 2013. The fact that degree of dependence rose rapidly not only is the reflection of rising significance of outflow parities in the whole network, but also shows the more reliance of inflow

① Breadth (*B*), Depth (*D*) and Intensity (*I*) indicators refer to institutions affected, round of impacts and funds affected, which were stated in Box 23of the *China Financial Stability Report 2012*. Besides, we introduced the Linkage (*L*) indicator to measure the network structure and stability. Based on the different direction of funding flow, it can be divided into two indicators, linkage of network on institutions and the linkage of institutions on network. The higher the indicators, the greater the linkage between network and the institution. When calculating the average level of all nodes in the network, there is no difference between trends of these two indicators.

parties on the outside funding. After the in-depth analysis, some institutions, especially the foreign banks, experienced a substantial decline in their positions or a prominent rise in funding flow during May and June, which is the main reason that resulted in the sharp rise of dependence on the outside funding, and further affected the network's stability on the whole.

We select June 2013 as the time point for updated analysis on the network consisting of large commercial banks, policy banks①, joint stock banks and foreign banks, and the results are as follows:

Large commercial banks. When there are liquidity shocks coming from large commercial banks respectively, on average around 38 banks would be affected more or less. The spillover would last for 5 rounds on average, and the proportion of affected fund exceeds 13% on average. The dependence of network on the large commercial banks is far more than the dependence of large commercial banks on the network. If all large commercial banks are regarded as a whole, the spillover would last 7 rounds, and most institutions would be affected. Compared to June 2012, large commercial banks are the major funding supplier, and have strong impact on the network.

Policy banks. When there are liquidity shocks coming from policy banks, on average 19 institutions would be affected, the spillover could last up to 5 rounds, and the proportion of affected fund would be 2% on average. Compared to 2012, the impact of policy banks was relatively stable. In terms of the degree of linkage, the dependence of the network on the policy banks is low, yet the dependence of the policy banks on the network is rather high.

Joint-stock commercial banks. when there are liquidity shocks coming from joint-stock commercial banks respectively, on average 23 institutions would be affected, the spillover would last 5 rounds and the proportion of affected fund would be more than 4%. The degree of linkage between joint-stock commercial banks and the network is appropriate on the whole. But there are specific joint-stock commercial banks that rely much more on the network, and the network's dependence on a few joint-stock commercial banks is rather high. It shows that the way in which joint-stock commercial banks affect the network has changed, though the overall impact of them is still lower than that of the large commercial banks.

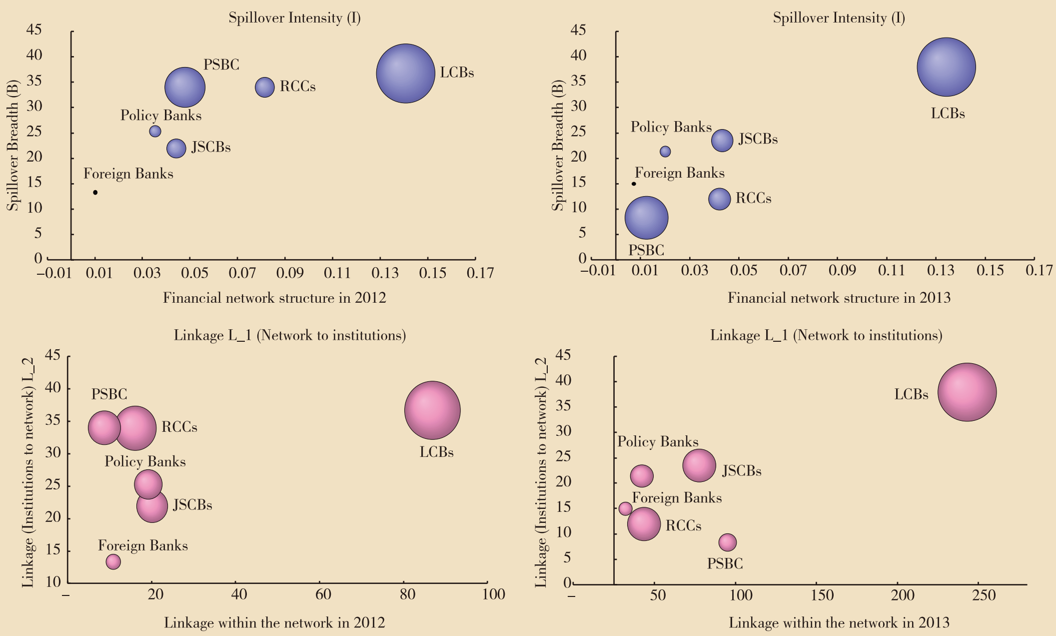
PSBC and Rural Credit Cooperatives. Compared to the past, in June 2013, there are great changes in terms of the impact degree and channels of PSBC. The number of affected institutions declined to 12, the rounds of spillover lasting was

① In this Box, large commercial banks refer to four banks, ICBC, ABC, BOC and CCB. BOCOM is included in joint stock commercial banks, and policy banks refer to three banks, CDB, EXIMbank and ADBC.

5 on average; the proportion of affected fund also fell to 1%. It's notable that the dependence of the network on the PSBC increased substantially, showing that during this period, the funding supply provided by the PSBC, which has become the second largest funding supplier except for the large commercial banks, was crucial to maintaining the network's stability. Similar with the PSBC, if all RCCs are regarded as a whole, the number of affected institutions and the rounds of spillover lasting would be 12 and 8, affecting 8% of the total funds. But different from the PSBC, RCCs heavily rely on the network, and the degree of the dependence is on the rise.

Foreign Banks. The impact of foreign banks in the network is rather stable. In June 2013, when there are liquidity shocks coming from individual foreign banks, on average 15 institutions, most of them are foreign banks, would be affected, the spillover would last nearly 5 rounds and affect 1% of transaction volume. However, the dependence is rather high for most foreign banks, which shows although the impact of foreign banks is still weak, they are sensitive to the changes in the liquidity risk and easily affected by the change in the terms of funding.

Figure 8.3 Financial Network Structure and the Linkage Within the Network in 2012 and 2013①



Source: The PBC.

① In the graphs of financial network structure, the area of circles refers to gross funding position of financial institutions. Whereas in the graphs of linkage within the network, the area of circles refers to the proportion of affected funds.

In conclusion, there were notable changes in the financial network structure in China in 2013, but the fundamentals of network's stability were good, and the status of the large commercial banks in the network was still solid. It should be noted that all the indicators on network stability were relatively high on average during May and June, which was mainly caused by the changes of liquidity condition, adjustment of institutions' behavior and the fluctuations in macro economy.

4. Enhancing supervision on SIFIs

The PBC, together with the relevant authorities, based on the work done by G20 and FSB in regards of SIFIs and the circumstances of China, take measures to develop the identification standards and assessment framework for Domestic Systemically Important Financial Institutions (D-SIFIs), properly tighten the regulatory requirements, and set up orderly resolution and liquidation arrangements. In 2013, the BOC CMG made efforts to guide the development of recovery and resolution plans, and the resolvability assessment was launched at the end of 2013. The relevant authorities were establishing the CMGs for ICBC and Ping An Group, researching on recovery and resolution planning. In 2013, the CBRC laid down the *Guidance on Disclosure of Assessment Indicators of Global Systemic Importance by Commercial Banks*, stipulating that commercial banks, whose total assets on- and off-balance sheets exceed RMB 1.6 trillion or which were identified as G-SIBs in the previous year, should begin to disclose their indicators of global systemic importance since 2014. Implementation of this guidance would help to strengthen market discipline on commercial banks, urge banks to improve their internal IT systems and management, enhance transparency and reinforce the analysis, monitoring and mitigation of systemic risks.

5. Regulating shadow banking

In 2013, the PBC improved the statistics system of total social financing, expanding the statistical scope to the shadow banking system. The regulatory authorities constantly enhanced supervision on shadow banking, and regulated banking wealth management products in terms of size, investment scope, transparency, disclosure, accounting and sales, etc. In order to prevent potential risk and direct development of shadow banking in a more healthy way, the State Council released *the Notice of Some Issues Concerning Strengthening Supervision of Shadow Banking* in December 2013, defining the scope and classification of shadow banking, clarifying the regulatory responsibilities for various categories of shadow banking, improving license approval and product supervision, reinforcing conduct supervision, regulating and directing financial market order, enhancing risk management and risk control, and improving supporting measures like regulatory coordination, data collection and credit information system.

Box 22 Orderly Breaking the Practice of "Rigid Redemption" of Wealth Management Products

The so-called 'rigid redemption' refers to the situation when wealth management products may default or fail to deliver targeted interest payment, the commercial banks, trust companies and insurance companies as the issuers or conduits must guarantee to pay off the principal and interests to the investors by means of seeking the third party's take-over, paying by own funds or providing compensation to investors, etc., so as to maintain their own reputation. In recent years, the wealth management products issued by banking, trust and securities companies are booming, and the practice of 'rigid redemption' has become a big challenge since to some extent it would distort the market discipline and disturb the resource allocation.

The overall risk to the financial system has increased. Rigid redemption could lead to mismatch between risk and yields of wealth management products, induce investors' irrational adjustment on their portfolios, raise the risk-free rate, and lead to improper allocation and flow of funds in different markets. Funds flooded into high-yield wealth management products and non-standard credit products, deposits with commercial banks diminished, while funds in bond market, stock market and insurance sector were squeezed out. Free-risk rate would rise, which results in declining of PE ratio of blue chips and depression of bond and stock market.

Moral hazard of investors and financial institutions has been provoked. For a long time, since the expected yield on wealth management products rarely has been broken, some investors' willingness of risk-taking is lower than stock, foreign currency and fund investors. They pursue profits while not willing to take risk and they would flood into financial institutions' outlets to demand the repayment once undue delivery happened, which becomes a source of social instability. Meanwhile, financial institutions have such expectations that a third party would intervene or take over, so they would overlook risks of the projects, do badly due diligence, and choose the high-yield projects to attract more investors. Funds from high-yield wealth management products are always invest into some macro-control areas like local government financing platforms and the real estate market, making the funding difficulties of SMEs more serious.

In order to develop the wealth management market in a healthy manner, improve the role of credit risk in pricing, reduce moral hazard and strengthen market discipline, we should orderly break the rigid redemption in the precondition of risks under control, conforming to the release of risks in underlying assets, and allowing some defaults to happen naturally in compliance with the market strength. We should enhance investors' risk awareness, setting up the concept that sellers should fulfill their duties and buyers also assume their own responsibilities. When default happens, the responsibilities and obligations shouldered by issuers, conduits and investors should be defined clearly to make sure that they would take their own risks, so as to push wealth management business to return to the nature of 'entrusted by others and managing wealth for others'.

Special Topic Ⅰ

The Banking Sector Stress Tests

I. The Snapshot of the Stress Tests

At the end of 2013, PBC organized 17 systemically important commercial banks to conduct the Financial Stability Stress Tests of 2014. The tests were composed of credit risk stress test, market risk stress test and liquidity risk stress test. The tests, based on the end of 2013 balance sheet data of 17 commercial banks, were to assess the soundness of the commercial banks amid negative shocks.

Scope. The tests covered 17 banks including the large commercial banks (LCBs) and the joint-stock commercial banks (JSCBs). The LCBs included ICBC, ABC, BOC, CCB and BOCOM; And JSCBs that participated in the tests were China Merchants Bank, Shanghai Pudong Development Bank, China CITIC Bank, Industrial Bank, China Minsheng Banking Corporation, Everbright Bank, Huaxia Bank, Guangdong Development Bank, Pingan Bank, Evergrowing bank, China Zheshang Bank, and Bohai Bank. As of end-2013, aggregate assets of the above banks, which were highly representative, accounted for about 61 percent of the total assets of the overall banking institutions.

Approach. The tests followed both top-down approach and bottom-up approach. In top-down approach, the PBC collected data in given format from the 17 commercial banks and conducted tests. The bottom-up tests aimed to assess the risk profile of individual banks or various groups of commercial banks, which were carried out by banks themselves. The PBC was in charge of compiling and analyzing the test results.

Methodology. The credit risk stress test consisted of sensitivity stress test and scenario stress test. The sensitivity stress test directly assessed the impact of credit risk exposure deterioration in key areas; the scenario stress test focused on the changes of overall NPL ratio and CAR in banking system under the condition of macroeconomic downturn. The market risk stress test mainly estimated changes of CAR of the commercial banks stemming from fluctuations in both interest rate and exchange rate. The liquidity risk stress test measured how the policy factors and macroeconomic factors affected liquidity ratio of the commercial banks.

Stress Scenarios[①]**.** The scenario test of credit risk chose GDP growth rate, M_2 growth rate and CPI annual rise as the stress indicators to characterize the macroeconomic downturn scenario. The sensitivity stress test of credit risk selected aggregate credit assets and NPL rate, default or losses in 6 key areas as the stress indicators. Stress test on interest rate risk of banking book selected the shift of deposit and loan interest rates in parallel as well as narrowing interest margin as the stress

① The stress scenarios were developed based on the feedbacks of questionnaires to external economic experts, and should not be assumed to represent PBC's judgements on macroeconomic condition.

indicators; stress test on the interest rate risk of trading book used the RMB-bond yields ratio as the stress indicator. The stress indicator of exchange rate risk stress test was RMB/USD exchange rate. The liquidity stress test selected bond price, NPL ratio, deposit scale and interbank deposit (borrowing) scale as indicators.

Table 1 Scenarios for the Financial Stability Stress Tests

<table>
<tr><th>Types of Risk</th><th>Types of Tests</th><th>Stress Target</th><th>Stress Scenarios</th></tr>
<tr><td rowspan="7">Credit Risk</td><td>Scenario Stress Test</td><td>Aggregate credit assets</td><td>Mild: GDP growth rate down to 7%
Medium:GDP growth rate down to 5.5%
Severe:GDP growth rate down to 4%
（M_2 growth rate and annual CPI were based on experts' opinions）</td></tr>
<tr><td rowspan="6">Sensitivity Stress Test</td><td>Aggregate credit assets</td><td rowspan="2">Mild: NPL ratio[①] up 100%
Medium: NPL ratio up 250%
Severe: NPL ratio up 400%</td></tr>
<tr><td>Loans to Yangtze river delta region</td></tr>
<tr><td>Customer concentration</td><td>Mild: the top 1 largest group(legal entity) customer defaults
Medium: the top 2 largest group(legal entities) customers default
Severe: the top 3 largest group(legal entities) customers default</td></tr>
<tr><td>Loans to LGFPs</td><td rowspan="2">Mild: NPL ratio up 5 percentage points[②]
Medium: NPL ratio up 10 percentage points
Severe: NPL ratio up15 percentage points</td></tr>
<tr><td>Loans to overcapacity industries</td></tr>
<tr><td>Exposures to on- and off-balance
sheet wealth management products[③]</td><td>Mild:10% loss of on- and off-balance sheet wealth management products
Medium: 20% loss of on- and off-balance sheet wealth management products
Severe: 30% loss of on- and off-balance sheet wealth management products</td></tr>
</table>

① Assuming that the initial NPL ratio is X %, up n percent means the NPL ratio becomes X %(1+n percent).

② Assuming that the initial NPL ratio is X %, up n percentage points means the NPL ratio becomes (X+n) percent .

③ In terms of the investment orientations of wealth management products, the exposures tested in this stess test were credit wealth management products, exclusive of products invested in bonds and deposits, capital market trust or overseas wealth management products, etc.

(concluded)

Types of Risk	Types of Tests	Stress Target	Stress Scenarios
Credit Risk	Sensitivity Stress Test	Real estate loans	Mild: NPL ratios of residential mortgage loans and real estate developing loans (including land reserve loans) up 3 and 5 percentage points respectively Medium: NPL ratios of residential mortgage loans and real estate developing loans (including land reserve loans) up 4.5 and 10 percentage points respectively Severe: NPL ratios of residential mortgage loans and real estate developing loans (including land reserve loans) up 7.5 and 15 percentage points respectively
Market risk	Interest rate risk stress test	Banking book	**Interest rate parallel shifting:** Mild: both deposit rate and loan rate up 50 bps Medium: both deposit rate and loan rate up 125 bps Severe: both deposit rate and loan rate up 250 bps **Benchmark interest rate:** Mild: deposit rate up 50 bps, while loan rate unchanged Medium: deposit rate up 125 bps, while loan rate down 25 bps Severe：deposit rate up 250 bps, while loan rate down 50 bps
		Trading book	Mild: bond yield curve up 100 bps Medium: bond yield curve up 250 bps Severe：bond yield curve up 350 bps
	Exchange rate risk stress test①	Banking book and trading book	Mild：RMB appreciating/depreciating 10% against USD Medium：RMB appreciating/depreciating 20% against USD Severe：RMB appreciating/depreciating 30% against USD
Liquidity risk	Scenario stress test	Banking book and trading book	Mild: 4% of loans due within 30 days turn to NPLs, securities' price down 4%, deposits down 4% , interbank deposits and borrowing down 10% Medium: 7% of loans due within 30 days turn to NPLs, securities' price down 7%, deposits down 6%, interbank deposits and borrowings down 30% Severe: 10% of loans due within 30 days turn to NPLs , securities' price down 10%, deposits down 8%, interbank deposits and borrowings down 50%

① The shock in the exchange rate risk stress test refers to changes of exchange rate of the RMB against the USD, while assuming that exchange rates of the USD against other currencies remain stable.

II. Overall Results of the Stress Tests

1. Credit risk

The banking sector illustrates strong resilience to credit shocks. The results of the Sensitivity Test and the Scenario Test of aggregate credit risk reflect banks' stable assets quality and solid capital position. The banking sector, represented by the 17 commercial banks, remains resilient to macroeconomic shocks and performs soundly.

The result of the Sensitivity Test indicates that, under the severe shock where the overall NPL ratio rises by 400%, the CAR of the banking sector would fall from 11.98% to 10.5% (Figure1). Specifically, the CAR of LCBs would decrease by 1.63 percentage points while the CAR of JSCBs would decline by 1.12 percentage points (Figure2). Under the mild, medium and severe shocks to the credit exposures to the 6 key areas, the CAR of banking sector remains high. Even under the severe shock, the CAR would be more than 10.5%.

Figure 1　The Sensitivity Stress Test for Aggregate Credit Assets: Overall

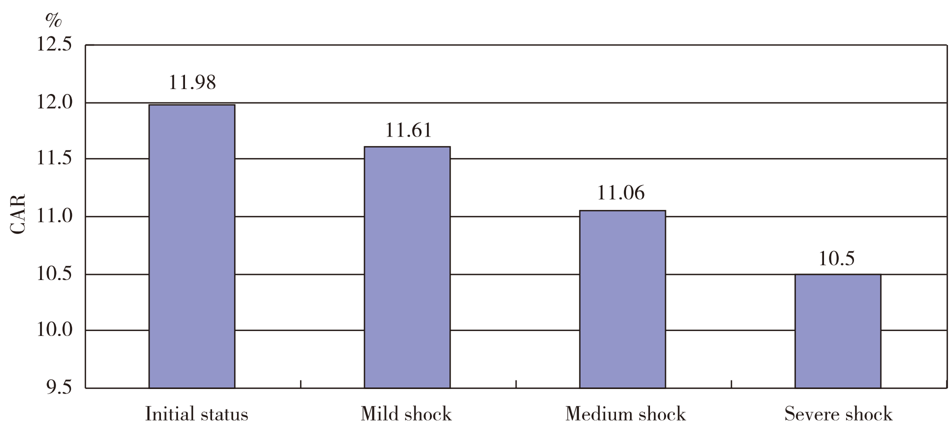
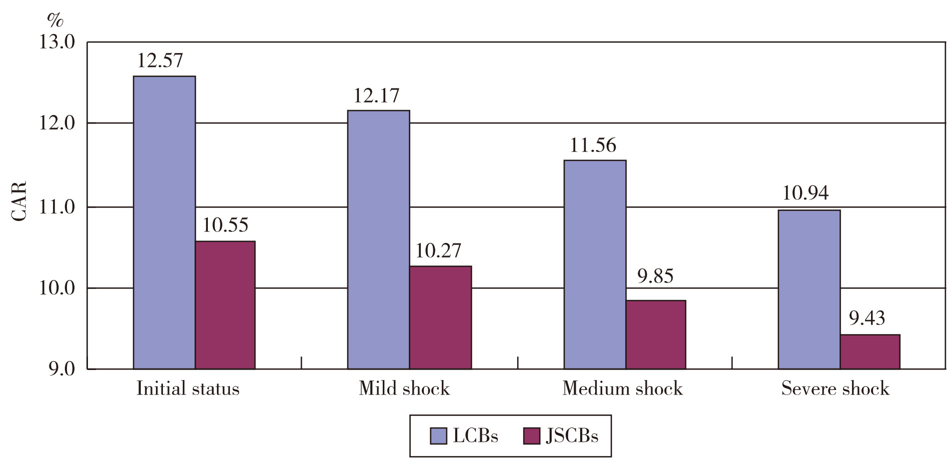
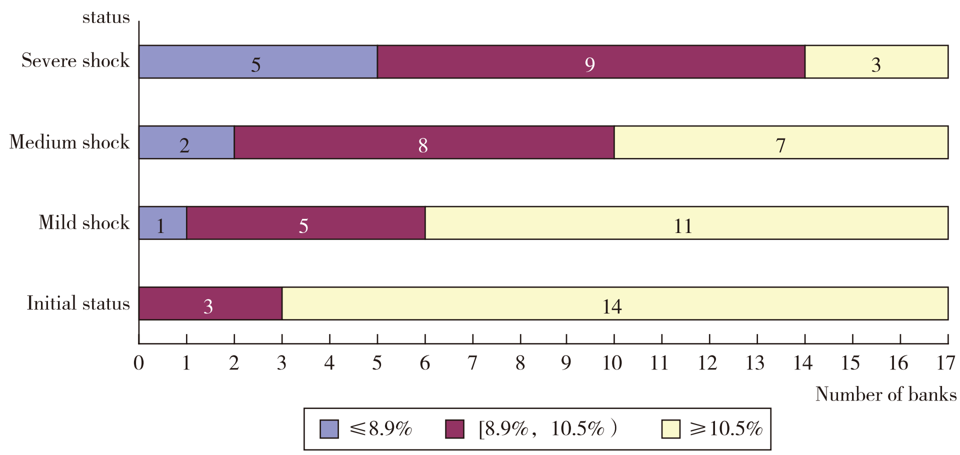


Figure 2　The Sensitivity Stress Test for Aggregate Credit Assets: by group



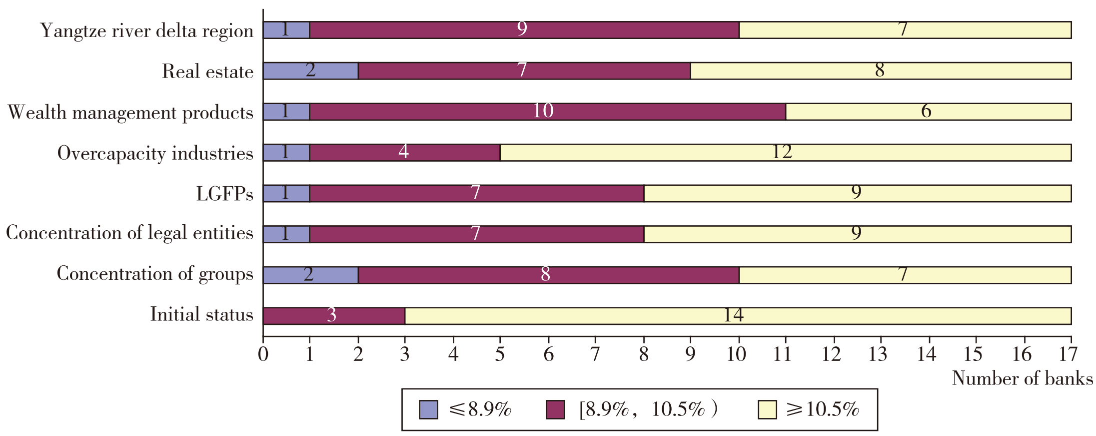
The Scenario Stress Test of credit risk suggests that, under mild, medium and severe shocks, the overall CAR of banking sector would decrease to 11.79%, 11.23% and 10.17% respectively. Although the medium and severe shocks would have significant impact on the banking sector, the high CAR under such shocks shows that China's banking sector is resilient to macroeconomic shocks and could perform soundly. Under the initial status, the CARs of 14 commercial banks are higher than 10.5%, while under the mild, medium and severe shocks, the number would decrease to 11, 7 and 3 respectively (Figure 3).

Figure 3 Distribution of Banks' CAR: the Scenario Stress Test



The focus of attention is on credit risks in several key areas. According to the results of Sensitivity Test of credit exposures to 6 key areas, risks in areas such as real estate, on- and off-balance sheet wealth management products, as well as customer concentration risks should be concerned (Figure 4). In terms of the types of institutions, due to the differences in capital adequacy, risk exposures and asset quality, the resilience of banks is different.

Figure 4 Distribution of Banks' CAR: the Sensitivity Stress Test (Severe Shock)



2. Market risk

The interest rate risk of banking book is basically under control. The results indicate that, under severe shock (both deposit and loan interest rates up 250 bps), the CAR of banking sector merely fell by 0.19 percentage point (Figure 5). Under mild, medium and severe shocks, while deposit rate up and loan rate down, the overall CARs of banking sector would decrease by 0.46, 1.36 and 2.73 percentage points respectively (Figure 6).

Figure 5 Interest rate parallel shifting risk of banking book

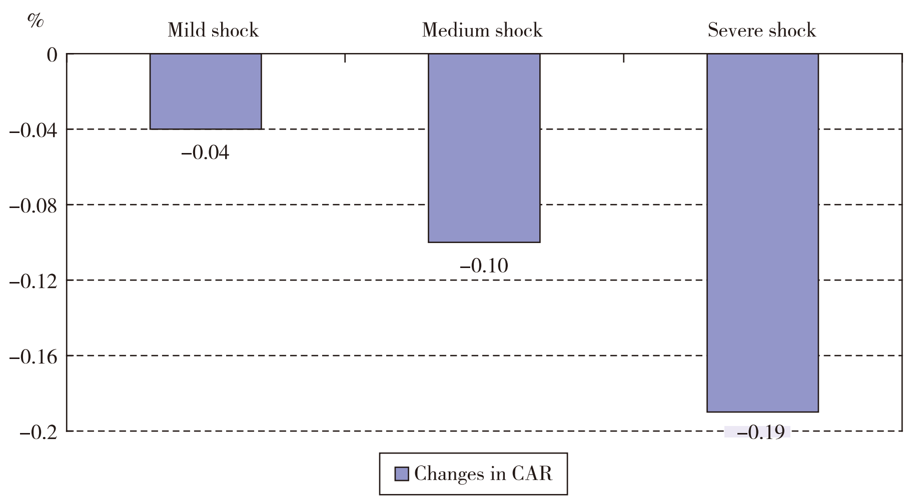
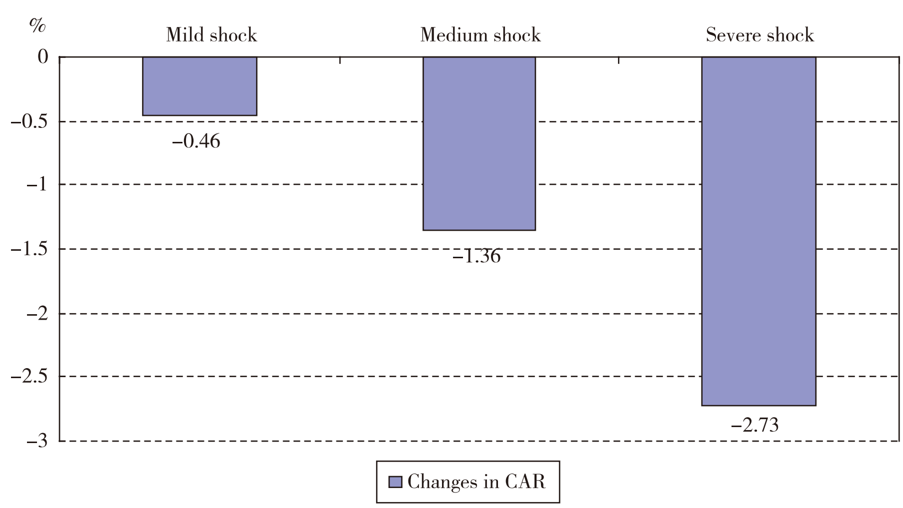


Figure 6 Benchmark interest rate risk of banking book



The interest rate risk has insignificant impact on trading book. The result under severe shock indicates that, even though the bond yield curve up 350 bps, the CARs of

17 banks would drop slightly, and the CAR of banking sector only decreased by 0.024 percentage point (Figure7). Thereinto, the CAR of JSCBs declines more than that of LCBs, suggesting JSCBs are more sensitive to upswing of bond yield curve (Figure 8).

Figure 7 Interest rate risk of the trading book

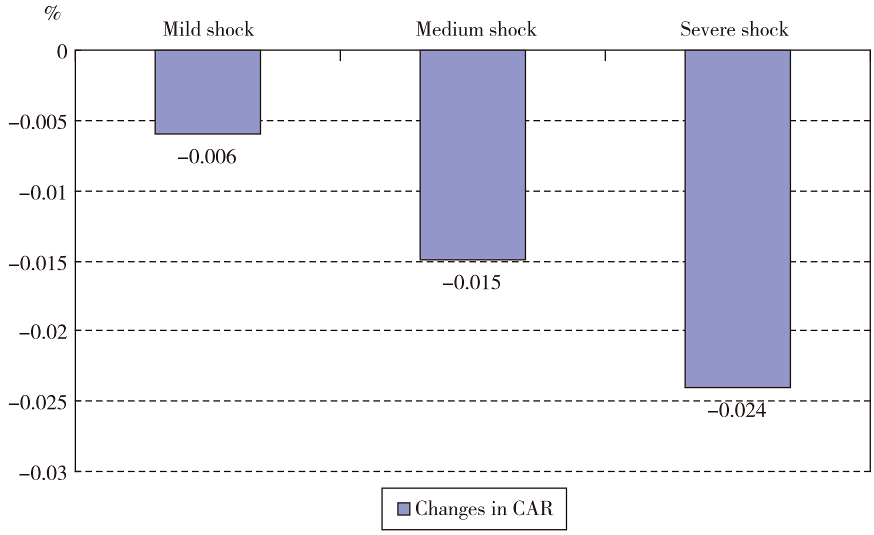
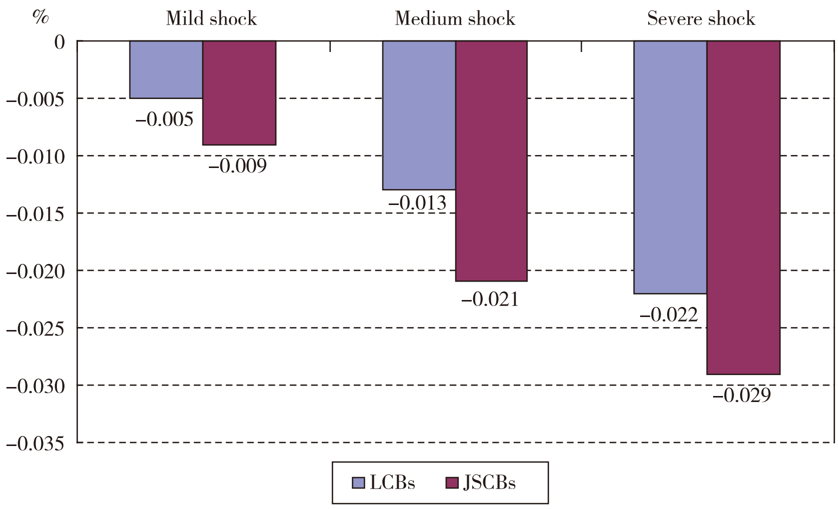


Figure 8 Changes of CAR caused by interest rate risk of the trading book: by group



The direct impact of exchange rate changes on banking sector is limited. The results show, even under the severe shock, the CAR of banking sector decreases by 0.06 percentage point (Figure 9). Thereinto, the CAR of JSCBs drops a little more than that of LCBs under the same shocks (Figure 10).

Figure 9 Direct Exchange Rate Risk

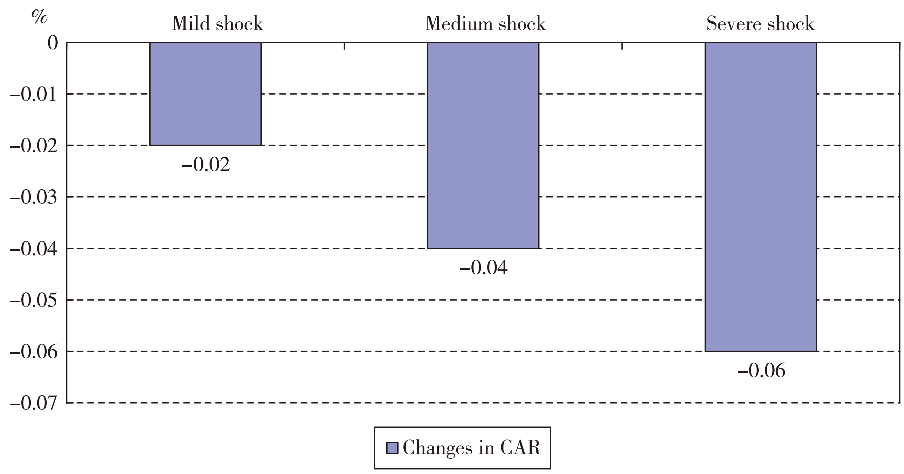
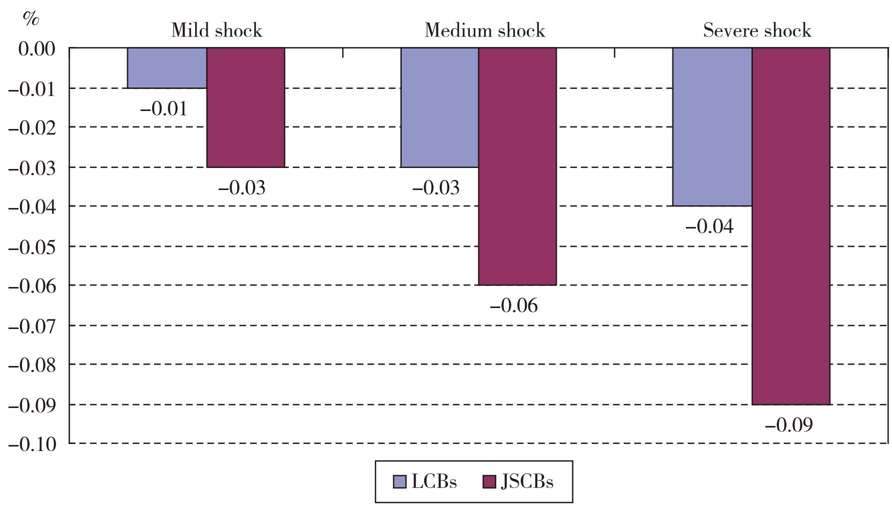


Figure 10 Changes in CAR Caused by Direct Exchange Rate Risk: by group

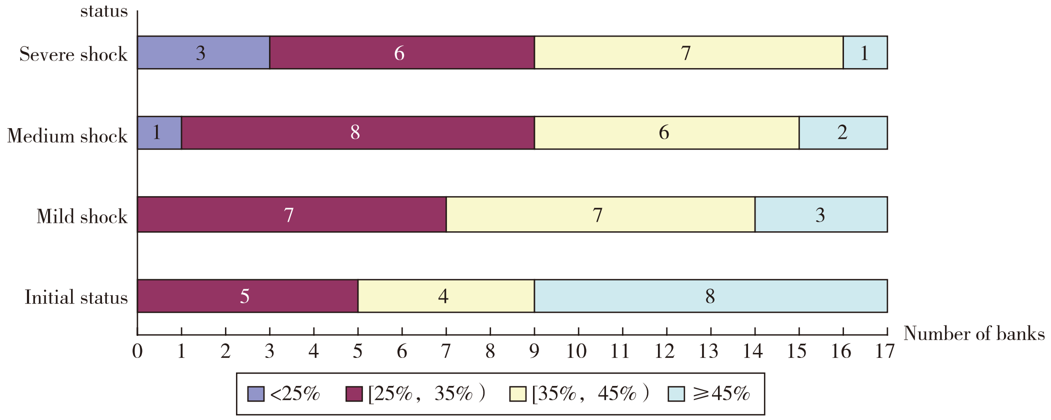


3. Liquidity risk

The Liquidity Risk Stress Test was carried out by the banks themselves. The results show that the liquidity ratios should decrease to different extents under different shocks. Under medium and severe shocks, there are 1 and 3 banks whose liquidity ratios fall below the requirement①.

① The core indicators of commercial banks (for trial implementation) issued by CBRC requires the liquidity ratio of a commercial bank should be above 25%.

Figure 11 Distribution of banks' liquidity ratios: liquidity risk



Special Topic II

Development and Oversight of Internet Finance

Since the beginning of 21st century, internet finance, which facilitates fund transfer, monetary circulation and infomediary via internet, has been developing rapidly with the wide use of internet technology and mobile terminals. Internet finance contributes to the availability of the financing to micro and small enterprises, the optimization of financial resource allocation, the improvement of the inclusiveness of the financial system and the promotion of inclusive finance. For now, the development of internet finance in China is still at an early stage. It is critical to protect the legitimate rights and interests of consumers and mitigate risks while encouraging innovation. Relevant authorities shall oversight internet finance moderately, and promote it to grow in a sustainable, healthy and stable way so as to better serve the real economy.

I. An Overview of Internet Finance

What is internet finance? At the moment, there is no specific and widely accepted definition either from the industry or the academia. However, there are several typical categories of internet finance, including internet payments, P2P lending, and crowd funding. Generally speaking, internet finance is a new type of financial mode that integrates the functions of financing, payment and information media via internet and mobile communications technology. In a broad sense, internet finance covers financial services provided by internet companies that are non-financial institutions and internet services provided by financial institutions. In a narrow sense, internet finance is limited to the financial services provided by internet companies based on internet technology.

What are the main characteristics of internet finance? First of all, such services are supported by the use of mega data, cloud computing, social media and search engines to dig deeply into customer information and manage credit information. The internet finance generates and disseminates information through the internet, use search engines to organize, align and retrieve information, process the information through cloud computing, and satisfy the customers' demand for information digging and credit risk management in a well-targeted manner. Second, allocation of financial resources is based on direct transactions in which the supply and demand information are published on the internet to enable the two parties to directly find one another and strike a deal. The transaction environment is more transparent and costs are reduced, therefore the borders of financial services are expanded. Third, internet-based fund transfer is supported by third-party payment institutions who are playing an increasingly important role.

Internet finance has gone through three development stages in China. The first stage was before 2005 when the combination of internet and finance took the form of banks using internet to "move their business online". At this stage, internet finance had not taken shape yet. The second stage started in 2005 when internet-based peer to peer lending emerged and the third-party payment providers started their business. The integration of internet and finance moved from technology sphere to financial business. A landmark event was that the PBC started to issue payment licenses in 2011. From then on, third-party payment services have been developing in a regulated way. The third stage started in 2012. The year 2013 witnessed the rapid growth of internet finance. Since then, the P2P platforms developed fast. The crowd funding activities began to grow. The first internet insurance company got the license. Banks and securities companies renewed their business model and built online platforms for innovation. All in all, the development of internet finance entered a new stage.

II. Contribution of Internet Finance in China

First of all, internet finance has promoted inclusive finance and filled in the gap in traditional financial services. Internet finance is targeted at micro and small business. The transactions are enormous in volume and low in value per order. Concerning its characteristics of low value, fast settlement, and easy access, internet finance helps to promote inclusive finance and inclusive growth and thus fill in the gap where traditional finance fails to cover to some extent. Internet finance and traditional finance compete and cooperate with each other, and grow together. They are both important elements of the financial system in China.

Second, internet finance has helped propel the development of private capital and guided private finance to develop in a more regulated way. Due to the lack of efficient channels and products of investment, large volume of private lending activities took place outside the financial system and were not subject to supervision. They need channels for transparent and sound operations. The regulated development of P2P and crowd funding could help channel private capital to the areas and projects that are encouraged by the state, contain loan sharks and mobilize the large stocks of private capital so that the private capital can provide better services to the real sector. The equity financing through crowd funding is also consistent with the trend of multi-layered capital market development.

Third, the development of internet finance has helped meet the demand of e-commerce development and boost domestic consumption. In August 2013, the State Council released the *Opinions on Promoting Information Consumption to Expand Domestic Demand*, setting the goals of increasing the volume of e-commerce to more than RMB 18 trillion yuan and the internet retail volume to more than RMB 3 trillion yuan in 2015. The development of e-commerce needs the support of convenient, fast and safe payments, which calls for the development of internet payment, especially mobile payment; the start-up fund and other financing needs of e-commerce and the consumer financing for e-commerce clients have boosted the development of internet-based micro loans, crowd funding and P2P lending. Development of e-commerce has been a catalyst in the evolution of financial services while the booming internet finance has facilitated the development of e-commerce.

Fourth, it has helped lower the cost and improved the efficiency of fund allocation and the quality of financial services. Thanks to the use of large data base generated by e-commerce, third-party payment and social media, and the data digging technology, internet finance has lowered the transaction cost significantly. Providers of such services do not need large amount of physical outlets or hire a large team, therefore their operational costs are cut by a very large margin. Internet finance offers new financing channels different from those of traditional banking services and equity market financing, and provides the convenience of all-weather and all-including services in a one-stop manner, thus raising the efficiency of fund allocation and quality of services.

Fifth, it has encouraged financial product innovation to satisfy the diversified need of customers. Rapid development and innovation in the internet finance have pushed traditional financial institutions to change their business and service models, and brought about close cooperation between internet financial service providers and traditional financial institutions. The enterprises that provide internet finance rely on mega data and cloud computing to get the dynamics of customers' diversified demand, and measure the credit standing of customers. This helps mitigate the information asymmetry in the traditional financial sector, enhance risk control and create financial products designed to meet the specific demand of customers.

III. Major Practice of Internet Finance in China

1. Internet Payment

Internet payment refers to fund transfer services in which payment orders are given via internet by terminals like computers and mobile phones. In essence, the new type of payment institutions serves as intermediaries and uses internet technology to provide fund transfer services for the payers and payees. Alipay is a typical internet payment institution.

Specifically, there are three types of internet payment services. In the first type, a customer uses a link provided by the payment institution to access his/her bank's online banking page, or swipe his/her card on the POS linked to a computer or a mobile phone to transfer money from his/her bank account. The money stays in the bank account before being transferred and the payment institution does not get itself involved in the transfer. In the second type, a customer opens a payment account with the internet payment institution and moves money from his/her bank account to this account before giving payment orders to the payment institution. This payment account is an account opened in the payment institution for the purpose of bookkeeping while the clients' fund is actually deposited in the account opened by the payment institution at the depository bank. The third type is the fast and easy payment model in which a payment institution opens a payment account for a customer, then the customer, the payment institution and the account opening bank sign a tri-partite agreement to link the customer's bank account with the payment account so that the customer can manage the fund in his/her bank account directly after logging on to the payment account. In this model, the customer's money stays in his/her bank account but the fund transfer order is given through the payment institution. Internet payment has been in a boom in recent years. As of August 2013, among the 250 licensed payment institutions, 97 institutions had provided internet payment services. In 2013, payment institutions processed 15.338 billion internet payment transactions with a total volume of RMB 9.22 trillion yuan. The use of internet payment business has expanded gradually from traditional transactions of online shopping and utility fee payment to wealth management, mutual fund subscription, travel, education, insurance, community service, health care, medical service, and etc.

2. P2P Online Lending

P2P refers to direct lending deals reached between individuals at online platforms. P2P online lending platforms provide intermediary services such as information exchange, demand and supply matching, creditworthiness assessment, investment consulting, legal procedure handling, and etc. Some platforms also provide fund transfer and settlement, debt collection, and other services. CreditEase and Renrendai are two typical P2P online lending platforms.

In the traditional P2P online lending model, it is up to the borrower and lender to sign the loan agreement, whereas the platform merely serves as an intermediary without providing any guarantee for the availability of loan or participating in the borrowing relations. Now, a new model of "quasi-guarantee" has emerged, in which when a borrower is in arrear, the P2P platform or its cooperation institution would pay the principal and interests in full or partially on behalf of the borrower. The source of fund for such payment may include the income of the P2P platform, guarantee fee payment to the guarantee company, or the risk reserve that is paid as a proportion of the loan. Furthermore, there are the so-called "quasi-equity", "quasi-asset-management" and other models. P2P online lending started in 2006. At the end of 2013, there were more than 350 active P2P online lending platforms, with accumulated transaction volume exceeding RMB 60 billion yuan. Judging from their business volume and operation, the platform companies generally have a low threshold, with registered capital around several million yuan, a team of several dozen staff members, a single lending transaction in the range of tens of thousand yuan, and annualized interest rate below 24 percent.

3. Non-P2P Online Micro Loans

Non-P2P online micro loans (hereinafter referred to as online micro loans) refers to internet companies providing, through its micro-loan company, micro credit loans to the customers of its e-commerce platforms. The micro-loan companies of Alibaba Financial are typical examples of online micro-loan providers.

Online micro-loan providers make use of transaction and cash flow data generated by their e-commerce and online payment platforms to evaluate the creditworthiness of borrowers, conduct online review and approval, and then provide short-term micro-loans in a very fast and convenient manner. For example, the online micro lending companies that belong to the Alibaba Group provide micro-loans to the sellers on the Taobao platform to satisfy their financing need. As of the end of 2013, the loans granted by the three micro-loan companies of Alibaba Financial accumulated to RMB 150 billion yuan and the outstanding balance exceeded RMB 12.5 billion yuan. The customers were over 650,000.

4. Crowd Funding

Crowd funding refers online platforms mobilizing funding for the initiator of a project through the online platform for a project or a start-up of a company. The initiator then gives returns to the investors. Angelcrunch and Demohour are the typical examples of crowd funding platforms.

Such platforms serve as an intermediary between investors and project initiators so that the project initiators can receive direct funding from the investors who consider their projects as promising. Depending on the way return is provided to the investors, there are two types of crowd funding. The first type provides equity or future profits to the investors, such as Angelcrunch; the second type offers products or services that the projects will produce in the future as returns to the investors, such as Demohour. Crowd funding has started rather late in China. There are about 21 such platforms. Since its founding, Anglecrunch has attracted about 8000 start-up projects on its platform, with more than 1000 enterprises verified and approved, more than 20000 entrepreneur members and 840 certified investors. The financing has exceeded RMB 250 million yuan.

5. Innovative Online Platforms of Financial Institutions

Financial institutions have generally created two types of innovative online platforms. The first type is the e-commerce and financial service platforms created by traditional financial institutions for their clients that support retail sales, fund transfer and financing activities. The platforms do not make money from margins between purchase and sale prices of the goods and services. Their profits come from payment and settlement, financing for enterprises and consumers, guarantee, credit card installment, and other financial services. Shanrong E-Commerce platform of China Construction Bank (CCB), the E-Mall of Bank of Communications (BOCOM), the online mall of China Merchants Bank, and the online banking arm of Huaxia Bank for wholesale customers are all examples of such platforms. The second type refers to those professional online financial institutions that do not have physical outlets and conduct all their business online. For example, the Zhongan Property Insurance only conducts internet related business, and sells insurance products on its own website and third-party e-commerce platforms.

6. Internet-based Mutual Fund Sales

Depending on the online platforms, internet based mutual fund sales can be divided into two types. In the first type, sales are based on a mutual fund company's own online platform where the mutual fund company provides sales service to the investors. In essence this is the extension of its traditional sales channel to internet. In the second type, fund sales companies sell mutual fund units on the internet platforms of other internet companies, including by opening online shops on third-party e-commerce platforms, selling mutual fund units on third-party payment platforms, and etc. In particular, the sale of mutual fund on third-party payment platforms is in essence direct sale by the mutual fund company whereby customers can buy and redeem mutual fund units very easily. Take Yu Ebao offered by Alipay and the mutual fund product "Licaitong" offered by Tencent on its WeChat platform as examples. The outstanding volume of Yu Ebao exceeded RMB 250 billion yuan with more than 49 million users as of January 15, 2014, while the outstanding volume of Licaitong exceeded RMB 10 billion yuan in less than 10 days after its launch on the WeChat platform on January 22, 2014.

IV. International Experience of the Oversight of Internet Finance

1. Internet Payment

In many countries, the authorities require non-financial institutions to apply for the licenses before allowing them to provide payment services, but the access threshold is usually lower than the license requirements of banking institutions. In many countries, oversight of internet payment usually focuses on anti-money laundering, the depository of the fund, disclosure of important information and protection of the rights and interests of consumers.

In the US, payment services provided by non-financial institutions are subject to federal and state regulation, focusing on the protection of rights and interests of consumers, information reporting, anti-money laundering and cracking down of financial crimes. In the UK, the Financial Conduct Authority (FCA) requires all payment institutions including internet payment institutions to register and comply with relevant prudential requirements. In France, payment institutions are subject to regulation by the banking regulatory authority and Banque de France in accordance with the provisions in the EU Electronic Money Directive II that require payment institutions to meet the access requirements in terms of paid-in capital, senior management qualification, corporate governance and internal control. In Germany, according to the *Payment Service Supervision Act*, payment institutions must get an electronic money institution licenses from BaFin and must not provide loans; moreover, they should entrust a third party to act as the custodian or provide guarantee for the fund that they handle in the payment procedure, and should comply with anti-money laundering requirements. In Japan, the Payment Services

Act requires a non-banking institution to receive a license from the Financial Services Agency (FSA) before conducting payment business and any single transaction to be handled by such an institution must not exceed JPY 1 million yen.

2. P2P Online Lending

Generally speaking, there are two approaches in the regulation and supervision of P2P lending worldwide. In the first approach, the financial regulatory authorities act in accordance with their mandates to formulate appropriate regulatory rules and exercise supervision; in the second approach, a P2P platform is required to apply for a bank license and subject to the same strict supervision as a bank.

In the US, the feature of P2P lending model is that instead of lending directly to a borrower, a lender buys beneficiary certification from the P2P platform. Therefore, an individual participate in lending by subscribing to the units of lending processed by the platform. The Security and Exchange Commission (SEC) considers this a kind of securities investment to be regulated according to the Securities Act. In the UK, P2P lending is governed by the *Consumer Credit Act* and the P2P lending legislation is in the making. The regulatory rules in the pipeline may include the following: a platform shall provide detailed explanation of the loan arrangement before lending to a borrower and identify the major risks involved; before lending, a platform should evaluate the credit standing of a borrower before making a decision. In France and Germany, P2P online lending is not subject to specialized supervision. However, supervision of the business is based on the banking law, i.e., an institution has to apply for a bank license to provide any banking service, such as lending or deposit taking. In Japan, the supervision of P2P lending is based on a series of underground finance response laws, with an emphasis on market access rules, also featuring a ceiling on the lending interest rate to curb over-borrowing and penalty on such activities as loan sharks, P2P lending without registering with the relevant authority, illegal advertising and soliciting.

3. Crowd Funding

Generally speaking, countries support and encourage the development of crowd funding activities, and exercise different degrees of regulation and supervision, reflecting the philosophy of moderate supervision.

In the US, the *Jumpstart Our Business Startups (JOBS) Act* allows small enterprises to raise equity capital through crowd funding, and provides an exemption from the requirement to register public offerings with the SEC. In the UK, the crowd funding is considered a legal business, but is not governed by a special legislation, rather the supervision of crowd funding is included in the current financial regulatory framework. In France, the AMF and Prudential Control Authority jointly issued a directive on crowd funding in May 2013 to make clear that its activities involving securities subscription or equity investment should be governed by the securities law and its lending activities should be governed by banking law and regulation. In Germany, *Capital Investment Act* requires that any institution that facilitates the offering of securities or investment products to get a license from BaFin. In March 2013, the EU released the *Green Paper on the Long-Term Financing of the European Economy*, in which it made clear that efforts would be made to support crowd funding and other non-traditional financing. In Japan, regulation of the crowd funding is subject to *the Act on Sales etc. of Financial Instruments and the Financial Instruments and Exchange Act*.

4. Innovative Internet Platforms of Financial Institutions and Internet-Based Mutual Fund Sale

Some countries have rolled out additional regulatory requirements on the financial products sold on internet platforms. For example, in France, an insurance policy holder who has bought the product online can return the policy and receive a full refund within 14 days after the purchase. In several countries, internet-based mutual fund sale is subject to the same regulation as those sold through traditional channels. When recommending products to a client, a sales agency should have full knowledge of the client's demand and investment profile and make sure the client's demand matches the risk expectation. Rules about how a wealth management advisor conducts advisory business shall be in place to avoid potential conflict of interests between the advisor's agency and the client, and protect the rights and interests of investors.

V. Five Principles for the Oversight of Internet Finance in China

The wide use of internet technology and the promotion of inclusive finance mutually benefit each other. The innovation in internet finance addresses the appeals of consumers and helps to promote inclusive finance. Relevant authorities should be supportive of it and allow it certain market share, but should also be prudential of some new business which still needs to be observed and analyzed. The innovation that serves real economy and promotes employment shall be respected and encouraged. Yet, the relevant authorities shall be fully aware of the nature and risks of internet finance and try to mitigate any possible risks. We shall specify the bottom line, strengthen the oversight of the business and guide the industry, which is motivated by innovation, to develop in a healthy and sustainable way.

First, the innovation of internet finance shall serve real economy and be prudential about the boundary and pace. Financial innovation inclusing internet finance shall be market-oriented and aim to enhance the efficiency and capability of financial services and better serve the real economy. Any innovation that evades from the supervision and bypasses real economy is discouraged. Internet payment shall address the need of e-commerce and provide low value, quick and convenient payment services for the society. P2P lending and crowd funding shall serve as trading platforms rather than cash pooling and are forbidden to illegally take deposits, raise fund and engage in securities business in the name of internet finance.

Second, the innovation of internet finance should abide by the overall requirements of macro-management and financial stability. Any financial innovation including internet finance shall support the improvement of the efficiency of resource allocation, the safeguarding of financial stability, the promotion of interest rate liberation, and the liquidity control by the PBC. The financial innovation shall not lead to abrupt fluctuations of prices in the financial market, the obvious increase of financing cost in real economy, or influence liquidity transfer of the banking system to avoid the possible drop of credit support capability of banks.

Third, the legitimate rights and interests of consumers should be protected. The enterprises engaged in internet finance shall disclose relevant information and alert risks timely, and shall not make profit commitment or mislead consumers. Arrangements for consumer protection shall be made before any business is initiated.

Fourth, a level-playing field shall be ensured. Fair competition is the necessary factor that enables the market to play the decisive role in resource allocation. On-line financial business shall abide by the same rules and capital restrictions as the off-line business. It is forbidden to accrual interest or charge fees as agreed while deposits have been withdrawn or services terminated in advance. Any market participant shall observe the requirements of the *Anti-unfair Competition Law* and shall not defame their competitors.

Fifth, government supervision and industry self-discipline shall be well balanced and givel full play of self-discipline. The founding of China Internet Finance Association shall be advanced, so as to promote industry self-discipline and the formation of integrated business standards and lead relevant enterprises to fulfill social responsibilities. Large enterprises in the internet finance industry shall play a leading role in setting industry standards, serving real economy and addressing the appeals of the public.

Special Topic III

The Development Trend of Operation Model and Regulatory Framework in Financial Sector

Over recent years, with the deepening of China's reform and opening up, the financial sector is becoming increasingly market-based, the competition among financial institutions has intensified and new business types keep emerging, which has brought profound impact onto the operation and regulatory structure of the financial sector. In the historical environment of carrying out the spirit of the Third Plenary Session of 18th CPC Central Committee and comprehensively deepening reform, China will continue to push forward the pilot program of integrated financial services in an active and stable manner, facilitate the coordinated development of comprehensive operation and differentiated operation, improve further the financial regulatory system, make the regulation more targeted and more effective, guard against systemic risks, and safeguard financial stability and soundness.

I. The Revolution of Operation Model and Regulatory Regime in Financial Sector

There are mainly two types of operation model in financial sector around the globe — integrated operation and separate operation. Integrated operation refers to the model in which financial institutions can operate across banking, securities and insurance sectors, which largely comprises universal banking and financial conglomerates. Universal banking refers to one financial institution that provides at least two types of financial services out of banking, securities and insurance sectors. A financial conglomerate refers to a conglomerate which is made up of the parent company and subsidiary companies and whose financial business accounts for over 50 percent of all its business. Financial conglomerates can be subdivided into parent-subsidiary companies and financial holding companies. In a parent-subsidiary company, the parent company - a financial institution - invests in or controls subsidiary companies from different sectors. A financial holding company does not undertake any specific financial business itself, instead it controls stake in financial institutions from different sectors. Separate operation means that a financial institution from banking, securities or insurance sector can only conduct business within its own sector. In the basic scenario of separate operation, financial institutions can conduct businesses such as asset management across sectors and across markets, which can be counted as integrated operation to some extent. The change of operation model in financial sector has some impact on the evolution of the financial regulatory system. But the two do not necessarily have a corresponding relationship. Financial regulatory system can be divided into uniform regulation and separate regulation, or institutional regulation and functional regulation, etc., from different perspectives.

Prior to the 1930s, driven by market competition, integrated operation in financial sector was common across the world. After the Great Depression, the United States issued the Glass-Steagall Act and drew a clear line between commercial banking and investment banking, marking that the world entered the era of separate operation. However, during this period, countries in the European continent, led by Germany, still employed universal banking. In the 1980s, driven by the trend of financial liberalization and disintermediation, the United Kingdom unveiled a financial revolution. Commercial banks set up comprehensive financial conglomerates through cross-sector M&A. Then in 1998, the Bank of England transferred the regulatory power to the Financial Service Authority (FSA). In the 1990s, Japan also began to allow financial institutions to go into integrated operation by establishing financial holding companies or providing financial services across different sectors. In 2000, Japan set up the Financial Services Agency to regulate the financial market as a whole. In 1999, the United States issued the *Financial Services Modernization Act*, allowing bank holding companies with good management and strong capital to transform into financial holding companies, and introduced the umbrella regulatory system that combined umbrella regulation and functional regulation. The world then returned to integrated operation all over again.

After the explosion of international financial crisis in 2008, international standard setting institutions and main economic powers have undertaken a series of regulatory reforms to improve and strengthen regulation. The financial sector thus has brought in a new set of stricter regulation standards and constraints for integrated operation.

Prohibit commercial banks from undertaking risky businesses. As financial institutions tend to take excessive risks, large economic powers and regions have proposed to reform the banking sector by business segregation. The United States introduced the Volcker Rule which prohibits banking entities from undertaking risky proprietary trading in securities, derivatives and commodity futures, and requires that the investment of commercial banks in hedge funds and private equity funds should not exceed 3 percent of their Tier 1 capital. The British Banking *Reform Act* requires banking groups to establish separate entities for retail banking and investment banking, stipulates that only retail banks could take deposits from individuals and SMEs, and imposes restrictions on their business location, business types and trading counterparts. The senior panel from the European Union on structural reform of banking sector proposed to establish respectively a trading entity for risky trading business and a deposit bank for absorbing deposits and extending loans within a banking group. Against this backdrop, large financial groups begin to review their development strategies, and adjust their management models in accordance with regulatory requirements and their need for profitability. Some groups shrink their businesses, cut outlets and personnel, and gradually returned to their core businesses. However, it is worth noting that these groups do not draw a clear line between banking, securities and insurance businesses, and still emphasize on catering to various demands of clients with a variety of financial instruments.

Establish macroprudential management system. The financial crisis has demonstrated that microprudential regulation is insufficient in ensuring the soundness of the whole financial system while macroprudential management not only wards off risk transmission due to interconnectedness in the financial system but also pays close attention to the soundness of the financial system through business cycles. Therefore, macroprudential management has become an important direction for financial regulatory reform in the wake of the financial crisis. The United States established the Financial Stability Oversight Council (FSOC), the Bank of England established the Financial Policy Committee (FPC), the European Union established the European Systemic Risk Board (ESRB), and Germany established the Financial Stability Committee to be in charge of macroprudential management, preventing and resolving systemic risks. Meanwhile, macroprudential policies keep improving, which now comprise strengthening the countercyclical regulation in the respect of capital and liquidity, establishing regulatory system for SIFIs and shadow banking, reducing the procyclicality of accounting standards, pushing for central clearing of standard OTC derivatives contracts, and imposing higher capital requirements on contracts not centrally cleared, etc.

Strengthen the regulatory function of central banks. The international financial crisis has demonstrated that the separation of financial regulatory function from central banks is not good for promptly collecting accurate and comprehensive financial information, nor good for dissipating risks in a forward-looking manner or resolving risks in an orderly manner. After the financial crisis, the reform of financial regulation has refocused on the coordination and integration of the monetary policy, financial stability and financial regulation, and emphasized the function and role of central banks in preventing and dissipating systemic risks. The United States placed non-bank institutions recognized by the FSOC under the regulation of the Federal Reserve. The United Kingdom abolished the FSA, and mandated the Bank of England to be in charge of microprudential regulation and macroprudential management. The European Union established the single supervisory mechanism (SSM) for banking sector, where large banks in euro area are put under the direct supervision of the European Central Bank (ECB) while other banks are supervised by supervisory authorities in each member country. The three financial supervisory authorities - the European Banking Authority (EBA), the European Insurance and Occupational Pensions Authority (EIOPA) and the European Securities and Markets Authority (ESMA) are responsible for formulating uniform supervisory rules across the European Union. Russia abolished the Federal Financial Markets Service, and established the Financial Supervision Committee under the Bank of Russia to supervise the whole financial system. The South Korea amended the Banking Act, greatly strengthening the financial stability function of the central bank.

Strengthen the regulation and risk resolution of SIFIs. The international community has been attempting to reduce the risk of “too big to fail” financial institutions through strengthening regulation and improving risk resolution. In November 2011, the BCBS made an assessment of global systemically important banks (G-SIBs) on the basis of cross-jurisdictional activity, size, interconnectedness, substitutability and complexity, imposed an additional capital requirement of 1-2.5 percent according to their importance, and proposed 12 principles for assessing domestic systemically important banks in November 2012. In July 2013, the IAIS issued the assessment methodology and policy measures for global systemically important insurers (G-SIIs), and the FSB announced an initial list of G-SIIs. In November 2011, the FSB issued the *Key Attributes of Effective Resolution Regimes for Financial Institutions*, requiring SIFIs to produce Recovery and Resolution Plans (RRPs) and to establish cooperation mechanism for cross-border resolution. In December 2012, the Federal Deposit Insurance Corporation (FDIC) and the Bank of England jointly issued the first cross-border cooperation plan for resolving globally active banks.

Promote financial regulatory coordination and cooperation. In order to deal with unsmooth information flow, inadequate policy coordination and slow crisis response, most countries have strengthened their construction of financial regulatory coordination mechanism, and placed great emphasis on the communication coordination among different regulatory authorities on regulatory standards, policies and information. In the United States, the FSOC is responsible for coordinating and resolving disputes among member institutions. The Federal Reserve, the FDIC, the Consumer Financial Protection Bureau (CFPB), the Office of the Comptroller of the Currency (OCC) and the National Credit Union Administration (NCUA) signed a memorandum to coordinate the acquisition of important regulatory information about banks that have an asset size of over USD 10 billion and have obtained federal deposit insurance. In the United Kingdom, the FPC is responsible for macroprudential regulation, focusing on identifying, monitoring and managing systemic risks, and providing guidance and suggestions to the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA) on financial stability. The FPC is chaired by the governor of the Bank of England and is composed of the chairmen of the Monetary Policy Committee (MPC), the PRA and the FCA. These departments should report to the Parliament their communication and regulatory coordination. The European Union requires the ESRB to establish the information communication mechanism with the three microprudential regulatory authorities in banking, securities and insurance sectors.

In general, while international financial regulatory rules and standards are to be further clarified and strengthened, integrated operation will continue to exist in financial sector and will develop healthily under new regulatory requirements. There are some views in the international community to split large banks and restore the Glass-Steagall Act. However, the feasibility study and the development law of financial sector indicate that it is hard for financial sector to return to separate operation. The practice has demonstrated that integrated operation can help financial institutions maintain their profitability, raise their comprehensive competitiveness and satisfy various demands of clients. At present, the 20 largest banking groups and the 20 largest insurance companies around the globe have diversified business structure and operation model. The strengthening of financial regulation in the wake of financial crisis is mainly aimed at preventing the 'too big to fail' risk of financial institutions, safeguarding depositors' money, making financial institutions' organizational structure and governance more clear and transparent, and ensuring that risks remain in control.

II. The Evolution and Status-quo of China's Operation Model and Regulatory System in the Financial Sector

After the Third Plenary Session of the 11th CPC Central Committee in 1978, there was once a period of diversified operation in China's financial sector. Unfortunately, due to lack of rules, insufficient internal control, incomplete accounting standards and inadequate regulation, financial sector experienced a chaos in the financial ecosystem at that time. In 1993, the Third Plenary Session of the 14th CPC Central Committee proposed to manage banking and securities sectors separately. The *Law of the People's Republic of China on the People's Bank of China*, the *Law of the People's Republic of China on Commercial Banks* and the *Insurance Law of the People's Republic of China* issued in 1995, and the *Securities Law of the People's Republic of China* issued in 1998 further defined the principle of separate operation and separate management in financial sector. With the successive establishment of the China Securities Regulatory Commission CSRC, CIRC and CBRC, the separate regulatory system of 'one central bank and three commissions' finally took shape in 2003. Entering the 21st century, as China's economy and finance is becoming more and more open, there is an increasingly stronger demand and impetus for integrated operation in financial sector. In 2006, the national 11th Five-Year Plan proposed to push forward the pilot program of integrated financial services steadily. In 2011, the national 12th Five-Year Plan modified the word "steadily" to "actively and steadily". In 2012, the national financial work conference reemphasized that China should sum up experiences, formulate rules and regulations, strengthen regulation, guard against risks, and push forward the pilot program of integrated financial services actively and steadily. Driven by policies as well as market force, the integrated operation in China's financial sector has been developing steadily.

Cross-sector investment by financial institutions is growing rapidly. By the end of 2013, 13 commercial banks had invested in fund management companies, 15 had invested in financial leasing companies, 4 had invested in trust companies, 7 had invested in insurance companies, 6 had obtained oversea investment banking licenses, 2 had obtained domestic investment banking licenses, and 3 had established consumer finance companies.

5 securities companies had acquired stake in commercial banks, 1 had invested in trust companies, 49 had acquired stake or even controlling stake in fund companies, and 71 had acquired stake or even controlling stake in futures companies. 5 insurance groups had acquired controlling stake in commercial banks, trust companies, securities companies, fund management companies, etc.

Various types of financial holding companies take shape. The State Council approved the establishment of Galaxy Financial Holdings Company and Everbright Financial Holdings Company in 2005 and 2008 respectively. After many years' development, CITIC Group, Everbright Group and Ping An Group have turned into de facto financial holding companies. Local financial holding companies such as Tianjin TEDA International Group and Shanghai International Group have been established. Asset management companies are transforming into financial holding companies.

The number of industrial groups investing in financial entities has been increasing. Industrial groups have entered financial sector through establishing new companies, M&A, controlling and shareholding. At present, tens of central government-led enterprises have invested in or even controlled some financial subsidiaries, which range from commercial banks, finance companies, trust companies, financial leasing companies, securities companies to insurance companies, etc. About 10 central government-led enterprises have established special companies within the groups to manage financial businesses, for example, AVIC Capital Co., Ltd., Yingda International Holdings Co., Ltd. and Huaneng Capital Services Co., Ltd., and so on. Private enterprises and listed companies such as Fosun Group and Wanxiang Group have equity investment in various financial institutions and acquire real controlling power, which also carry characteristics of financial holding companies.

Cross-sector financial products grow rapidly. Commercial banks, trust companies, securities companies, fund management companies and insurance companies have entered wealth management or asset management business. At the end of 2013, both wealth management products of banks and assets managed by trust companies exceeded RMB 10 trillion yuan, and trust fund managed by securities companies reached RMB 5.2 trillion yuan. Futures companies have just started asset management business. The cooperation between banks and trust companies, between banks and securities companies, between banks and insurance companies, between securities and insurance companies keeps deepening continuously.

The rapid growth of internet finance boosts the development of integrated financial services. Information technology such as mobile internet, mega data and cloud computing grows rapidly, reshapes the operation model of traditional finance gradually, and facilitates the mixing and integration of banking, securities and insurance sectors. Meanwhile, internet companies like Alibaba have gone into traditional financial services, and have made progress in the aspects of payment and clearing, small and micro loans, sales channels, etc. Some internet companies have also expanded their businesses to banking, securities and insurance sectors, and evolved to kind of integrated operation to some extent.

The regulatory system of integrated financial services keeps improving. In the process of pushing forward the pilot program of integrated financial services, the PBC, CBRC, CSRC and CIRC have issued the *Administration Measures for the Pilot of Commercial Banks Establishing Fund Management Companies*, the *Administration Measures for the Pilot of Credit Asset Securitization,* the *Guidelines for the Consolidated Supervision of Banks (Tentative)*, the *Administration Measures for Insurance Group Companies (Tentative)*, and the *Measures for the Pilot of Insurance Institutions Establishing Fund Management Companies*, etc. At the same time, the construction of financial regulatory coordination mechanism is going forward steadily. In accordance with the requirement of the State Council, the PBC, jointly with the CBRC, CSRC, CIRC and State Administration of Foreign Exchange (SAFE), established the Joint Ministerial Conference on Financial Regulatory Coordination in August 2013.

Driven by the demand of economic and social development, financial reform and innovation at a certain period, the pilot program of integrated financial services has been developing rapidly, which is also consistent with the development trend of financial sector against the background of globalization. Above all, integrated financial services satisfy the need of financial sector to provide one-stop financial services. The financial demand of clients is no longer limited to traditional businesses such as deposits, loans or transfer but calls for a comprehensive financial resolution including investment banking and insurance business. Compared with separate operation, integrated financial services can provide all-around financial services and satisfy clients' demand easily. Secondly, integrated financial services cater to the demand of financial institutions for diverse sources of income. With the advantage of economies of scale and scope, integrated financial services can bring synergy effects to financial institutions and can help them lower cost. With the deepening of interest rate liberalization reform, it is hard for commercial banks to continue to rely on the traditional interest rate spread for profits and it is imperative for them to explore diverse businesses so as to discover new sources of income and enhance their resilience to risks. Finally, the introduction of integrated financial services in financial sector satisfies the real demand of China to cope with international competition. Most large international financial institutions have accomplished integrated operation by various means, and have strong competitiveness and brand advantage in marketing and business development. Through integrated financial services, China's financial institutions can fully tap the advantage of their numerous outlets and clients, improve their single business structure, and enhance their profitability so as to strengthen their competitiveness around the globe and transfer themselves from being large to being strong.

III. New Situation and Challenges faced by China's Financial Sector

Since the reform and opening up, China's financial sector has witnessed historical changes. The reform of financial institutions has made a big stride. The construction of multi-layer capital market system has been advancing continuously. The opening of financial sector is deepening steadily. The asset scale, resilience and services of financial sector keep improving, providing great support for the continuous development of national economy. However, as China enters the new phase of economic restructuring, transition and upgrading, there are many challenges ahead for the operation and regulation in financial sector.

The economic restructuring speeds up, and the capacity of financial sector to serve real economy needs to be further enhanced. The rapid development of China's financial sector can be attributed to the continuous and stable economic development to a large extent. At present, as economic restructuring, transition and upgrading move forward, China's economic growth needs to transfer from relying on investments and exports to relying on consumption. In order to fulfill the essential mission of serving real economy, it is imperative for financial sector to enhance innovation, improve financial services to small and micro enterprises and to agriculture, farmers and rural areas, support urbanization and the construction of key industries and sectors related to people's livelihood, accelerate the construction of multi-layer capital market and expand the coverage of insurance.

It is imperative to accelerate financial product and business innovation so as to satisfy the demand for diverse services. As China's economy keeps growing rapidly, there has been a rising demand to maintain and increase the value of national wealth. At present, China's GDP per capita has exceeded USD 6000. The allocation of household financial assets is increasingly diversified, and the proportion of banking deposits has declined to less than 60 percent. Therefore, China needs to further enrich financial products for household investment. Meanwhile, although the proportion of bond financing and the holding of stock and government bonds by enterprises increase, enterprises still need diverse financial products to improve their asset and liability structure. The investment and operation of the social security fund, pension funds, insurance funds and housing public accumulation funds also bring new opportunity for development of the wealth management market. It is high time for financial institutions to accelerate the innovation of their own organizational structure, business products and service model so as to satisfy the demand for various financial services.

With the deepening of market reform, it is imperative for financial sector to transform operation model. Since 2013, the market-oriented reform of China's interest rate and exchange rate has accelerated, and there is an urgent need for financial institutions to go through transition and enhance risk management. At present, China's financial sector is still dominated by extensive operation and low efficiency. In particular, there is no fundamental change in commercial banks' profit model. Commercial banks still rely on interest spread income, which accounts for over 80 percent of total income of listed commercial banks on average. As interest rate spread narrows and interest rate becomes more volatile, the profit growth of commercial banks will slow down, and there is stronger pressure of capital replenishment. Hence, commercial banks need to transform their operation model, improve their comprehensive businesses and ensure continuous profitability.

Cooperation across sectors keeps deepening and the regulation over innovative areas is inadequate. In recent years, the cooperation between banks and trust companies, between banks and securities companies, between banks and insurance companies has been deepening continuously, which not only satisfies the financing demand of real economy but also facilitates the development of direct financing. However, there are also some institutions that take this chance to circumvent macroeconomic control and financial regulation. As the interconnectedness among the money market, bond market and stock market increases, market fluctuation and risks can easily transmit across sectors and markets. At present, the regulatory mechanism to prevent risks in innovative areas remains to be improved, the policy coordination and comprehensive statistics for cross-sector financial businesses remain to be enhanced, and there remains certain regulatory vacuum for financial holding companies.

As the market of private investment and financing gets larger, risk transmission becomes prominent. In recent years, non-financial institutions with financing functions like micro-credit companies, pawn shops, financing guarantee companies and rural mutual cooperatives have developed rapidly, and private investment and financing have become increasingly active, which provides great support for small and micro companies, the development of agriculture, farmers and rural areas, and economic restructuring. However, some institutions have weak internal control and an evident shortsighted bias towards profits. Thus, if regulation is inadequate, illegal fund-raising, feneration and fraud will be common, which will disturb the normal financial order, cause mass events and even transmit risks to the conventional financial system.

IV. Further Improve the Operation Model and Regulatory Regime of China's Financial Sector

The pilot program of integrated financial services in China has been around for nearly 10 years. Integrated financial services have become the real existence in financial system with good development momentum and controllable risks. The current separate regulatory system is basically in line with the characteristics and requirements of China's economic and financial development. However, with the deepening of reform and opening up in financial sector and the ever higher demand to serve real economy, the issues of regulatory vacuum and inadequacy become prominent. Therefore, China should draw on international experiences, continue to deepen reform, push forward the pilot program of integrated financial services actively and steadily, erect the concept of macroprudential management, further improve financial regulatory system and ensure the sustainable and healthy development of the financial sector.

Stick to market-oriented reform and continue to push forward the pilot program of integrated financial services actively and steadily. Integrated financial services facilitate the transformation of China's financial institutions from being large to being strong and provide strong impetus for the sustainable and healthy development of the financial sector. China should bring the decisive role of market in financial resource allocation to full play, reduce restrictions on market access to financial institutions and products, and allow financial institutions to choose market positioning and operation model according to their own advantages. While restraining risky businesses, China should push forward the pilot program of integrated financial services in an orderly manner, select some institutions with certain capital strength, perfect corporate governance, strong internal control and risk management, and a team of talented experts for integrated financial services, and build large financial groups with comprehensive competitiveness. In addition, China should allow financial institutions to develop cross-sector financial businesses based on their main business and traditional advantage, and explore new service areas, which will promote the development of direct financing, and facilitate the establishment of a financial market system with reasonable layers and complementary functions.

Explore the possibility to make financial holding companies an important model of integrated financial services, and encourage small and medium-sized institutions to stick to specialized operation. The model of financial holding companies where the parent company controls stake and subsidiary companies operate in separate sectors can better tap the advantage of integrated financial services while maintaining effective control over risks, and adapt to the status-quo of separate operation and separate regulation. As such, it can serve as an important model of the pilot program of integrated financial services in China. Industrial groups investing in financial sectorsshould be encouraged to establish financial holding companies within the groups to be in charge of financial businesses, which can segregate risks between industrial and financial sectors. Faced with the diversification of market participants and client demand, China should change the homogeneity of financial institutions. Small and medium -sized financial institutions should distinguish their development strategy from the comprehensive development strategy of large financial institutions, foster their own special business model in terms of client segment, region positioning, product innovation, etc., and avoid blind pursuit of size and expansion across regions. China should establish a competitive grid with differentiated operation and dislocation development.

Improve the macroprudential management system and strengthen regulatory coordination. International concepts such as strengthening macroprudential management, reinforcing the regulatory mandate of central banks and the macroprudential perspective of regulatory authorities, and restraining risky financial businesses are instructive for China in improving the financial regulatory system. In light of the rapid development of integrated financial services, separate regulation becomes more difficult now. While respecting the status-quo and tapping the advantage of separate regulation, China should have a global view, earnestly strengthen macroprudential management, allow for the influence of different sectors and different markets on each other, take the financial sector as a whole, and safeguard the overall macro stability. Meanwhile, China should improve the regulatory coordination mechanism, fully tap the function of the Joint Ministerial Conference on Financial Regulatory Coordination, strengthen the planning and coordination of policies, measures and implementation, and bring the joint forces of regulation to full play.

Clearly designate the regulatory body for financial holding companies and strengthen overall regulation. With the aim of better preventing and resolving overall risks, China should integrate institutional regulation and functional regulation, clearly define the regulatory bodies for financial holding companies and their subsidiaries, accelerate the formulation of regulatory rules for financial holding companies, strengthen capital adequacy regulation, avoid double counting of capital and capital arbitrage, and effectively control leverage. Meanwhile, China should bring affiliated transactions into line, reinforce the principle of pricing at market fair value and being transparent, and avoid the contagion of risks across sectors. In addition, China should enhance risk concentration regulation, improve corporate governance, raise the qualification requirements for shareholders and management, and prevent shareholders with controlling stake from abusing their controlling power to infringe the legitimate rights and interests of small shareholders and clients.

Strengthen the regulation over financial institutions' cross-sector investment and improve regulatory rules for cross-sector businesses. China should enhance consolidated regulation capacity, establish stricter regulatory standards for large financial institutions, and improve the system of risk indicators including capital, leverage ratio, liquidity, risk provision and M&A investment. Besides, China should standardize the decision-making procedure for cross-sector investment, set reasonable capital adequacy goals on the consolidated base, and strengthen the regulation of overall risk management capacity. China should clearly define the authority responsible for the regulation and risk prevention of cross-sector financial businesses, formulate business rules and standards, establish a comprehensive statistics system, apply uniform regulatory rules to the same type of cross-sector business, and reduce regulatory arbitrage. Furthermore, China should reinforce the risk segregation between on-balance sheet businesses and off-balance sheet businesses, and prevent off-balance sheet risks from transmitting to the balance sheet.

Promote the healthy development of private financial institutions and prevent risk transmission of the non-conventional financial system. While reinforcing regulation, China should allow eligible private capital to initiate the establishment of financial institutions like small and medium -sized banks by law and regulate relevant business operation. In addition, China should further clarify local governments' responsibility to manage micro-credit companies, financing guarantee companies, pawn shops and regional stock markets so that they can better support the development of small and micro enterprises, agriculture, farmers and rural areas, and county economy. China should bring private borrowing and lending into line and under the sunshine, strengthen the monitoring, guidance and management of capital flow and utilization, and coordinate the mutually beneficial development of private borrowing and lending with the conventional financial system while segregating risks.

Appendix Ⅰ

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

In 2013, China's banking sector continued to run stably with further improvements of asset size, capital position and risk management, and the banking sector indicators remained favorable. In order to analyze the operational condition and evaluate the risk profile of the banking sector, we selected 17 major commercial banks① (hereafter referred to as major commercial banks) with aggregate assets accounting for 61% of total assets in all banking institutions②, and conducted a quantitative analysis in terms of profitability, assets, liabilities, capital and liquidity.③

I. Profitability Analysis

1. Breakdown Analysis of ROE

In 2013, the ROE of major commercial banks registered 20.05%, 0.67 percentage point lower than last year. Breakdown analysis showed that the change of ROE was primarily attributed to the reduction of risk-adjusted return and leverage ratio (Table B1.1), as well as slight increase of profit margin and operational risk. Operational risk of major commercial banks has increased for three consecutive years, indicating that banks held more risky assets. Higher profit margin suggested banks' profitability increased slightly, and dropped risk-adjusted return indicated that banks' risk management declined, whereas leverage ratio has fell for four consecutive years, showed that soundness of the banking sector was strengthened.

Table B1.1 ROE Breakdown of 17 Major Commercial Banks

	Profit Margin (%)		Risk-adjusted Return (%)		Operational Risk (%)		Leverage Ratio (%)		ROE (%)	
	2012	2013	2012	2013	2012	2013	2012	2013	2012	2013
17 Major Commercial Banks	26.65	27.73	8.53	7.62	56.94	60.87	16.01	15.59	20.72	20.05
5 LCBs	29.22	30.36	8.15	7.29	55.77	60.28	15.52	14.97	20.60	19.98
12 JSCBs	21.11	22.24	9.50	8.42	60.09	62.35	17.51	17.36	21.11	20.27

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

Source: The CBRC.

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

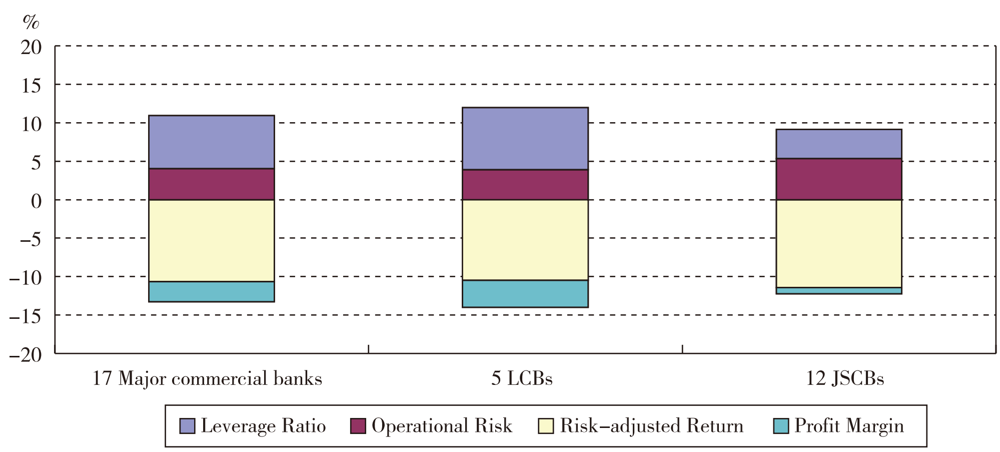
② Including policy banks, state-owned commercial banks, JSCBs, urban commercial banks, rural commercial banks, rural cooperative banks, foreign banks, UCCs, RCCs, non-banking institutions (TICs, finance companies, finance leasing companies, auto finance companies and money brokerage companies) and PSBC.

③ Data source: PBC, CBRC, calculated on the aggregated data of the legal entities.

The comparison analysis suggested that LCBs' ROE was lower than that of JSCBs. The results of ROE breakdown analysis showed that, the former had almost 8.12 percentage points higher profit margin than that of the latter, but lower risk-adjusted return, operational risk and leverage ratio. In that case, the JSCBs should further enhance their operational efficiency, reduce operational risk and improve their soundness, while the LCBs should improve risk management.

In 2013, the profit margin and operational risk of major commercial banks increased by 4.03 percent and 6.91 percent respectively on y-o-y basis, while the risk-adjusted return and leverage ratio went down by 10.66 percent and 2.62 percent respectively (Figure B1.1). Specifically, the profit margin and operational risk of LCBs rose by 3.89 and 8.08 percentage points respectively, while the risk-adjusted return and leverage ratio went down by 10.49 percent and 3.5 percent respectively. The profit margin and operational risk of JSCBs increased by 5.35 percent and 3.76 percent respectively, while the risk-adjusted return and leverage ratio went down by 11.42 percent and 0.83 percent respectively.

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



Source: The CBRC.

2. Income Structure Analysis

In 2013, the major commercial banks' net operating income amounted to RMB 2.8 trillion yuan, up 11.32 percent y-o-y. In particular, the net income of LCBs increased by 9.11 percent to RMB 2.02 trillion yuan, while that of JSCBs increased by 17.49 percent to RMB 0.78 trillion yuan (TableB1.2).

The net interest income remained the major source of operating income. In 2013, the net interest income of the major commercial banks increased by 8.17 percent, accounting for 56.66 percent of the net operating income, down 1.65 percentage points y-o-y. In particular, the growth rate of net interest income of the LCBs and JSCBs were 10.16 and 3.54 percent, down 3.2 and 12.82 percentage points respectively.

The growth rate of intermediate business income increased in 2013. The net fee income of the major commercial banks increased by 22.11 percent y-o-y, up 7.82 percentage points. In particular, the growth rate of net fee income of the LCBs and JSCBs were 12.7 and 54.96 percent respectively. The proportion of net fee in net operating income of major commercial banks was 19.56 percent, up 1.72 percentage points y-o-y. In particular, the proportion of net fee in net operating income of the LCBs rose by 0.62 percentage point while that of the JSBCs rose by 4.79 percentage points, increasing for the seventh consecutive year and exceeding that of LCBs for the first time.

The proportion of investment income continued to rise in 2013. Both domestic and foreign investment income rose, and investment income of the major commercial banks rose by 12.94 percent, down 11.14 percentage points y-o-y. Bond investment income increased by 12.58 percent, while equity and other investment income ballooned by 16.18 percent. Investment income of the LCBs and JSCBs increased by 5.14 percent and 42.79 percent respectively. The proportion of investment income in operating income reached 22.45 percent, up 0.32 percentage point. Specifically, the proportion of investment income in operating income of the LCBs decreased by 0.87 percentage point, while the proportion of JSCBs increased 3.73 percentage points.

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

Items		17 Major commercial banks		5 LCBs		12 JSCBs	
		2012	2013	2012	2013	2012	2013
Balance (100 million of RMB yuan)	Net interest income	14 690.29	15 890.69	10 285.71	11 330.23	4 404.59	4 560.46
	Net fee and commission income	4 493.64	5 487.02	3 493.48	3 937.21	1 000.17	1 549.81
	Investment income	5 575.22	6 296.40	4 421.23	4 648.63	1 153.99	1 647.77
	Other business income	435.42	373.16	339.34	312.41	96.08	60.74
	Net operating income	25 194.58	28 047.27	18 539.75	20 228.48	6 654.82	7 818.79
Proportion (percent)	Net interest income	58.31	56.66	55.48	56.01	66.19	58.33
	Net fee and commission income	17.84	19.56	18.84	19.46	15.03	19.82
	Investment income	22.13	22.45	23.85	22.98	17.34	21.07
	Other business income	1.73	1.33	1.83	1.54	1.44	0.78
	Net operating income	100	100	100	100	100	100

Source : The CBRC.

3. Cost Structure Analysis

In 2013, the operating cost[①] of the major commercial banks amounted to RMB 1.09 trillion yuan, with a y-o-y growth of 9.69 percent. In particular, the operating cost of the

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

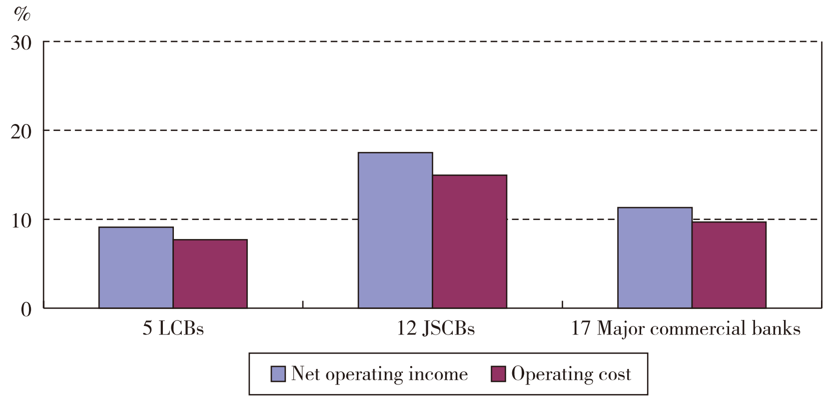
LCBs increased by 7.71 percent to RMB 778.21 billion yuan, and that of the JSCBs rose by 14.95 percent to RMB 312.253 billion yuan.

In 2013, the cost/income ratio① of the 17 major commercial banks was 32.19 percent, 0.43 percentage point lower than that of the previous year, declining for the seventh consecutive year, suggesting a continuous improvement in operational management (Figure B1.2). In particular, the cost/income ratio of the LCBs was 32 percent, 0.33 percentage point lower than that of the previous year, while that of JSCBs decreased by 0.76 percentage point to 32.69 percent. The net operating income growth rate of major commercial banks was 1.63 percentage points higher than the operating cost. Specifically, the growth rate of LCBs' net operating income was 2 percentage points higher than that of operating cost, while the growth rate of LCBs' net operating income was 2.54 percentage points higher than that of operating cost (Figure B1.3).

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

Source: The CBRC.

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



Source: The CBRC.

① Cost/ income ratio= (operating cost -business tax and additions) / (net interest income +net fee and commission income +other business income +investment income) × 100%.

II. Asset Analysis

1. The Scale and Structure of Total Assets

In 2013, the total assets of commercial banks maintained a stable growth. Total assets of the 17 major commercial banks amounted to RMB 92.53 trillion yuan, up 10.73 percent y-o-y and accounting for 61 percent of the total assets of all banking institutions. In particular, assets of the LCBs totaled RMB 65.6 trillion yuan, up 9.26 percent; assets of the JSCBs totaled RMB 26.93 trillion yuan, up 14.45 percent.

In terms of the asset structure, loans and investment were still the main constituents, which accounted for 66.58 percent in total assets of major commercial banks. In 2013, the share of deposits in central bank to total assets decreased by 0.89 percentage point y-o-y, while the share of outstanding loans, trade finance, repurchase and investment increased by 1.02, 3.15, 0.02 and 0.98 percentage points respectively, and the share of discount and interbank deposits declined by 3.37 and 1.26 percentage points respectively (Table B1.3).

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

Items	Balance (100 million of RMB yuan)		As a percentage of total assets (%)	
	2012	2013	2012	2013
Deposits in central bank	132 489.03	138 435.21	15.85	14.96
Inter-bank deposits	35 709.11	27 891.48	4.27	3.01
Loans	377 590.44	427 530.35	45.18	46.20
Discount	9 567.38	8 070.41	4.24	0.87
Trade finance	35 450.75	39 683.97	1.14	4.29
Inter-bank lending	20 130.81	22 945.59	2.41	2.48
Investment	162 110.34	188 629.74	19.40	20.38
Repurchase of assets	49 560.37	55 033.71	5.93	5.95
Others	13 063.69	17 145.32	1.56	1.85
Total assets	835 671.93	925 365.78	100.00	100.00

Source: The CBRC.

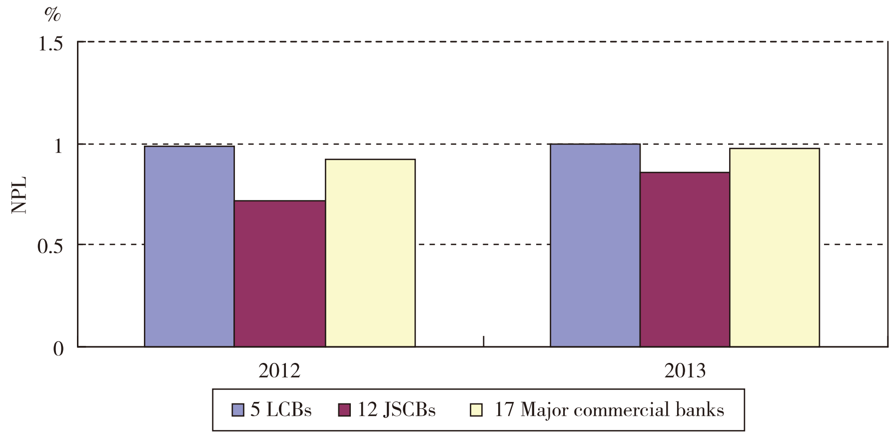
2. The Scale and Quality of Loans

By the end of 2013, outstanding loans of the major commercial banks totaled RMB 47.53 trillion yuan, increasing RMB 5.27 trillion yuan and 12.47 percent compared with the beginning of the year. In particular, the outstanding loans of the LCBs and JSCBs rose by 11.72 percent and 14.6 percent, reaching RMB 34.89 and 12.64 trillion yuan respectively.

By of the end of 2013, outstanding NPLs of the major commercial banks totaled RMB 459.128

billion yuan, increasing RMB 69.914 billion yuan y-o-y. NPL ratio registered 0.97 percent, up 0.05 percentage point y-o-y. In particular, NPL ratio of the LCBs and JSCBs were 1 percent and 0.86 percent, up 0.01 percentage point and 0.14 percentage point respectively (Figure B1.4).

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

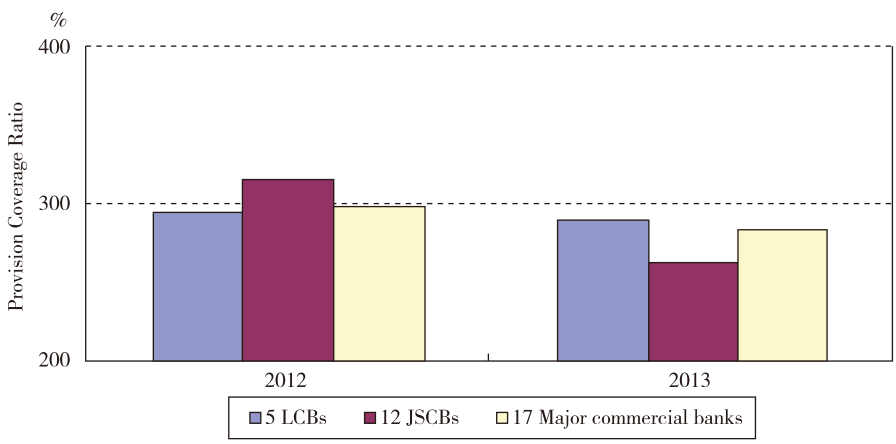


Source: The CBRC.

3. Provision Coverage Ratio[①]

In 2013, the provision coverage ratio of the major commercial banks was adequate in whole. At end-2013, the overall provision coverage ratio was 283.92 percent, down 15.69 percentage points y-o-y. In particular, provision coverage ratio of the LCBs was 290.42 percent, down 5.31 percentage points, while the ratio of the JSCBs was 263.07 percent, down 51.61 percentage points (Figure B1.5).

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



Source: The CBRC.

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

III. Liabilities, Capital and Liquidity

1. The Scale and Structure of Liabilities

As of end-2013, liabilities of major commercial banks totaled RMB 86.5 trillion yuan, with a y-o-y growth of 10.47 percent and accounting for 61.27 percent of the total liabilities of all banking institutions. In particular, the shares of liabilities of the LCBs and JSCBs in the total were 43.32 percent and 17.95 percent, down 1.56 percentage points and up 0.17 percentage point respectively.

By the end of 2013, the outstanding deposits of the 17 major commercial banks reached RMB 70.93 trillion yuan, growing by 10.55 percent y-o-y. In particular, the growth rate of enterprise deposits declined by 3.08 percentage points to 11.38 percent, while the household savings rose by 10.5 percent, with a decrease of 4.63 percentage points in the growth rate. The proportion of total deposits to total liabilities of the major commercial banks was 81.99 percent, up 0.05 percentage point y-o-y.

2. Capital and CAR

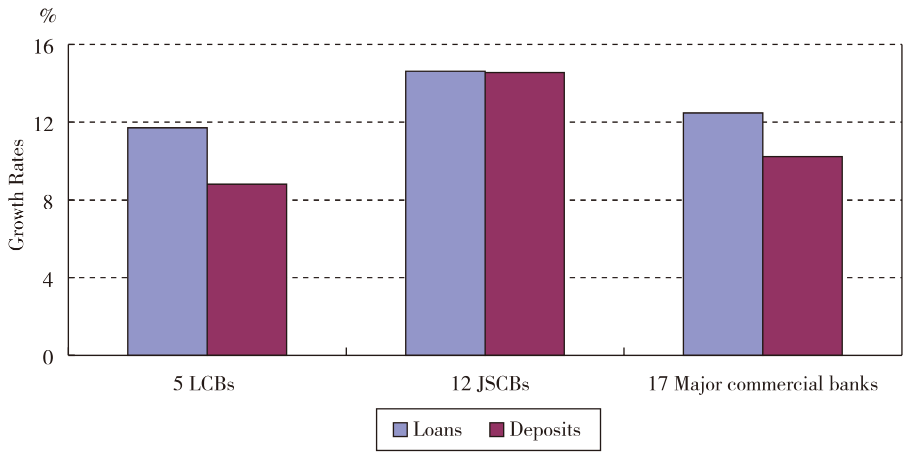
As of end-2013, all the 17 major commercial banks had met the CAR requirement set by CBRC. Since the Capital Rules for Commercial Banks (Provisional) was formally carried out on January 1, 2013, the basis for CAR calculation became more stringent. But common Equity Tier 1 CAR and CAR of the major commercial banks still registered 9.55 percent and 11.98 percent. Due to the increase of retained earnings and bond issuance, the net capital saw a substantial growth in 2013. At end-2013, the net capital of the major commercial banks reached RMB 6.82 trillion yuan , increasing by 11.8 percent or RMB 0.72 trillion yuan y-o-y.

3. Liquidity

In 2013, loans of the LCBs and JSCBs grew faster than their deposits (Figure B1.6). By the end of 2013, the loan/deposit ratio of the major commercial banks recorded 67.01 percent, up 1.14 percentage points y-o-y. Liquidity ratio[①] decreased by 2.04 percentage points to 42.81 percent, Liquidity coverage ratio declined by 3.43 percentage points to 120.65 percent, indicating overall sufficient liquidity in the banking sector.

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

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



Source: The CBRC.

Appendix II

Statistics

Table B2.1 Selected Economic Indicators

(Year-end Balance)

Items	2009	2010	2011	2012	2013
Gross Domestic Product (RMB 100 million yuan)	340 903	401 513	473 104	519 470	568 845
Industrial Value Added	135 240	160 722	188 470	199 671	210 689
Fixed Asset Investment (RMB 100 million yuan)	224 599	278 122	311 485	374 695	447 074
Retail Sales of Consumer Goods (RMB 100 million yuan)	132 678	156 998	183 919	210 307	237 810
Export & Import (USD 100 million)	22 075	29 740	36 419	38 671	41 600
Export	12 016	15 778	18 984	20 487	22 096
Import	10 059	13 962	17 435	18 184	19 504
Balance	1 957	1 816	1 549	2 303	2 592
Foreign Direct Investment (USD 100 million)	900	1 057	1 160	1 117	1 176
Foreign Exchange Reserve (USD 100 million)	23 991.5	28 473.4	31 811.0	33 116.0	38 213.0
Consumer Price Index (previous year = 100)	99.3	103.3	105.4	102.6	102.6
Fiscal Revenue (RMB 100 million yuan)	68 518.30	83 101.51	103 874.43	117 253.52	129 143
Fiscal Expenditure (RMB 100 million yuan)	76 299.93	89 874.16	109 247.79	125 952.97	139 744
Per Capita Urban Residents Dispensable Income (RMB)	17 175	19 109	21 810	24 565	26 955
Per Capita Rural Residents Net Income (RMB)	5 153	5 919	6 977	7 917	8 896
Number of Employed Persons in Urban Area (million)	311.2	—	359.1	371.0	382.4
Registered Unemployment Rate in Urban Area (%)	4.3	4.1	4.1	4.1	4.05
Total Population (million)	1 334.7	1 339.7	1 347.4	1 354.0	1 360.7

Notes：1.GDP from 2009 to 2012 is verified and final, and GDP in 2013 is preliminary.

2.Since 2011，the cut-off size of fixed assets investment projects rose from a total planned investment above RMB 500 thousand yuan to RMB 5 million yuan.

Source: Calculated on the basis of data from *China Statistical Year Book* and *Statistical Communique of The People's Republic of China* on the National Economic and Social Development.

Table B2.2 Selected Financial Indicators (1)

(Year-end Balance)

(RMB 100 million yuan)

Items	2009	2010	2011	2012	2013
Money & Quasi-money (M_2)	606 225.0	725 851.8	851 590.9	974 148.8	1 106 525.0
Money (M_1)	220 001.5	266 621.5	289 847.7	308 673.0	337 291.1
Currency in Circulation (M_0)	38 246.0	44 628.2	50 748.5	54 659.8	58 574.4
Total Deposits with Financial Institutions	597 741.1	718 237.9	809 368.3	917 368.1	1 043 846.9
Household Deposits	260 771.7	303 302.5	343 635.9	399 546.9	447 601.6
Non-financial Enterprise Deposits	217 110.0	244 495.6	303 504.3	327 444.9	361 555.2
Total Lending by Financial Institutions	399 684.8	479 195.6	547 946.7	629 906.6	718 961.5

Note: Urban & Rural Household Deposits and Enterprise Deposits have been replaced by Household Deposits and Non-financial Enterprise Deposits since 2011.

Source: The PBC.

Table B2.3 Selected Financial Indicators (2)

(Growth Rates)

(percent)

Items	2009	2010	2011	2012	2013
Money & Quasi-money (M_2)	27.68	19.73	13.61	13.80	13.59
Money (M_1)	32.35	21.19	7.85	6.49	9.27
Currency in Circulation (M_0)	11.77	16.69	13.76	7.71	7.16
Total Deposits with Financial Institutions	28.21	20.16	13.54	13.34	13.76
Household Deposits	19.68	16.31	13.78	16.27	12.03
Non-financial Enterprise Deposits	37.73	12.61	9.23	7.89	10.43
Total Lending by Financial Institutions	31.74	19.89	15.83	14.96	14.14

Note: Growth rate has been adjusted to reflect recent changes in statistical coverage.

Source: The PBC.

Table B2.4 International Liquidity

(USD million)

Items	2009	2010	2011	2012	2013
Total Reserves (minus gold)	2 414 131	2 862 276	3 197 107	3 325 440	3 833 291
Special Drawing Rights (SDRs)	12 510	12 345	11 855	11 366	11 184
Reserve Positions in IMF	2 469	2 593	4 104	2 485	792
Foreign Exchange	2 399 152	2 847 338	3 181 148	3 311 589	3 821 315
Gold (1 million ounces)	33.89	33.89	33.89	33.89	33.89
Gold (national valuation)	9 815	9 815	9 815	9 815	9 815
Foreign Liabilities of Other Depository Companies	88 146	108 406	123 250	157 509	294 789

Note: Data of "Foreign Liabilities of Other Depository Companies" for 2009 has been adjusted to reflect changes in statistical coverage.

Source: The PBC.

Table B2.5 Gold and Foreign Exchange Reserves

Year	Gold Reserves (10 thousand ounces)	Foreign Exchange Reserves (USD 100 million)	Change in Foreign Exchange Reserves (percent)
1995	1 267	736.0	42.6
1996	1 267	1 050.3	42.7
1997	1 267	1 398.9	33.2
1998	1 267	1 449.6	3.6
1999	1 267	1 546.8	6.7
2000	1 267	1 655.7	7.0
2001	1 608	2 121.7	28.1
2002	1 929	2 864.1	35.0
2003	1 929	4 032.5	40.8
2004	1 929	6 099.3	51.3
2005	1 929	8 188.7	34.3
2006	1 929	10 663.4	30.2
2007	1 929	15 282.5	43.3
2008	1 929	19 460.3	27.3
2009	3 389	23 991.5	23.3
2010	3 389	28 473.4	18.7
2011	3 389	31 811.5	10.7
2012	3 389	33 115.9	4.1
2013	3 389	38 213.2	15.4

Note: The PBC made adjustments to statistical coverage of gold reserves in December 2001, December 2002 and April 2009.
Source: The PBC.

Table B2.6 Assets of China's Financial Sector

(December 31, 2013)

(RMB trillion yuan)

Type of Financial Institutions	Assets
Financial Sector	192.89
Central Bank	31.73
Banking Financial Institutions	151.35
Securities Financial Institutions (Assets of clients excluded)	1.52
Insurance Financial Institutions	8.29

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

Table B2.7 Depository Corporations Survey in 2013

(Quarter-end Balance)

(RMB 100 million yuan)

Items	Quarter 1	Quarter 2	Quarter 3	Quarter4
Net Foreign Assets	269 481.7	272 681.6	272 740.1	280 986.4
Domestic Credit	846 427.3	867 997.5	899 230.2	927 007.0
Claims on Governments (net)	48 554.8	41 570.2	41 580.1	49 043.6
Claims on Non-financial Sectors	729 509.3	753 846.6	780 422.8	796 463.8
Claims on other Financial Sectors	68 363.3	72 580.7	77 227.3	81 499.6
Money & Quasi-money	1 035 858.4	1 054 403.7	1 077 379.2	1 106 525.0
Money	310 898.3	313 499.8	312 330.3	337 291.1
Currency in Circulation	55 460.5	54 063.9	56 492.5	58 574.4
Demand Deposits	255 437.8	259 435.9	255 837.8	278 716.6
Quasi-money	724 960.1	740 903.9	765 048.8	769 233.9
Time Deposits	215 732.9	228 029.1	239 080.3	232 696.6
Savings Deposits	449 007.5	453 410.6	461 958.2	467 031.1
Other Deposits	60 219.7	59 464.2	64 010.4	69 506.2
Deposits not Included in Broad Money	26 890.2	26 580.6	26 844.3	25 940.3
Bonds	95 986.0	99 129.7	101 362.2	103 672.1
Paid-in Capital	30 772.0	31 215.6	31 871.5	32 765.6
Other Items (net)	-73 597.6	-70 650.4	-65 486.9	-60 909.6

Source: The PBC.

Table B2.8 Balance Sheet of the Monetary Authority in 2013

(Quarter-end Balance)

(RMB 100 million yuan)

Items	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Foreign Assets	254 127.2	257 853.9	261 561.5	272 233.5
Foreign Exchange	246 103.3	249 868.8	253 548.7	264 270.0
Money Gold	669.8	669.8	669.8	669.8
Other Foreign Assets	7 354.0	7 315.3	7 343.0	7 293.7
Claims on Governments	15 313.7	15 312.7	15 312.7	15 312.7
Of Which: Central Government	15 313.7	15 312.7	15 312.7	15 312.7
Claims on Other Depository Corporations	11 374.8	16 182.0	16 680.8	13 147.9
Claims on Other Financial Corporations	10 025.9	10 218.5	10 242.2	8 907.4
Claims on Non-financial Corporations	25.0	25.0	25.0	25.0
Other Assets	8 073.8	7 148.8	7 369.0	7 652.0
Total Assets	**298 940.4**	**306 741.1**	**311 191.2**	**317 278.6**
Reserve Money	253 649.8	257 776.5	263 137.9	271 023.1
Currency Issuance	61 330.9	59 831.3	63 041.1	64 980.9
Deposits of Other Depository Corporations	192 319.0	197 945.1	200 096.7	206 042.2
Deposits of Financial Corporations not included in Reserve Money	1 349.9	1 316.9	1 268.3	1 330.3
Bond Issuance	13 880.0	10 381.8	7 878.0	7 762.0
Foreign Liabilities	1 296.0	1 127.1	1 817.8	2 088.3
Deposits of Government	22 757.2	32 330.0	34 480.8	28 610.6
Own Capital	219.8	219.8	219.8	219.8
Other Liabilities	5 787.7	3 589.2	2 388.7	6 244.6
Total Liabilities	**298 940.4**	**306 741.1**	**311 191.2**	**317 278.6**

Source: The PBC.

Table B2.9 Balance Sheet of Other Depository Corporations in 2013

(Quarter-end Balance)

(RMB 100 million yuan)

Items	Quarter1	Quarter2	Quarter3	Quarter4
Foreign Assets	28 622.0	28 686.4	27 768.6	28 814.1
Reserve Assets	197 788.5	203 119.8	206 057.3	211 775.6
Deposits with Central Bank	191 918.1	197 352.4	199 508.7	205 369.1
Cash in Vault	5 870.3	5 767.4	6 548.6	6 406.5
Claims on Governments	55 998.3	58 587.5	60 748.1	62 341.5
Of Which: Central Government	55 998.3	58 587.5	60 748.1	62 341.5
Claims on Central Bank	15 209.9	10 183.6	6 135.9	10 301.4
Claims on Other Depository Corporations	262 063.2	259 553.7	253 805.3	260 442.0
Claims on Other Financial Corporations	58 337.3	62 362.2	66 985.1	72 592.3
Claims on Non-financial Corporations	559 589.1	573 036.3	589 767.9	599 575.2
Claims on Other Resident Sectors	169 895.2	180 785.3	190 629.9	196 863.6
Other Assets	66 392.1	70 700.1	71 913.7	82 046.0
Total Assets	**1 413 895.7**	**1 447 014.8**	**1 473 811.8**	**1 524 751.5**
Liabilities to Non-financial Institutions and Households	952 641.8	972 848.1	989 356.0	1 012 778.8
Deposits Included in Broad Money	920 178.2	940 875.6	956 876.3	978 444.3
Enterprise Demand Deposits	255 437.8	259 435.9	255 837.8	278 716.6
Enterprise Time Deposits	215 732.9	228 029.1	239 080.3	232 696.6
Household Savings Deposits	449 007.5	453 410.6	461 958.2	467 031.1
Deposits not Included in Broad Money	26 890.2	26 580.6	26 844.3	25 940.3
Transferable Deposits	8 069.9	8 227.8	7 666.8	7 454.0
Other Deposits	18 820.2	18 352.8	19 177.5	18 486.3
Other Liabilities	5 573.5	5 391.9	5 635.5	8 394.2
Liabilities to Central Bank	8 881.3	14 428.9	15 030.3	11 663.2
Liabilities to Other Depository Corporations	111 646.0	107 641.3	102 469.5	110 397.9
Liabilities to Other Financial Corporations	64 524.7	65 250.3	69 570.3	74 804.7
Of Which: Deposits Included in Broad Money	60 219.7	59 464.2	64 010.4	69 506.2
Foreign Liabilities	11 971.6	12 731.7	14 772.2	17 973.0
Bond Issuance	95 986.0	99 129.7	101 362.2	103 672.1
Paid-in Capital	30 552.3	30 995.8	31 651.8	32 545.8
Other Liabilities	137 691.9	143 989.1	149 599.6	160 916.0
Total Liabilities	**1 413 895.7**	**1 447 014.8**	**1 473 811.8**	**1 524 751.5**

Source: The PBC.

Table B2.10 Balance Sheet of Chinese-funded Large Banks in 2013

(Quarter-end Balance)

(RMB 100 million yuan)

Items	Quarter1	Quarter2	Quarter3	Quarter4
Foreign Assets	19 956.68	19 929.37	18 977.88	19 356.15
Reserve Assets	115 377.77	116 172.04	117 421.01	114 779.03
Deposits with Central Bank	112 075.63	113 009.45	113 672.12	111 157.87
Cash in Vault	3 302.14	3 162.59	3 748.90	3 621.16
Claims on Governments	38 837.36	40 139.10	40 711.57	40 884.26
Of Which: Central Government	38 837.36	40 139.10	40 711.57	40 884.26
Claims on Central Bank	13 446.45	8 890.03	5 735.04	9 906.40
Claims on Other Depository Corporations	115 153.06	116 535.22	114 513.19	112 958.07
Claims on Other Financial Corporations	22 625.63	20 810.53	20 965.71	22 269.38
Claims on Non-financial Corporations	309 101.62	314 164.00	322 990.96	328 232.63
Claims on Other Resident Sectors	91 904.00	97 432.02	102 191.05	105 640.46
Other Assets	45 243.54	49 267.08	50 038.33	59 569.52
Total Assets	**771 646.10**	**783 339.41**	**793 544.74**	**813 595.90**
Liabilities to Non-financial Institutions and Households	541 025.91	545 124.55	552 734.98	559 212.62
Deposits Included in Broad Money	522 616.33	527 835.17	535 313.53	540 342.35
Enterprise Demand Deposits	140 833.81	141 670.71	139 301.98	148 850.18
Enterprise Time Deposits	92 649.46	98 046.44	102 986.59	98 546.21
Household Savings Deposits	289 133.06	288 118.02	293 024.97	292 945.96
Deposits not Included in Broad Money	14 443.01	13 777.97	13 831.48	13 077.25
Transferable Deposits	4 164.36	4 234.97	3 948.12	3 587.00
Other Deposits	10 278.65	9 543.00	9 883.36	9 490.26
Other Liabilities	3 966.57	3 511.41	3 589.97	5 793.02
Liabilities to Central Bank	3 389.17	6 845.25	7 273.91	4 127.96
Liabilities to Other Depository Corporations	24 548.68	21 911.95	20 454.94	21 960.06
Liabilities to Other Financial Corporations	34 279.48	34 269.50	34 295.08	35 825.90
Of Which: Deposits Included in Broad Money	32 881.44	32 106.01	32 259.77	34 117.92
Foreign Liabilities	5 673.21	5 762.08	6 770.66	8 668.73
Bond Issuance	61 816.13	63 404.61	64 903.48	65 949.37
Paid-in Capital	16 067.25	16 047.89	16 050.64	16 070.02
Other Liabilities	84 846.27	89 973.57	91 061.05	101 781.25
Total Liabilities	**771 646.10**	**783 339.41**	**793 544.74**	**813 595.90**

Source: The PBC.

Table B2.11 Balance Sheet of Chinese-funded Medium-sized Banks in 2013

(Quarter-end Balance)

(RMB 100 million yuan)

Items	Quarter1	Quarter2	Quarter3	Quarter4
Foreign Assets	7 059.72	7 194.58	7 373.36	7 937.39
Reserve Assets	34 550.86	37 218.62	37 359.86	38 461.75
Deposits with Central Bank	33 987.85	36 597.75	36 748.31	37 789.89
Cash in Vault	563.01	620.87	611.55	671.86
Claims on Governments	8 801.89	9 351.75	10 287.37	10 911.79
Of Which: Central Government	8 801.89	9 351.75	10 287.37	10 911.79
Claims on Central Bank	748.58	540.81	91.07	90.14
Claims on Other Depository Corporations	67 540.81	65 148.77	60 047.51	60 806.49
Claims on Other Financial Corporations	15 705.67	22 048.39	24 923.41	26 712.65
Claims on Non-financial Corporations	131 634.48	134 299.64	136 830.90	138 872.84
Claims on Other Resident Sectors	32 310.00	34 905.84	37 320.19	38 770.70
Other Assets	8 017.77	7 913.27	8 041.62	8 641.13
Total Assets	**306 369.78**	**318 621.68**	**322 275.29**	**331 204.88**
Liabilities to Non-financial Institutions and Households	169 829.49	177 177.11	178 430.49	180 861.25
Deposits Included in Broad Money	160 266.73	167 264.61	168 162.49	170 689.72
Enterprise Demand Deposits	53 025.20	54 372.95	52 534.49	57 170.36
Enterprise Time Deposits	69 408.71	72 907.36	75 288.44	72 658.18
Household Savings Deposits	37 832.82	39 984.30	40 339.56	40 861.17
Deposits not Included in Broad Money	8 820.69	9 005.32	9 246.75	9 019.53
Transferable Deposits	2 154.92	2 190.61	1 988.17	2 098.31
Other Deposits	6 665.78	6 814.71	7 258.59	6 921.22
Other Liabilities	742.06	907.19	1 021.24	1 152.01
Liabilities to Central Bank	3 565.90	5 095.49	4 872.03	4 956.22
Liabilities to Other Depository Corporations	44 055.35	45 549.31	40 823.83	43 044.25
Liabilities to Other Financial Corporations	25 648.16	25 684.10	29 169.83	32 294.56
Of Which: Deposits Included in Broad Money	23 485.44	23 006.40	26 608.82	29 822.92
Foreign Liabilities	1 987.17	2 288.53	2 762.43	3 402.75
Bond Issuance	32 512.34	33 761.65	34 407.15	35 736.47
Paid-in Capital	2 412.83	2 442.70	2 575.80	2 646.82
Other Liabilities	26 358.54	26 622.80	29 233.72	28 262.56
Total Liabilities	**306 369.78**	**318 621.68**	**322 275.29**	**331 204.88**

Source: The PBC.

Table 2.12 Balance Sheet of Chinese-funded Small Banks in 2013

(Quarter-end Balance)

(RMB 100 million yuan)

Items	Quarter1	Quarter2	Quarter3	Quarter4
Foreign Assets	204.83	283.90	211.52	273.54
Reserve Assets	30 894.42	32 853.30	34 096.50	38 957.19
Deposits with Central Bank	29 860.02	31 836.25	32 930.07	37 711.77
Cash in Vault	1 034.40	1 017.06	1 166.43	1 245.42
Claims on Governments	6 807.92	7 252.78	7 796.58	8 321.72
Of Which: Central Government	6 807.92	7 252.78	7 796.58	8 321.72
Claims on Central Bank	428.40	330.62	101.76	88.24
Claims on Other Depository Corporations	48 324.82	48 486.16	48 720.59	55 187.45
Claims on Other Financial Corporations	15 181.78	16 076.71	17 408.46	19 855.04
Claims on Non-financial Corporations	78 049.96	83 116.71	87 251.92	88 879.19
Claims on Other Resident Sectors	22 868.67	24 793.11	27 120.54	29 082.92
Other Assets	7 849.66	8 529.20	8 567.95	8 734.19
Total Assets	**210 610.47**	**221 722.48**	**231 275.84**	**249 379.49**
Liabilities to Non-financial Institutions and Households	147 528.12	155 950.94	162 049.65	173 423.96
Deposits Included in Broad Money	146 369.69	154 404.17	160 469.27	171 625.57
Enterprise Demand Deposits	40 518.62	42 850.67	43 318.27	48 775.95
Enterprise Time Deposits	37 037.13	39 533.23	41 988.15	43 004.07
Household Savings Deposits	68 813.94	72 020.26	75 162.85	79 845.54
Deposits not Included in Broad Money	782.61	1 076.58	1 054.92	1 099.53
Transferable Deposits	287.32	344.90	342.20	358.87
Other Deposits	495.29	731.69	712.72	740.66
Other Liabilities	375.82	470.19	525.46	698.86
Liabilities to Central Bank	709.69	1 023.78	1 352.96	1 120.56
Liabilities to Other Depository Corporations	34 459.09	34 309.05	34 920.25	39 674.60
Liabilities to Other Financial Corporations	3 319.54	4 190.43	4 893.81	5 429.27
Of Which: Deposits Included in Broad Money	3 082.10	3 654.87	4 444.45	4 876.28
Foreign Liabilities	636.07	645.46	601.40	632.72
Bond Issuance	1 443.76	1 699.23	1 779.05	1 744.55
Paid-in Capital	6 186.64	6 478.52	6 758.21	7 226.45
Other Liabilities	16 327.56	17 425.06	18 920.50	20 127.38
Total Liabilities	**210 610.47**	**221 722.48**	**231 275.84**	**249 379.49**

Source: The PBC.

Table B2.13 Balance Sheet of Foreign-funded Banks in 2013

(Quarter-end Balance)

（RMB 100 million yuan）

Items	Quarter1	Quarter2	Quarter3	Quarter4
Foreign Assets	1 243.00	1 139.88	1 098.01	1 127.57
Reserve Assets	2 803.12	2 804.18	2 756.11	3 082.84
Deposits with Central Bank	2 793.53	2 795.23	2 746.73	3 073.25
Cash in Vault	9.60	8.95	9.38	9.59
Claims on Governments	936.10	1 239.91	1 376.81	1 535.16
Of Which: Central Government	936.10	1 239.91	1 376.81	1 535.16
Claims on Central Bank	449.12	307.47	127.31	127.22
Claims on Other Depository Corporations	5 577.64	5 009.57	5 595.19	6 312.82
Claims on Other Financial Corporations	2 139.99	1 176.34	1 281.63	1 400.03
Claims on Non-financial Corporations	10 036.89	9 963.36	10 312.78	10 580.86
Claims on Other Resident Sectors	626.16	661.28	719.14	789.63
Other Assets	1 115.25	828.01	799.68	849.12
Total Assets	**24 927.27**	**23 130.01**	**24 066.67**	**25 805.26**
Liabilities to Non-financial Institutions and Households	14 140.49	13 594.55	13 960.33	15 107.58
Deposits Included in Broad Money	11 214.84	10 778.74	11 162.05	12 119.95
Enterprise Demand Deposits	2 450.60	2 310.69	2 107.41	2 886.72
Enterprise Time Deposits	6 814.99	6 495.17	7 073.85	7 193.25
Household Savings Deposits	1 949.25	1 972.88	1 980.79	2 039.97
Deposits not Included in Broad Money	2 557.60	2 426.91	2 426.26	2 426.25
Transferable Deposits	1 256.42	1 257.72	1 189.86	1 158.40
Other Deposits	1 301.18	1 169.20	1 236.40	1 267.85
Other Liabilities	368.05	388.90	372.02	561.38
Liabilities to Central Bank	22.98	5.44	15.18	1.03
Liabilities to Other Depository Corporations	2 748.71	1 461.01	1 447.07	1 226.74
Liabilities to Other Financial Corporations	826.43	693.57	691.91	736.13
Of Which: Deposits Included in Broad Money	656.66	551.70	550.93	551.87
Foreign Liabilities	3 673.09	4 035.61	4 637.67	5 268.39
Bond Issuance	60.82	111.09	111.71	80.71
Paid-in Capital	1 532.16	1 509.65	1 513.54	1 585.73
Other Liabilities	1 922.58	1 719.08	1 689.26	1 798.94
Total Liabilities	**24 927.27**	**23 130.01**	**24 066.67**	**25 805.26**

Source: The PBC.

Table B2.14 Balance Sheet of Rural Credit Cooperatives in 2013

(Quarter-end Balance)

(RMB 100 million yuan)

Items	Quarter1	Quarter2	Quarter3	Quarter4
Foreign Assets	3.86	3.70	3.73	3.50
Reserve Assets	11 905.56	11 603.54	11 802.66	13 855.03
Deposits with Central Bank	10 944.42	10 645.64	10 790.38	12 996.64
Cash in Vault	961.14	957.91	1 012.28	858.39
Claims on Governments	519.25	505.93	517.58	632.29
Of Which: Central Government	519.25	505.93	517.58	632.29
Claims on Central Bank	136.18	113.54	80.04	88.19
Claims on Other Depository Corporations	18 788.83	17 522.41	17 651.51	16 287.33
Claims on Other Financial Corporations	2 163.44	1 766.58	1 876.26	1 837.28
Claims on Non-financial Corporations	20 865.68	21 259.72	21 580.33	21 753.52
Claims on Other Resident Sectors	21 941.57	22 731.89	22 982.40	22 225.97
Other Assets	3 900.72	3 957.71	4 276.35	4 069.31
Total Assets	**80 225.09**	**79 465.03**	**80 770.87**	**80 752.41**
Liabilities to Non-financial Institutions and Households	64 622.86	64 921.84	65 111.36	65 312.59
Deposits Included in Broad Money	64 500.47	64 804.50	64 982.05	65 123.83
Enterprise Demand Deposits	11 045.02	11 171.97	11 187.69	11 514.66
Enterprise Time Deposits	2 177.19	2 317.52	2 344.43	2 270.71
Household Savings Deposits	51 278.27	51 315.01	51 449.93	51 338.46
Deposits not Included in Broad Money	8.33	9.95	9.22	8.35
Transferable Deposits	0.49	0.70	0.72	0.97
Other Deposits	7.83	9.25	8.50	7.38
Other Liabilities	114.06	107.39	120.08	180.41
Liabilities to Central Bank	1 081.73	1 361.75	1 414.29	1 341.24
Liabilities to Other Depository Corporations	5 143.17	3 788.06	4 357.91	3 935.85
Liabilities to Other Financial Corporations	396.89	369.15	467.60	459.35
Of Which: Deposits Included in Broad Money	68.59	109.77	106.87	90.30
Foreign Liabilities	2.02	0.02	0.03	0.02
Bond Issuance	0.00	0.00	0.00	0.00
Paid-in Capital	2 388.47	2 432.30	2 420.38	2 570.11
Other Liabilities	6 589.95	6 591.90	6 999.30	7 133.26
Total Liabilities	**80 225.09**	**79 465.03**	**80 770.87**	**80 752.41**

Source: The PBC.

Table B2.15 Statistics of Securities Market

Year	2007	2008	2009	2010	2011	2012	2013
Number of Domestic Listed Companies (A share, B share)	1 550	1 625	1 718	2 063	2 342	2 494	2 489
Number of Domestic Listed Foreign Companies (B share)	109	109	108	108	108	107	106
Number of Overseas Listed Companies (H share)	148	153	159	165	171	179	182
Number of Shares Issued (100 million shares)	22 416.85	24 522.85	26 162.85	33 184.35	36 095.52	38 395.00	40 569.08
Of Which: Negotiable Shares (100 million shares)	10 331.52	12 578.91	19 759.53	25 642.03	28 850.26	31 339.60	36 744.16
Total Market Value of Shares (RMB 100 million yuan)	327 140.89	121 366.44	243 939.12	265 422.59	214 758.10	230 357.62	239 077.19
Of Which:Negotiable Shares (RMB 100 million yuan)	93 064.35	45 213.90	151 258.65	193 110.41	164 921.30	181 658.26	199 579.54
Trade Volume of Shares (100 million shares)	36 403.76	24 131.38	51 106.99	42 151.99	33 957.55	32 881.06	48 372.67
Turnover of Shares(RMB 100 million yuan)	460 556.20	267 112.64	535 986.74	545 633.54	421 646.74	314 667.41	468 728.60
Shanghai Composite Index (close)	5 261.56	1 820.81	3 277.14	2 808.08	2 199.42	2 269.13	2 115.98
Shenzhen Composite Index (close)	1 447.02	553.30	1 201.34	1 290.87	866.65	881.17	1 057.67
Number of Investor Accounts (10 thousand)	13 887.02	10 449.09	12 037.69	13 391.04	14 050.37	17 064.46	17 517.63
Average P/E							
Shanghai	59.24	14.86	28.73	21.61	13.40	12.30	10.99
Shenzhen	69.74	16.72	46.01	44.69	23.11	22.01	27.76
Average Turnover Rate (%)							
Shanghai	927.19	392.52	499.41	197.61	124.80	101.59	123.59
Shenzhen	987.42	469.11	793.27	557.46	340.49	297.85	389.11
Treasury Bonds Issuance (RMB 100 million yuan)	23 139.10	8 558.20	17 927.24	19 778.30	17 100.10	16 154.20	20 230
Corporate Bonds Issuance (RMB 100 million yuan)	5 181.00	8 723.40	16 599.30	16 094.45	21 395.32	37 365.46	36 699
Trade Volume of Bonds (10 thousand units)							
Turnover of Bonds (RMB 100 million yuan)							
Turnover of Outright Treasury Bonds Purchase (RMB 100 million yuan)	21 446.79	38 422.29	42 291.52	78 391.44	87 629.52	92 221.85	56 498.86
Turnover of Treasury Bonds Repo (RMB 100 million yuan)	18 345.08	24 268.65	35 475.87	65 877.79	199 581.50	443 655.31	583 253.84
Number of Securities Investment Funds	346	439	557	704	914	1 173	1 552
Total Net Asset Value of Securities Investment Funds (RMB 100 million yuan)	22 339.84	25 741.79	26 767.05	24 228.35	26 510.37	28 661.81	30 025.77
Turnover of Securities Investment Funds (RMB 100 million yuan)	8 620.10	5 831.06	10 249.58	8 996.43	6 365.80	8 667.36	1 024.87
Trading Volume of Futures (10 thousand lots)	72 846.08	136 396.00	215 751.76	156 684.42	105 413.75	145 052.57	206 182.30
Turnover of Futures (RMB 100 million yuan)	409 740.77	719 173.35	1 305 142.92	15 40 296.21	1 375 162.44	1 711 269.35	2 674 662.02

Source: The CSRC, China Government Securities Depository Trust &.Clearing Co.

Table B2.16 Ratio of Stock Market Capitalization to GDP

(RMB 100 million yuan unless otherwise noted)

Year	GDP	Market Capitalization	Ratio of market captialization to GDP (percent)	GDP	Negotiable Market Capitalization	Ratio of negotiable market captialization to GDP (percent)
1996	71 177	9 842	13.83	71 177	2 867	4.03
1997	78 973	17 529	22.20	78 973	5 204	6.59
1998	84 402	19 506	23.11	84 402	5 746	6.81
1999	89 677	26 471	29.52	89 677	8 214	9.16
2000	99 215	48 091	48.47	99 215	16 088	16.21
2001	109 655	43 522	39.69	109 655	14 463	13.19
2002	120 333	38 329	31.85	120 333	12 485	10.38
2003	135 823	42 458	31.26	135 823	13 179	9.70
2004	159 878	37 056	23.18	159 878	11 689	7.31
2005	183 868	32 430	17.64	183 868	10 631	5.78
2006	211 923	89 404	42.19	211 923	25 004	11.80
2007	249 530	327 141	131.10	249 530	93 064	37.30
2008	300 670	121 366	40.36	300 670	45 214	15.04
2009	335 353	243 939	72.74	335 353	151 259	45.10
2010	397 983	265 422	66.69	397 983	193 110	48.52
2011	471 564	214 758	45.54	471 564	164 921	34.97
2012	519 322	230 358	44.36	519 322	181 658	34.98
2013	568 845	239 077	42.03	568 845	199 580	35.09

Source: The CSRC.

Table B2.17 Ratio of Domestic Stock Financing to Bank Loan Increment

(RMB 100 million yuan unless otherwise noted)

Year	Domestic Stock Financing	Loan Increment	Ratio of deomestic stock financing to loan increment (percent)
1996	341.52	10 683.33	3.20
1997	933.82	10 712.47	8.72
1998	803.57	11 490.94	6.99
1999	897.39	10 846.36	8.27
2000	1 541.02	13 346.61	11.55
2001	1 182.13	12 439.41	9.50
2002	779.75	18 979.20	4.11
2003	823.10	27 702.30	2.97
2004	862.67	19 201.60	4.49
2005	338.13	16 492.60	2.05
2006	2 463.70	30 594.89	8.05
2007	7 722.99	36 405.60	21.21
2008	2 619.71	41 703.76	6.28
2009	3 894.53	96 290.18	4.04
2010	8 954.99	79 510.73	11.26
2011	5 073.07	68 751.14	7.38
2012	3 127.54	81 962.95	3.82
2013	3 457.52	93 326.01	3.70

Note: Since 2008,the Statistics of stock refinancing were divided into two items: asset injection and cash injection, and the former was not included in “Domestic Stock Financing”。

Source: Calculated on the basis of data from the CSRC and the PBC.

Table B2.18 Statistics of Stock Market

Year		2007	2008	2009	2010	2011	2012	2013
Number of Domestic Listed Companies (A share, B share)		1 550	1 625	1 718	2 063	2 342	2 494	2 489
Of Which: ST Companies			140	142	153	137	96	57
Medium/ Small-sized Companies		202	273	327	531	646	701	701
Growth Enterprises Board				36	153	281	355	355
Number of Domestic Listed Foreign Companies (B share)		109	109	108	108	108	107	106
Of Which: ST Companies			20				12	
Number of Shares Issued (100 million shares)		22 416.85	24 522.85	26 162.85	33 184.35	36 095.52	38 395.00	40 569.08
Of Which: Medium/ Small-sized Companies		339.64	591.60	794.13	1 366.74	1 943.50	2 410.25	2 818.48
Growth Enterprises Board				34.60	175.06	399.53	600.89	761.56
Total Market Capitalization of Shares (RMB 100 million yuan)		327 140.89	121 366.44	243 939.12	265 422.59	214 758.10	230 357.62	239 077.19
Of Which: Medium/ Small-sized Companies		10 646.84	6 269.68	16 872.55	35 364.61	27 429.32	28 804.03	37 163.74
Growth Enterprises Board				1 610.08	7 365.22	7 433.79	8 731.20	15 091.98
Market Capitalization of Negotiable Shares (RMB 100 million yuan)		93 064.35	45 213.90	151 258.65	193 110.41	164 921.30	181 658.26	199 579.54
Of Which: Medium/ Small-sized Companies		3 823.66	2 672.68	7 503.57	16 150.32	14 343.52	16 244.15	25 543.70
Growth Enterprises Board				298.97	2 005.64	2 504.08	3 335.29	8 218.83
Volume (100 million shares)	Total	36 403.76	24 131.38	51 106.99	42 151.99	33 957.55	32 881.06	48 372.67
	Daily Average	150.43	98.10	209.45	174.18	139.17	135.31	203.25
	Medium/ Small-sized	815.56	1 189.26	3 283.65	4 055.35	3 729.74	5 075.85	8 245.92
	Growth Enterprises Board	—	—	38.55	400.53	761.69	1 478.14	3 035.83

(concluded)

Year		2007	2008	2009	2010	2011	2012	2013
Turnover (RMB 100 million yuan)	Total	460 556.22	267 112.64	535 986.74	545 633.54	421 649.72	314 667.41	468 728.60
	Daily Average	1 903.12	1 085.82	2 196.67	2 254.68	1 728.07	1 294.93	1 969.45
	Medium/ Small-sized	16 173.66	16 637.28	48 273.52	85 832.42	69 026.48	61 891.45	1 00 224
	Growth Enterprises Board	—	—	1 828.11	15 717.88	18 879.15	23 304.64	51 182
Average Turnover Rate (%)	Shanghai	927.19	392.52	499.41	197.61	124.80	101.59	123.59
	Shenzhen	987.42	469.11	793.27	557.46	340.49	297.85	389.11
Average P/E	Shanghai	59.24	14.86	28.73	21.61	13.40	12.30	10.99
	Shenzhen	69.74	17.13	46.01	44.69	23.11	22.01	27.76
	Medium/ Small-sized	85.07	24.96	51.01	56.93	28.26	25.42	34.07
	Growth Enterprises Board			105.38	78.53	37.62	32.01	55.21
Shanghai Composite Index	Open	2 728.19	5 265.00	1 849.02	3 289.75	2 825.33	2 212.00	2 289.51
	Highest	6 124.04	5 522.78	3 478.01	3 306.75	3 067.46	2 478.37	2 444.80
	Date	2007-10-16	2008-01-14	2009-08-04	2010-01-11	2011-04-18	2012-02-27	2013-02-18
	Lowest	2 617.02	1 664.92	1 844.09	2 319.74	2 134.02	1 949.46	1 849.65
	Date	2007-01-05	2008-10-28	2009-01-05	2010-07-02	2011-12-28	2012-12-04	2013-06-25
	Close	5 261.56	1 820.81	3 277.14	2 808.08	2 199.42	2 269.13	2 115.98
Shenzhen Composite Index	Open	555.26	1 450.33	560.10	1 207.33	1 298.60	871.93	887.36
	Highest	1 567.74	1 584.40	1 240.64	1 414.64	1 316.19	1 020.29	1 106.27
	Date	2007-10-08	2008-01-15	2009-12-04	2010-11-11	2011-01-06	2012-03-14	2013-10-22
	Lowest	547.89	452.33	557.69	890.24	828.83	724.97	815.89
	Date	2007-01-05	2008-11-04	2009-01-05	2010-07-02	2011-12-28	2012-12-04	2013-06-25
	Close	1 447.02	553.30	1 201.34	1290.87	866.65	881.17	1 057.67

Source: The CBRC,Shanghai Stock Exchange and Shenzhen Stock Exchange.

Table B2.19 Summary of China's Bond Issuance

(RMB 100 million yuan)

Year	Treasury Bonds			Financial Bonds			Corporate Credit Bonds		
	Issuance	Redemption	Outstanding Balance	Issuance	Redemption	Outstanding Balance	Issuance	Redemption	Outstanding Balance
1994	1 137.55	391.89	2 286.40				161.75	282.04	682.11
1995	1 510.86	496.96	3 300.30				300.80	336.30	646.61
1996	1 847.77	786.64	4 361.43				268.92	317.80	597.73
1997	2 411.79	1 264.29	5 508.93				255.23	219.81	521.02
1998	3 808.77	2 060.86	7 765.70				147.89	105.25	676.93
1999	4 015.00	1 238.70	10 542.00				158.20	56.50	778.63
2000	4 657.00	2 179.00	13 020.00				83.00		861.63
2001	4 884.00	2 286.00	15 618.00				147.00		
2002	5 934.30	2 216.20	19 336.10				325.00		
2003	6 280.10	2 755.80	22 603.60				358.00		
2004	6 923.90	3 749.90	25 777.60				327.00		
2005	7 042.00	4 045.50	28 774.00				2 046.50	37.00	
2006	8 883.30	6 208.61	31 448.69				3 938.30	1 672.40	
2007	23 139.10	5 846.80	48 741.00				5 181.00	2 880.90	7 683.30
2008	8 558.20	7 531.40	49 767.80				8 723.40	3 277.84	13 250.62
2009	17 927.24	9 745.06	57 949.98				165 99.30	4 309.12	25 540.80
2010	19 778.30	10 043.38	67 684.90				16 094.45	5 099.23	36 318.15
2011	17 100	10 959	75 832	23 491	7 683	75 748	23 548	10 326	49 095
2012	16 154	9 464	82 522	26 202	8 588	93 362	37 365	8 750	77 710
2013	20 230	8 996	95 471	26 310	13 306	105 772	36 784	18 673	93 242

Notes:① "Financial Bonds" are bonds issued by financial insitutions, including financial bonds issued by CDB, policy financial bonds, common bonds, subordinated bonds and hybrid bonds issued by commercial banks, asset-backed securities, bonds and short-term financing bills issued by securities companies, and financial bonds issued by asset management companies.

②Due to statistical method adjustment, since 2012, the item "Enterprise bonds" is replaced by "Corporate credit bonds", including Debt Financing Instruments of Non-financial Enterprises, Enterprise Bonds, Corporate Bonds, Convertible Bonds, Bonds with Detachable Warrants, and SME Private-funded Bonds.

Source: The PBC.

Table B2.20 Statistics of China's Insurance Sector

(RMB 100 million yuan Unless otherwise noted)

Items	2007	Growth (y-o-y) (percent)	2008	Growth (y-o-y) (percent)	2009	Growth (y-o-y) (percent)	2010	Growth (y-o-y) (percent)	2011	Growth (y-o-y) (percent)	2012	Growth (y-o-y) (percent)	2013	Growth (y-o-y) (percent)
Premium Income	7 035.76	24.72	9 784.10	39.06	11 137.30	13.83	14 527.97	30.44	14 339.25	—	15 487.93	8.01	17 222.24	11.20
1.Property Insurance	1 997.74	32.35	2 336.71	16.97	2 875.83	23.07	3 895.64	35.46	4 617.82	18.54	5 330.93	15.44	6 212.26	16.53
2.Personal Accident Insurance	190.11	17.01	203.56	7.08	230.05	13.02	275.35	19.69	334.12	—	386.18	15.58	461.34	19.46
3.Health Insurance	384.17	1.93	585.46	52.40	573.98	-1.96	677.47	18.03	691.72	—	862.76	24.73	1 123.50	30.22
4.Life Insurance	4 463.75	24.25	6 658.37	49.17	7 457.44	12.00	9 679.51	29.80	8 695.59	—	8 908.06	2.44	9 425.14	5.80
Claim Payment	2 265.21	57.47	2 971.17	31.16	3 125.48	5.19	3 200.43	2.40	3 929.37	22.78	4 716.32	20.03	6 212.90	31.73
1.Property Insurance	1 020.47	28.15	1 418.33	38.99	1 575.78	11.10	1 756.03	11.44	2 186.93	24.54	2 816.33	28.78	3 439.14	22.11
2.Personal Accident Insurance	63.43	22.76	62.57	-1.35	63.92	2.15	71.39	11.69	81.84	14.64	96.80	18.28	109.51	13.12
3.Health Insurance	116.86	-6.58	175.28	49.99	217.03	23.82	264.02	21.65	359.67	36.23	298.17	-17.10	411.13	37.88
4.Life Insurance	1 064.45	128.71	1 314.98	23.54	1 268.74	-3.52	1 108.99	-12.59	1 300.93	17.31	1 505.01	15.69	2 253.13	49.71
Operating Expenses	947.62	42.06	1 079.52	13.92	1 234.06	14.32	1 538.35	24.66	1 882.38	22.36	2 171.46	15.36	2 459.59	13.27
Bank Deposits	6 516.26	8.80	8 087.55	24.11	10 519.68	30.07	13 909.97	32.23	17 737.17	27.51	23 446.00	32.19	22 640.98	-3.43
Investment	20 205.69	71.29	22 465.22	11.18	26 897.43	19.73	32 136.65	19.48	37 736.67	17.43	45 096.58	19.50	54 232.43	20.26
Of Which: Treasury Bonds	3 961.12	8.61	4 208.26	6.24	4 053.82	-3.67	4 815.78	18.80	4 742.40	-1.52	4 795.02	1.11	4 776.73	-0.38
Securities Investment Funds	2 530.46	177.44	1 646.46	-34.93	2 758.78	67.56	2 620.73	-5.00	2 915.86	11.26	3 625.58	24.34	3 575.52	-1.38
Total Assets	29 003.92	46.99	33 418.44	15.22	40 634.75	21.59	50 481.61	24.23	60 138.10	19.13	73 545.73	22.29	82 886.95	12.70

Notes: ①Since 2011, the calculation of premium income has been adjusted according to Accounting Standards for Enterprises No.2 circulated by the Ministry of Finance. As a result, data of premium income since 2011 is incomparable with those in previous years.

②Data of premium income, claim payment and operating expenses are data for the year.

③Data of bank deposits, investment and total assets are data of year-end balance.

Source: Calculated based on data from CIRC Website.

Table B2.21 The Structure of Non-life Insurance Premium Income

(RMB 100 million yuan unless otherwise noted)

Insurance Lines	2010	proportion (percent)	2011	proportion (percent)	2012	proportion (percent)	2013	proportion (percent)
Automobile Insurance	3 004.15	74.60	3 504.56	73.33	4 005.17	72.43	4 720.79	72.84
Enterprise Property Insurance	271.61	6.74	329.81	6.90	360.36	6.52	378.80	5.84
Cargo Transportation Insurance	78.74	1.96	97.83	2.05	101.71	1.84	102.94	1.59
Accident Insurance	85.53	2.12	105.12	2.20	126.54	2.29	150.93	2.33
Liability Insurance	115.88	2.88	148.01	3.10	183.77	3.32	216.63	3.34
Others	470.98	11.70	593.73	12.42	752.33	13.60	911.07	14.06
Total	4 026.89	100.00	4 779.06	100.00	5 529.88	100.00	6 481.16	100.00

Source: The CIRC.

Table B2.22 The Structure of Life Insurance Premium Income

(RMB 100 million yuan unless otherwise noted)

Insurance Lines	2010	proportion (percent)	2011	proportion (percent)	2012	proportion (percent)	2013	proportion (percent)
Life Insurance	9 679.31	92.18	8 695.40	90.96	8 907.90	89.46	9 424.99	87.75
Of Which: Common Life Insurance	948.17	9.03	951.20	9.95	969.65	9.74	1 200.27	11.17
Participating Insurance	7 454.77	70.99	7 662.54	80.15	7 854.29	78.88	8 132.81	75.72
Unit-linked Insurance	152.82	1.46	4.55	0.05	4.35	0.04	4.42	0.04
Accident Insurance	189.83	1.81	229.00	2.40	259.64	2.61	310.41	2.89
Health Insurance	631.74	6.02	635.61	6.65	790.35	7.94	1 005.52	9.36
Total	10 500.88	100.00	9 560.00	100.00	9 957.89	100.00	10 740.93	100.00

Source: The CIRC.

Table B2.23 Insurance Premium Income of China's Different Regions in 2013

(RMB 100 million yuan)

Regions	Insurance Premium Income	Property Insurance	Life Insurance	Accident Insurance	Health Insurance
Total	17 222.24	6 212.26	9 425.14	461.34	1 123.50
Guangdong	1 446.08	518.61	809.17	41.88	76.41
Jiangsu	1 434.15	487.35	805.11	40.27	101.42
Henan	1 101.44	370.47	628.46	25.23	77.29
Shandong	994.44	288.03	570.81	29.93	105.68
Beijing	924.42	415.14	435.16	25.37	48.75
Sichuan	916.52	238.83	613.40	14.81	49.49
Hebei	914.68	315.12	520.99	26.70	51.87
Shanghai	837.59	309.77	467.24	16.63	43.94
Zhejiang	821.43	285.25	435.89	32.44	67.85
Hubei	587.40	169.35	362.81	15.79	39.45
Hunan	508.57	176.02	286.13	13.70	32.72
Anhui	483.01	203.85	242.56	9.00	27.60
Shanxi	468.76	172.80	252.76	13.35	29.86
Shanxi	463.06	157.16	257.17	13.51	35.22
Liaoning	446.65	165.50	242.73	9.34	29.07
Heilongjiang	417.45	137.07	246.82	10.40	23.17
Chongqing	412.38	144.55	239.70	7.97	20.16
Fujian	384.32	113.62	240.47	7.57	22.65
Shenzhen	359.23	112.52	208.42	13.82	24.48
Jiangxi	320.77	151.76	131.65	12.30	25.06
Jilin	317.95	116.20	177.52	7.70	16.53
Tianjin	276.80	102.28	148.54	5.91	20.07
Guangxi	275.47	112.15	135.42	10.50	17.41
Yunnan	274.69	129.73	121.38	6.46	17.13
Xinjiang	273.49	113.23	124.40	10.66	25.20
Inner Mongolia	266.44	91.09	150.68	4.48	20.19
Dalian	185.50	96.84	78.10	4.66	5.89
Gansu	181.62	89.03	74.90	7.24	10.43
Qingdao	180.15	68.34	95.78	4.94	11.09
Ningbo	178.99	75.13	88.24	4.09	11.53
Guizhou	176.00	63.60	96.84	3.90	11.67
Xiamen	111.78	48.13	53.24	3.22	7.19
Hainan	72.70	31.40	32.11	2.04	7.16
Ningxia	72.61	31.70	35.62	1.88	3.41
Qinghai	39.02	19.51	13.82	1.33	4.35
Tibet	11.43	7.96	0.94	1.41	1.12
Group and Head Office Level	85.24	83.18	0.16	0.93	0.97

Note: Data of “Group and Head Office Level” refers to the premium income earned by the group and head office, which is not reflected in any regions’ data.

Source: The CIRC.

Table B2.24 Transactions of Payment Systems

(10 thousand transactions/RMB 100 million yuan)

Items	2009		2010		2011		2012		2013	
	Number	Value	Number	Value	Number	Value	Number	Value	Number	Value
HVPS	24 801.90	8 039 463.72	29 121.66	11 043 680.19	37 211.44	13 552 814.97	47 035.96	17 719 972.13	59 548.66	20 607 617.10
BEPS	22 580.53	114 617.04	38 672.84	162 124.36	56 304.92	183 614.11	75 393.50	185 477.54	104 027.48	203 154.11
IBPS							26 580.35	35 630.14	71 784.34	94 684.65
ACH	43 043.30	694 061.69	44 957.39	731 904.25	41 803.08	709 484.72	39 135.21	665 182.46	41 871.79	682 892.87
CDFCPS	28.29	3 445.88	54.48	9 506.38	76.24	17 103.76	111.05	33 614.79	139.44	44 294.86
Intra-bank Payment Systems of Banking Institutions	338 783.44	3 147 552.55	524 460.31	4 580 717.89	729 076.77	5 305 821.12	895 492.15	6 245 593.61	1 075 915.50	7 452 224.44
UnionPay Bankcard Interbank Clearing System	694 167.83	76 687.16	845 329.81	112 267.74	1 038 147.93	159 285.29	1 248 897.88	217 631.82	1 513 946.08	322 972.28

Note: HVPS(High-value Payment System), BEPS(Bulk Electronic Payment System), IBPS(Internet Banking Payment System), ACH(Automated Clearing Houses), CDFCPS(China Domestic Foreign Currency Payment System).

Source: The PBC.

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