Abstract: Governance of Banks in China

With the economic reform in the late 1970s, it has been an objective of government policy for Chinese banks to move away from their traditional passive role of executing directives adapted to the active role in resource allocation of banks in a market economy. However, owing to unclear ownership structures and a history of support of regional and industrial policy, most Chinese banks have had difficulty making the transition. This is particularly true for the four large state-owned commercial banks (SOCBs). In 1998-99, a significant effort to strengthen SOCB balance sheets was undertaken, but the results were disappointing. In the most recent phase of the reform, which began in 2003, the authorities concluded that further attempts at rehabilitation of the SOCBs had to address the issue of bank governance.

The key elements of the most recent phase of the reform, which began in 2003, are ownership diversification, public listing and expanded foreign presence, designed to subject all banks to higher standards of transparency and disclosure.

While the programme is bold, there are doubts about how bank restructuring will proceed. Ownership diversification and public listing thus far have generally not led to markedly improved performance for Chinese companies and thus their impact on banks is uncertain. Despite these uncertainties, the changes already introduced are so far ranging that there is no serious option of reverting to the old patterns of behaviour.

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Governance of Banks in China*

Executive summary

The conceptual framework for governance in banking reflects the special role of banks in a market economy. In order for the bank to act as a profit-oriented corporation, it must have genuine owners and the corporate governance regime should enable the owners to hold the management accountable for achieving a competitive return at acceptable risk. At the same time, banks have fiduciary obligations to depositors and also perform many "public good" functions such as acting as repository of savings, supplying currency and allocating resources in the real economy. Therefore, banks operate in a regulated environment.

There is a very close link between governance and supervision. The supervisors retain the right to determine whether their governance system, including their system of risk management, is appropriate. The modern paradigm of financial supervision relies on the bank's internal governance as the first "pillar" of bank oversight. The other two "pillars" are: *i*) surveillance by the market; and *ii*) official banking supervision.

With the economic reform begun in the late 1970s, Chinese banks have been moving away from their passive role under central planning. However, owing to unclear ownership structures and a history of support of regional and industrial policy, most Chinese banks have a governance regime that is not well adapted to the active role in resource allocation of banks in a market economy. This is particularly true for the four large state-owned commercial banks (SOCBs) which account for the predominant share of bank assets. Lacking profit-oriented owners to monitor bank management, the SOCBs have historically functioned as extensions of the government, with senior executives named by the party and approved by the State Council.

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Part of the problem is that with their poor quality assets, the banks are financially weak. In 1998-99, a significant effort to strengthen SOCB balance sheets was undertaken with the sale of a large portion of non-performing loans (NPLs) to government-owned asset management companies. While resources committed to bank restructuring amounted to more than 16 per cent of GDP, the results were nonetheless disappointing. The financial quality of the big four SOCBs remained rather poor, with low earnings, inadequate capital, and continued high levels of NPLs. The authorities concluded that further attempts at rehabilitation of the SOCBs had to address the issue of bank governance.

In contrast to the SOCBs, the second largest category of banks, the 11 Joint Stock Banks (JSBs), have stronger earnings and better balance sheets. The JSBs, which are owned partly by the government and partly by other interests, do not have the historical legacy as instruments of supporting government policy and their management has a stronger commitment to profitability.

The key elements of the most recent phase of the reform, which began in 2003, are:

- improved ownership structures of SOCBs;
- government support for two "pilot" SOCBs, conditional upon improvements in governance;
- heightened competition between the SOCBs and other kinds of domestic banks;
- increased transparency and exposure of all Chinese banks to scrutiny by the market;
- an expanded foreign presence partly linked to Chinese WTO membership and partly linked to a desire to benefit from foreign competition.

Ownership diversification, public listing and expanded foreign presence are designed to subject all banks to higher standards of transparency and disclosure, with more intense scrutiny by banking counterparties, investment analysts, institutional investors and rating agencies. At the same time, measures to improve bank supervision were accelerated with the formation of a specialised independent agency for bank supervision (the China Banking Regulatory Commission or CBRC) and the enactment of a series of laws and regulations pertaining to bank supervision.

In December 2003 a special entity (Huijin) was set up to assume the state's ownership interest in the SOCBs. The "pilot" SOCBs will first be transformed into joint stock companies with the state as the sole owner and will receive cash injections to increase capital to adequate levels and build reserves against NPLs. The pilot banks are expected to find domestic and international strategic

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investors to assume ownership positions and play an active role in corporate governance while Huijin represents the state's interest. The SOCBs will select their own management, which will be accountable for meeting the most commonly used benchmarks for earnings and balance sheet quality as well as targets for improvement in internal governance.

The JSBs have already been gaining market share in recent years and now have an opportunity to expand their share of the banking market yet further. To make further gains, the JSBs will raise capital by: *i*) domestic or international equity; *ii*) issues of subordinated debt; and/or *iii*) strategic investments by foreign banks. This will lead to changes in ownership structures and more intense market scrutiny for the JSBs.

While the programme is bold, there are doubts about how bank restructuring will proceed. On the one hand, competition may lead to a further contraction of the share of SOCBs in total lending, which could make the problems more manageable. On the other hand, it is not certain whether planned reforms are sufficient to make the SOCBs operate as market-based institutions. Continued majority state control of SOCBs with dispersed minority stakes may not result in effective monitoring of bank performance. The banks may be seen as "too big to fail"; they may still be perceived as benefitting from government support and therefore may not be exposed to full market competition. Ownership diversification and public listing thus far have generally not led to markedly improved performance for Chinese companies and thus their impact on banks is uncertain. Despite these uncertainties, the changes already introduced are such that there is no serious option of reverting to the old patterns of behaviour.

Introduction

This chapter analyses the special governance issues facing banks in China. Owing to their poor financial quality and their substandard governance systems, the major Chinese banks have been operating in ways that run counter to market-based rules of economic conduct. Since the onset of the reform in the late 1970s, awareness of the need to reform banks has grown. But banks have been slow to adapt their ways to the economic paradigms of a market economy and continue to lend support to state-owned enterprises, especially those that enjoyed the support of local government.

Efforts to change patterns of bank behaviour accelerated in the late 1990s, when the government sought to address the problem through providing funds to the banks for recapitalisation and for the removal of impaired assets from bank balance sheets. However, it soon became obvious that these measures were insufficient in scope to address the balance-sheet problems of banks and in any case

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the provision of funds provided no incentive to prevent the banks from reverting to earlier patterns of lending.

Since 2003, efforts to reform banks have been accelerated, with one of the express objectives of the present reform being an improvement in bank governance practices. While most of these policy changes have been under discussion for several years, taken together, the measures to reform the banking system represent a major step in the direction of a market-based financial system. Specific reform measures include further upgrading of supervisory techniques in line with international practices as well as significant opening and liberalization of the banking system.

Since this study focuses on issues of governance, it will focus on those particular parts of the banking system where reforms aimed at improving governance are explicit policy aims. As a result, the note will not be a full analysis of the situation in the banking system. Measures specifically aimed at improving governance include a change in the ownership of commercial banks, an enlarged possibility for banks other than those entirely owned by the state to compete, improved internal control systems, greater transparency and market discipline, and more competition from foreign-owned banks. The aim of these measures is to strengthen incentives for bank management to operate the bank in the interests of financial return rather than in response to a mix of financial and non-financial considerations, some of which may be mutually inconsistent.

This chapter first considers the question of why the governance of financial institutions, and particularly banks, requires a special framework of analysis, and some of the distinctive governance issues that characterise banks. Subsequently, the specific issues facing the Chinese banking system will be addressed.

Governance in the banking sector

The role of financial institutions in a market economy

Financial institutions (banks, securities companies, pension funds and investment management companies) occupy a unique place in market economies. Financial institutions gather the savings of the public, exchange and analyse information about prospective users of financial resources, price risk, balance risk against return, and channel resources to those entities in the economy that seem most profitable while encouraging change in those where performance is deficient. To the degree that the behaviour of financial institutions deviates from this pattern, the economy will have difficulty in operating according to market signals.

Financial institutions operate in a highly regulated environment. All governments have decided that it is permissible to carry out financial business (banking, securities, insurance or pensions) only through a defined legal and regulatory framework and

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have devised formal arrangements that stipulate the conditions under which it is permissible to solicit the savings of the public for various financial activities.

While financial institutions are expected to operate inside the normative framework that covers all corporate entities,[1] the governance structure of financial companies must also address some issues that are peculiar to the financial sector. Financial institutions typically utilise only small amounts of their own funds (capital) and instead deploy funds entrusted to them by the public. Financial institutions control large pools of assets and it is extremely difficult for the individual saver to monitor the ways in which financial institutions use those funds. Persons inside the institution, such as the management, brokers, traders, or money managers may not act in the interests of the client. Moreover, financial institutions frequently have ownership and control linkages to other key actors, such as allied industrial companies, governments, and local communities as well as their own management and workers. These linkages raise the risk of conflicts of interest and agency problems. Indeed, in emerging markets it is fairly common for these institutions to be "captured" by some group of outside parties. The governance regime has to build robust structures to protect the interests of parties to whom the institution owes a fiduciary duty.

Supervision and regulation are parts of the governance systems of the financial institution in a way that differs from non-financial institutions. Provisions in laws and regulations typically define products and prices, and licenses are required to engage in financial business. Furthermore, the supervisory authorities reserve the right to pass judgment on the adequacy of the governance of the institution.

Special characteristics of banking

The basic framework for governance of financial institutions has certain specific characteristics when applied to banking. Banks have special responsibilities regarding the issue of currency and the conduct of monetary policy. In most OECD member countries, a regime of deposit insurance guarantees that at least smaller depositors will be made whole even if the bank in which the deposit is made is unable to honour its commitments. By extending such guarantees, the authorities in effect remove the incentive for insured depositors to monitor banks, thus enabling banks to obtain funds without paying a risk premium fully commensurate with their risk profile. Systemic bank failures can have powerful negative effects on household wealth and on economic performance more generally. Furthermore, official rescues of failed banking systems are often very costly. For all these reasons, the authorities of most countries have decided that the banking supervisors may exercise higher degrees of control surveillance of the process whereby banks assume risks than is exercised over most companies and over other financial institutions.

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Governance and banking supervision

While banking supervision entails a higher degree of control than other financial supervision, a process of deregulation has been occurring in finance over the past few decades. With deregulation, banking has become a highly competitive market-driven activity. In current conditions, banks are devising new product mixes and undertaking mergers and acquisitions and strategic alliances, frequently eroding the earlier lines of product segmentation. In current conditions, banks are allowed to compete much more freely than in the past and, at least in advanced markets, are under intense pressures to produce value for shareholders. The supervisory authorities are much more inclined than in the past to allow banks to determine their own risk preferences and to devise their own expansion strategies. Thus, the methods of bank supervision have evolved.

When a bank is adequately capitalised, the management places the capital of the owners at risk and the owners' investment is the first line of defence in maintaining financial integrity. It is plainly in the interest of the bank's shareholders to assure that high standards of profitability and financial soundness are maintained, since any deficiency on these scores ultimately falls on the bank's owners. The supervisor's main concern is to make sure that the bank operates within these parameters and does not experience a deterioration in financial condition that would shift the burden for risk-bearing to the public sector, by triggering government deposit insurance or by requiring intervention to assure the continuing operation of the bank or to prevent a disorderly bank failure that may cause systemic disturbances. Instead of the multiplicity of objectives and tight restrictions they faced in the past, banks are now expected: *i*) to earn adequate rates of return; *ii*) to observe high prudential standards and to maintain high quality risk management systems; and *iii*) to protect the interests of depositors.

Rather than criticising the bank's loan portfolio in detail, banks supervisors now see their role as one of engaging in dialogue with the directors of the bank and senior management about the risks the bank is taking, the quality of the bank's balance sheet and the systems that are in place to deal with those risks. Bank supervisors have systems under which they use a variety of quantitative and judgmental indicators to score banks under their own supervision.

Internal risk management and the credit culture

In order to protect the owners' investment and satisfy the requirements of supervisors, banks require strong internal "credit cultures" consisting of a strong in-house capability to analyse credit risk coupled with in-house systems to monitor the granting of credit and the assumption of risk. In competitive markets, the ability to characterise and price risk is a crucial determinant of whether the bank will survive and prosper. Credit analysts assign each proposed transaction a risk

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rating, and based upon this rating a cost of credit is assigned. Only deals that clear the bank's profit hurdles are approved.[2]

The internal audit function assures that information disseminated internally and externally is accurate and protects the integrity of the disclosure process. The audit committee of the board of directors is the ordinary means by which the attention of the board is kept focused on the audit process. The responsibilities of this committee include communications, selection and oversight of external auditors, safeguarding risk management and internal controls, oversight of accounts, and communications with and oversight of external auditors.

Market discipline

Banks and their operations are expected to be under constant surveillance by the capital markets, where they issue bonds and equities, and by rating agencies who assess their creditworthiness. Banks engage not only in funding and lending to final customers, but also in a variety of operations, such as interbank lending and borrowing, foreign exchange dealing and trading of various assets in which they act as counterparties. The institution is expected to disclose reliable data that enable interested parties, such as depositors, investors and prospective counterparties, to reach an informed judgment about the creditworthiness of the institution. One routine operation of banks is to assess the creditworthiness of other institutions that are active participants in the market and modify the conditions under which they are willing to deal with other institutions. In performing this task, banks are typically assisted by credit-rating agencies and other suppliers of financial information.

A loss of credit standing is likely to be a leading indictor that a bank is encountering financial difficulty. Any lessening of the willingness of other banks to engage in credit activities, or increases in risk premiums charged for engaging in such activity would make it impossible for banks to function competitively. An increase in the cost of borrowing due to a perceived decline in creditworthiness is one of the principal ways in which market discipline is exerted over banks, and the judgment of the market is imposed on banks.

Shareholders and bank governance

The concept underlying the governance paradigm for banks is that the owners of the bank have placed their own capital at risk and the institution is to be operated, at least in very large part, in order to protect the investment of the owners and to produce a competitive yield to investors. Shareholders are entitled to the residual profits of the bank. Thus, if the bank should be especially successful, its owners will obtain most of the benefits. Conversely, the owners' funds equity (or capital) acts as a buffer in cases where the institution sustains losses due to inade-

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quate earnings and/or losses on loans and investments. Thus, the shareholders have an important stake in maintaining adequate systems to monitor the management of the bank. The board of directors of the financial institution is charged with ensuring that the management is acting in the interests of the owners. It is important that the bank have a group of owners who actually behave in accordance with this paradigm and that the owners have effective means to monitor.

Banks in major industrial countries can generally be relied upon to act in accordance with this model. In emerging markets, however, experience shows that it is difficult to assemble a group of investors who can perform the normal moni-

Box 1. **Internal governance and banking supervision**

The relationship between the supervisory system of financial institutions and the internal governance of the institution has evolved significantly with deregulation. Previously, bank supervisors expended considerable effort validating financial accounts and examining individual loans, balance sheets and lending practices to check conformity with rules. These examinations often tended to occur at discrete time intervals. In the 1990s, however, banks began to innovate and to accept new kinds of risk. Many of these newer risks were not amenable to traditional examinations at discrete time intervals, since risk profiles changed rapidly within time periods. Simultaneously, the authorities have increasingly concluded that the responsibility for risk oversight must ultimately be the responsibility of the individual bank. The full process of oversight of banks consists of three elements: *i*) risk management and governance systems within the institution; *ii*) surveillance by the market; and *iii*) prudential oversight by the supervisory authorities.

As the nature of bank supervision evolved, supervisors increasingly insist on sound corporate governance inside the bank as the foundation of bank supervision. One aspect of bank governance is that the bank's directors and senior managers are responsible for seeing that banks have adequate risk management systems, including an internal audit function.[1] The revised global framework for banking supervision, commonly known as Basle II, places enlarged responsibility on the risk management systems of banks and establishes the accountability of bank boards and management for the adequacy of such systems.

The philosophy of banking supervisors with respect to the importance of corporate governance is spelled out in a statement by the Basle Committee on Banking Supervision, the international grouping that brings together banking supervisors from all major countries. This document highlights the crucial role that the board and senior management play in corporate goals and strategies, selection and appraisal of management, operations of risk controls and audit while building safeguards to minimise the risk of bank failure and to protect the interests of depositors.

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Box 1. **Internal governance and banking supervision** (*cont.*)

The role of the board is crucial. The board is accountable to the shareholders, but also the supervisory authority. It names, monitors, compensates and, if necessary, removes the management. The board is responsible for the development of in-house systems to identify, quantify and manage risk.[2] The board is also responsible for the adequacy of the company's risk management and reporting systems.

While there is nearly universal agreement that the internal governance structure of the bank is the first line of defence in banking supervision, the exact specification of the role of the internal governance system differs in some degree among banking supervisors. The Governor of the Reserve Bank of New Zealand (RBNZ) states that "the ultimate responsibility for ensuring that risks are properly identified, monitored and controlled, lies in the boardroom and not with the supervisor". The RBNZ stresses the responsibility of bank directors in ensuring that a sufficient number of independent directors are on the board and that the board and senior management be accountable for devising strategies for the bank to thrive and earn adequate income while maintaining adequate internal systems for risk control.[3]

In an analysis specifically keyed to the situation of emerging Asian markets, Dr. Estanislao, President of the Institute of Directors of the Philippines, defines building board oversight capacity as an urgent priority for bank supervisors, especially in emerging markets which are often characterised by histories of government directed lending and of linkages between the banks and industry and government. The need to sensitise directors to their role in providing oversight to management and to defending the interests of minority shareholders is especially important in emerging markets. In order to do this, banks are required to provide prospective training to directors to explain their responsibilities and also to require minimum numbers of independent directors and specialised committees on audit, risk oversight and governance. The majority of directors of these committees should be independent. Estanislao also emphasises the need to develop rigorous definitions of independent directors and to use various tools to asses the quality of bank governance, such as the balanced scorecard approach.[4]

1. Bies (2002), pp. 1-2.
2. Basle Committee (September 1999).
3. See Bollard (2004).
4. See Estanislao (2004).

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toring roles of shareholders. Domestic capital markets have not developed to the point that dispersed groups of domestic investors can act as effective monitors. Domestic strategic investors often have links to domestic industrial groups and hence the risk that the bank may be captured by domestic industry is always present. As a result, many emerging markets have found that efforts to reform bank governance require an expanded presence by foreign strategic investors. (This issue will be considered at length in the discussion of the Chinese case.)

When banks have no real owners, when the bank's capital is inadequate (or can be made to appear adequate only with regulatory forbearance), there is a likelihood that the management will engage in dysfunctional behaviour. Banks may take on excessive risk or they may engage in adverse credit selection in order to enable weak borrowers to maintain payments. Thereby, they increase their exposure to poor credits and conceal the true state of their balance sheets.

Governance of banks in China

Historical legacy

China's experience is distinctive inasmuch as between the early 1950s and the 1980s the economy functioned as a centrally planned socialist economy, with a system based upon state ownership in which a central authority issued directives that lower echelons executed.[3]

With the introduction of market reforms around 1980, a partial modification of the pattern of financing occurred. Some separation of commercial banking from the central bank took place, with the PBC focusing on its role as central bank. The banking system was expanded and diversified to meet the needs of the reform programme. New budgetary procedures permitted state enterprises to retain profits and to remit to the state only a tax on income and to seek investment funds in the form of bank loans. Between 1979 and 1985, the volume of deposits nearly tripled and the value of bank loans rose by 260 per cent. Meanwhile SOEs became dependent upon bank loans rather than budget transfers for external finance. Further institutional reforms were accelerated in 1994, when the policy execution function of banks was separated from the commercial banking function, with new specialised "policy banks" being formed. In theory, the commercial banks were expected to act in accord with market-based principles of finance, but owing to conflicting motivations of bank management, banks have been slow to change patterns of behaviour.

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The present situation in the banking sector

After two decades of partial and at times contradictory reform, the banking system shows some prominent characteristics:

1. China has a very high savings rate, with savings averaging about 40 per cent of national income. The public holds the preponderant share of its savings in the form of bank deposits.

2. The post-1994 series of reforms, designed to subject the state-owned enterprises (SOEs) to greater market discipline, have been only partly effective. The formal financial system (*i.e.* banks and securities market institutions) has had only limited success in instilling discipline in the SOEs. Many SOEs operate at a loss, partly because the SOEs have limited flexibility to control the size of their labour forces and still undertake many operations that are not closely related to their basic economic functions. This situation has been ameliorated somewhat by reforms in the SOE sector after 1997, but pressures from SOEs and local governments remain strong.

3. The private sector, which has been the source of the economy's dynamism over the past two decades, has been obliged to use informal finance for its expansion.

4. The financial quality of Chinese banks, especially the state-owned commercial banks (SOCBs), is rather poor, with low earnings, inadequate capital, and high levels of non-performing assets. Indeed, most SOCBs would probably be insolvent if their balance sheets were subjected to careful scrutiny using strict loan classification standards.

5. A process of adverse credit selection is at work in which one of the main motivations of the banks is to extend enough credit to weak but privileged borrowers to stave off bankruptcy. There is a certain symbiosis between the SOEs and the banks which have some motivation to continue lending to weak SOEs in order to avoid report credits to such SOEs as non-performing.

6. As currently structured, the governance system of Chinese banks is not well suited to operating as profit-seeking institutions under which the bank aims at providing a competitive yield to shareholders and maintain high prudential standards. This is particularly true of the major state-owned commercial banks (SOCBs). The banks do not have clear owners. The management of the banks is not conducted by professional managers with a clear mandate to return value to shareholders, but by government officials whose goal is to achieve a balance of economic and non-economic objectives.

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Box 2. Chinese banks under central planning

Under central planning, financial institutions played a passive role and were expected to check on conformity of lower-level actors with the objectives and directives of the plan. The Ministry of Finance exercised firm control over the banking system, credit, and the money supply. The People's Bank of China (PBC) essentially functioned as the "monobank" characteristic of centrally planned economies. As the central bank, the PBC had sole responsibility for issuing currency and controlling the money supply. It also served as the government treasury, the main source of credit for economic units, the clearing centre for financial transactions, the holder of enterprise deposits and the national savings bank. As a result, the skills of credit assessment and the use of financial tools to guide the conduct of enterprises did not develop.

There were some specialised banks alongside the monobank. The Bank of China (BOC) handled financial transactions with foreign firms and individuals as well as all operations in foreign currency. The Agricultural Bank provided financial support to agricultural units, issuing loans, distributing state appropriations for agriculture and overseeing the operations of the rural credit co-operatives. The China Construction Bank (CCB) managed state appropriations and loans for capital construction. It checked the activities of loan recipients to ensure that the funds were used for their designated construction purpose. Money was disbursed in stages as a project progressed.

Rural credit co-operatives were small, collectively owned savings and lending organisations that were the main source of small-scale financial services at the local level in the countryside. They handled deposits and short-term loans for individual farm families, villages, and co-operative organisations. Subject to the loose direction of the Agricultural Bank, they followed uniform state banking policies but acted as independent units for accounting purposes. Urban credit co-operatives began appearing in the mid-1980s. As commercial opportunities grew in the reform period, the thousands of individual and collective enterprises that sprang up in urban areas created a need for small-scale financial services that the formal banks were not prepared to meet.

The institutional structure of the banking system

The system contains five levels of banks. These banks differ in terms of their ownership structures, client base, governance structures and their balance-sheet quality.

State-owned commercial banks (SOCBs)

The four big SOCBs were created in their present form in 1994 with the passage of the Commercial Banking Act. This Act separated the commercial banks, which were supposed to operate in accordance with market criteria, from the

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policy banks, which were expected to execute government policy. The four SOCBs are the Bank of China (BOC), the Industrial and Commercial Bank of China (ICBC), the Agricultural Bank of China (ABC) and the China Construction Bank (CCB). These banks have extremely large nationwide branch networks, large numbers of employees and a workforce of some 1.7 million.

At the end of 2000, the SOCBs accounted for some 75 per cent of banking assets, but their share has been declining in recent years as credit has expanded rapidly and other banks have been able to gain a market share. By the end of the first half of 2004, data from the CBRC showed that their share had fallen to about 55 per cent of total bank assets, as well as 57 per cent of deposits and 55 per cent of lending, but SOCBs still handled 80 per cent of payments and settlements. By volume of assets, the SOCBs are among the 50 largest banks in the world and the 10 largest in Asia.

Even on the simplest organisational level, the SOCBs lack the basic attributes of profit-making banks. In mid-2004, these banks had not yet been transformed into a corporate form and have not been fully separated from the Ministry of Finance (MOF). The banks do not have identifiable owners, boards of directors, or any of the specialized organs generally considered necessary for monitoring management, and are not subject to the governance rules that apply to independent banks. Like all Chinese companies, these banks have an external board of supervisors that is designed mainly to monitor conformity of bank acts with regulations and policies, but has no role in the governance or oversight of the management of the bank. Disclosure requirements are minimal. The bank is accountable only to the government, *i.e.* the MOF or the CBRC.

The management has traditionally been selected from inside the ministerial system, approved by the State Council, and subject to the close control of the Communist Party. The general manager (or chief executive officer, CEO) traditionally is subject to few checks and balances inside the bank. Senior managers tended to be from the civil service and to move between assignments in the banks and those in government ministries. The presidents of the SOCBs have the rank of vice-ministers. Bank management is not under a clear mandate to return value to the owners of the company or even to protect the interest of the owners, but instead responds to a variety of pressures from within the bureaucracy or the Communist Party, or from local governments.

Control over the operations of regional branches of the SOCBs has been a problem. Many local branches are subject to the influence of local industry, governments and the party. The traditional commitments of SOCBs are to distribute credit among regions and to support state-owned enterprises (SOEs), which in turn are responsible for maintaining employment and for making payments to retired workers as well as maintaining facilities such as schools and hospitals. Some progress has been

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made in relieving SOEs of the responsibility of supporting non-essential activities and in assuring payments for retired workers. In addition, the SOCBs have been given more autonomy in credit decisions. Nevertheless, local governments still have a considerable say in how bank credits are distributed.

The SOCBs have traditionally had poor credit assessment and control systems, and in any case they were not structured to exercise credit discrimination. The SOCBs have serious problems of asset quality, earnings inadequacy, inadequate capitalisation and balance sheet quality. Earnings tend to be low, due to high costs, low margins on lending and failure to develop non-interest sources of income. Data indicate that the return on assets of SOCBs is in the range of 15 basis points. Internationally, a return norm of 100 basis points is considered adequate, and many emerging markets have far higher rates.

The large volume of non-performing loans (NPLs) in China is concentrated in the SOCBs. CBRC data indicate that at the end of 2003, NPLs of the SOCBs accounted for 80 per cent of NPLs in the banking system and that the NPL ratio was 20 per cent compared to 8 per cent for the joint stock banks and 17 per cent for the policy banks. Furthermore, reserves against NPLs are insufficient, with BOC and CCB having reserves adequate to cover 10-20 per cent of NPLs and the two other SOCBs having lower coverage ratios. Banks in other East Asian countries have NPL coverage ratios averaging around 75 per cent. The SOCBs as a group do not have sufficient capital to meet the minimum 8 per cent capital assets ratio. (However, as will be explained below, the two "pilot" SOCBs now have ratios in excess of 8 per cent.)

Although the balance-sheet quality of SOCBs is already poor using existing data, there is a clear suspicion that reported data give a misleadingly positive picture of the financial state of the SOCBs. There are strong incentives for the management of banks to misclassify assets, since reporting of high NPLs would expose the bank to sanctions from the authorities and it is uncertain whether any benefits would result from more accurate reporting.

The authorities have recognised the poor earnings and balance-sheet quality of the SOCBs for several years. At first, the authorities tried to address the problem with cash infusions to strengthen the bank balance sheets. In 1998, capital of RMB 270 million (3 per cent of GDP) was injected into the four SOCBs. In 1999, the government purchased NPLs for RMB 1.4 trillion (about 20 per cent of the outstanding loans and 15 per cent of GDP) from the SOCBs (as well as some assets from China Development Bank) at face value.[4] As these figures suggest, expenditure on rehabilitating the banking system has already been very significant. The government also lowered reserve requirements and allowed the SOCBs to invest the funds deducted from reserves to purchase special non-negotiable 30-year government bonds, with coupon rates of 7.2 per cent. Simultaneously, the banks

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were warned to cease lending to poor customers and to adapt their internal credit systems.

Despite this significant support in the form of public resources, bank behaviour did not change sufficiently. True, banks cut back on lending to some borrowers of doubtful creditworthiness. The financial performance of the banks still remained substandard while SOCBs still functioned as appendages of the state rather than as true financial intermediaries. The authorities concluded that any further support should only be extended in circumstances in which SOCBs had strong incentives to focus on financial performance. Therefore in the most recent round of restructuring in 2003-2004, efforts to strengthen the balance sheets of the banks have been tied to efforts to modify the governance regime of the SOCBs.

The policy banks

Three "policy banks" (the Agricultural Development Bank of China, the Development Bank of China and the Export Import Bank of China) were created in 1994 to assume the state-directed lending previously undertaken by the commercial banks. The policy banks accept few deposits and are funded mainly by government deposits and guaranteed bond issues. These banks are expected to fund infrastructure and development projects. The policy banks accounted for 14 per cent of banking assets at the end of 2003. Their NPL ratios were lower than those of the SOCBs.

Joint stock commercial banks (JSBs)

There are 11 banks which have been operating in the corporate form for several years. (The first JSBs were formed more than 10 years ago.) The equity of these banks is partly owned by the state and partly by other interests, such as state-owned enterprises, private enterprises and minority investors. One bank, China Minsheng Bank, is entirely owned by non-state entities.[5] Since they are organised as corporations, they are required to have shareholder meetings and boards of directors and to produce accounts. As explained below, the JSBs are subject to additional governance requirements established by the banking supervisors. Five of these banks are listed on domestic stock exchanges in China and thus have additional disclosure requirements. All of these banks have some foreign owners, but until recently the foreign share in ownership has been small.

Although some JSBs were partly organised to further the objectives of local government, the JSBs do not have the same historical legacy as the SOCBs of having been formed mainly to support the objectives of central planners. The management of these banks has a clearer commitment to shareholder value. Their share of lending has been rising considerably in the past few years. They accounted for 14 per cent of banking assets at the end of 2003. The JSBs have

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lower NPLs ratios, better capitalisation and more adequate provisions against NPLs than the SOCBs.

The JSBs have been seeking to introduce innovative products and to upgrade their internal risk management and credit procedures. Many JSBs have relied on international consultants and/or agreements with external partners in order to obtain access to the best international techniques. Among the improvements in credit procedures instated at the JSBs are the requirement for the management to articulate an overall lending strategy and to have written credit policies and procedures. All of the JSBs have now separated loan origination and loan approval and established limits on individual customers as well as regions and industries. JSBs are also developing databases on their lending portfolios. However, databases on consumer credit are not well developed and the JSBs do not have credit scoring models – a tool that has proven effective in minimising loan losses from retail lending in many countries. While some of the SOCBs have been taking similar measures to introduce enhanced credit systems, the JSBs are generally seen to have acted more rapidly and to have advanced farther.

City commercial banks

There are more than 1 000 city commercial banks, which are owned by municipal governments. These banks accounted for about 5 per cent of the total banking sector. They originated in the consolidation of urban credit co-operatives under the guidance of local authorities and are organised as joint stock companies. City commercial banks have been tightly controlled by local government and enterprises, which hold significant shares in the banks and often receive low-interest loans from them. Unlike SOCBs, they have multiple shareholders with representation on the board.

This group is very disparate with widely varying standards of governance. Some of the city commercial banks are simply financing appendages of local governments, but a few of the larger banks have governance structures and business plans that are comparable to those of the joint stock banks.

Rural credit co-operatives (RCCs)

There are 38 000 rural credit co-operatives which collectively account for 10 per cent of total banks assets. With the reform of banking, the SOCBs have largely withdrawn from rural finance. (A partial exception is the ABC which retains a leading role in the rural sector.) As a result, the rural sector has been financed either from government banks, mainly ABC, some local commercial banks and rural credit co-operatives. The RCCs have succeeded in attracting large amounts of deposits but have been unable to expand lending to keep pace with demand, leading to rising dependence on informal money-lenders.

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The RCCs have weak governance structures and very weak balance sheets. Indeed, the RCC sector is reportedly the weakest sector in the banking system, with major problems of governance and large stocks of NPLs. The RCC sector is benefiting from government policies that distribute rural credit at subsidised rates, but a more comprehensive long-run reform aimed at strengthening balance sheets in RCCs and improving their governance regimes is advisable.

Renewed efforts to reform the banking system after 2003

Since the 1990s, the authorities have been considering the basic elements that should be included in a transformation of the banking system. These elements included the corporatisation of the banks with the objective of public listing, the adoption of more sophisticated asset classification systems and an enlargement of the independence of the bank *vis-à-vis* local government. Taken as a whole, these reforms signify that the authorities have decided to change the nature of Chinese banking from a relatively opaque system with limited competition and limited foreign presence, where banks were protected by government guarantees, to a system based on more global standards of transparency and competition. Eventually banks should rely less on the protection of government guarantees and more on their own risk management capability.

In 2003, the process of bank reform advanced considerably as the authorities decided to step up attempts to translate these ideas, which had been under debate for more than a decade, into concrete action. The Sixteenth Congress of the Communist Party endorsed accelerated efforts to restructure the banking system. In the light of the limited progress made after the 1998-99 financial injections, it was recognised that attempts to repair the balance sheets by pumping additional funds into the banks would remain ineffective without changing the basic framework of incentives inside which the banks operate.

Future reforms had to address issues such as the ownership of the bank, the incentives of the bank's owners and managers, the market signals which the banks receive and the degree of competition in the market.

Since that time, the authorities have been articulating a doctrine as to how the governance system in banks should change. In the case of the SOCBs, this change will be linked to an attempt to strengthen the banks' balance sheets through additional financial support.

The key elements of the policy are:

1. A reform of ownership structures of banks in order to find owners capable of monitoring bank performance effectively.
2. Upgrading supervisory practices in line with international norms.

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3. A strengthening of the legal and regulatory framework for bank governance.
4. Increased transparency and increased exposure of Chinese banks to scrutiny by the market.
5. An expanded foreign presence in the banking system partly linked to Chinese WTO membership and partly linked to a desire to benefit from foreign competition.

These measures apply to all banks. Simultaneously, a special programme is being launched for the SOCB sector, in which two "pilot" SOCBs, BOC and CCB, will be subjected to radical restructuring and in which access to public funds will be conditional upon reforms undertaken by the banks. The programme for the two pilot SOCBs is discussed below.

Reforms in bank supervision

Supervision of banks has been evolving along with the reform of the banking system since the late 1970s. The People's Bank of China (PBC), which functioned as both a lending institution and as the central bank under the central planning system, was designated as the nation's central bank and charged with the functions of all central banks, such as the conduct of monetary policy and lender of last resort, as well as responsibility for all financial supervision. The supervisory responsibilities of the PBC have been progressively diminished, with responsibility for insurance and securities being transferred to specialised bodies during the 1990s. Until 2003, however, bank supervision remained its responsibility.

The PBC had ongoing difficulties in providing effective bank supervision for several reasons. There was an inherent difficulty in supervising banks that still functioned as quasi-governmental agencies. While aware of the need to enforce prudential norms, government officials also responded to other considerations, such as the need to keep enterprises functioning in order to support employment and social benefits. The effectiveness of the PBC as banking regulator was further limited by the fact that local offices reported to the local government as well as to PBC headquarters in Beijing. Since local governments typically supported local enterprises that provided local employment and social services, there was a serious conflict between the PBC role as banking supervisor and its role as an arbitrator of the regional distribution of credit (Cai, 1999).

Despite these problems, the PBC made gradual progress in upgrading banking supervisory practices during the 1990s. Significant strides were made in building capacity and developing supervisory techniques based upon international norms. However, the PBC lacked the means of sanctioning banks that were unable to meeting prudential norms and were protected by local government or party interests. There were problems with the old loan classification system inasmuch as in the past loans were classified under four headings: normal, overdue, idle

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(more than 180 days overdue), and bad. Banks were not required to provide for NPLs, although they were required to set aside 1 per cent of assets as a general provision each year. In 1999, the PBC proposed a more rigorous system of loan classification and provisioning. The new system contained five categories with progressively higher requirements for provisions: *i*) pass (1 per cent provisioning requirement); *ii*) special mention (2 per cent); *iii*) substandard (20 per cent); *iv*) doubtful (50 per cent); and *v*) loss (100 per cent). The new system was, in principle, based upon forward-looking criteria and assessments of repayment capability rather than upon delinquency history. While some of the banks experimented with the system, few banks actually adopted it.

With the decision to accelerate banking reform in 2003, supervisory responsibility was transferred to the newly formed China Banking Regulatory Commission (CBRC). This decision reflected the thinking in many advanced countries that the central bank should focus on monetary policy and issues of systemic stability while actual supervision of banking institutions should be performed by a separate entity. At the same time, the PBC as central bank and lender of last resort will have significant responsibility for the soundness of the banking system as a whole.

The CBRC is now attempting to align its domestic activities with best international practices. The CBRC will be more centralised and its local offices will be insulated from local pressures. Three new laws on commercial banking, banking supervision and the PBC were enacted at the end of 2003. A series of directives and rules have been issued, covering a wide-range of issues related to supervision. The CBRC stated its intention of moving from the earlier compliance-based methods of supervision to the newer risk-based system. The five-tier loan classification system previously proposed by the PBC was made mandatory. The CBRC began building institutional capability to conduct on-site and off-site inspections and imposed a large number of sanctions for infractions of rules. The CBRC initiated a self assessment of its own compliance with the Basle Core Principles of Banking Supervision, the recognised global standard for banking supervision, and prepared a medium-term plan for improving compliance.

In February 2004, the authorities introduced a new risk assessment system that will be used in evaluating the JSBs. This system will be similar to the systems used in other markets. Banks will be scored for capital, asset quality, management competence, liquidity and profitability. The system will be used in interacting with the banks senior managers and board.[6]

Since late 2003, the CBRC has been articulating a strategy to reform the banking system based upon accelerated introduction of market-based principles of corporate governance in the banks as well as special programmes to rehabilitate the SOCBs.

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Changing patterns of ownership

In the past, the lack of identifiable owners has been one of the reasons that the banks have operated in a systemic vacuum. The authorities have accepted that a different ownership structure for banks is needed to support a sound governance regime and thus are seeking to diversify present ownership patterns.

Investors can be sought for several reasons: *i*) to bring new capital into the bank; *ii*) to rectify a deficiency in governance by acting as genuine owners and active monitors; *iii*) to assist in the transfer of relevant skills into the bank. Various categories of owners can make different contributions to the bank. To find the appropriate mix of new owners is a critical challenge.

Clearly, a large share of equity will be owned by domestic interests. Domestic industrial interests may have some capital to contribute and may regard their investment in the bank as an "arm's-length" financial investment. Moreover, given the lack of a strong domestic institutional investor community, they may represent the category of domestic investor that is best able to act as a monitor. Most of the JSBs, the category of domestic bank most focused on shareholder value, have large investments from domestic industry. However, a very large presence in bank ownership raises the possibility that the industrial companies will seek to use the bank for connected lending. On balance, the possibility of conflicts of interest between banking and industrial interests suggests that such ownership linkages should be limited.

Domestic retail and institutional investors are an additional source of new owners, and there will be significant domestic ownership of banks by dispersed groups of Chinese investors. With large numbers of Chinese citizens holding sizeable stakes in the banks, a definable constituency should emerge for sound banking practices that will give boards and management a strong incentive to produce competitive returns and to avoid action that would result in diminution or loss of value of shareholders equity. On the negative side, neither domestic retail investors nor institutional investors have historically shown strong capabilities or inclination to monitor companies in which they are shareholders, and neither has tended to place pressure on the corporate sector to raise standards of transparency and disclosure or to respect the rights of minority investors. At this time, the Chinese capital market does not have a strong infrastructure of rating agencies and securities analysts who will engage in rigorous analysis, demand higher standards of performance and disclosure from companies. On the other hand, domestic investors will clearly benefit if the degree of professionalism in the Chinese investment market increases as a result of better governance standards and a more active presence by foreign investors. On balance, domestic portfolio investors can help improve bank performance, but they are likely to be most effective if

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they act in partnership with other kinds of investors. In any case, the enhancement of the monitoring capability of domestic institutional investors should be a long-term objective of the authorities, not only for the banking sector but throughout the entire capital market.

Foreign investors can plainly contribute to the improvement of governance in banks, and the Chinese authorities have decided that increased foreign presence will help to effect the desired transformation of the banking system. Foreign equity investors will demand better disclosure and will measure the performance of Chinese banks by the same criteria that other companies are measured. To the degree that foreign equity investors cannot be convinced that Chinese banks are producing value for investors, the share price will decline. Moreover, the listing of Chinese banks on overseas stock exchanges will oblige banks to observe stock exchange rules about disclosure organisation, governance and investor protection, which are more rigorous than in the domestic market.

Foreign strategic investors can make a sizeable contribution to the transformation of the banking sector. Foreign strategic investors are likely to be major banks from major OECD member countries or other financial centres that have developed significant banking-related skills in areas such as credit assessment and risk control, and they are likely to have state-of-the-art knowledge in banking. Such skills are abundant in the major, more advanced countries of the world but are still relatively scarce in many emerging markets. Many banks have developed strategies of expansion to key emerging markets where banking skill is less abundant. The pattern of bank rehabilitation making use of foreign strategic partners has been the basis for successful rehabilitation of banks in Central Europe, some Latin American countries and in the Republic of Korea.

China offers huge attractions to foreign banks pursuing global expansion strategies because of the size of the market, the high levels of savings and the low current levels of products and services. For example, the Chinese consumer and mortgage markets are largely underdeveloped, and skills in assessing the creditworthiness of smaller and private enterprises are not well developed. These activities are currently being financed through parallel markets that could be made highly profitable if they were brought within the formal financial system. Foreign banks would thus have an opportunity to have strategic investment in Chinese banks that would have the potential to grow as the bank moves toward global levels of competence.

At this time, the effort to change ownership structures is focused on two categories of banks: *i*) the joint stock banks where the ownership/governance structure is already more favourable than in the remainder of the banking system; and *ii*) the two pilot SOCBs which aim to transform their ownership structures as part of the reform.

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The JSBs are in the process of broadening their ownership structures. The JSBs have already been gaining a significant market share and now have an opportunity to expand their share of the banking market yet further. In order to gain market share, however, it will be necessary to increase their capital without recourse to official support. The JSBs have been increasing their assets rapidly, so their capital adequacy ratios are consequently only marginally sufficient.[7] The JSBs will seek to raise their capital by: *i*) public equity issues on domestic or international exchanges, including rights issues; *ii*) issues of subordinated debt; and/or *iii*) strategic partnerships with foreign banks. At this time only five banks are publicly listed, but further domestic and international listings are expected.

Several JSBs have already included foreign entities such as Citibank, Hang Seng Bank, the IFC or the ADB as strategic investors, but thus far their positions have been rather small. Under the WTO rules accepted by China, foreign institutions will be authorised to own as much as 20 per cent of total bank capital, with the share scheduled to rise to 49 per cent in 2007.

There have been several highly publicised cases of large-scale foreign strategic acquisitions in recent months. In May 2004, Newbridge Capital, a US-based private equity firm that has a record of successful turnarounds of banks in other Asian countries, bought a 19 per cent stake in Shenzhen Development Bank. In July 2004, the Hong Kong and Shanghai Banking Corporation (HSBC) announced its intent to acquire 19 per cent of the Bank of Communications, the largest JSB in the country. This investment will give HSBC access to a network of 2 700 branches in 139 cities and a customer base. It may well set a pattern for other banks seeking to enter the Chinese market. The HSBC investment follows an increase in capital provided by the Chinese bank's existing shareholders and is also expected to lead to an overseas listing in the next two to three years. With increased capital and with increased transfer of foreign banking skills, the JSBs will aim to expand their market share further. The inclusion of foreign investors in the ownership structure is likely to facilitate the transfer of skills, the upgrading of risk controls and closer alignment of governance practices in the Chinese banking system with those in global markets. In fact, in some investment agreements, specific provisions are made for the foreign partner to devote resources to building up skills in the Chinese partner, usually in areas such as risk management, consumer finance or marketing.

Since there are only a limited number of opportunities for strategic partnership with JSBs, there may be some possibilities to forge partnerships with city commercial banks as well, especially some of the larger banks with a more commercial orientation. A few alliances of this kind have already been launched and more are reportedly under consideration.[8]

At the same time, many major international banks have strong reservations about participating as small minority investors in the SOCBs. This represents a

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major challenge for the authorities in implementing a change in ownership of the SOCBs in order to effect an improvement in bank governance.

Improving the framework for corporate governance in banking

The authorities have been seeking to improve the corporate governance framework, both for banks and for the non-financial corporate sector, during the past decade. Many laws, regulations, codes and standards necessary for a complete system of governance have been enacted. Efforts have been undertaken to ensure that those who will hold key positions under the new governance framework have sufficient training and experience. Simultaneously, enforcement efforts have been stepped up.

The legal and regulatory framework governance is not identical for commercial banks and for non-financial enterprises. Some instruments, such as the Company Law, are binding on banks and non-banks alike, so long as the entity is organised in the corporate form. State-owned enterprises (SOEs), other than banks, are also subject to an additional instrument.[9] On the other hand, banks are subject to several special laws and other instruments that create more stringent obligations than those applied to SOEs.

The main instruments affecting the corporate governance framework for banks are: *i*) the Company Law; *ii*) the Banking Law; *iii*) the Law on Banking Supervision;[10] *iv*) the Guidance on Corporate Governance for Joint Stock Commercial Banks; and *v*) the Code of Corporate Governance for Listed Companies (CCGLC).[11] The Company Law and the CCGLC apply to financial and non financial companies, but the other instruments only apply to banks. The CCGLC applies only to publicly listed companies, *i.e.* five JSBs, but a growing number of banks are expected to be listed eventually. As will be explained below, the two pilot commercial banks are subject to additional instruments.

The Company Law stipulates that all SOEs must have a board of directors with a chairman and vice chairman, and a general manager. The general manager, who is accountable to the board, may also be a member of the board. The Law limits the size of the board for a joint stock company to between five and 19 members. In addition, the Company Law also specifies the responsibilities of boards, which are generally in line with those accepted in international practice, but the Law does not provide board members with clear guidance on how they are to exercise their responsibilities.

The Banking Law of 1994, amended in 2003, contains many provisions concerning the corporate governance of banks such as the role of various organs of the company and the requirements regarding transparency and disclosure.

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A number of laws and regulations impose further requirements on banks. In 2002, the PBC issued Guidance for Joint Stock Banks (the Guidance) which is aimed at giving more precise guidance to banks over and above the obligations specified in the Company Law and the Banking Law. This document specifies the framework for decision-making inside the bank, with specific roles with necessary checks and balances for the shareholders meeting, the board of directors, the board of supervisors and senior management and also stipulates that banks have an obligation to establish an adequate system of reporting and disclosure. These requirements go beyond those in the Company Law. One of the aims of the Guidance is to define means to protect the interests of shareholders and depositors and specifically establishes an obligation on the part of controlling shareholders to respect the rights of noncontrolling shareholders and depositors. The obligation of directors to defend these interests is specified. Various prohibitions are established regarding related party transactions.

In order to promote the effectiveness of the board as an independent check on management, various persons having borrowing relationships with the bank are disqualified from serving as directors. The directors of banks have the right to obtain all information needed to monitor the operations and financial situation of the bank. Executive directors shall constitute between a quarter and one-third of all directors. In addition to non-executive directors, the board must have fully independent directors, *i.e.* those with no relationship to the bank or its shareholders that may raise conflicts of interest. Independent directors are specifically mandated to take into account the interests of smaller shareholders and depositors. Independent directors also have the duty to report any violations of laws or regulations to the banking supervisor.

There are some ambiguities concerning the concept of independent directors. In general, the term "independent directors" is used to mean a non-executive director, *i.e.* someone who is not an employee of the company. There is another definition of independent meaning free from other connections to the company and conflicts of interest arising from those connections. The connections may be personal (*i.e.* individuals having personal or family ties to the company or its executives), or they may be commercial (*i.e.* those affiliated with an entity that deals with the bank), thus posing the risk of conflict of interest. However, there has been some tendency in China to nominate fully independent directors, usually from universities or professions such as law and accounting.

One of the obligations of the board of directors is to disclose the assessments by the banking supervisors and in cases where remedial action is mandated to describe plans to correct shortcomings. The Guidance also mandates the separation of the chairman and the CEO of the bank, and the board is required to establish specialised committees including Related Party Transactions Control, Risk Management, and Remuneration.

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The CCGLC further stipulates that the audit committee, the nomination committee and the remuneration and appraisal committee shall be chaired by an independent director, and independent directors shall constitute the majority of these committees. At least one independent director from the audit committee shall be an accounting professional. The main duties of the corporate strategy committee are to conduct research and make recommendations on the long-term strategic development plans and major investment decisions of the company.

Under the Guidance and under Chinese practice generally, the audit process is somewhat different than is generally recommended in international practice. The Guidance does not require the board to form an audit committee, and it also specifies that the internal audit report to the president of the bank rather than the board. Instead, the audit procedure is closely linked to the supervisory board which plays a distinct role in Chinese companies. The Bank Guidance also gives the senior management relatively strong protection from interference from the board and strongly discourages the board from replacing the senior management before the expiration of their term.

It is specified that the banks shall comply with disclosure requirements of the supervisor, but the specific items that must be disclosed are not spelled out. One of the obligations of the board of directors is to disclose the assessments by the banking supervisors in cases where remedial action is mandated and to describe plans to correct shortcomings.

Like all Chinese companies, banks are required to have a board of supervisors. Unlike the supervisory board in systems with two-tier board systems, the Chinese board of supervisors does not form part of the governance hierarchy. The board of supervisors is an entity that operates outside the decision-making hierarchy and with the function of overseeing compliance with laws and regulations. The supervisory board is composed of outside supervisors appointed by the state as well as some representatives of the workers. The supervisory board is responsible for: *i*) monitoring compliance of the company with laws, regulations and rules; *ii*) examination of the financial statements of the SOE; *iii*) inspection of business performance; and *iv*) evaluation of the CEO. The supervisory board engages the outside auditor. An audit is performed at least once a year and when the CEO changes. The supervisory board reports to the president and presents its finding to the shareholder meeting. Many analysts have argued that the board of supervisors does not represent an effective contribution to a set of checks and balances needed to establish clear lines of accountability from management to board to shareholder. In this context it has frequently been recommended that the role of the board of supervisors be re-evaluated as part of the general effort to align Chinese and international practices.

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Overall, the basic set of instruments that form the governance framework for banks are in line with those in other countries. Given China's limited experience of the use of market-based governance tools, it would be desirable to devote significant resources to deepening understanding among those who will play significantly expanded roles under the new governance regime. For example, written guidance concerning the duties of bank directors would be helpful. This could be part of a general code of conduct for company directors or more specifically directed at bank directors. Many countries have such codes which may be formulated by the regulatory authorities, self-regulatory organisations, or by individual companies. Institutes of directors, which often engage in training for directors, often assist in formulating such codes and in promoting their use. Finally, difficulties in enforcement of laws and regulations remain a serious obstacle to improved corporate governance in China.

Since only a few banks have been corporatised and even fewer have been listed, for the most part banks have not been obliged to operate inside the formal corporate governance framework in China. At the same time, it is widely agreed that corporate governance in China needs to move closer to world standards. Specifically, it is generally agreed that corporatisation and public listing have not succeeded in improving the financial performance of listed Chinese companies and has not obliged listed companies to pursue shareholder value as an overriding corporate objective. Therefore, the goal of improving bank governance by subjecting Chinese banks to the same corporate governance framework to which listed Chinese companies are already subjected can only succeed if that framework itself improves significantly. To some degree the banking supervisors can impose stricter practices on Chinese banks than are imposed on other corporate entities. Thus, banking supervisors can be stricter regarding disclosure than is required by stock exchange rules for listed companies and the supervisors can require each bank to bring its system of corporate governance up to minimal norms. However, the entire system of corporate governance in China will have to improve in order for the policy of requiring banks to operate in the corporate governance for listed companies to have its intended effect.

Transparency and exposure to markets

Under the new governance environment, banks will be required to observe far higher standards of transparency and will be subject to much more intense market oversight than in the past. Banks will be scrutinised by other banks, both domestic and foreign, be subjected to more intense coverage by the financial press and constant scrutiny of the capital market. As Chinese banks seek to raise capital through equity and subordinated debt issues, many foreign investment banks are undertaking analyses of the Chinese banking system and making recommendations concerning equity investments. In order to meet the expectations of

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new investors, Chinese banks will have to increase the quantity and quality of data disclosed and also to perform in line with market expectations. The CCGLC will add further disclosure requirements, and those banks that list on foreign stock exchanges will be subjected to additional requirements.

In addition to assessments by equity markets, the debt and interbank markets will place Chinese institutions under growing scrutiny. At this time, credit-rating agencies rely heavily on official guarantees in assigning ratings to Chinese banks, but as relationships become more complex, banks that can establish credibility with rating agencies and counterparties based upon their own financial strength will gain competitive advantage. In addition, Chinese banks will be engaging in an increasingly complex range of operations with foreign institutions. Each Chinese institution will have to take pains to convince prospective counterparties of its creditworthiness. On the strength of these ratings and their own assessments, investors and other financial institutions will be deciding whether, and at what cost, they are prepared to engage in various kinds of operations with Chinese intermediaries. The decision to accept market discipline means that in the long run the banks will be under growing pressure to persevere in restructuring. Thus, in order to raise new capital while borrowing on competitive terms, banks will have to meet market expectations by raising earnings to competitive levels, to bring costs under control and to reduce NPLs. The pressure from the market to make progress on these indicators will supplement the pressures from the banks' directors and from the banking supervisors.

Expanded foreign competition

As noted above, the foreign presence in the market will expand as a result of foreign participation in the equity of Chinese banks. Foreign participation in the market will also expand as the scope for foreign banks to compete directly in the domestic market through branches and subsidiaries increases and as foreign banks gain greater access to domestic currency operations. Previously, China imposed strict limitations on the operations that foreign banks could undertake and particularly limited operations in domestic currency. Largely as a result of these restrictions, foreign banks accounted for only 1 per cent of total banking assets at the end of 2003. Most foreign banks operated in a few large cities and confined themselves to foreign currency loans, mainly to foreign businesses. With liberalisation, this share is expected to grow significantly. By the end of 2006, all geographic restrictions on operations in Chinese currency will be lifted.

The Chinese authorities are unlikely to open their market to the same extent that countries in Latin American and Central Europe did when dealing with failed banking systems. In many of those cases the majority of capital in domestic banks eventually passed into the hands of foreign banks. First, the Chinese, with their

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huge stock of domestic savings, do not need foreign resources to recapitalise their banks. Second, the Chinese authorities are undoubtedly not prepared to accept such a degree of foreign ownership at this time. Nevertheless, the opening to foreign competition, through ownership in Chinese institutions, foreign-controlled branches and subsidiaries through cross border competition, has to be significant enough for foreign competition to have a visible impact on the Chinese market.

The experience of the Republic of Korea may be of relevance for China. Until the 1997 crisis, the Korean authorities limited foreign equity participation in Korean banks to very small amounts. At the same time, foreign bank branches and representative offices were restricted to a narrow range of activities which differed significantly from those permitted to Korean banks. After the 1997 crisis, the Koreans opened their banking system and encouraged foreign investors to acquire sizeable strategic positions in domestic banks with the objective of improving the governance of banks. Simultaneously, the authorities removed remaining capital controls and moved toward a policy of national treatment regarding foreign banks. While the foreign presence in the banking system was measured, it was markedly larger than in the years before 1997. The decision to accept an enlarged foreign presence was instrumental in effecting the improvement in bank governance and the successful restructuring of the banking system in ensuing years.[12]

Rehabilitation programme for the SOCBs

The preceding section discussed the framework for corporate governance of all banks that are organised in the corporate form. While most of the reform measures currently being implemented will apply to the SOCBs, the authorities have decided to concentrate reform efforts on two “pilot banks” the China Construction Bank (CCB) and the Bank of China (BOC). Based upon experience in rehabilitating these two target institutions, the programme may be extended or modified in coming years. The programme involves both the commitment of significant sums of money and an effort to change the incentives and governance systems in the banks.

In March 2004, the CBRC issued guidelines explaining their strategy for the BOC and CCB.[13] These Guidelines were the first concrete steps in a policy designed to produce a significant change in the two pilot banks by the end of 2007. Within that time frame, the banks are expected to operate profitably while maintaining adequate capitalisation, good internal controls, sound business operations and high quality services. In order to strengthen the balance sheets of the pilot banks, some USD 45 billion equivalent of resources from the country’s international reserves was injected into these banks (USD 22.5 billion for each bank). The banks are expected to dispose of remaining NPLs through provisioning

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or through sale at a discount to face value to the AMCs. In June 2004 the pilot banks sold an additional RMB 279 billion (USD 34 billion) of NPLs to the AMCs. These two banks have also been engaging in sales of NPLs to foreign investment banks.

Projected ownership changes

The lack of identifiable owners and the resulting lack of a commitment to the shareholders are at the heart of the governance vacuum in the SOCBs. Unlike the JSBs, which are already operating as independent banks, the SOCBs were still not separated from the state in early 2004. The first step in changing the ownership structure was taken in December 2003 when a special state entity, the Central Huijin Investment Company (Huijin), was set up to assume formal ownership of the SOCBs.[14] Huijin will operate under a Task Force for Pilot Joint Stock Reforms of State Owned Banks under the State Council. To some degree, the position of Huijin is comparable to that of the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) which has the mission of assuming the role of state ownership of SOEs and promoting governance reform in the non-financial sector (see Chapter 10).

While there will be additional owners for the SOCBs, Huijin is likely act as the majority owner for the foreseeable future. Huijin will have the task of representing the state's ownership interest. The state's supervisory interest in the banks will be represented by the CBRC while it is hoped that the government will pursue its regional, social and industrial policy objectives using traditional tools such as tax and expenditure policy.

The ownership transformation process is expected to pass through three stages:

1. Corporatisation. In August-September 2004, the banks were transformed into joint stock companies with the state as the sole owner.
2. Ownership Diversification. While the state acting though Huijin will remain the majority owner, other entitles will become owners of minority stakes.
3. Public Listing. The banks will be listed on domestic and international exchanges.

At this stage, the state has no intention of relinquishing its controlling interest in the SOCBs. Most OECD member countries and most non-members with dynamic financial sectors have eventually decided to privatise their banks. One of the basic uncertainties overhanging the reform is whether the SOCBs can be transformed into profit-oriented entities while a commanding share of bank capital remains under the control of the state.

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As noted above, domestic industrial interest or portfolio investors do not have a strong history of effectively monitoring investments in pursuit of shareholder value. Nevertheless, it is useful to give domestic investors experience in monitoring investments alongside international investors. Moreover, the commitment of savings by domestic retail investors and institutions will build a constituency in favour of pursuit of shareholder value by management.

It is part of the official strategy of the Chinese authorities to solicit participation by foreign banks as strategic partners in the SOCBs. Chinese policy makers insist that they are not seeking investment by foreign banks in order to obtain capital – which is comparatively abundant in China. Rather they are seeking to gain access to the monitoring capability and banking techniques of foreign banks.

There are reasons why foreign banks may hesitate to become strategic partners in SOCBs. In particular, even for banks that are committed to expanding in the Chinese market, many banks would find other means of entering the market, such as ownership stakes in JSBs or expansion of branch or subsidiary networks to be more appealing. Foreign banks are likely to be wary of a strategic partnership with SOCBs where the lack of history of operation as a profit-making entity represents a heavy burden. Furthermore, the SOCBs face a long period of restructuring and down-sizing, and are saddled with a large stock of NPLs. Foreign banks may well hesitate to be drawn into visible positions as strategic investors in which they will suffer the risk of financial loss and loss of reputation but over which they can exercise little control. Foreign banks may only be willing to take a minority position in order to promote their business with the SOCB in a specific area (*e.g.* credit cards), or to gain official support for their expansion into other, more lucrative areas of the banking sector through branches, strategic alliances or cross-border operations. Thus, the commitment of the foreign partners to improve governance may not be sufficient to produce the needed changes. On balance, foreign strategic investors are vital to the success of the effort to rehabilitate the SOCBs, but the authorities face an uphill struggle in persuading foreign institutions to participate as minority strategic partners.

Many market participants believe that the two pilot banks will seek to be publicly listed in 2005 and both banks are keen to achieve listing, but no deadline has been set for public listing.

Internal governance of the pilot SOCBs

The authorities aim to transform the SOCBs into entities that have a distinct legal identity with identifiable owners who have a stake in the financial performance of the bank while building governance structures designed to protect the interests of the owners. By assuming the corporate form, the pilot banks will become subject to the Company Law and the Bank Guidance as well as the spe-

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cific measures aimed at the pilot banks. Overall, these instruments require the formation of a shareholder committee, board of directors, supervisory board and executive management with established functions for each organ. The two pilot banks are expected to find domestic and international strategic investors to assume ownership positions in the banks and to nominate directors and to take part in meetings of the shareholder committees. Huijin will nominate directors to represent the state's interest as an investor. Presumably these directors will include both those having very close ties to the government as well as some fully independent directors. The exact modalities by which Huijin will represent the state's interest are still under discussion.

The pilot banks will be expected to articulate strategies to achieve business targets and to set annual targets while assessing progress in meeting these targets. In order to be able to meet these targets, systems of human resource management are to be revamped. A quantitatively-based system to evaluate management performance is to be instituted and reported quarterly to the banking authorities.

The banks will have greater freedom in choosing their own management and in implementing personnel policy. In July 2004, the two banks each named their CEOs who will be separate from the chairmen of the bank. CCB chose an outsider who had been vice-chairman of a major financial institution controlled by the government, while BOC chose a governor of a province.[15] Moreover, both banks are engaging foreign consulting firms in upgrading skills such as risk management.[16] Beginning in 2004, the pilot banks applied the CBRC five category loan classification system to their entire portfolios including their off balance sheet items.

The pilot banks are expected to meet specified targets for the most commonly used benchmarks for earnings and balance sheet quality. In particular, return on assets should rise to 60 basis points by the end of 2005 and subsequently to internationally competitive levels. Return on equity should rise to 11 per cent by the end of 2005 and to at least 13 per cent by 2007. The cost-income ratio should be held within a range of 35-45 per cent. At all times the capital adequacy ratio shall be at least 8 per cent.[17] NPLs will be held in the range of 3-5 per cent. The pilot banks are expected to make continued progress in resolving NPLs and to identify any irregularities that occurred during the process under which loans became delinquent. By the end of 2005, provisions for NPLs shall be increased to 60 per cent for the BOC and 80 per cent for CCB.

The CBRC will evaluate progress in implementing corporate governance reforms and in improving financial indicators, through inspections and surveillance reports. The results of these reports will be transmitted to the Task Force for Pilot Joint Stock Reforms of State Owned Banks under the State Council.

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Summary and conclusions

Banking in China is now entering a new historical phase. Following the decision to launch the economic reform in 1978, the authorities have been seeking to redefine the role of the banking system from its passive position under the old system of central panning to an active position in credit and resource allocation. The changes over the years have included the separation of the central bank from commercial banks, as well as a series of measures designed to encourage banks to act as independent monitors over the enterprise sector.

Through the late 1990s, the results were disappointing. The banks, particularly the state-owned commercial banks, lacked the identity of independent profit-seeking entities. Thus, the management continued to operate the banks as appendages of the government and continued to subordinate the financial soundness of the banks to a variety of political, social and economic considerations. Easy access to bank credit removed the incentives for enterprises to take action to become more efficient. One of the results of this adverse credit selection was very poor quality in bank balance sheets. Even with the commitment of significant resources to strengthen bank balance sheets in 1998-99, banks persisted in their earlier patterns of behaviour.

Observing the unsatisfactory results of these earlier efforts, the authorities concluded that any further use of public resources to strengthen bank balance sheets had to be linked to improvement in the governance regime of the banks. Following the decision at the 2003 Party Congress to press ahead with banking reform, the authorities introduced the most ambitious set of reform plans undertaken to date. The specific measures that were included in the programme had been under discussion for several years. Nevertheless, taken as a whole, the programme represented the most serious effort to date to change the behaviour patterns of banks. The key elements of the reform are:

1. a reform of ownership structures of banks in order to find owners capable of monitoring bank performance effectively;
2. upgrading banking of supervisory practices in line with international norms;
3. a strengthening of the legal and regulatory framework for bank governance;
4. increased transparency and increased exposure of Chinese banks to scrutiny by the market;
5. an expanded foreign presence in the banking system partly linked to Chinese WTO membership and partly linked to a desire to benefit from foreign competition.

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In addition to these measures that will affect all banks, the authorities have committed USD 45 billion to support financial restructuring in two "pilot" state-owned commercial banks, contingent upon the implementation of governance reform by these banks.

The reform programme, which is very bold in its aspirations, reflects a striking willingness on the part of the Chinese authorities to relinquish direct control over banks and to allow the banks to be subjected to market pressures. Previously, the Chinese banking system operated under a system that was under the close control of the authorities and where efforts were made to minimise the influence of the global financial market on China. This set of policy changes represents a significant narrowing of the differences between the Chinese banking system and the world banking system.

The new policy postulates that, with ownership and governance changes, the boards and management of the banks will have to respond to the interests of their owners rather than act as agents of state policy. The enlarged flexibility to select and remunerate their managers should increase their independence. By encouraging stock exchange listing and enhanced transparency, the banks should ultimately rely less upon the guarantees of the government and more on their own standing with the market. Banks will be under great pressure to meet the expectations of financial markets, especially as they will be seeking to raise large sums in the capital markets both domestically and internationally.

While the present policy is the boldest introduced since the beginning of reforms two decades ago, there are still limits to the moves that the authorities have been willing to make. In the first place, the projected reform covers only the two smallest SOCBs and to a lesser degree the JSBs. This study, which is focused on governance issues, has concentrated on those sectors where governance reforms are expected to be centred. Other categories of lending institutions, such as the remaining SOCBs, the city commercial banks, and the rural credit co-operatives (RCCs), where the problems of solvency are more acute, are not targeted for reform at this time, but their problems may well continue to grow, even if some progress is made in the targeted groups of banks.

With respect to the two pilot SOCBs it is not obvious that the planned change in ownership structure, in which the state will retain its controlling share indefinitely, represents a viable model for governance. Additionally, if prospective foreign strategic partners are restricted to very small holdings, it is uncertain whether they will be interested in participating or whether their participation can be effective under these conditions. Furthermore, the SOCBs are extremely large and indeed they may be so large that they produce diseconomies of scale, particularly for banks that are only marginally solvent and that are troubled by serious flaws in governance.

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It is not possible to foresee how the banking reform will proceed. For example, if the efforts to reform the "pilot" banks are encouraging, the programme might be extended to other SOCBs. Conversely, if the results are unsatisfactory, the authorities may have to consider more drastic measures, such as breaking up the state-owned banks or simply closing them.

Given the country's history of partial economic reforms and the lack of depth in the legal and institutional infrastructure, the problems to be overcome are formidable. The country lacks a cadre of experienced corporate directors and guidelines for directors are unclear. Public listing thus far has generally not led to markedly improved performance for Chinese companies. Therefore, the effect of market discipline will be felt only if improvements in the entire framework for corporate governance, for financial and non-financial companies, are made. Despite all the uncertainties, it is clear that, given the magnitude of the changes already introduced and those to be introduced shortly, there is no serious option of reverting to the old patterns of behaviour, especially since the reform is taking place in the full view of the Chinese population and the international financial community.

Although there are serious questions of whether the reform will succeed in its present form, there are some recommendations that can be made to maximise the chances for success. Many of the recommendations for improved bank governance are similar to those that would be made for the entire corporate sector. Some of the more salient of these recommendations concerning the corporate governance of JSBs and pilot SOCBs are:

1. Domestic industry will be permitted to have some ownership stakes in the pilot SOCBs. In view of the potential conflicts of interest between banking and industrial interests, such ownership linkages should be limited.
2. Foreign banks should be allowed to expand their presence in the market to the extent that they provide serious competition to domestic institutions.
3. Efforts should be enhanced to develop adequate regulatory frameworks for institutional investors and to enhance the capability of domestic institutions to act as monitors for the corporate sector.
4. The role and responsibilities of independent directors should be clarified. Codes of conduct for directors and specialised training have been used in other countries.
5. The means whereby Huijin will exercise the ownership rights of the state should be clarified and aligned with international practice.
6. Special programmes tailored to the needs of bank directors should be considered.

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7. The Guidance on Corporate Governance for Joint Stock Commercial Banks of 2002 should be reviewed to assure that it adequately covers the situation of the pilot SOCBs.
8. The authorities should study the effectiveness of boards of supervisors in the context of corporate governance to determine whether fundamental changes are needed.

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Notes

1. The international standard for corporate governance of both financial and non-financial companies is the OECD's Principles of Corporate Governance.

2. In addition to the traditional credit risk that banks have historically assumed, many banks are now becoming involved in innovative transactions that involve other kinds of risk, such as market risk and exchange rate risk. Additionally, as banks began to engage in longer term, over-the-counter operations, often in unfamiliar products, counterparty risk, liquidity risk, settlement risk and legal risk assume greater significance. A complete risk management system requires that the bank develop adequate systems to identify each one of these risks and to quantify the amount of risk that is undertaken in each transaction. A strong internal compliance function should assure that all policy areas actually being implemented. The Risk Management committee of the Board typically approves the risk policies of the bank and seeks to ascertain that systems to ensure compliance are adequate.

3. In addition to characteristics stemming from China's history as a centrally planned economy, the Chinese financial system shares many characteristics with those of other Asian countries. In many Asian countries financial resources were not allocated on market-based criteria. Instead, the assets held by banks and other financial institutions tended to be used by governments, allied industrial groups and other well connected groups to further national industrial and social policy objectives. As a result, there was a subordination of prudential considerations to the interests of the banks' controlling shareholders and to the aims of national industrial policy. Consequently, financial supervisors did not attain the independence or the technical capacity to pose a counterweight to the pressures of industrial ministries within the decision-making structure. After the 1997 crisis exposed the risks of this pattern of intermediation, most Asian countries have identified the need to build capacity in financial supervisors and to change the governance regimes of financial institutions as a key task in their reform effort. China has followed this general pattern.

4. The assets that were removed from the balance sheets of the banks were transferred to four state asset management companies (AMCs) which had the mission of resolving the impaired assets of banks and recovering value from imparted assets. These AMCs were modelled on similar institutions that were formed in the Asian crisis countries to purchase impaired assets from banks, thereby allowing banks to concentrate energy on improvements in the institutions. Meanwhile the AMCs were expected to focus on recovery of value from impaired assets. The four AMCs in China have made less progress in loan recovery than many of their counterparts in other Asian countries such as Korea or Malaysia.

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5. For some useful insights, see "Building a Transparent Private Bank in China", *China Daily*, 23 February 2004.
6. "The CBRC introduces a Provisional Risk Assessment System for Joint-Stock Commercial Banks", *China Daily*, 22 February 2004. Also see: "New Banking Risk System Lauded", *China Daily*, 23 February 2004.
7. According to analyses of Morgan Stanley, the tier one capital as a share of assets of the four listed JSBs is the lowest of any group of banks in the East Asia region.
8. For example, the Bank of Shanghai has formed an alliance with Citibank with equity participation, while the Nanjing City Commercial Bank has a similar agreement with the IFC.
9. Interim Regulations on Supervision and Management of State-Owned Assets of Enterprises, 27 May 2003.
10. *Law of the People's Republic of China on Banking Regulation and Supervision*, 27 December 2003.
11. The *Code of Corporate Governance for Listed Companies of the CSRC and the State Economic and Trade Commission*, 7 January 2001.
12. See OECD (1999).
13. CBRC, *Guidelines on Corporate Governance Reforms and Supervision of Bank of China and Construction Bank of China*, 11 March 2004.
14. Several options for the ownership transformation were considered such as forming a Committee under the State Council with the responsibility for bank rehabilitation, transferring ownership to the CBRC or creating a special bank rehabilitation agency with a limited life.
15. "China Moves to Improve Bank Boards", *Financial Times*, 29 July 2004.
16. "Bank of China Grooms Itself for Public Offer", *Wall Street Journal*, 30 March 2004.
17. Although 8 per cent is the international standard, the banking supervisors in other Asian emerging economies are now setting higher standards for their domestic banks.

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Résumé : La gouvernance des banques en Chine

Avec les réformes économiques de la fin des années 70, la politique des autorités chinoises s'est fixé pour objectif d'amener les banques du pays à abandonner leur rôle traditionnel passif consistant à exécuter les directives adoptées à un rôle actif dans l'allocation des ressources bancaires dans une économie de marché. Toutefois, en raison d'un régime de propriété peu transparent et de leurs antécédents en matière de soutien à la politique régionale et industrielle, la plupart des banques chinoises ont eu du mal à effectuer cette transition. C'est particulièrement vrai des quatre grandes banques commerciales d'État qui représentent la majeure partie des actifs bancaires et qui ont toujours fonctionnés comme des prolongements de l'administration publique. En revanche, la deuxième grande catégorie de banque, les 11 banques par actions affichent des bénéfices plus importants et des bilans de meilleure qualité. En 1998 99, des efforts importants ont été consentis pour renforcer les bilans des banques commerciales d'État avec la vente subventionnée d'une grande partie de leurs créances non productives à des sociétés de gestion des actifs publics, mais les résultats ont été décevants. Lors de la toute récente phase des réformes qui a commencé en 2003, les autorités sont parvenues à la conclusion que les tentatives futures de redressement des banques commerciales d'État devaient s'attaquer à la question de leur gouvernance.

Les principaux éléments de cette récente phase de réformes lancée en 2003 résident dans la diversification de l'actionnariat, l'introduction en bourse et le développement de la présence étrangère en vue de soumettre l'ensemble des banques à des normes plus rigoureuses de transparence et de communication financière, les contreparties des banques, les analystes financiers, les investisseurs institutionnels et les agences de notation étant amenés à exercer une surveillance plus intense des établissements de crédit. Parallèlement, l'application de mesures destinées à améliorer le contrôle des banques a été accélérée avec la création d'une autorité indépendante spécialisée de contrôle des banques (la Commission de réglementation bancaire de Chine ou CRBC) et la promulgation d'une série de lois concernant le contrôle bancaire.

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En décembre 2003, une entité spéciale (H*uijin*) a été mise en place pour prendre en charge les intérêts de l'État actionnaire dans les banques commerciales d'État. Deux banques commerciales « pilotes » vont dans un premier temps être transformées en sociétés par actions dont l'État sera l'unique actionnaire et elles bénéficieront d'injections de liquidités pour porter leur capital à des niveaux convenables et constituer des provisions pour leurs créances non productives. Les banques pilotes sont censées trouver des investisseurs stratégiques nationaux et internationaux pour prendre des participations à leur capital et jouer un rôle actif dans leur gouvernement d'entreprise, H*uijin* représentant pour sa part les intérêts de l'État. Une intensification de la concurrence va pouvoir se faire entre les banques commerciales d'État et les autres catégories de banques du pays. Les banques par actions, qui ont déjà conquis des parts du marché ces dernières années, ont là une occasion de progresser encore, en faisant appel à des capitaux nationaux et étrangers. Cela devrait entraîner des modifications des structures actionnariales et intensifier la surveillance exercée par le marché dans le cas des banques par actions.

Ce programme est certes audacieux, mais on peut éprouver des doutes quant à la façon dont va se dérouler la restructuration des banques. De façon générale, la diversification de l'actionnariat et les introductions en bourse n'ont jusqu'ici pas sensiblement amélioré les performances des sociétés chinoises et leur impact sur les banques est donc incertain. Malgré ces incertitudes, les changements déjà introduits ont une telle ampleur qu'il n'est pas sérieusement envisageable de revenir aux anciens modes de comportement.

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. . *Donnée non disponible* $ *dollar des États-Unis*

– *Néant*

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