

The Ways of Dealing with Non-Performing Loans in China: Challenges and Problems

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要 旨

中国の四大国有銀行には多額の不良債権が存在しているが、その大きさの実情を把握することは難しい。2006 年 12 月の銀行業務の外資への全面開放に向けて、中国政府は 1999 年から、不良債権の処理に力を入れてきた。そして四つの国有商業銀行とそれぞれの資産管理会社は、市場オプションを通じて不良債権の削減に努力している。不良債権の処理はストックを減少させるだけでなく、新たに発生する追加的なフローの増加を防がなくてはならない。しかし、不良債権比率は低下傾向が見られるものの、その処理方法にはいろいろな問題がある。本論文では、まず、不確実な不良債権の実情の原因を究明した上で、2004 年までの中国の不良債権処理の進展を概観する。次に不良債権処理の方法を考察し、中国における不良債権処理方法を分類して、個別の処理法その問題点を指摘した。

Keywords: Non-performing loans, Asset management company, Debt-for-Equity Swap

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Introduction

Studying the disposition methods of the non-performing loans (henceforth, NPLs) through the government's administrative means and the four state-owned commercial banks' (henceforth, SOCBs¹) marketing operations, and pointing out their problems are main objectives of this paper.

Remarkable economic growth has been accomplished in 20 years after the conversion from the centrally planned economy to the progressive development of market-oriented economy. In the year 2001, China became a member of World Trade Organization (WTO), and as a result, China committed that by the year 2006, the country's entire banking system would be subject to fair market competition.

Up to now, however, China has been confronted with serious structural problems, one of which is the accumulation of NPLs in the financial institutions. Thus, to be able to compete against foreign capital banks, the reform has become a pressing need in the banking industry. What options does China have to solve these problems?

At present, the four SOCBs, the Bank of China (BOC), the China Construction Bank (CCB), the Agricultural Bank of China (ABC) and the Industrial and Commercial Bank of China (ICBC), continue to dominate China's banking sector, with the market share of 53.45 percent of loans and 58 percent of deposits corresponding to entire China's banking sector in the year 2004². So, it is necessary to solve the NPLs problem of the four SOCBs first.

Since the year 1999, the Chinese government has made efforts to solve the NPLs problem. In order to increase the four SOCBs' capital and accelerate their joint-stock reform, the government has injected public funds into them three times. In addition to that, four asset management companies (henceforth, AMCs) were established pairing up with the four SOCBs to help them accelerate their NPLs disposition. Also, the Debt-for-Equity Swap has been the important mean for AMCs to dispose of the NPLs acquired from their affiliated SOCBs. On the other hand, the four SOCBs and their AMCs are proactively positioning themselves to decrease the total NPLs by selling them at auctions to foreign and domestic investors, securitizing them and using other marketing operations.

Until the year 2004, many strategies have been adopted. For these efforts above, the decelerating trend can be seen in the ratio of NPLs to the total loans every year. However, there is still a large amount of NPLs remained unsolved in the financial institutions. According to the statistics of the China Banking Regulatory Commission (CBRC)³, as of Dec. 31st, 2004, NPLs in SOCBs and the joint-stock commercial banks

(henceforth, JSCBs) totals Ren Min Bi (RMB, monetary unit of China) 17,176 million, which is about 13.21 percent of the total loans. The data of SOCBs, totals RMB 15,751 million, which becomes a 15.57 percent. Since China's GDP of 2004 is RMB 136,515 million, the total NPLs in the four SOCBs sums an 11.54 percent of the year's GDP. Where are the problems in the challenges for NPL disposition? This paper analyzes administrative methods for disposition of NPLs and point out their problems.

Concerning the NPLs disposition methods, many literatures can be found on this subject, such as Deacons, (2005), Min Xu (2005), John Bonin and Paul Wachtel (2004), Guifen Pei and Sayuri Shirai (2004), Guonan Ma and Ben S C Fung (2002), and so on. These literatures have mentioned the methods, such as Debt-for-Equity Swap, Direct Sales to Investors, Securitization, and point out their problems, but they have not classified them.

In China, most of the considerable NPLs in SOCBs were generated in the conversion of economic system, and extended by the loans to the state-owned enterprises (henceforth, SOEs), so the government should bear part of the expenses for NPLs disposition. On the other hand, the four SOCBs and their AMCs should dispose of their NPLs through marketing operations on their own initiative. Based on these viewpoints, this paper considers the strategies taken for the disposition of NPLs and classifies them into administrative means and market operations. At the same time, this paper points out their problems introduced in the preceding literatures and supplement them with some new insights.

In order to help SOCBs write off the NPLs and improve their joint-stock reform, NPLs off-load from SOCBs to AMCs has been carried out twice. In this paper, BOC and CCB's second NPLs off-load in 2004 is classified as a marketing operation, different from the first time in 1999 as an administrative means, which was also the NPLs transfer from SOCBs to AMCs. The reasons are: the first one was simply a NPLs transference from the four SOCBs to the four AMCs via administrative means, and was made at the NPLs' book values, while the second one was via public bidding among the four AMCs, and the selling price was about 30 percent of the book value, so both banks had to accept losses.

Moreover, in the preceding literatures, Guifen Pei and Sayuri Shirai (2004), Min Xu (2005) and other scholars gave some foreign research institutions and credit rating agencies' estimates to state that the data on NPLs released by the government is underestimated by pointing out estimates of some foreign research institutions and credit rating agencies'. Although, they gave these examples to show that the official data was underestimated, they did not analyze the causes properly. This paper discusses three causes why it is difficult to accurately grasp the magnitude of NPLs in the banks. First of all, China's loan classification system for

commercial banks was changed from four-category classification to five-category classification, which caused complicated problems in term of technology. Secondly, since many SOCB loans made to SOEs were on a non-commercial basis during the conversion of the Chinese economic system, it is difficult for SOCBs to evaluate how many loaned money can be recoverable. Thirdly, the top ranking officers of the banks intentionally have disclosed a lower data of total NPLs.

This paper is organized as follows:

The first section studies the actual situation of NPLs and analyses the causes why the released data on NPLs in the financial institutions by the government is underestimated. The second section examines and classifies the NPLs disposition methods to date and then, point out the problems of them. The third section proposes how to reinforce government's behavioral norms and build a fine social credit environment.

NPLs in the four SOCBs

Financial sector reform has been proceeding in the past two decades, even if it lagged significantly behind those in the real economy. The Asian financial crisis in 1997 ~ 1998 made the picture changed. Additional reforms took place after it to improve the health and the safety of the banking system, aiming at gradually transforming a fully state-owned banking system into a profitable and competitive one (Alicia Garcia-Herrero, and Daniel Santabarbara, 2004). It is supposed that it will require cleaning up the NPLs in SOCBs first.

1. Can the magnitude of NPLs be accurately understood?

An accurate grasp of the realities is difficult. To make a comparison between the data released by the government and estimated by foreign research institutions and credit agencies, we can find that available evidence is underestimated. For example, Moody's Investors Service estimated that the NPLs ratio of SOCBs was in the range of 35~70 percent in 1996, while Morgan Stanley Dean Witter estimated that the ratio was 36 percent in 1998⁴. But in contrast, by the government data, the ratio is 25 percent in 1997 (there is no data of 1996) and 10 percent in 1998; contrasting with the official figures of NPLs in the financial system about RMB 2.8 trillion or US\$ 340 billion, the Pricewaterhouse Cooper's estimates this figure to be about US\$ 500 billion⁵.

The reasons are thought to be as follows:

First, there are some complicated problems in terms of technology. Before the year 2002, the accounting

and auditing system were opaque, as a result, collecting reliable data was an extremely difficult task (Guifen Pei, and Sayuri Shirai, 2004). In 2001, according the “Guidelines on Risk-Based Loan Classification” of the People’s Bank of China (PBC), China’s loan classification system for commercial banks was changed from four-category classification to five-category classification, and this makes it difficult to compare the NPLs ratios between before and after the change. The four-category classification is (Table 1):

Table 1 NPLs classification

	Four-category classification		Five-category classification												
<i>Normal</i> ,	Normal		Pass												
<i>Past-due</i> : less than 2 years of overdue;	NPLs		Special-mention												
<i>Idle</i> : over 2 years of overdue;	<table border="1" style="margin-left: auto; margin-right: auto;"> <tr> <td style="width: 50%;"></td> <td style="width: 50%; text-align: center;">Past-due</td> </tr> <tr> <td style="width: 50%;"></td> <td style="width: 50%; text-align: center;">Idle</td> </tr> <tr> <td style="width: 50%;"></td> <td style="width: 50%; text-align: center;">Bad</td> </tr> </table>		Past-due		Idle		Bad		<table border="1" style="margin-left: auto; margin-right: auto;"> <tr> <td style="width: 50%;"></td> <td style="width: 50%; text-align: center;">Substandard</td> </tr> <tr> <td style="width: 50%;"></td> <td style="width: 50%; text-align: center;">Doubtful</td> </tr> <tr> <td style="width: 50%;"></td> <td style="width: 50%; text-align: center;">Loss</td> </tr> </table>		Substandard		Doubtful		Loss
	Past-due														
	Idle														
	Bad														
	Substandard														
	Doubtful														
	Loss														
<i>Bad</i> : irrecoverable.															
While the five-category classification is:															

Note: made by the author.

Pass: borrowers can honor the terms of the contracts, and there is no reason to doubt their ability to repay principal and interest of loans in full and on a timely basis.

Special mention: borrowers are still able to service the loans currently, although the repayment of loans might be adversely affected by some factors.

Substandard: borrowers' ability to service loans is apparently in question, cannot depend on their normal business revenues to pay back the principal and interest of loans and certain losses might incur even when guarantees are executed.

Doubtful: borrowers cannot pay back principal and interest of loans in full and significant losses will incur even when guarantees are executed.

loss: principal and interest of loans cannot be recovered or only a small portion can be recovered after taking all possible measures and resorting to necessary legal procedures.

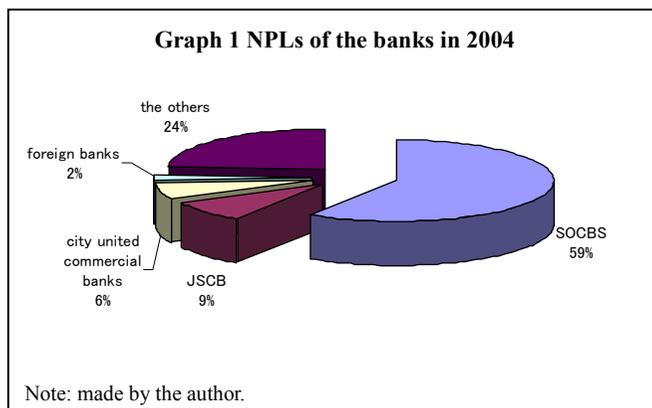
Second, in the late 1980s and through the 1990s, as the Chinese economic system were converting from the centrally planned economy to the market-oriented economy, most of the candidates for SOCBs loans are SOEs. Since both of the lender and the borrower were state enterprises, the incentive for avoiding risk and acquiring profits didn’t work. In order to avoid SOEs’ bankruptcy, the government sometimes was making SOCBs to continue lending out loans also to the unprofitable SOEs. In other words, many SOCB loans made to SOEs during this period were on a non-commercial basis, and could be looked as a kind of financial

support to SOEs. In this case, if production of SOE was recovered and it succeeded in reconstruction, the loaned money could be appropriated for a normal one. But if it failed, the additional loans would also be repeated to NPLs. It is difficult for SOCBs to evaluate how much loaned money can be recoverable.

Third, it is difficult for each of SOCBs to hold the NPLs' actual condition of all the branch banks by the four-category classification according to the domestic standard. On the other hand, however it is emphasized that most of the NPLs were produced by governmental requests, the depositors, who are present outside the banks, will believe that the top ranking officers of the banks should be blamed for the presence of NPLs. So for them, the data of NPLs is "the smaller, the more advantageous". They need a lower data of total NPLs to disclose. The old classification enabled banks to report an underestimated amount of NPLs by lending to insolvent firms and allowing them to repay using the proceeds of those new loans, thereby postponing the timing of the resolution of the problem (Guifen Pei, and Sayuri Shirai, 2004).

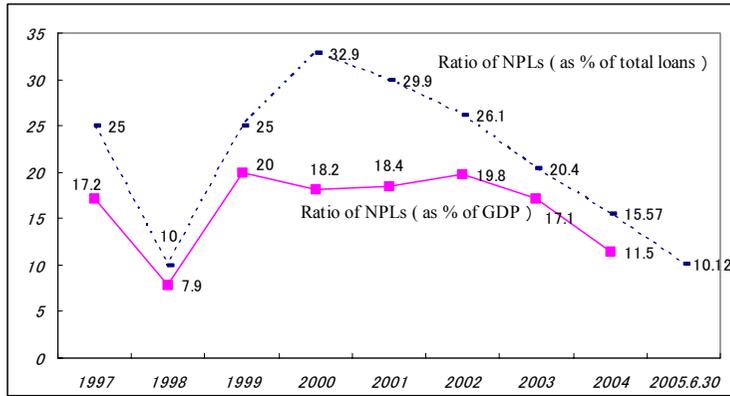
2. NPLs disposition Trend

The total NPLs of the banks in 2004, reported in Graph 1, reached RMB 1.7 trillion yen: RMB 1.008 trillion in the four SOCBs, RMB 145 billion in the JSCBs, RMB 107.3 billion in the city united commercial banks, and RMB 3.6 billion in the foreign banks⁶.



Graph 2 reports the NPLs Ratio in the four SOCBs as percent of total loans and of GDP. It shows that despite the government's efforts since 1999 to resolve the problem, the four SOCBs remain suffered by huge NPLs. Though the NPLs ratio remains declining every year, at the end of 2004, it still accounts for 11.55 of GDP.

Graph 2 NPL Ratio in the four SOCBs



Source: made by the author. Data from CBRC website; Guifen Pei, and Sayuri Shirai

(2004); Pieter Bottelier (2003); <http://www.jri.co.jp/asia/2005/03bank.html>

method to ensure the soundness of the banking system. So banks in various countries have drawn their own warning line. 1988 Basel Capital Accord requires that banks hold minimum capital equal to 8 percent of the debt obligations they hold as assets. Table 2 shows the trend of capital equal ratio of the four SOCBs respectively.

Table 2 Capital Adequacy Ratio of SOCBs

	1999	2000	2001	2002	2003	2004
ICBC	-	5.38	5.76	5.54	5.52	-
CCB	-	-	6.88	6.91	6.51	11.29
BOC	9.8	8.31	8.3	8.15	6.98	10.04

Note: the data of ABC is not reported.

Source: Annual Reports of the four SOCBs.

NPLs disposition methods and their problems

1. Administrative means

It is proved that, if there is no support of the government, there is no banks' success in disposing of the NPLs. In China, because the ratio of state-owned economy in China is still high, the vast majority of NPLs were extended by SOCBs to SOEs. Therefore, the cost of NPLs disposition should be allotted between government and the bank by reasonably shares. If the government attempts to construct a healthy bank system, it should assist SOCBs in policy and seek a suitable way to pay the bill for these large amounts of cost.

1.1. The injection of public funds

Because SOCBs' NPLs have the obvious centrally planned economy's character, said from some kind of significance, they are an embodiment of the cost for the social economy reforming in the financial sphere. Many functions that should be undertaken by the finance transferred to SOCBs, so it is thought that injecting public funds to dispose of part of SOCBs' NPLs is natural.

The first time was in 1998, aiming at capital increase. RMB 270 billion (\$32.6 billion) worth of special government bonds were issued to recapitalize the four SOCBs. The breakdown is: RMB 60 billion to CCB, RMB 42.5 billion to BOC, RMB 93.3 billion to ABC, and RMB 74.2 billion to ICBC. The plan aimed at raising the average capital adequacy ratio of the four SOCBs to 8 percent. But actually, the capital adequacy ratio only rose to 4.6 percent and then dropped to 4.28 percent in 2003⁷.

The second and the third time were said for SOCBs' joint-stock reform, and at the same time, writing off bad loans and improving capital adequacy was also one of the important intentions. As SOCBs are busy preparing for competitions from foreign rivals, listing schemes is seen as crucial in enhancing their financial strength and efficiency.

At the end of 2003, the CPC (Communist Party of China) Central Committee and the State Council selected BOC, the country's foreign exchange bank, and CCB, the main property lender, whose financial positions were well-managed in the four SOCBs, as the pilot banks to test the viability of transforming the state-owned banks into internationally competitive joint-stockholding banks. Reinforcing the capital by injecting the public funds was the first step. The Central Huijin Investment Company, which is a separate component company of PBC, injected US\$22.5 billion worth of foreign exchange reserves into the two SOCBs respectively.

Then, approved by the State Council of the People's Republic of China, and under the sponsorship of China SAFE Investments Ltd.⁸, Bank of China was converted into Bank of China Limited on Aug.26th, 2004. This is a significant milestone in its reform process. And then, CCB was separated and China Construction Bank Corporation was incorporated into a joint stock company with limited liability in September, 2004.

The third time happened in April, 2005. A total of US\$15 billion of the country's foreign exchange has been allocated to the ICBC for its reform. It represents a further positive step by the Chinese government to resolve the legacy problems of the country's banking system⁹.

1.2. Establishment of AMCs

a. Background

After the Asian financial crisis, non-performing asset of financial institutions burst into the center of attention. China's big four SOCBs have been the central pillar of the state's financial system and have played important roles in economic development. Prior to the release of *the Law of the People's Republic of China on Commercial Banks* in 1995, the state-owned banks operated as specialized banks. Their activities were often determined by the government industrial policies and the local government authorities used them as major sources of funds to finance local capital construction projects (Jianhuai Shi, 2001). After the Talks given by comrade Deng Xiaoping when he visited the south, the economy became overheated. State and local governments' administrative intervention, lack of a healthy creditor protection environment, absence of effective internal management system, jointly produced a considerable sum of NPLs in SOCBs. With the development of China's economy and the acceleration of economic structure reforms, NPLs has become a major hidden risk. If the problem couldn't be solved rapidly, it would endanger financial and social stability.

Having learned experiences and lessons from overseas, the government decided to set up financial asset management companies.

b. Major business

Four AMCs were established like saucers to receive NPLs of SOCBs, and the Ministry of Finance (MOF) provided each AMC with an initial capital injection of RMB 10 billion (USD 1.2 billion) in 1999. The government launched out the disposal of SOCBs' NPLs by injecting public funds. Each of the four AMCs pairs up with one of these four SOCBs: Cinda with CCB, Great Wall with ABC, Orient with BOC, and Huarong with ICBC (Table 3).

SOCBs don't have any direct equity stakes in AMCs. AMCs are wholly state-owned financial institutions, under the supervision of PBC, the guidance of the State Securities Supervisory Committee of China and MOF. On the other hand, they have independent legal person statuses. Their major role is to purchase, manage and dispose of NPLs acquired from their affiliated "parent" SOCB and other financial institutions. The key mandate of them is to maximize recovery value of the assets acquired from SOCBs within 10 years. The ultimate disposal of NPLs is not only to sell NPLs and settle accounts, the critical issue is to salvage the maximum value of them and let them play their role in economic development (Li Fu-an, 2004).

Table 3 Details of AMC's (RMB billions)					
AMC	Cinda	Orient	Great Wall	Huarong	Total
Time of establishment	1999.4.20	1999.10.15	1999.10.18	1999.10.19	-
affiliated bank	CCB	BOC	ABC	ICBC	-
Total assets (Dec.31st, 1999)	2,201.1	2,618.1	2,275.8	3,539.9	10,634.9
Source of capital					
Capital (MOF contributions)	10	10	10	10	40
PBC loans	0	107.4	345.8	94.7	547.9
Financial bonds issuance	373	160	0	313	846
NPLs acquired	373.0*	267.4	345.8	407.7	1,393.9
Source: made by the author, using the evidences of http://www.mof.go.jp/jouhou/soken/kouryu/h13/chu02.pdf , Annual Report 1999 of the four SOCBs and website releases of the four AMC's. Note: RMB 100 billion of the NPLs bought by Cinda were from the China Development Bank (Guonan Ma and Ben S C Fung, 2002).					

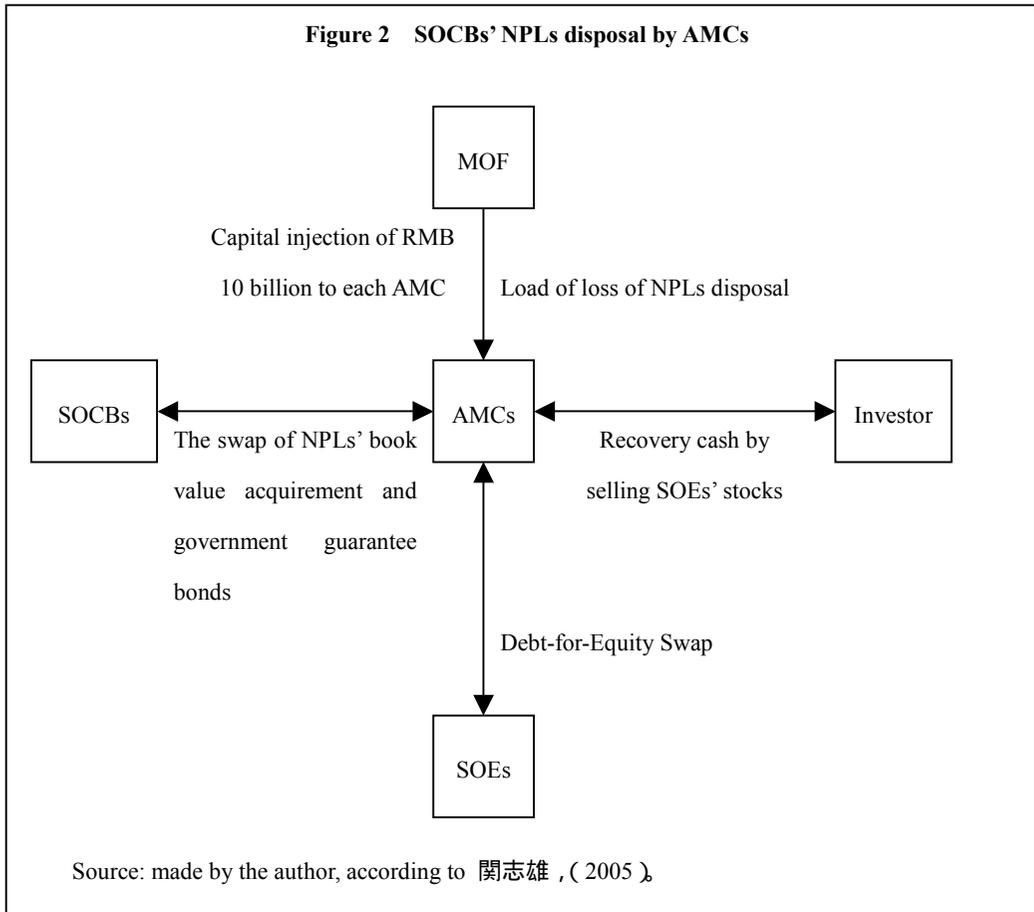
Their business scope¹⁰ is:

- To acquire and manage NPLs from banks and other financial institutions, including acquisition of NPLs on commercial basis.
- Debt collection.
- Asset leasing, transfer and restructuring.
- swapping debts into equity and temporarily holding the equity.
- Issuance of financial bonds and borrowing from financial institutions.
- IPO (Initial Public Offering) recommendation for the enterprises under their management, bond and stock underwriting.
- Non-performing assets (henceforth, NPA) securitization upon approval.
- Financial and legal consultancy, asset and project appraisal.
- Making further investments in the asset under management.
- Other business approved by the CBRC and China Securities Regulatory Commission (CSRC)¹¹.

In April, 2004, State Council promulgated a regulation which allowed AMC's to carry out the three commercial businesses including acquisition of NPLs on a commercial basis, asset servicing and further investment in the asset under management, providing the legal basis for AMC's to be engaged in such businesses. In September, 2004, Huarong became the first AMC to gain approval to carry out such businesses.

c. the first off-load of NPLs from SOCBs to AMC's

In principal, the NPLs that become the acquirement object by AMC's are limited to the kinds of NPLs formed before the promulgation of the PBC Commercial Banking law in 1995. Under this law, the four state-owned specialized banks¹² have been transformed into wholly state-owned commercial banks. Prior to the law, they had been operating under the government's instruction. The law recognized their legal status of operating principles of profitability, safety and liquidity and responsible for their own profits and losses¹³. For



this reason, the NPLs to be transferred are those (the past-due and idle loans classified under the four-category classification) before 1996 at their book value. This indicates that the government is take responsibility for potential bank losses from policy lending in the era of planning economy. However, the NPLs generated afterwards, about RMB1.8 trillion will be still remained in SOCBs. In addition, the NPLs not only in SOCBs, but also in the China Development Bank (CDB), which transferred the credit from the CCB when it was established were to be disposed. The Mechanism of SOCBs' NPLs disposal by AMC is reported as Figure 2.

After the establishment of the four AMCs, based on the State Council's arrangement, AMCs acquired RMB1.394 trillion (US\$168 billion) NPLs from the four SOCBs at book value without discount, and completed their purchase in July, 2000. Reported in Table 3, the purchase was made in part by cash (PBC lending) and in part by bonds (AMC issuing).

As the bond is a kind of debt, SOCBs were still exposed to AMC credit risks, equivalent to the original NPLs exposure. To address this, PBC was required to guarantee the AMC bonds. As a result, the credit risk was transferred to PBC. Since MOF owns AMCs, SOCBs and PBC, there is no net cost incurred to the State in providing such backing.

"The arrangement effectively passed the credit risk of the NPLs from the banks to PBC, via AMCs. The end result is, of course, a dramatic strengthening of the balance sheets of the banks (Deacons, 2005)."

d. Establishment of AMCs is not the only route to dispose the existing NPLs problem.

The establishment of AMC is a necessary way to dispose of the NPLs in SOCBs, and to reduce the financial risk in China. It is also an important measure to accelerate finance reform. In the process of NPLs disposition, the four AMCs are playing an important part. However, Guonan Ma and Ben S C Fung (2002, p4) said: "The AMCs neither address the entire NPLs problem of the big four banks nor focus solely on it." They give three causes:

First, it is now clear that far from all NPLs at the big four SOCBs were transferred to AMCs during 1999-2000, and in any event, the NPLs transferred to AMCs represent less than half of the total estimated NPLs at the four SOCBs.

Second, the asset transfers during 1999-2000 are often regarded as "policy-based". It is only the NPLs which formed from policy lending before 1996 in SOCBs that will be transferred to AMCs. Moreover Governor Dai Xianglong reiterated a State Council decision that, in the future, there will be no more

policy-driven NPLs transfers from the big four banks to AMCs.

Third, even within the policy transfers, there have been two additional complications. Not all policy transfers were taken from the big four banks (for example, RMB 100 billion of the NPLs bought by Cinda were from the China Development Bank); According to the Four-category Classification, it is not all the policy-based assets transferred were NPLs at the time. Some of the transferred assets, reportedly RMB 200 billion, might have been “performing loans” carved out solely for the purpose of facilitating the debt-for-equity swaps to be discussed later.

Moreover, they are required to dispose of all the NPLs transferred from SOCBs in 1999 no later than Dec.31st, 2006. However, in terms of their performance to date, according to the CBRC’s statistics data¹⁴ of AMCs’ NPLs disposal, as of June.30, 2005, the Accumulated Disposal¹⁵ is RMB 7174.2 million, the Disposal Ratio¹⁶ is 57.28 percent, and the Cash Recovery Ratio¹⁷ is 20.69 percent. Whether this target can be achieved in remaining one and a half years is still a doubt.

So, it is impossible to put great hopes on AMCs to solve all NPLs’ problems, and therefore, a certain policy should be given to help SOCBs accelerate the NPLs disposition and SOCBs should solve quite a lot of problems voluntarily, too.

1.3 Debt-for-Equity Swap

a. Background

Debt-for-Equity Swap in China is to convert debts owned by SOEs to AMCs into ownership shares in the borrower SOEs, and to change the principal and interest repayment into the dividend based on the stocks. Thus, AMCs become stockholders of the enterprises. They exercise stockholder’s right by the law, and participate in the decision of important clerical work of the enterprises, but don’t participate in the normal production management activities. In addition to AMCs, the banks themselves have also converted some of the NPLs into equity, although the exact amount is unclear (Min Xu, 2005).

Debt-for-Equity Swap was a hot topic in 1993 and 1994. But afterwards, *the Law of the People’s Republic of China on Commercial Banks* was promulgated in 1995, in which the bank was prohibited from having the corporate stocks¹⁸. So it cooled down.

With the problems of the management of SOEs facing with the difficulty, and the banks’ NPLs not decreasing easily, becoming obvious, debt-for-equity swap regained its popularity. In March, 1999, China unveiled a debt-for-equity swap scheme to restructure the bank debt of SOEs. And then, the four AMCs were

established to carry out a role of the mediators. Through them, debts owned by SOEs to SOCBs are converted into stocks held by AMCAs to borrower-SOEs.

b. Scheme

Debt-for-Equity Swap is not something which is applied to all enterprises. To become the object, recommendation of State Economic & Trade Commission, People's Republic of China (SETC) and investigation of AMCAs must be received. These enterprises are limited for those:

(1) Which were established in 1986~1997, mainly with the financing of SOCBs. They have fallen into the vicious circle of loan principal and interest payment for insufficiency of the capital as the main cause.

(2) Which are among 512 overriding enterprises of SOEs, and have heavy burdens to repay the debts for the renewal and expansion of equipments and run deficits.

And furthermore, the following qualifications must be fulfilled:

- (1) The products have high quality and market competitiveness;
- (2) Equipments suit the international level, and have harmless to the environment;
- (3) Management is done well, and the financial accounting is transparent;
- (4) Managers are competent;
- (5) The enterprises meet the demand of modern corporate system, and restructuring has been executing (such as workforce reduction and separation of hospital, school, etc.).

As a result, the enterprises selected were mostly state-owned producing enterprises, and only a few were foreign trading enterprises (Guifen Pei, and Sayuri Shirai, 2004).

The scheme of Debt-for-Equity Swap is, in a nutshell, as the following (Figure 3):

SETC investigate SOEs and recommend suitable ones to their relevant AMCAs.

AMCAs purchased the principal and interest of SOEs from the relevant SOCBs, based on their book value.

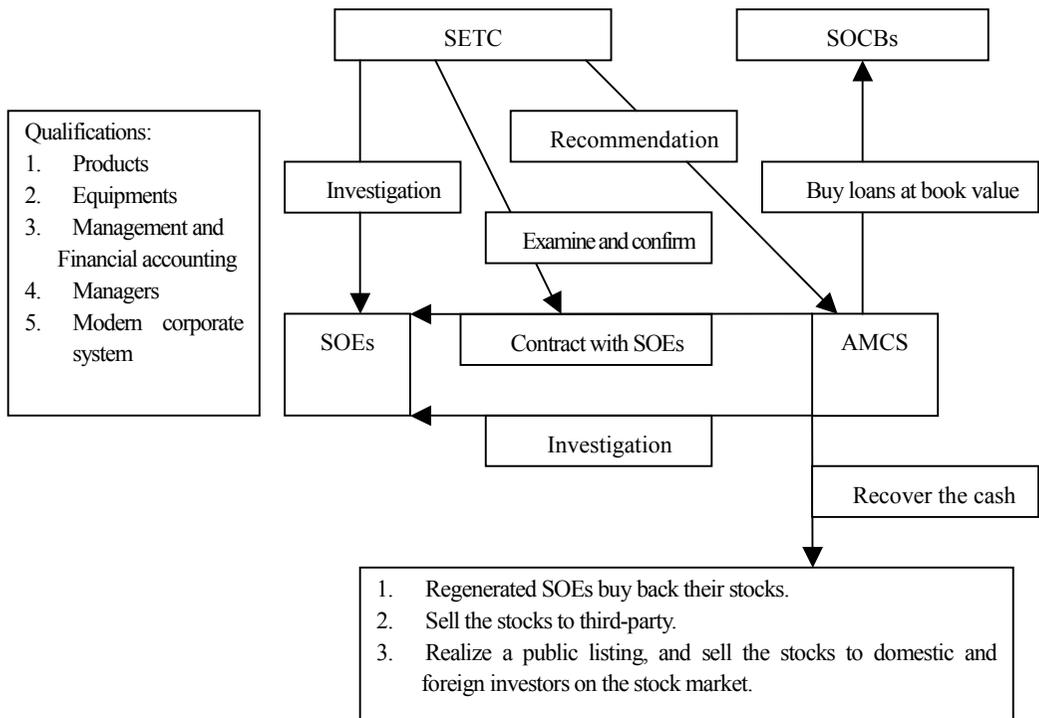
AMCAs investigate the SOEs themselves.

AMCAs contract with SOEs for Debt-for-Equity Swap.

After the examination and confirm of SETC, MOF, PBC and then the State Council's agreement, the contracts become effective.

Encourage SOEs to improve their management and then to recover the cash.

Figure 3 Debt-for-Equity Swap Scheme



Source: Made by the author, according to Guifen Pei, and Sayuri Shirai, (2004) and 関志雄, (2005).

c. Effectiveness

The Debt-for-Equity Swap is designed as a "Win-to-Win" policy.

To SOEs, Debt-for-Equity Swap brings changes to the capital structure, stock structure and budget constraints of SOEs: debts are converted into capital and so the interest burden of the firms will be greatly lessened, thereby, the financial circumstance will be improved. So Debt-for-Equity Swap will provide opportunities for stock structure reform and help the enterprises get out of the distressed situation.

To SOCBs, by the Debt-for-Equity Swap, NPAs are activated and their recovery is accelerated and the liquidity of assets becomes rising; thereby it is advantageous to reduce financial risk and speed up the commercialization of SOCBs.

In addition, by the Debt-for-Equity Swap, AMCs become the stockholder, and pursuing the investment return is a matter of course. If the management can not be improved, they have the right to switch the managers. So the Debt-for-Equity Swap will promote paving the way for the establishment of a modern

governance structure in SOEs and consequently, the conversions will also be caused in the management mechanism adequately.

The short-term result of the program appears quite positive. The first debt-for-equity swap agreement was signed by Cinda AMC with Beijing Cement Plant on Sep.2nd, 1999. Until Jun.30th, 2004, the four AMCs have conducted a series of debt-for-equity swaps with 557 SOEs, involving RMB 306,079 million of debts converted into equity rights held by AMCs¹⁹.

For those SOEs selected for swap, it is a quick means for them to reduce their liability-to-asset ratio. According to Guifen Pei and Sayuri Shirai (2004), the enterprises have reduced the ratio of their liabilities, on average, from 73 percent to 50 percent. And in 2000, the balances of 80 percent of enterprises performing debt-equity swaps shifted from deficit to surplus.

For the four SOCBs, it is a fast lane for them to off-load their NPLs and to improve their balance sheets. By the Chinese central bank's estimates, the removal of these distressed assets reduced the national banking system's level of NPLs from 35 percent of the total loan portfolio in 1999 to 25 percent by the end of 2000 (Edward Steinfeld, 2005).

The Debt-for-Equity Swap helps the NPLs in SOCBs decline and SOEs regenerate. At a glance, it seems like an efficient program, but on a long view, the Debt-for-Equity Swap program is just like an accounting exercise, transferring NPLs from SOCBs to AMCs, equivalent to debt relief for both selected SOEs and SOCBs, nothing has really changed yet.

First, AMCs undertake a potential loss by acquiring the NPLs from SOCBs by book value.

In general, it is an original appearance that the higher the risk, the larger the return. Thereby, the investment asks for a larger return than financing, for its risk is higher. It is not easy to think that SOEs who cannot pay the interest for the banks' loans, while can pay a suitable return for the investment.

When AMCs recover the cash, the loss will occur if the disposition price is lower than the purchase price. As MOF is the ultimate guarantor of the AMCs' debt issued to buy NPLs from SOCBs, the processing loss becomes a load of the nation's finance ultimately.

Second, in the longer term whether the program is successful or not will depend on the government's determination to implement reform in selected SOEs to strengthen their management so that the exercise will not end up as a debt amnesty²⁰. After the Debt-for-Equity Swap, many of SOEs have their management unchanged and still keep the low efficiency. Maybe they thought, anyway, the government would relieve them. For this reason, the Debt-for-Equity Swap program gave moral hazards to both SOEs and SOCBs.

Third, the Debt-for-Equity Swap progress is very slow. Many SOEs haven't welcomed the program because debt-for-equity swap will mean painful lay-offs and management reform. Moreover, the AMC's authority of supervision on SOEs is limited; and the property rights are very often not clearly defined in many SOEs, so that it is sometimes difficult for AMCs to carry out the restructure. So the program needs further modification to become effective.

2. Marketing operation

Except the administrative means, the four SOCBs and their AMCs are disposing of the NPLs through marketing operations on their own initiative. But since the landmark Huarong sale, the vast majority of transactions have been smaller trades of loans or settled assets at the (SOCB or AMC) branch level (ERNST & YOUNG, 2004). Table 4 is an overview of China's prominent NPLs transactions.

2.1. BOC and CCB's second NPLs off-load

In June 2004, MOF and PBC organized a public bidding among the four AMCs. Cinda AMC was the winner bidder over its AMC rivals. Through the auction, BOC and CCB sold certain Category (doubtful) NPLs with a face value of RMB 278.7 billion (US\$33.7 billion) to Cinda AMC: RMB 149.8 billion at BOC and RMB 128.9 billion at CCB. This deal will help the two banks clean their balance sheets. It is also called "off-load", but is something different from the first time in 1999.

The first time is a simply NPLs transference from the four SOCBs to the four AMCs via administrative means, and it is often regarded as "policy-based". Four reasons can be mentioned (Guonan Ma and Ben S C Fung, 2002):

AMC purchase of the NPLs was executed uniformly at book value.

The government explicitly authorized the related AMC financing that covers such transfers.

These NPLs transfers were mostly restricted to those loans incurred before the end of 1995 and identified as "substandard" or "doubtful" loans before end-1998 under the old Chinese loan classification system (Four-category classification).

Some of the banks' assets transferred were selected to serve certain specific government goals such as debt-for-equity swaps.

The transfer in 1999 were made at their book values, while the second time was via public bidding among the four AMCs and, the selling price was about 30 percent of the book value, and both banks had to

Table 4 OVERVIEW OF CHINA'S PROMINENT NPL TRANSACTIONS

BID DATE	SELLER	BRANCH	BUYER(S)	TRANSACTION TYPE	PRIMARY ASSETTYPE	CURRENT STATUS	FACE VALUE (RMB)
November 2001	Huarong AMC	18 Branches	Consortium Led By Morgan Stanley Goldman Sachs	Open Auction	Loans	Closed	12.8
December 2001	Orient AMC	Guangdong	Chenery & Associates	Negotiated	Loans	Closed	1.8
May 2002	CCB	5 Branches	Morgan Stanley	Negotiated	Loans	Pending Approval	4.3
July 2002	Great Wall AMC	Unknown	Goldman Sachs	Closed Auction	Loans	On-hold	8.1
Early 2002	ICBC	Unknown	Lone Star Merrill Lynch Goldman Sachs Others	Closed Auction	Settled Assets	Cancelled	1.03
January 2003	Cinda AMC	10 Cities	Deutsche Bank	Securitization	Loans		2.6
June 2003	Huarong AMC	Multiple Branches	Citic Trust	Securitization	Loans	Closed	13.3
October 2003	ICBC	Ningbo	CS First Boston	Securitization	Loans	In Process	1
November 2003	BOC	Hong Kong	Citigroup	Open Auction	Loans	Closed	14.9
December 2003	Huarong AMC	Wuhan	Consortium of GE Capital & Morgan Stanley	Closed Auction	Loans	Pending Approval	1.8
December 2003	Huarong AMC	Multiple Branches	Ao Vi Er Morgan Stanly Citigroup UBS Goldman Sachs Lehman Brothers JP Morgan	Open Auction	Loans	In Process	22.2
First Quarter 2004	ICBC	3 Branches	To Be Determined	Negotiated	Settled Assets	Planned	2.3
First Quarter 2004	CCB	18 branches	To Be Determined	Open Auction	Settled Assets	In Process	4.2
Second Quarter 2004	BOC	Guangdong	To Be Determined	Closed Auction	Loans/Settled Assets	Planned	6.0
Total:							96.33
Source: ERNST & YOUNG, (2003).							

accept the losses. Cinda won the auction by, among other things, offering a promised cash recovery rate of 30.5 percent on the face value of the loans transferred, and demonstrating its competency and capability for NPLs resolution: its cumulative recovery rate to date is in the range of 32 percent, well beyond that of its competitors (Price Waterhouse Coopers, 2004).

2.2. Auction to Foreign and Domestic Investor

In order to attract foreign capital in buying and restructuring the NPLs assets, the Ministry of Commerce, MOF and PBC jointly promulgated the "Absorption of Foreign Capital by Financial Asset Management Companies to Participate in Asset Restructuring and Disposal Tentative Provisions" on October 26, 2001.

Various attempts have been made to attract foreign investment in NPLs assets.

Huarong AMC signed a landmark agreement to sell 4 asset pools with RMB 10.8 billion (about US\$ 1.5 billion) worth book value to a Morgan Stanley led consortium (including Lehman Brothers and Salomon Smith Barney), which agreed to pay Huarong in cash about 9 percent of the face value of the loans on Nov.29th, 2001. In the same year, On Dec.21st, Huarong sold a second tranche of NPLs assets RMB 1.9 billion (about US\$ 250 million) worth book value to Goldman Sachs²¹.

On Nov 26th, 2002, the Ministry of Foreign Trade and Economic Cooperation (MOFTEC)²² granted its approval to Huarong for the establishment of two joint ventures: First United Asset Management Company Ltd. and Rongsheng Asset Management Company Ltd. with the Morgan Stanley led consortium and Goldman Sachs respectively responsible for the resolution of the transaction portfolio of Huarong's 1st international NPLs auction. The Goldman Sachs and the Morgan Stanley transactions received government approvals in February and March 2003, respectively.

In light of its experience in the first international NPLs auction, Huarong held its second international NPLs auction of RMB 22.5 billion worth of NPLs assets. The finalists, Citigroup, JP Morgan, Goldman Sachs, UBS, Morgan Stanley and domestic investor Ao Yier have either bought some of the asset units or qualified to negotiate a structured deal on an upfront cash payment basis. According to Huarong AMC's announcement, among these asset pools, two were sold outright to Citigroup. Another 11 were disposed of by Huarong in a Joint Venture (JV) approach with UBS, JP Morgan, Lehman Brother, Goldman Sachs, and Morgan Stanley. The second international NPLs auction was not only the largest NPLs auction in China, but also the largest one in Asia.

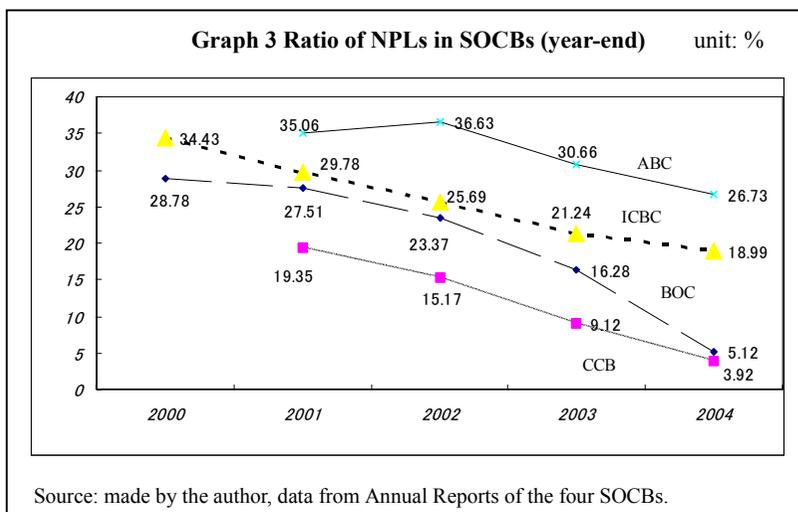
Separately, about SOCBs, because they have been prohibited disposing of loans at prices below their net

book value, SOCBs have shied away from large scale asset dispositions. In 2003 and 2004, an attempt of gaining cooperation between SOCBs and foreign investors was seen: CCB moved forward with three portfolios sale of settled assets to Morgan Stanley, with book value totaling approximately RMB 4.2 billion (US\$ 507 million).

Though it ran into approval problem, the deal envisaged a direct sale by SOCBs and the sale of loans at below book value²³.

For the efforts though many means, the four SOCBs NPLs

ratios has been declining every year (Graph 3).



2.3. Securitization

Securitization is to convert an asset, especially a loan, into marketable securities, typically for the purpose of raising cash. Before 2001, securitization was almost impossible due to the absence of legal rules or guidelines for the trust business created. The introduction of the People's Republic of China Trust Law (effective from Oct.1st, 2001) made it possible to execute securitization transactions by using a trust certificate structure.

Table 5 summarizes securitization and quasi- securitization projects by the end of 2004.

Table 5 Primary securitization/ Quasi-securitization Projects Overview			
Year	AMC/Bank	Securitized Assets	Details
2003	Huarong	RMB 13.3 billion US\$ 1.6 billion	<ul style="list-style-type: none"> • Repackaged 256 NPLs • Sold only to domestic investors • Two classes of trust certificates: RMB 1.0 trillion of senior trust certificates were issued to investors → recovery rate of about 10%; the subordinated tranche was retained by Huarong • Interest rate of on the senior trust certificates: 4.17% • 80% of senior trust certificates have changed hands • Used the Trust Law • Three-year maturity
2004	Cinda	RMB 2 Billion US\$ 240 million	<ul style="list-style-type: none"> • Assets dispersed in ten regions • Engaged Deutsche Bank as servicer • Established offshore SPV to bypass Chinese legal restrictions • Sold to international investor (U.S. and Southeast Asia) • Promise term: three to five years
2004	ICBC	RMB 2.6 billion US\$ 314 million	<ul style="list-style-type: none"> • Assets in Ningbo • Securitized portfolio included non-performing and sub-performing loans • First securitization project by a commercial bank • Partnered with CSFB • Three classes of trust certificates: Class A Senior, Class B Junior, and residual equity position retained by ICBC • Class A and Class B, both rated AAA per 2 domestic rating agencies and guaranteed by ICBC • RMB 820 million (US\$ 99 million) in certificates issued to investors → recovery rate of 31.5% • Marketed only to domestic investors • Used the trust Law

Source: M in Xu, (2005), p.51

Reinforcing government's behavioral norms

A detailed survey about the historical causes of NPLs said, 30 percent of the NPLs resulted from state planning and administrative intervention, 30 percent was due to defaults of state enterprises after state banks providing financing based on state policy, 10 percent came from structural adjustments as a result of state orchestrated closure, merge and transformation of enterprises, 10 percent stemmed from intervention of local governments including poor creditor protection in the judicial and enforcement process, while 20 percent was due to the inappropriate internal management²⁴.

With the progress of the reforms, some of the causes have begun to dissolve. According to the speech²⁵ by Zhou Xiaochuan, Governor of PBC, after the Asian financial crisis, the Chinese government basically stopped administrative intervention in SOCBs as laws defining banks' lending autonomy were put into place.

At the beginning of this century, the government has gradually refrained from asking the state-owned banks to follow policies that favor SOEs. As SOEs reform deepened, some big SOEs became public listed companies and the improvement in business operation was also allowed commercial banks to improve asset quality.

Furthermore, to dispose of the NPLs problem fundamentally, means not only to decrease of the NPLs stock, but also to avoid the increase in newly generated NPLs. If the newly generation of the NPLs cannot be practically prevented, even if the old NPLs have been processed, but the new ones are massively occurring, we cannot say the NPLs problem has been solved. This requires that strengthening SOCBs' balance sheets and improving their management should sever the vicious cycle of NPLs which is increasing while disposing.

On the other hand, it is necessary to improve the government's "Financial administration ability" and correct the relationship between the government and SOCBs. The government should not intervene in SOCBs' daily management activities directly, and should cancel all the "government requests" in the financial mechanism. That is to say, SOEs and SOCBs should be converted into the subjects who pursue the profit based on the self-responsibility. The role of SOCBs and SOEs' supervisor should be entrusted to the investors, whose concern in the achievement is high, through privatization. And in order to objectively value the performance of the enterprises, an impartial, competing market regulatory environment should be developed.

Conclusions

The government, SOCBs and affiliated AMCs have adopted many strategies for disposing of the existing NPLs and got a certain results. But there are still many problems remain unsolved.

The government has supported SOCBs through injecting public funds, establishing AMCs to acquire a part of SOCBs' NPLs and carrying out a Debt-for Equity Swap program, but these administrative means imposed a burden on the nation's finances and caused moral hazard problems to SOCBs.

At the same time, SOCBs and affiliated AMCs have also done their best to dispose of the existing NPLs by selling them to foreign and domestic investors, securitizing them, and implementing other marketing operations. But prevention of the increase in newly generated NPLs is also the important and thorniest problem. It required SOCBs to intensify market regulation, emphasize corporate governance, prevent from corruption, increase operation transparency, and introduce international banking standards.

This paper has studied the process of SOCBs' NPLs disposition, which was conducted by the

government's administrative means and the four SOCBs' marketing operations, and point out their problems. It shows that: First, to dispose of the NPLs problem needs the government's support and SOCBs' own initiatives; Secondly, to solve the NPLs problem fundamentally, not only to decrease of the NPLs stock, but also to avoid the increase in newly generated NPLs is important; Thirdly, for the reform of China's financial system, privatization of the state-owned sectors is unavoidable, and an impartial, competing market regulatory environment should to be developed.

BOC and CCB have completed corporate restructuring into shareholding commercial banks in the year 2004. However, now the government continues owning them substantially. To what extent privatization is to be achieved and what methods should be adopted to push forward it remains unsolved. The future behavior about the government decreasing the stock holding ratio, and a real introduction of the market mechanism will attract more attention.

Although, AMC's were established to be given 10 years life originally, it seems to be extended with the changes of its function putting, more weight on a commercial activities in 2004. Deacons (2005) thinks that it is possible AMC's will evolve into financial holding companies, involved in asset management as well as corporate and investment banking. Where are AMC's going to? The future performance of AMC's should be dictated more attention.

Appendix 1 Key Events in the Development of China's Banking System

- 1948 People's bank of China established.
- 1951 Renminbi issued as new currency.
- 1978 Vice Premier Deng Xiaoping begins the process of transforming China from a centrally planned to a socialist market economy.
- 1979 The People's Bank of China's banking monopoly ends with the formation of the first two state-owned banks of the Big Four: the Agricultural Bank of China and the Bank of China.
- 1980 China resumes its memberships in the world Bank and returns to the International Monetary Fund.
- 1983-4 The next two state-owned banks of the Big Four are created: the China Construction Bank and the Industrial and Commercial Bank of China.
- 1985 China approves establishment of the first foreign branch bank office in China since 1949.
- 1990 Shanghai Securities Exchange established.
- 1991 Shenzhen Securities Exchange established.
- 1992 China Securities Regulatory Commission established.
- 1994 The Big Four are recast as commercial banks; three new policy-development banks are established: the China Agriculture Development Bank, China Development Bank, and China Import and Export Bank.
- 1995 National People's Congress passes the Law of the People's Bank of China, codifying the People's Bank of China as China's central bank.
- National People's Congress passes the Commercial Banking Law, enabling the Big Four to become genuine commercial banks; the law also segregates the business operations of banks, securities firms and insurance companies.
- 1996 China Minsheng Bank Corp., the nation's first publicly traded private bank, established.
- 1998 China Insurance regulatory Commission established to take over regulation of the insurance industry from the People's Bank of China; the China Securities Regulatory Commission takes over supervisory responsibility of securities market regulation from the people's Bank of China.
- Big Four infused with RMB 270 billion (\$32.6 billion) of capital.
- 1999 China's first bankruptcy of a major financial institution: China International Trust & Investment Corporation (CITIC)
- Four asset-management companies established to off-load RMB 1.394 trillion (US\$168 billion) in

non-performing loans from the Big Four: China Cinda Asset Management Corporation (Cinda), Dongfang Asset Management Company (Oriental); China Huarong Asset Management Corporation, China Great Wall Asset Management Company.

2001 China become a member of the World Trade Organization; commits to opening up its financial services industry to foreign banks on equal terms by 2006.

HSBC holdings becomes the first foreign bank to buy a stake in a mainland Chinese bank.

2003 Law of the people's Bank of China and the Commercial Banking Law of China amended; Law on the Supervision of the Banking Industry passed; the China Banking Regulatory Commission legalized and the People's Bank of China further empowered as the nation's central bank.

State Council approves Reform Measures for Rural Credit Cooperatives, thereby promulgating reforms on supervision, ownership, policies and operations.

US\$ 45 billion injected into the China Construction Bank and the Bank of China, two of the Big Four Considered to be the least burdened by non-performing loans.

Measures for the administration of equity investment made by overseas financial institutions in Chinese-funded financial institutions take effect on Dec.31st. The amount of equity investment allowed to be made by foreign financial institutions in Chinese financial institutions is increased to a maximum of 20 percent.

2004 Three major new financial laws implemented: Law of the People's Bank of China (amended), Administrative Measures on the Supervision of the Banking Industry, and Commercial Banking law of China (amended).

Source: James R. Barth, Rob Koepp and Zhongfei Zhou (2004), p.89

Appendix 2 The Structure of China's Financial Institutions		
Supervisory Management Authorities		Financial Institutions
		China Development Bank China Import and Export Bank China Agriculture Development Bank
Ministry of Finance People's Republic of China	Policy Banks	
		Bank of China (BOC) China Construction Bank (CCB) Agricultural Bank of China (ABC) Industrial and Commercial Bank of China (ICBC)
China Banking Regulatory Commission	State-owned Commercial Banks	
	Commercial Banks	Bank of Communications Everbright Bank Shanghai Pudong Development Bank etc. (total 12 banks)
	Regional Commercial Banks	Shanghai Bank Beijing Commercial Bank etc. (total 120 banks)
People's Bank of China (the central bank)		Foreign Banks total 190 offices
The State Council of China	Credit Cooperatives	Rural Credit Cooperatives (1,689 corporations) Urban Credit Cooperatives (40,141 corporations)
	Postal Savings Institutions	total 36,000 offices
	Non-bank Financial Institutions	Corporate Group Finance Companies (69 corporations) Finance Lease companies (50 corporations) Trust & Investment Corporations (50 corporations) Auto Finance Companies
Ministry of Finance People's Republic of China	Financial Asset Management Companies	China Huarong Asset Management Corporation China Cinda Asset Management Corporation China Great wall Asset Management Corporation China Orient Asset Management Corporation
	Market Management Institutions	China Foreign Exchange Center Inter-bank Call Loan Market Government Bond Registration and Management Institutions
China Securities Regulatory Commission	Securities Firms	
	Security Investment Fund Management Companies	
	Securities Exchanges	Shanghai Securities Exchange Shenzhen Securities Exchange
	Commodities Futures Exchanges	
China Insurance Regulatory Commission	Non-life Insurance Companies	State-owned Non-life Insurance Companies(2 corporations) Joint Stock Non-life Insurance Companies (8 corporations) Foreign Non-life Insurance Companies (22 offices)
	Life Insurance Companies	State-owned Life Insurance Companies Joint Stock Life Insurance Companies (5 corporations) Foreign Life Insurance Companies (140 offices)
	Reinsurance Companies	
	Insurance Intermediaries	

Note: made by the author, using Mizuho Research Institute (2003) and other available evidences of the end of 2004.

Notes

- 1 Bank of China (BOC), China Construction Bank (CCB), Agricultural Bank of China (ABC), Industrial and Commercial Bank of China (ICBC). BOC and CCB have completed restructuring and converted into shareholding commercial banks in 2004. But in this paper, they two are still dealt with as the state-owned commercial banks.
- 2 According to “*Reforming China’s Banking Sector Reform and Opening to the outside World*”. Chairman of the China Banking Regulatory Commission, Liu Mingkang’s Speech in Sydney, Australia on May 23rd, 2005.
- 3 China Banking Regulatory Commission (CBRC) was established as a government agency under the State Council on April 28th, 2003. The CBRC is responsible for the regulation and supervision of banks, asset management companies, trust and investment companies as well as other deposit-taking financial institutions.
- 4 Guifen Pei and Sayuri Shirai (2004), p13.
- 5 Min Xu (2005), p3.
- 6 http://www.chugoku-kabu.net/blog/archives/2005/05/post_138.html
- 7 According to “*Issues Relating to the Reforms of State-owned Commercial Banks*”. Vice Chairman of the China Banking Regulatory Commission, Tang Shuangning’s speech at the China Society for Finance and Banking Leadership Forum 2005 on March 25th, 2005.
- 8 Previously known as Central Huijin Investment Co..
- 9 Yahoo! News, July 15, 2005. <<http://au.biz.yahoo.com/050715/17/62v3.html>>
- 10 AMC website releases.
- 11 The State Council Securities Commission (the “SCSC”) and the China Securities Regulatory Commission (the “CSRC”) were established in October 1992. The SCSC is the State authority responsible for exercising centralized market regulation and the CSRC is the SCSC’s executive branch responsible for conducting supervision and regulation of the securities markets in accordance with the law. In April 1998, the SCSC and the CSRC were merged to form one ministry rank unit directly under the State Council. Both the power and the functions of the CSRC have been strengthened after the reform. A centralized securities supervisory system was thus established.
- 12 Prior to 1984, the banking system was a mono one with the PBC as the only financial institution. In 1984, a two-tie banking system was been adopted that PBC functioned as the central bank, and the big four banks (BOC, CBC, ABC and ICBC) operated as specialized banks. In 1994, three policy banks (State Development Bank of China, Agricultural Development Bank of China and Export-Import Bank of China) were established. It is a symbol of the separation of policy finance from commercial banking.
- 13 Article 4 of “*the Law of the People’s Republic of China on Commercial Banks*”: The business operations of commercial banks shall be governed by the principles of efficiency, safety and liquidity. Commercial banks shall make their own decisions regarding their business operations, take responsibility for their own risks, assume sole responsibility for their profits and losses and exercise self-restriction. Commercial banks shall, pursuant to law, conduct business operations without interference from any unit or individual. Commercial banks shall independently assume civil liability with their entire legal person property.
- 14 Website of CBRC: <<http://www.cbrc.gov.cn/english/index.htm>>
- 15 Accumulated Disposal refers to the accumulated amount of cash and non-cash assets recovered as well as loss incurred by the end of the reporting period.
- 16 Disposal Ratio = Accumulated Disposal / Total NPAs Purchased.
- 17 Cash Recovery Ratio = Cash Recovered / Accumulated Disposal.
- 18 Article 43 of “*the Law of the People’s Republic of China on Commercial Banks*”: No commercial banks may, within the People’s Republic of China, engage in trust investment to share business, or invest in immovable property which is not for their own use.
- 19 MOF’s statistics data. <<http://www.mof.gov.cn>>
- 20 “China’s State-Owned Enterprise Reform”, Tokyo-Mitsubishi Review, Vol.6 No.2 February 2001.
- 21 Huarong transaction received the necessary regulatory approvals in 2003.
- 22 MOFTEC is a functional department under the State council which is in charge of the overall administration of China’s foreign trade and economic cooperation.
- 23 A settled asset are not explicitly governed by the policy of that the banks are prohibited from disposing their loans below their book value.
- 24 <http://www.bis.org/review/r050128c.pdf>
- 25 At the “Forum of 50 Chinese Economists”, in Beijing, on Dec.2nd, 2004.

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