

Banking & Finance in China

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New Zealand Government

NEW ZEALAND CHINA FREE TRADE AGREEMENT

www.ChinaFTA.govt.nz

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China – Current Developments:

➤ **GDP: short, sharp slowdown going into 2009, then fiscal stimulus will start to kick in.**

- GDP- 2007 full year real GDP growth of 11.3%, highest since 1994 is estimated to fall to around 7-8%
- The epicentre of the weakness of just about everything else is property. GFA started and under construction in September contracted 13.2% and 8% YoY, respectively, bigger falls than anytime since the 1990s. This fall-off is dragging down everything from steel production to furniture buying. And there is little sign of a turnaround, with transactions in October still down sharply YoY.
- Growth in exports of consumer goods has slowed towards zero, but overseas sales of capital goods was still expanding by in real terms. This is the good news. The bad news, and the real reason for the bounce in the trade surplus, is the collapse in import demand. However the slowdown likely to mean a greater trade surplus as falling import prices offset export volume decline
- Imports have been dragged down by weak domestic demand, the epicentre of which is the property market.
- All of this suggests a serious downturn is very much underway. It is worth noting though that the chain of causation for now looks like a falling off in domestic investor confidence, which is keeping money in banks and away from asset mkt.s.
- With the growth outlook deteriorating so much, more aggressive loosening is now likely. In this respect, there is hardly any constraint on the government. Not only is there a big current account surplus, but inflation is collapsing. The input price component of the PMI has fallen from 76 in June to just 32 in October. As for the CPI, food prices are falling sharply, according to the Ministry of Agriculture declining 4% MOM in October.



China – Current Developments:

➤ Government Reaction

- Reserve requirement hikes and sales of PBoC bills have together taken some US\$1.6tr away from the banks over the last five years; including the RRR that was effective before 2003, and the total stock of sterilisation instruments held by the PBC now totals US\$1.8tr (the total is even bigger if government deposits at the PBoC are included).
- What would you buy with the US\$1.8tr China has stored up in sterilisation instruments? Africa (GDP of US\$1.4tr), two years of oil production from OPEC (around US\$1.5tr), or more saliently for Beijing, almost four years of bank lending in China (US\$2tr) or five years of property purchases (US\$1.8tr) *
- Central Bank has pledged US\$589 billion stimulation plan to prop up growth. How much is new and how much was already factored in?

* Macquarie Bank

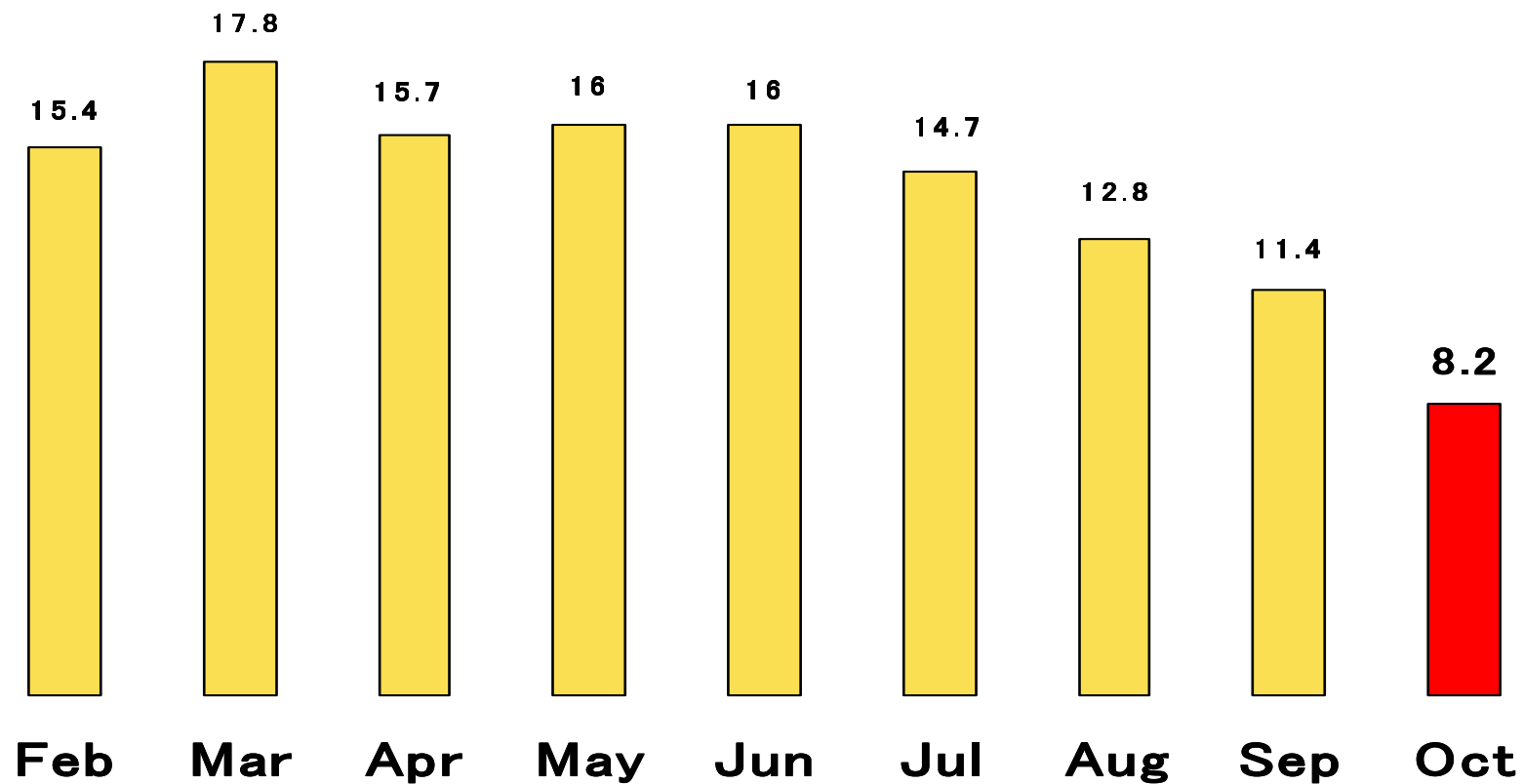


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China – Industrial Production Growth:



China – Industrial Production Growth

Selected Industries:

	Oct	Sep	Aug	Jul	Jun	May
Textiles	7.8	11.6	8.9	10	12.7	12.1
Chemicals	2.7	13.0	8.9	15.5	14.2	11.9
Ferrous metals	5.6	12.4	8.1	13.9	14.6	12.8
Power	3.4	11.0	8.2	10.6	11.9	11.8
Coal	9.2	14.4	12.1	10.9	14.8	18.5
Electricity	4.0	9.9	5.1	8.1	12.9	11.8
Cars	6.2	12.5	6.0	8	16.6	17.6



China – Banking & Finance Regulatory:

Peoples Bank of China

- Formulates and implements monetary policy
- Safeguards financial stability
- Prevents and resolves financial risks
- Issues and administers circulation of CNY
- Regulates inter-bank lending, FX, gold and bond markets
- Holds official FX and gold reserves
- Manages State Treasury
- Guides anti-money laundering
- Participates in international financial activities

State Admin for Foreign Exchange

- Implements exchange control regulation
- Supervises the FX financial markets
- CNY conversion and repatriation requires SAFE approval**

China Banking Regulatory Commission

- China's banking regulator
- Formulates supervisory rules governing banks
- Responsible for administration of supervisory boards

China Securities Regulatory Commission

- Supervision and regulation of national securities markets

China Insurance Regulatory Commission

- Supervision and regulation of insurance market

*Foreign Trade and Investment Office
Ministry of Commerce*

*Industry and Commerce Office
Tax Bureau etc*



China – Regulatory eg:

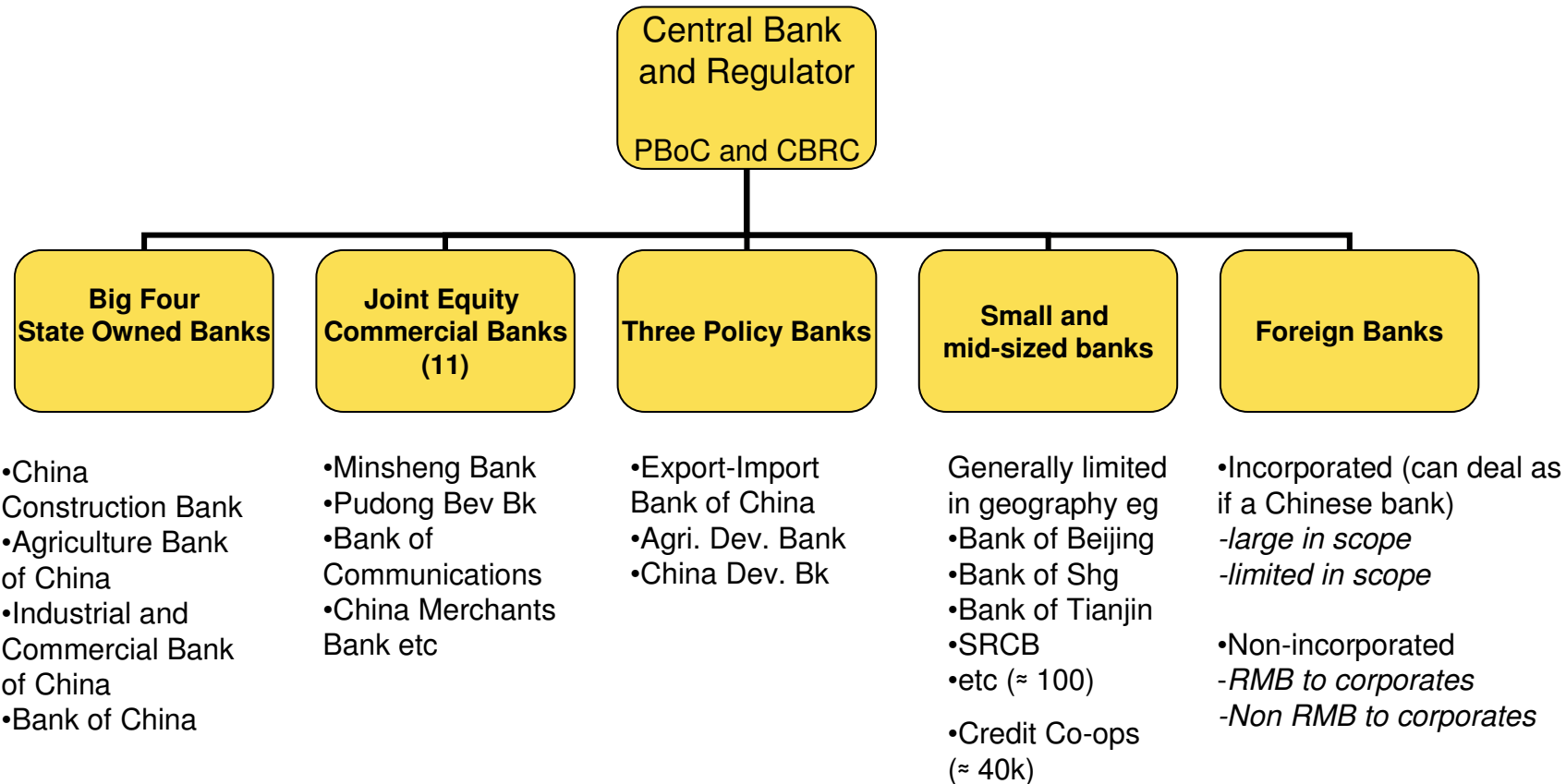
An architect, for example, planning to take advantage of the opening of the market in relation to construction and engineering design must refer to the *Provisional Rules on the Administration of Foreign Enterprises Engaging in Design Activities for Construction Projects within the People's Republic of China*.

If he plans to participate in design work in China from outside China. If he plans to set up a permanent operation in China, he must attempt to set up a foreign investment enterprise under the *Regulations on the Administration of Foreign-Invested Construction and Engineering Design Enterprises* and the applicable foreign investment laws.

An educational institution planning to enter into a cooperation arrangement in China must comply with the provisions of the *Regulations of the People's Republic of China on Chinese-foreign Cooperation in Running Schools*¹¹ (which deal with the establishment of permanent educational institutions) and the *Measures for the Implementation of the Regulations of the People's Republic of China on Chinese-foreign Cooperation in Running Schools* (which deal with cooperative arrangements of various kinds).



China – Banking & Finance Structure:



Banking & Finance Capability:

Transactional banking - Individual

- Debit cards (EFTPOS) widespread. Local credit cards in major cities very common
- ATM's widespread but mostly accept only local **China Union Pay** (CUP) cards. Visa/Mastercard (Maestro/Cirrus) ATM's less common even in larger cities.
- CUP aiming to be a Visa/MC/JBL competitor. Already accepted widely in some Asian countries (including NZ)
- Visitors, depending on how much they are spending and where they want to go, can often get by quite satisfactorily just using their FCy credit card. Would require using high degree of cash (eg few merchants outside western name brands will accept)
- No legal restriction on foreigner (resident or non-resident) opening a local savings account (and obtaining CUP debit card)
- Upon obtaining account number (depending upon the bank) easy to remit in money from overseas
- USD50k p.a FCy conversion limit. Transferring overseas easy via foreign bank; generally straightforward with local bank but can be dependant upon branch
- Transfer between accounts at other banks somewhat straightforward but on occasions problematic



Banking & Finance Capability:

Transactional banking - Company

- Cheques rare
- Mainly bank transfer
- China payments system efficient. Can transfer funds throughout the country. Issues will be branch and bank dependant
- Local bank capability re Cash Management limited
- Corporate credit card offerings limited but growing
- Documentation can be onerous – for transactional and lending / trading (eg trade finance)
- System remains very branch focused a la pre 1980's.
- Predominately a guanxi as opposed to business based model
- Transfer of FCy amongst companies not permitted i.e. essentially regarded as a new inward remittance requiring all requisite permissions etc
- A company registered offshore that operates an offshore foreign currency account is not governed by these regulations and therefore can remit foreign currency domestically (to other offshore accounts) and internationally



Microsoft Word Document



Microsoft Word Document



Corporate Structures:

Representative Office	WFOE	Joint Venture
<ul style="list-style-type: none"> ▪ Non-direct business ▪ Represents it's enterprise ▪ Engages in liaison services, marketing survey, product introduction, and technical exchange for it's enterprise. ▪ No capital investment. ▪ Cannot collect revenue in China – no profit repatriation issues. 	<ul style="list-style-type: none"> ▪ 100% owned by one or more foreign entities (generally is a limited liability company) ▪ Greater flexibility in terms of management and control ▪ Better intellectual property protection ▪ Easier to terminate ▪ More stringent investment restrictions ▪ Combination Chinese and foreign bank finance, term loans, working capital loans – parental support for foreign partner 	<ul style="list-style-type: none"> ▪ Must incorporate as a limited liability company ▪ Investment is evaluated and assigned as monetary value or valued 'cooperative conditions' ▪ Distribution of profits is in proportion to each shareholder's capital contribution or 'cooperative conditions' ▪ A board is required ▪ Combination Chinese and foreign bank finance, terms loans, working capital loans – parental support for foreign partner



Account Types:

Accounts, payments and CNY conversion - There are numerous restrictions on the settlement of CNY and the bank account that these activities can take place through. Bank accounts required are outlined.

Account type

Account features

Capital account

For overseas foreign currency injection only, which can't be over approved total investment amount. Account is closed after the incorporation process is completed

Foreign currency account

Foreign currency settlement account for international trade and non trade purposes

CNY Basic Account

CNY bank account, for cash withdrawals, petty cash and payroll etc. Usually located close to your office, PBOC Approval (1 only)

CNY General Account

For business income and expenditure (i.e. run your business through this account (Accounts payable, receivable, rent, remittances and Borrowing etc)

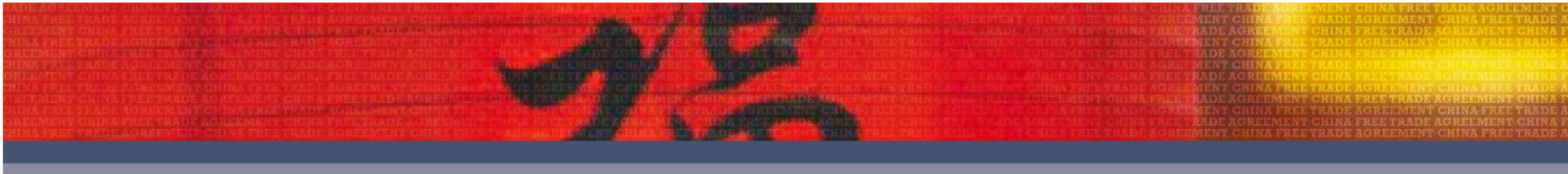
Note: Cash cannot be withdrawn from this account



Payment Types:

Allowed payments	Any approved overseas trade / non trade payments that can be evidenced by supporting documents
Trade payments	Imported goods – materials, components, machines and equipment. Require evidence including contracts, invoices shipping documents and customs Declaration forms
Non Trade payments	Dividends, royalties, franchise fees, licensing fees, technical guidance, patents etc Dividend payments audited financial statements, board resolution, capital verification certificate, income tax certificate and foreign currency registration book Other non trade payments – contract, invoice, registration sued by relevant authority and withholding tax payment evidence. Must be within business scope
CNY General Account	CNY may be converted to foreign currency to make any current account allowed payments
Capital Account	Conversion under capital account requires SAFE approval (foreign debt repayment etc.)





	Bank acct openings		Domestic funds Remittance		International Funds Remittance	Profit Repatriation
	RMB	FCy	RMB	FCy	RMB Conv. to FCy	FCy
PERSONAL BANKING						
Foreign Individual	Y	Y	Y	N	Y ¹	N/A
Domestic Individual	Y / N ²	Y	N	Y ⁴	Y ³	N/A
BUSINESS BANKING						
Offshore	N	Y	N	Y	N/A	N/A
Rep Office	Y	Y ⁵	Y	N	Y	N
JV	Y	Y	Y	Y	Y	Y
WFOE	Y	Y	Y	Y	Y	Y

¹ Amount for conversion is in accordance to evidence of foreigner's respective salary and tax receipts for tax paid.

² Domestic individuals can only open RMB term deposit account with unincorporated foreign bank if > 1m RMB

³ < USD 50K per domestic (Chinese) individual per ID card. > USD50K require SAFE approval.

⁴ Remit FCy funds only to oneself and/or parent, spouse, children

⁵ FCy settlement account opening (not capital account opening)



Borrowings in CNY and FCY:

Domestic Foreign Exchange Loans

Foreign companies can borrow loans in foreign currency but one designated loan account can only be opened for one loan and the account should be cancelled when the loan is repaid

When the debtor settles the loan and interest, he/she shall first use own foreign currency. Only the insufficient portion should be exchanged. Generally speaking, the domestic foreign currency loan cannot be exchanged into CNY.



Borrowings in CNY and FCY:

There are numerous restrictions on the borrowings of CNY and FCY and frequently change. Current bank accounts required are outlined.

CNY Loan with Foreign Guarantees

Foreign company can borrow CNY loan with a guarantee from Parent company as security but the foreign debts of a debtor incurred from the guarantor's performance should be no more than the difference between its investment amount and its registered capital (ratio generally 2~3 times).

In case the foreign debts of a debtor incurred from the guarantor's performance is more than the difference between its investment amount and its registered capital, the local foreign exchange bureau may handle the registration of foreign debts for the debtor after imposing proper punishments

If the CNY loan is guaranteed by own foreign exchange, funds must come from its current or capital account. Domestic foreign exchange loan cannot perform as a guarantee.



Trade Finance:

- **Documentation and FCy exchange onerous, hard to define exactly and often dependant upon individual bank view.**
- Customer must get approval to undertake import/export business
- Open account with desired bank
- Examples of key documents to undertake trade:
 - ✓ customs declaration from China customs,
 - ✓ Verification sheet from SAFE,
 - ✓ the contract or the invoice,
 - ✓ Payment instructions,
 - ✓ E-card for online registration of the payment etc.
 - ✓ Other documents also need to be provided depending on different payment methods or type of enterprise

Key point is that the market for FCy is heavily regulated and whilst there are broadly clear national regulatory requirements, within this it varies from bank to bank and province to province. All documents are used to prove the authenticity of the import business. There are numerous regulations and policies issued by different administrative institutions.



Interest Rates:

Interest rates – heavily regulated by PBOC

All RMB, and USD/EUR, HKD and JPY deposit rates for amounts < USD3m equiv. are set by PBoC.

RMB lending rates have floor / FCy no limit

Local currency deposit

Deposits	Current	1 day Call	7 days Call	3 months	6 months	1 year	2 years
Interest rate	0.7200%	1.1700%	1.7100%	2.8800%	3.2400%	3.6000%	4.1400%

Local currency loan

Loan	< 6 months	6 months - 1 year	1 year - 3 years	3 years - 5 years
Interest rate	6.03%	6.66%	6.75%	7.02%

US dollars deposit

Deposits	Current	1 month	3 months	6 months	1 years	2 years
Interest	1.1500%	2.2500%	2.7500%	2.8750%	3.0000%	3.1500%

