

# **Asian Development Bank and the People's Republic of China:**

## **Partnership in the Financial Sector**

May 2005

### **Executive Summary**

The financial sector in the People's Republic of China (PRC) has supported the country's rapid economic growth, and it also has borne the cost over the past two decades. As in other transition economies, excessive government intervention and slow in reforming the property rights has led to a number of major challenges, salient among which is the hefty level of non-performing loans in the banking industry, large amount of non-tradable shares in the securities markets, dwindling financial sustainability of the social security system, and limited small- and medium-sized enterprises and rural financing. Meanwhile, weak governance structure is the crosscutting issue among all financial industries and markets.

The Asian Development Bank (ADB) has supported the development of the PRC's financial sector mainly through policy oriented advisory technical assistance (TA). Since 1987, ADB has provided 64 TAs for about \$37.4 million ranging from banking, insurance, securities, social security system as well as public finance management. These TAs supported the establishment of legal and regulatory framework, strengthening of governance structure, designing of operation procedures, as well as institutional and human resource capacity building.

Other countries' experience has shown that financial sector reform poses most difficult challenges in transiting from a centrally planned to a market based economy. ADB has supported the Government in dealing with some challenges in the past, and is committed to support the Government in completing this transition in the future.

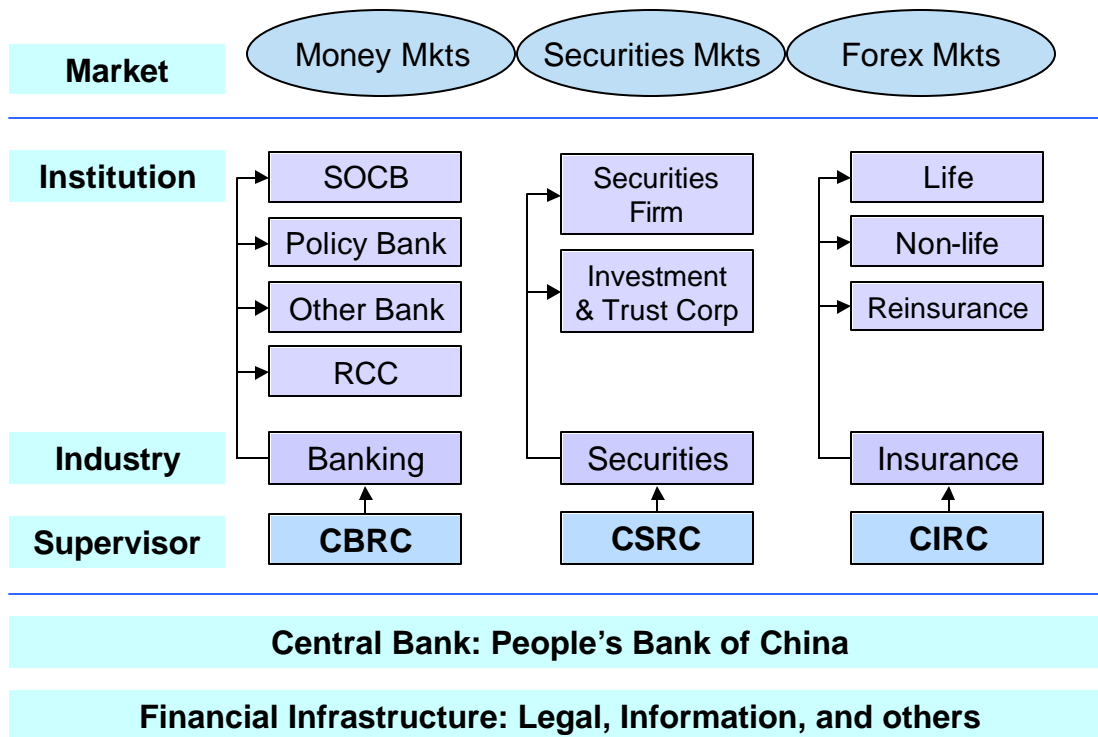
## I. The Financial Sector in the People's Republic of China

### A. Sector Profile

1 The financial sector in the People's Republic of China (PRC) is critical in sustaining the country's rapid economic growth, and has experienced drastic expansion along with the economic development since early 1980s. By 2002, the total financial assets amounts to \$3.1 trillion, 244 percent of the gross domestic products. The financial assets to GDP ratio is equivalent to the level of the U.S. (236 percent). The total deposit to GDP ratios stands at (CNY23 trillion/6) 384 percent in 2003, above the ratios for other emerging economies.

2 The PRC's financial sector consists of banking, securities and insurance industries, and these industries are active players in money, securities (stocks and bonds) and foreign exchange markets. The banking industry plays an overwhelming role in the PRC's financial sector. In 2002, banking sector assets comprise of 77 percent of the financial assets, followed by a remote second of stock market capitalization which counts for 15 percent of the total. Bond ranks the third with 9 percent of the share, of which less than 1 percent are corporate bond and the remaining government securities. This contrast to the financial structure of the U.S. where the stock market capitalization counts for 45 percent of the financial system, while bank assets only amounted to 26 percent in the same year.

**Figure 1. Structure of the Financial System in PRC**



Note: SOCB means state-owned commercial banks, RCC means rural credit cooperatives, CBRC means China Banking Regulatory Commission, "Forex Mkt" means foreign exchange markets, CSRC means China Securities Regulatory Commission, CIRC means China Insurance Regulatory Commission.

### Overview of PRC' s Financial System

**Banking.** There are 4 large state-owned commercial banks (SOCBs), 3 policy banks, 10 joint-stock banks, 112 city commercial banks, and around 150 foreign bank branches. The banking sector has total assets of RMB47,720 billion as of November 2003, and employs more than 2 million people. The SOCBs and policy banks devote most of their lending to SOEs or designated development projects, while the joint stock and city commercial banks are more private-sector oriented and generally lend to smaller and medium-sized enterprises (SMEs). The total amount of loan outstanding is RMB20,000 billion as of 2003, with the 2003 new lending of around RMB2,900 billion.

**Rural Finance.** The PRC rural financial system comprises a policy bank (the Agricultural Development Bank of China), a commercial bank (the Agricultural Bank of China) and the rural credit cooperatives (RCCs) system. By latest count, there are over 30,000 RCCs and accounts for 13% of deposits and 10% of loans of the banking sector, and 60% of agriculture loans. Survey shows that only 15 percent of PRC's 240 million rural families have access to credit, the others have to turn to the private creditors.

**Insurance.** The insurance industry has been developing at an annual growth rate of more than 30 percent over the past 20 years. In 2003, the gross premium reached RMB388 billion, 3.5 percent of GDP. This translated to a per capita insurance expenditure of RMB287 (\$29), comparing to the world average of \$423. As of 2002, there are 57 insurance companies with a total employment of 1.5 million, of which 1 re-insurance company, 4 holding companies, and 22 life insurance companies. In addition, there are 160 insurance intermediary companies, including brokers, loss adjusters, and consulting companies. By mid-2003, 36 foreign insurers have received permission in operations in PRC. The total assets of these insurance companies amounted to RMB921 billion, 41.5 percent more than that of 2002, or around 4 percent of the total financial assets.

**Securities Markets.** The securities markets have been developing at fast speed. Currently, PRC has 1290 listed companies of January 2004, up from 752 in the beginning of 1998. The total market capitalization is RMB4,546 billion, a whopping growth rate of around 17 percent per year since 1998. Nevertheless, the total market capitalization for tradable share is only RMB1430 billion, less than one third of the total market value.

**Social Security.** Prior to 1978, Chinese workers received lifelong employment and pensions payments from employers. The Social Security Fund, unifying more than 800 pension schemes nationwide, was established in 2000 under the National Council for Social Security. As of March 2003, the Fund controls about RMB124 billion, a little over 1 percent of GDP.

3 The financial sector operates on a set of financial infrastructure, including legal framework and financial information system. Among other laws, the following are important in underpinning the commercial and financial activities: (i) Civil Code (1986), (ii) Companies Law (1993), (iii) Contract Law (1999), (iv) Price Law (1997), (v) Enterprises Bankruptcy Law (1986), (vi) Law on Negotiable Instruments (1995), (vii) Trust Law (2001), and (viii) Labor Law (1994). The financial information system builds on the Accounting Law (1985), Law on Registered Accountants (1993), Accounting Standards for Enterprises, Accounting Standards for Financial Institutions, Financial Management Norms for Enterprises, and Financial Management Norms for Financial Institutions. The Ministry of Finance is authorized to set and interpret the accounting and auditing standards and implement related regulations. The special regulations for commercial

enterprises, insurance companies, and collaborate institutions were also issued. Nevertheless, it will take another few years before PRC's accounting standards to be fully in line with the international accounting standards.

4 The legal base of the financial sector regulation and supervision consists of a number of laws and related implementation decrees and regulations. The laws and major regulations include:

- (i) Law on the People's Bank of China (adopted in 1995 and amended in 2003), which legalized the People's Bank of China as the central bank and separated its commercial banking function;
- (ii) Law on Commercial Banks (adopted in 1995 and amended in 2003), which segregates the banking, insurance and securities business, enables the big four state-owned banks to become genuine commercial banks free of policy directed loan operation;
- (iii) Law on Supervision of the Banking Industry (adopted in November 2003), which authorized the China Banking Regulatory Commission's legal status as a bank supervisor;
- (iv) Securities Law (adopted 1998, and under amendment), which set out the requirements for share issuance, trading, and code of conducts for listed companies, stock exchanges, securities intermediaries, self-regulatory associations, and established the China Securities Regulatory Commission (CSRC) as the supervisory agency for the stock markets;<sup>1</sup>
- (v) Insurances Law (1995, and amendment in October 2002), which specified the licensing and operation of the insurance companies, and established the China Insurance Regulatory Commission (CIRC) as the regulatory and supervisor; and
- (vi) Decision on the Establishment of a Unified Basic Old Age System for Enterprise Staff and Workers (Decision 26, 1997), which outlined the conceptual framework for a multi-pillared pension system to replace the pay-as-you-go scheme. The two other piece of regulations on social security include "Decision on the Establishment of a Basic Medical Insurance System for Urban Staff and Workers" (1998) and the Unemployment Insurance Regulations (1999).

5 Prior to 1998, PBOC is the regulatory for banks, insurance companies, and other financial institutions. In 1998, the regulatory function of the insurance companies and securities markets were carved out with the establishment of CIRC and the transfer of the power to CSRC, which was established in 1992. In addition, the National Council for the Social Security Fund as established in 2000, and part of its responsibility is to oversee the management of the pension fund.

## **B. Issues and Constraints**

6 While the financial sector has had tremendous improvement over the past two decades, it has born some of the costs during China's transition from a centrally planned

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<sup>1</sup> Note that the regulatory function of the bond markets is shared by the People's Bank of China (for financial institution bond), the Ministry of Finance (for government bonds), and the National Development Reform Commission (for corporate bonds).

to a market based economy. The excessive government intervention and slow in reforming the property rights has led to a number of problems – high non-performing loans; weak corporate governance structure; weak risk management and credit appraisal systems; controlled interest rates preclude the pricing of risk and weaknesses in the legal and regulatory framework. In practice, majority of private sector enterprises and the rural sectors do not have access to credit.

## 1. Banking Sector

7 **Non-performing loan.** The official estimate of the non-performing loan (NPL) NPL ratio of nearly 20% is much higher than that of other countries and the loan loss reserves are seen as under-provisioned in many banks. Foreign analysts have estimated a much higher NPL ratio. The Government has taken several steps to accelerate the disposal of NPLs: (i) banks signed agreements with foreign financial institutions about the cooperation in resolution of NPLs in 2003; (ii) capital injections to the big four banks strengthened their capital base and will allow them to bear larger losses from provisions and write-offs of NPLs; and (iii) a new bankruptcy law that gives more protection to creditors is likely to be adopted in the foreseeable future, which will allow banks to dispose NPLs through legal procedures more smoothly, and will create a legal framework to help reduce the flow of the new NPLs.

8 **Rapid Increase in Bank Lending.** Another potential risk is the rapid increase of bank lending in the past two years (14% in 2002; 20% in 2003). Much of the increase is associated with large investment projects. There is a risk of over-investment in some sectors and real estate bubble in some cities. This increases the risk of a new round of NPL accumulation if economic conditions change in the future. The Government is has taken some timely mitigation measures. The central bank raised the reserve rate in last August and CBRC has held several meetings with banks' top management to monitor credit expansion. Because of these efforts, the expansion of lending slowed down slightly in the second half of the last year, and PBC has set the target new lending in 2004 within CNY2600 billion, a CNY300 billion reduction from that in 2003.

9 **Governance Structure.** Weaknesses in the governance structure of commercial banks are serious concerns particularly for SOCBs and policy banks because of their financing structure<sup>2</sup> and lack of independent regulatory oversight. The State Council and Central Finance Working Committee of the Communist Party appoints all senior officials of SOCBs. Joint stock and local banks are also governed in the similar manner since most of their major shareholders are state-owned. Recognizing the challenges, the PBC has recently developed a governance model and framework, a performance monitoring and accountability system, and internal control mechanisms for SOCBs. The PBC has issued a Guideline on Independent Directors and External Supervisors of Share-Holding Commercial Banks aimed at strengthening corporate governance of commercial banks.

## 2. Securities Markets

10 **Nontradable State Shares.** A fundamental issue facing the market is that about 70% of the SOE shares and the legal persons are non-tradable. In August 2001, the Government decided to sell off 10% of the SOE holdings to mobilize funding for the

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<sup>2</sup> PBC lending to the 4 SOCBs amounts to more than RMB460 billion and lending to the three policy banks is more than RMB1 trillion.

social security system. However, the process was forced to stop as the stock market prices plunged by over 30%. The twisted share structure resulted in mismatch of the prices of the two different types of shares, and that the majority shares don't reflect the market performance of the stock. Starting early 2005, CSRC is conducting pilot tests to circulate the non-tradable shares for those listed companies with solid fundamentals.

11 **Corporate Governance.** The corporate governance of listed enterprises is weak in the following aspects:

- The control structure for SOEs is thinly spread across Government agencies and departments. For this, the Government established the State Asset Management and Supervision Commission in 2003 to improve the management of state owned assets;
- Opaque ownership structures;
- Poor internal control mechanism, with dominant management and Board of Directors, weak independent Board of Supervisors and inadequate protection of minority shareholder rights;
- Low or no professional requirements for membership in boards;
- Restrictions on resale of shares held by promoters and directors; and
- Poor disclosure practices, deficient accounting and auditing practices and misleading or fraudulent financial statements.

### 3. Social Security

12 The principal strategy of the social security system reform is the transition from a pay-as-you-go system to a multi-pillared system combining social pooling with individual accounts. The current system has five major defects:

- Systemic fragmentation with unbalanced coverage and a lack of affordability;
- A high Implicit Pension Debt of between 50 and 150 percent of GDP or between \$500 billion and \$1.5 trillion.
- Weak administrative structures and poor governance and accountability;
- Underdeveloped supplementary social security schemes such as private supplementary pensions and private supplementary health insurance; and,
- Underdeveloped legal, regulatory and supervisory frameworks for social security, the insurance industry and the capital markets.

### 4. Insurance Sector

13 The major constraints in insurance industry development include insufficient capital, inefficient fund management, and lack of human resources.

### 5. Private Sector and SME Development

14 As of 1999, only 12 percent of total SOCB lending was directed to private sector enterprises, and more than 80 percent of non-SOCB lending went to SMEs, particularly medium-sized enterprises. The Government policy framework still has inconsistencies and there is no suitable definition on what constitutes an SME. Other concerns relate to

practical constraints such as the high paid up capital requirements being imposed on joint venture firms. The incentive framework for SME development is not well articulated and needs rationalization and streamlining. The guarantee mechanisms promoted by different provincial governments are not operating on commercial principles and are being used by commercial bank dients which already have credit access but lack collateral to borrow.

## **6. Rural Finance**

15 PRC's agricultural sector and rural township enterprises contributed to more than 30 percent of the gross domestic product while receiving 5.19 percent of loans. A number of systemic constraints remain in enhancing the credit accessibility of the majority rural population. First, the farmers cannot use cultivated land, land use rights, or their houses as collateral to borrow from financial institutions. The use the first two as collateral is prohibited under the Guarantee Law, while farmers are unable to use their houses as collateral because the Government does not house certificates to self-built houses. This prevents them from borrowing from local credit cooperatives. Second, since the loans to the farmers are relatively small in sizes, the operational costs for financial institutions are higher than in the urban areas with larger lending sizes. Third, even though farmers are willing to borrow at higher interest rates, the interest rate band is heavily regulated for reasons of market order.

16 Rural financial institutions are also weak. A large number of RCCs suffer from low quality assets, high risks, and low efficient operation. Prior to the establishment of CBRC, PBOC was both the supervisor and the industry manager.

### **C. Recent Development**

#### **1. Banking Industry**

17 Year 2003 is a watershed period for the banking industry in China with significant progress made in strengthening legal and regulatory framework, strengthening the state-owned commercial banks, and widened interest rate band. First, CBRC was established in April 2003 and the Bank Supervision Law and the amendments to the Law on People's Bank of China (PBC) were adopted in December 2003. The separation of the supervisory function from the central bank, the new legal framework, and risk-based supervisory approach by CBRC will contribute to strengthen banking supervision by CBRC and risk management in banks. Second, the adoption of amendments to the Law on Commercial Banks in December 2003 freed the state-owned commercial banks from granting policy-oriented loans, and loosen the limits on investment by commercial banks.

18 Over the last four years, the SOCBs have closed more than 21,000 branch offices and reduced staff by more than 100,000. In January 2004, the Government made a \$45 billion capital injection into the Bank of China and the China Construction Bank to strengthen their capital base and support their listing on stock exchanges. Similar plans are expected for the Industrial and Commercial Bank of China and the Agricultural Bank of China. These are important steps to strengthen the four largest banks that are central to the PRC's financial system.

19 The band for interest rates at which banks can lend was widened from 10-30% to 70%. This step is expected to encourage banks to price risk and lending to small and

medium-sized enterprises and private sector which are perceived to be riskier than large enterprises. However, further interest rate liberalization is needed to allow banks to fully price their lending according to risks.

## **2. Securities Markets**

20 To restore confidence in the capital market, the CSRC has undertaken a number of measures, including the adoption of (i) a code of corporate governance based on OECD principles for listed companies and securities firms, (ii) regulations on independent directors stipulating that at least one third of the Board should be independent directors, and (iii) a code of ethics for CSRC and stock exchange professionals. Progress is underway to formulate regulations (i) prohibiting related party transactions, (ii) mergers and acquisitions, and (iii) changes in the quota system for allocation of initial public offering shares to a voluntary and merit-based application process. Greater access to the equity markets has also been provided to private companies and foreign joint ventures. These moves are expected to build the credibility of the CSRC as an effective market regulator and improve the efficiency of the capital market.

## **3. Insurance Industry**

21 In 2003, People's Property Insurance Corp. and China Life Insurance Corp. listed in the overseas securities exchanges, and the later made record high initial public offering of the year. The two listing raised a total capital of CNY35.4 billion equivalent.

## **4. Social Security System**

22 The Ministry of Labor and Social Security is continuing the pilot program in Liaoning province on a number of aspects, and one of which is the personal account. The program in Liaoning is being replicated in other provinces in the northeast region.

## **5. Rural Finance**

23 "Phased reform of rural credit unions" is aimed at establishing a competitive financial system in the financial sector roadmap outlined by the Prime Minister Wen. In July 2003, the State Council announced pilot programs to reform RCCs. Eight provinces participated in the program to transforming RCCs into rural commercial banks and rural cooperative banks. In 2004, these pilot programs expanded to 21 provinces.

## **II. ADB's Strategy and Experience in the PRC Financial Sector**

24 ADB's China Country Strategy<sup>3</sup> proposes a seven-point financial sector reform program:

- (i) resolving the NPL problem;
- (ii) diversifying ownership of financial institutions to improve corporate governance and market-based risk management and credit risk assessment;

<sup>3</sup> James Chan Lee, Li-Gang Liu and Masaru Yoshitomi. Policy Proposals for Sequencing PRC's Domestic and External Financial Sector Liberalization. ADB Institute. 2002. Tokyo.

- (iii) further strengthening financial regulators;
- (iv) deepening the equity and bond markets;
- (v) sequencing interest rate liberalization starting from lending to deposit and from long-term to short-term rates;
- (vi) phasing in capital-account opening after strengthening domestic institutions; and,
- (vii) at an appropriate time, adopting a more flexible exchange rate regime.

25 To materialize the strategy, ADB has supported financial sector reform in PRC through the provision of policy oriented technical assistance to the relevant government agencies. Since 1987, ADB has provided 60 TAs for about \$35 million to support the development of capital markets, insurance, banking, social security, non-banking financial institutions as well as the development of state-owned enterprises and small- and medium-sized enterprises (Appendix 1). These TAs supported the establishment of legal and regulatory framework, strengthening of governance structure, designing of operation procedures, as well as institutional and human resource capacity building.

26 ADB has been working with the Government to support the development of an efficient, competitive and modern banking system. Our support has covered (i) establishing the policy and institutional framework, (ii) improving the legal and regulatory environment, (iii) facilitating China's integration into the global financial market, and (iv) enabling the financial sector to play an important role in the transition to a market economy. In addition, ADB has provided assistance to Cinda AMC to help deal with the NPL problem. In the mid-1990s, ADB supported the development of a central payments system but this eventually did not materialize.

27 The capital market has been one of ADB's major areas of operation in the financial sector. Seven ADB TAs for more than \$4 million have facilitated: (i) the gradual development of basic policy, legal and regulatory framework for securities market; (ii) establishment of the National Electronic Trading in Securities System; (iii) finalization of the 1998 Securities Law that provided the legal basis for the CSRC with powers to operate as a sole regulator of securities market; and (iv) support to the CSRC to implement the Securities Law and strengthen institutional capabilities of CSRC and self-regulatory organizations at levels of securities exchanges and securities market participants.

28 ADB was the first donor to provide assistance to help develop CIRC as a regulatory and supervisory organization and prepare regulations and procedures to improve the management and market conduct of insurance companies. Modernizing the insurance sector can play a significant role in capital market development and social security reform.

29 ADB has provided a series of TAs since 1995 to support social security that helped to: (i) review pension reform issues and develop a blueprint of reform; (ii) formulate and implement the administrative, legal, regulatory, and supervisory frameworks of the new pension system; (iii) facilitate the development of financial and insurance markets in support of pension reform; (iv) examine policy issues for extending pension and health insurance schemes to rural areas; (v) promote the growth of capital markets and the insurance sector by strengthening regulations and oversight; (vi) advise Liaoning Province on the management of individual accounts, actuarial modeling and enhancement of the MIS with improved risk management; (vii) strengthen NSSF's

institutional capability; and (viii) improve the legal framework by supporting the drafting of the 2001 Trust Law and ongoing work to draft the Social Security Law.

30 ADB supported the development of the financing and legal infrastructure for SMEs to facilitate access to finance and promote private sector activity. This work has resulted in the drafting of the SME Promotion Law that was adopted in 2002. Work is underway to formulate the policies and regulations for SME Development Fund (SDF) and credit guarantee schemes based on the best international practice and develop effective structure of the SDF and its management in the State Economic and Trade Commission (SETC). ADB supported the All China Federation of Industry and Commerce to identify constraints faced by the domestic private sector, the output of which became an essential input into the PRC Private Sector Assessment. Corporate governance, financing, infrastructure, marketing, transparency, Government interference, local protectionism and lack of intellectual property rights protection were identified as some of the main constraints inhibiting the development of the private sector. ADB disseminated these findings and sought the views of the Government agencies and market participants on the design of potential reforms.

31 The TA on Improving Corporate Governance and Financial Performance of SOEs aimed at strengthening the Enterprise Performance Evaluation System (EPES) methodology and formulating methods to link evaluation outcomes with incentives to enhance productivity. This is achieved by integrating international practices in operational and financial performance analysis and assessment of corporate governance norms with the existing EPES.

32 Public finance management is another important area of ADB's assistance. Ongoing work related to fiscal reforms is design to support: (i) improving the linkage between the established policy priorities and budget formulation and resource allocation in key sectors; (ii) initiating a redesign of the internal control systems within the MOF and provincial finance bureaus to improve utilization of budgetary funds; (iii) assessing the current policy, institutional, legal, and regulatory arrangements for external debt management; (iv) formulating debt management guidelines that are consistent with international practices; and (v) developing proposals to consolidate all public debt management functions into a single unified framework.

### **III. Government Sectoral Development Policy**

33 In February 2004, the Prime Ministry outlined a financial sector roadmap in a conference. That is the PRC's financial sector development will focus on improving the competitiveness of the financial sector by: (i) restructuring the state-owned banks, (ii) phased reform of rural credit cooperatives, (iii) improving financial assets management companies, (iv) reforming the capital markets, (v) restructuring of insurance sector, and (vi) opening up the banking, securities and insurance sectors to overseas investment. Priority measures will include: (i) improving legal and regulatory framework, (ii) establishing of a unified corporate and personal credit information infrastructure, and (iii) improving the management of credit information institutions.

34 Although there is no official document on the detailed policy actions to be taken over medium-term to address the constraints of the financial sector, the Government has shown strong will in reforming the financial sector and has implemented strong measures to preclude system crisis. In the banking sector, the Government has taken

well-paced sequential actions to address the NPL issues by large capital injection in two of the better performed SOCBs, strengthening their capital base and internal control mechanism to prepare for the future public listing. And two other SOCBs are also expected to receive capital injection.

35 To development the securities markets, the State Council announced a 9-point policy statement in February 2004 which outlined the important issues and measures to be taken. The new manifesto is significant in several aspects. First, it emphasizes protection of public investor's interest, and adoption of market orientation in the capital market reform. Second, it outlines related policy actions to sustain the capital market development. These include, among others, emphasizing the importance of investment returns, encouraging investment fund development, resolving issues related in the transaction of state and public entities' shares of the state-owned entities, and improving relevant tax regulations. Third, it supports the phased introduction of second board, and development of bond markets, futures markets, as well as financial innovation. CSRC has also drafted a White Paper on PRC's Securities Markets, which is waiting to be released.

36 In February 2004, the MOLSS announced that the major focus of the year is to (i) ensuring the timely release of the pension; (ii) continue to expanding the pension coverage, and strengthening the collection process; (iii) establish a national pension network; (iv) enhance pension management; (v) actively promote corporate pension; and (vi) conduct pilot tests for city and township's social security system.

37 CIRC listed the following four areas are the main tasks for 2004: (i) complete the restructuring of the state-owned insurance companies into shareholding companies, (ii) improve the corporate governance, and establish internal control mechanisms of the insurance companies, (iii) guide more resources to small- to mediums-sized insurance companies, and (iv) allowing foreign insurance companies to be involved in health insurance, group insurance, pension (annuity) according to PRC's WTO Agreement.

#### IV. ADB's Future Operations

38 ADB's future operation in the financial sector will focus on:

- (i) **Strengthening poverty impacts** of the financial sector operations by:
  - a. Supporting social security reforms to broaden the coverage so that pensioners do not fall into poverty, and improving the institutional capacity and administrative efficiency of the social safety net to protect urban and rural poor. Development of supplementary pension schemes will provide alternative means of retirement provision for low income workers or workers with intermittent earnings, for whom participation in social insurance schemes may not be cost-effective. This would encourage labor mobility and economic activity. Ongoing ADB TA is supporting the drafting of the Social Security Law;
  - b. Supporting the reforms of the rural financial system and developing an effective microfinance mechanism. The immediate challenges are to (i) redefine RCCs' role in a market economy; (ii)

clarify ownership structure, restructure organizations, and strengthen management; (iii) improve financial soundness; (iv) establish proper regulatory and supervisory framework, and (v) improve RCCs' financial prudence by liberalizing interest rates. An effective microfinance scheme would achieve wider outreach in financial services and be profitable at the same time. One possibility is to encourage the licensed financial institution to adopt the so-called downscaling approach.

- (ii) **Supporting private sector and SME development** by improving the financial environment for private sector and SMEs, and supporting the Government's efforts to create an enabling environment for private sector development. ADB is working with various government agencies to support the formulation of policies and design mechanisms to facilitate SMEs' access to credit and equity financing and to develop an SME credit support system. Besides, ADB is exploring possibilities of projects directly with private sector, including private commercial banks.
- (iii) **Enhancing governance** by encouraging government agencies and financial institutions to adopt sound corporate governance standards in harmony with international best practices and strengthening legal, regulatory and supervisory framework. Also by ongoing policy dialogue supporting the amendment of the Company Law, Administrative Licensing Law, Commercial Registration Law, the Bankruptcy Law, strengthening institutional capabilities of financial market regulators and supervisors such as PBC, CBRC, CSRC and CIRC and industry associations, as well as set of minimum criteria to adhere to sound corporate governance standard by respective market participants;
- (iv) **Promoting sound and orderly growth of the capital markets** by strengthening oversight, market surveillance and enforcement functions of CSRC, developing governance and regulatory standards of the stock markets, securities associations and other bodies in line with the IOSCO guidelines and other best practices; and facilitating the Government's effort to strengthen corporate governance on listed companies; and
- (v) **Supporting reforms and restructuring of financial institutions** and help prepare for the intensified competition in financial sector brought by WTO accession by assisting the restructuring of state-owned financial institutions, strengthening regulatory and supervisory framework, taking concrete steps leading towards rate liberalization and capital account convertibility.

39 Moreover, ADB is discussing with the relevant Government agencies and securities firms on the issuance of the CNY bond in China. Although the issuance details are yet to be determined, the issuance of CNY bond will promote the development of the bond markets and the securities firms. In addition, ADB's private sector group is actively exploring opportunities in participating in the financial sector reform in the PRC.

**List of TAs in Finance and Governance****A. Banking**

1. Loan 845-PRC: China Investment Bank Project, for \$100 million, approved on 8 October 1987.
2. TA905-PRC: China Investment Bank, for \$400,000, approved on 8 October 1987.
3. TA918-PRC: Institutional Development of People's Bank of China, for \$350,000, approved on 5 November 1987.
4. TA1773-PRC: Institutional Development of People's Bank of China II, for \$100,000, approved on 30 October 1992.
5. TA2133: Developing the Performance Evaluation Capability of People's Bank of China, for \$100,000, approved on 9 August 1994.
6. TA2249-PRC: Upgrading Monetary Statistics, for \$260,000, approved on 20 December 1994.
7. TA2318-PRC: International Conference on Financial Sector Development in Southwest PRC, for \$100,000, approved on 6 April 1995.
8. TA2492-PRC: Institutional Strengthening of China Investment Bank, for \$500,000, approved on 21 December 1995.
9. TA2565-PRC: Everbright Bank of China, for \$100,000, approved on 8 May 1996.
10. TA2626-PRC: A Study of Foreign and Joint Venture Banks, for \$450,000, approved on 16 August 1996.
11. TA2658-PRC: Capacity Building of the Everbright Bank of China, for \$691,000, approved on 6 October 1996.
12. TA 2664-PRC: Institutional Strengthening of the State Development Bank of China, for \$500,000, approved on 16 October 1996.
13. TA2938-PRC: Developing National Automatic Payment System, for \$750,000, approved on 15 December 1997.
14. TA3098-PRC: Strengthening the Banking Supervision and the Liquidity Risk Management System, for \$825,000, approved on 20 November 1998.
15. TA3303-PRC: Institutional Strengthening of CINDA Asset Management Company, for \$800,000, approved on 24 November 1999.
16. TA3527-PRC: Institutional Strengthening Of China Development Bank, for \$600,000, approved on 20 October 2000.

17. TA3890-PRC: Banking Laws And Regulations, for \$800,000, approved on 25 June 2002.
18. TA4240-PRC: Foreign Bank Rating and Risk Management System, for \$400,000, was approved in December 2003.
19. TA4349-PRC: Strengthening of the Statistical System for the China Banking Regulatory Commission, for \$400,000, approved on 18 June 2004.

**B. Social Security**

1. TA1923-PRC: Study of Social Welfare and Labor Adjustments for Enterprise Reform, for \$573,000, approved on 3 August 1993.
2. TA2383-PRC: Fiscal Policy and Regulatory Framework for Social Security System Reform, for \$540,000, approved on 25 August 1995.
3. TA3148-PRC: Pension Reform, for \$2,400,000, approved in December 1998.
4. TA3607-PRC: Policy Support for Social Security Reform under Tenth Five-Year Plan, for \$150,000, approved on 21 December 2000.
5. TA3733-PRC: Policy And Institutional Support For The Social Security Reform Pilot Program, for \$1,000,000, approved on 2 October 2001
6. TA4201-PRC: Policy and Institutional Support for Social Insurance Administration, for \$700,000, approved on 21 October 2003.
7. TA4206-PRC: Advisory Support for the National Council for the Social Security Fund, for \$500,000, approved on 27 October 2003.

**C. Insurance**

1. TA3302-PRC: Capacity Building for the Insurance Sector Regulatory and Supervision System, for \$700,000, approved on 23 November 1999

**D. Securities markets**

1. TA 1516-PRC: Development of Securities Market, for \$600,000 approved on 27 May 1991.
2. TA 1748-PRC: Establishment of National Securities System, for \$100,000 approved on 19 August 1992.
3. TA 1887-PRC: Regulation and Supervision of Securities Markets, for \$600,000 approved on 17 May 1993.
4. TA 2512-PRC: Integration of Securities Markets, \$600,000 approved on 27 December 1995.

5. TA 3032-PRC: Legislation Drafting Support for PRC Securities Law, \$150,000 approved on 24 June 1998.
6. TA3304-PRC: Capacity Building of the Capital Markets' Regulatory System, for \$1,000,000, approved on 24 November 1999.

**E. Micro/Rural Finance**

1. TA1912-PRC: Preparation of Second Agricultural Bank of China Project, for \$591,000, approved on 23 July 1993.
2. TA2939-PRC: Reform of Rural Credit Cooperative, for \$997,000, approved on 15 December 1997.
3. TA3026-PRC: Strengthening Risk Management of the Agricultural Bank of China, for \$1,800,000, approved on 4 June 1998.
4. Loan1347-PRC: Second Agricultural Bank of China Project, for \$100 million, approved on 10 November 1994.
5. TA4430-PRC: Rural Finance Reform & Development of Microfinance Institutions, for \$1,000,000, approved on 9 November 2004.

**F. Nonbanking Financial Institutions**

1. TA1941-PRC: Study of Nonbanking Financial Institutions (SSTA 1993), for \$249,000, approved on 23 August 1993.
2. TA2443-PRC: Strengthening the Regulatory Framework for the Trust and Investment Industry (SSTA)
3. TA2952-PRC: Corporatization, Leasing and Securitization in the Road Sector (1997)

**G. Legal**

1. TA3000-PRC: Strengthening of the Legal Information System, for \$630,000, approved on 23 March 1998.
2. TA3279-PRC: Development of Economic Laws, for \$1,400,000, approved in September 1999.
3. TA3971-PRC: Enforcement of World Trade Organization Rules by the Judicial System, for \$400,000, approved on 4 November 2002.
4. TA4237-PRC: Support To The Review And Planning For Development Of The Legal And Judicial System, for \$350,000, approved on 4 December 2003.
5. TA4529-PRC: Competition Laws and Policy, for \$600,000, approved on 23 December 2004.

## **H. Private Sector Development/SME**

1. TA-PRC: Township and Village Enterprise (TVE) Development, for \$540,000, approved on 23 December 1993.
2. TA3493-PRC : Development of a Small- and Medium-sized Enterprises Credit Support System, for \$750,000, approved on 30 August 2000.
3. TA3534-PRC: Development of Financing Policies and Mechanisms for Small and Medium-Sized Enterprises, for \$700,000, approved on 10 November 2000.
4. TA3543-PRC: Private Sector Development, for \$600,000, approved on 14 November 2000.
5. TA3930-PRC: Development of Small and Medium Enterprise Alternative Financing Mechanism, for \$150,000, approved on 24 September 2002.
6. TA4350-PRC: Development of SME Credit Guarantee Companies, for \$550,000, approved on 18 June 2004.

## **I. Governance & Public resource management**

1. TA1483-PRC: Audit Administration of the People's Republic of China, for \$600,000, approved on 21 February 1991.
2. TA1593-PRC: Supporting Policy Analysis in the Ministry of Finance, for \$599,000, approved on 2 January 1992.
3. TA1923-PRC: Public Enterprise Reform Study, for \$600,000, approved on 3 August 1993.
4. TA2118-PRC: Study of Subprovincial Fiscal Relations, for \$500,000, approved on 28 June 1994.
5. TA2186-PRC: Strengthen the Legal Framework for Customs Administration, for \$585,000, approved on 18 October 1994.
6. TA2257-PRC: Enterprise Accounting System Reform, for \$345,000, approved on 21 December 1994.
7. TA2271-PRC: State Enterprise Insolvency Reform, for \$590,000, approved on 24 December 1994.
8. TA2288-PRC: Institutional Strengthening of Commercial Finance, Management and Accounting, for \$830,000, approved on 12 January 1995.
9. TA2748-PRC: Restructuring of Insolvent State Enterprises, for \$600,000, approved on 27 January 1997. (OGC)
10. TA2924-PRC: Study of Municipal Finance, for \$600,000, approved on 27 November 1997.

11. TA3103-PRC: Strengthening the Government Auditing System, approved on 28 November 1998.
12. TA3253-PRC: Strengthening Public Infrastructure Investment Policy, for \$600,000, approved on 8 September 1999.
13. TA3713-PRC: Strengthening The Accountancy Profession, for \$600,000, approved on 5 September 2001
14. TA3806-PRC: Study of Foreign Capital Utilization in Western Region, for \$550,000, approved on 18 December 2001.
15. TA3933-PRC: Improving Corporate Governance And Financial Performance Of State-Owned Enterprises, for \$500,000, approved on 25 September 2002.
16. TA3979-PRC: Fiscal Management Reforms, for \$875,000, approved on 8 November 2002.
17. TA3980-PRC: Strengthening Public Debt Management, for \$400,000, approved on 8 November 2002.
18. TA4365-PRC: Policy Reform Support, for \$450,000, approved on 26 July 2004.
19. TA4399-PRC: Agricultural Taxation Reform, for \$500,000, approved on 29 November 2004.