



# Technical Assistance Report

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Project Number: 36024  
December 2005

## Technical Assistance People's Republic of China: National Fund for Development of Credit Guarantees for Private Enterprises

Asian Development Bank

## CURRENCY EQUIVALENTS

(as of 30 November 2005)

Currency Unit	–	yuan (CNY)
CNY1.00	=	\$0.12
\$1.00	=	CNY8.0

## ABBREVIATIONS

ADB	–	Asian Development Bank
CGC	–	credit guarantee company
EA	–	executing agency
MOF	–	Ministry of Finance
NCG	–	National Fund for Development of Credit Guarantees for Private Enterprises
NDRC	–	National Development and Reform Commission
PBC	–	People's Bank of China
PRC	–	People's Republic of China
SBA	–	Small Business Administration
SME	–	small and medium-sized enterprise
SBS	–	Small Business Service
SOE	–	state-owned enterprise
TA	–	technical assistance

## TECHNICAL ASSISTANCE CLASSIFICATION

<b>Targeting Classification</b>	–	General intervention
<b>Sector</b>	–	Finance
<b>Subsector</b>	–	Finance sector development
<b>Theme</b>	–	Private sector development
<b>Subtheme</b>	–	Private sector investment

## NOTES

- (i) The fiscal year of the Government ends on 31 December.
- (ii) In this report, "\$" refers to US dollars.

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<b>Director General</b>	H. S. Rao, East and Central Asia Department (ECDR)
<b>Director</b>	A. Siackhachanh, Governance, Finance, and Trade Division, ECRD
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## I. INTRODUCTION

1. The Government of the People's Republic of China (PRC) requested the Asian Development Bank (ADB)—during the 2005 country programming mission—for technical assistance (TA) to establish the National Fund for Development of Credit Guarantees for Private Enterprises (NCG). A fact-finding mission visited Beijing 8–15 July 2005 and reached an understanding with the Government on the impact, outcome, cost, financing arrangements, terms of reference, and implementation arrangements for the TA.<sup>1</sup> The design and monitoring framework is in Appendix 1.

## II. ISSUES

2. Over the past 15 years, the PRC's gross domestic product has grown by more than 8% per year. The private sector has been growing faster than state-owned enterprises (SOEs), and is contributing an increasing share to economic growth and job creation.<sup>2</sup> The Government has made commendable efforts to remove constraints on private-sector development, including (i) amending the constitution to provide a legal foundation for the private sector and protect legal property rights; (ii) diversifying ownership of SOEs and encouraging mergers and acquisitions; and (iii) promoting equal treatment for investment, financing, taxation, land use, and foreign trade. The State Council Document No. 3<sup>3</sup> specifically removed entry barriers for private enterprises to operate in previously state or SOE-controlled sectors—such as finance, insurance, energy, urban development, environment protection, education, and healthcare. The same Document also enhanced government support for financial services to private enterprises.

3. Despite the rapidly growing importance of private enterprises in the PRC, most of them have had difficulty accessing financial services. Private enterprises are often perceived by banks as less creditworthy, mainly because of lack of business track records and quality assets for collateral. Unlike SOEs that enjoy effective government support, most private enterprises do not have access to financing support from international organizations and other foreign sources. On the other hand, there is excess liquidity in the banking sector as banks are not willing to lend to private enterprises unless loans are guaranteed by third parties.

4. The Government has facilitated the establishment of credit guarantee companies (CGCs) to address market failures—regulated interest rates and asymmetric information—to give private enterprises access to finance. ADB has supported comparative studies of international credit guarantees to promote the development of private enterprises, including those of USA, UK, and Japan.

5. Many local governments and business communities established CGCs in the mid-1990s. By the end of 2004, more than 3,000 CGCs and reguarantee companies were registered.<sup>4</sup> Some CGCs have made progress in the past few years, particularly in the areas of institutional capacity, risk management, recognition and registration of collateral, and providing better value-added services to private enterprises (such as market access and managerial training). However, serious challenges remain for the CGC industry—including limited coverage; limited

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<sup>1</sup> The TA first appeared in *ADB Business Opportunities* (Internet edition) on 16 May 2005.

<sup>2</sup> Only 90,581 private enterprises were registered by the National Bureau of Industry of Commerce in 1989. This has increased 33 times from 1993 to 2003; registered capital has increased 52 times; employment has risen 12 times; and revenue has increased 48 times. By 2004, there were 3.44 million private enterprises with a total registered capital of 4,214 billion yuan (CNY), 47 million employees, and revenue of CNY2,008 billion.

<sup>3</sup> “Policy Directives Regarding Encouraging the Development of Private Sector”, issued on 19 February 2005.

<sup>4</sup> Despite a large number of CGCs in operation, in aggregate they serve less than 10% of total number of SMEs and meet 1–3% of financing needs of SME borrowers. Cumulatively by mid 2004, these CGCs supported over 48,000 SME borrowers with a total of CNY126.7 billion, representing a multiplier of 4.4 times.

financial, technical, and risk management capability; lack of risk-sharing arrangements with banks; lack of a consistent regulatory system; and lack of risk transferring and sharing mechanisms (such as coguarantees and reguarantees).

6. The PRC has been the most attractive destination for foreign capital in Asia for more than a decade, primarily attracted by immense market potential and competitive factor prices. However, the domestic private sector—particularly small and medium-sized enterprises (SMEs)—has not been able to tap into these financial resources. Foreign financial institutions, including ADB, find it hard to formulate practical projects for private sector finance because of lack of effective intermediation mechanisms to channel financial support.

7. In an effort to facilitate the use of foreign capital in private sector development, the National Development and Reform Commission (NDRC) recently completed a detailed NCG proposal, aimed at attracting funding support from foreign and domestic resources—particularly from institutional investors—to support private sector finance. The NCG is expected to have following features:<sup>5</sup>

- (i) The fund's objective is to (a) support private sector development in the PRC by facilitating access to finance, and (b) establish an effective institutional framework and funding mechanism at the central government level to streamline development of the CGC industry.
- (ii) The fund will be multi-tranched with the first tranche targeted at \$1 billion equivalent. Funding sources will include (a) loans from international donors, (b) grants from international donors, and (c) capital contributions by private enterprises.
- (iii) The NCG's scope of business will be to support CGCs through equity investment, loans, coguarantees, and reguarantees. In the case of equity investment, the exit strategy will include initial public offerings, buy-backs, and mergers and acquisitions.
- (iv) NCG income will be from investment yields, loan interests, coguarantee and reguarantee fees, and advisory service fees.
- (v) The sponsors will ensure that NCG adopts (a) sound corporate governance principles, (b) market-based operations, (c) high standard of internal control (particularly regarding risk management), (d) highest degree of professionalism among its staff, and (e) minimum state interference.
- (vi) NCG will be managed by one or more professional fund management companies and custodians, which will be competitively selected and approved by financial market regulators.

8. NDRC has worked in close coordination with other ministries—particularly the Finance Department of the Ministry of Finance (MOF) and People's Bank of China (PBC)—to develop the NCG proposal. By the end of 2004, a concept paper had been submitted to the State Council and received positive endorsement. NDRC has invited ADB to participate in the establishment and operation of the NCG through financing and technical support.

9. Development of the private sector and private enterprises is a strategic objective of ADB. ADB's operational objectives are to facilitate private enterprises' access to finance and promote the development of the financing and legal infrastructure for private enterprises. ADB helped draft the SME Promotion Law (29 June 2002) and establish policy and regulatory framework for

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<sup>5</sup> Subject to State Council's approval.

SME CGCs, based on international best practice, through previous TAs.<sup>6</sup> ADB also helped the All-China Federation of Industry and Commerce to identify constraints faced by private enterprises and the domestic private sector,<sup>7</sup> whose output became an essential input into the PRC private sector assessment.<sup>8</sup> ADB disseminated these findings and sought the views of government agencies and market participants on the design of potential reforms. Through joint-efforts of ADB's public and private operations, ADB's Private Sector Department made an equity investment in a majority private-owned CGC.<sup>9</sup>

### III. THE TECHNICAL ASSISTANCE

#### A. Impact and Outcome

10. The TA will improve private enterprise access to financial services and financial resources. NCG is expected to be an effective and sustainable mechanism for the use of foreign and private sector capital for private enterprises. The TA will assist in the effective use of NCGs, ensuring timely drawdown of NCG proceeds while maintaining prudent risk exposure and complete compliance with regulatory requirements, in line with international best practices.

#### B. Methodology and Key Activities

11. The TA will establish a proper NCG fund governance structure to maximize political, financial, economic, and social impacts; and optimize risk and capital allocation for NCG, while ensuring regulatory compliance and financial sustainability, specifically to

- (i) address policy and regulatory issues necessary to establish NCG, assess the level of funding required, identify potential NCG funding sources and scope of operations, and design a fund governance structure aimed at optimizing political, financial, economic, and social impacts, by
  - (a) reviewing the existing government policy and regulatory environment for special purpose funds (such as the NCG) and identifying a strategy for NCG's establishment;
  - (b) examining demand and supply of private enterprise credit guarantees, the competitive landscape of CGCs, and cost of capital;
  - (c) evaluating major benefits and costs of NCG operations and measuring development effectiveness in terms of business performance, economic sustainability, private sector development, foreign capital utilization, and streamlining of government functionalities; and
  - (d) conducting thorough financial and economic analyses and poverty analysis for NCG, and formulating a capacity building and training program for NCG staff.

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<sup>6</sup> (i) ADB. 2000. *Technical Assistance to the People's Republic of China for the Development of a Small and Medium-Sized Enterprise Credit System*. Manila; (ii) ADB. 2000. *Technical Assistance to the People's Republic of China for the Development of Financing Policies and Mechanisms for Small and Medium-Sized Enterprises*. Manila; (iii) ADB. 2002. *Technical Assistance to the People's Republic of China for the Development of Small and Medium Enterprise Alternative Financing Mechanism*. Manila; (iv) ADB. 2004. *Technical Assistance to the People's Republic of China for the Development of Small and Medium-Sized Enterprise Credit Guarantee Companies*. Manila.

<sup>7</sup> ADB. 2000. *Technical Assistance to the People's Republic of China for Private Sector Development*. Manila.

<sup>8</sup> ADB. 2003. *Private Sector Assessment*. Manila

<sup>9</sup> ADB. 2004. *Shenzhen Orienwise Guarantee and Investment Co. Ltd*, Manila.

- (ii) establish efficient NCG administration and operations by optimizing risk and capital allocations while ensuring regulatory compliance, by
  - (a) ensuring only fund managers with proven track records and good internal risk controls are selected to manage NCG, and adopting international guidance on management standards;
  - (b) establishing an effective monitoring and supervision mechanism for fund managers and custodians;
  - (c) identifying key management issues and potential legal risks in implementing contracts with fund management companies and custodians; and
  - (d) recommending policies to ensure efficiently coordinated information exchange within NCG and monitor investment managers and custodians, performance review, and external audit.
- (iii) adopt prudent risk management standards for NCG and achieve financial sustainability, through
  - (a) analyzing various types of risks faced by NCG and recommend risk mitigation measures. These will include, but not be limited to, macroeconomic risk, market risk, key personnel risk, exit risk, legal and regulatory risks, risk of government intervention, and general business risks;
  - (b) developing eligibility criteria for obtaining NCG support in forms of equity debt, reguarantee and coguarantee, and assistance for institutional strengthening based on sound banking, commercial, and financial principles;
  - (c) preparing operational guidelines for CGC credit analysis and provide a uniform set of norms embracing internal controls and prudential/operational standards; and
  - (d) streamlining business scope and plans for investee guarantee or reguarantee companies, implementing a comprehensive training program for investee CGC staff (with special emphasis on risk assessment, rating, pricing, and management concepts), and ensuring social and environmental safeguards.

### **C. Cost and Financing**

12. The total cost of the TA is estimated at \$900,000 equivalent, comprising \$420,000 in foreign exchange costs and \$480,000 equivalent in local currency costs. The Government has requested ADB to finance \$700,000 equivalent, covering the entire foreign exchange costs and \$280,000 equivalent of the local currency costs. The TA will be financed on a grant basis by ADB's TA funding program. The Government will provide the remaining \$200,000 of local currency costs in kind, to cover office accommodation, counterpart staff, transportation, and other related services. Detailed cost estimates are in Appendix 2.

### **D. Implementation Arrangements**

13. NDRC's Foreign Capital Utilization Department will be the Executing Agency (EA). A leading group will be set up comprising officials of NDRC, MOF, and PBC to provide policy guidance for NCG operations as well liaison with other relevant ministries and government bodies. The Director of Loan Division II of the NDRC's Foreign Capital Utilization Department

will be the overall coordinator of the leading group. The EA will provide the necessary office space, counterpart staff, transportation, and other services to the consultants and will arrange meeting appointments for the consultants with relevant agencies and organizations.

14. The TA will engage three international consultants for a total of 9 person-months, including a fund governance specialist (3 person-months), a fund operations specialist (3 person-months), and a risk management specialist (3 person-months); and six domestic consultants for a total of 18 person-months, including a fund governance specialist (3 person-months), a legal specialist (3 person-months), a fund management company specialist (3 person-months), a custodian specialist (3 person-months), a risk management specialist (3 person-months), and a social impact and safeguard specialist (3 person-months). There is a separate budget to engage additional international and domestic specialists for specific technical areas during TA implementation, as the need arises. The consultants' terms of reference for consultants are in Appendix 3. The consultants will be selected and engaged on an individual basis in accordance with ADB's *Guidelines on the Use of Consultants* and other arrangements satisfactory to ADB on the engagement of domestic consultants. Equipment will be purchased in accordance with ADB's *Guidelines for Procurement*. Overseas training will be organized in neighboring Asian countries which have government-sponsored operations similar to NCG. Such training will target 10–20 key NCG personnel to give them first-hand experience of live operations.

15. The TA is expected to begin in October 2005 and end in December 2006. The consultants will submit (i) inception reports 2 weeks after commencement of their services, (ii) interim progress reports every quarter during TA implementation, (iii) draft final reports before the conclusion of the contract, and (iv) final reports 2 weeks after incorporating comments from the EA and ADB. All reports must be submitted in English and Chinese. Workshops will be organized periodically to invite comments from international and domestic experts and disseminate report findings.

#### **IV. THE PRESIDENT'S DECISION**

16. The President, acting under the authority delegated by the Board, has approved the provision of technical assistance not exceeding the equivalent of \$700,000 on a grant basis to the Government of the People's Republic of China for the National Fund for Development of Credit Guarantees for Private Enterprises, and hereby reports this action to the Board.

## DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets/Indicators	Data Sources/Reporting Mechanisms	Assumptions and Risks
<b>Impacts</b> Improved access to financial services and financial resources by private enterprises	Reduced percentage of small and medium-sized enterprises with difficulty accessing finance from 80% to 50% by 2007  Streamlined policy and regulatory environment for use of foreign capital for private sector development	Reports by financial market regulators and industry professionals	<b>Assumption</b> Strong government commitment to private sector development
<b>Outcomes</b> Effective use of the National Fund for Development of Credit Guarantees for Private Enterprises (NCGs)	Timely drawdown of NCG proceeds while maintaining prudent risk exposure  Complete compliance with regulatory requirements in line with international best practices	Progress reports by consultants and the Executing Agency (EA)  Supervision by review missions	<b>Assumption</b> Effective coordination between government agencies to enable establishment of NCG
<b>Outputs</b> 1. Establishment of an effective and sustainable mechanism for use of foreign and private sector capital for private enterprises 2. Improved administration and operational efficiency of NCG 3. Prudent risk management standard for NCG	Adequate level of funding, clearly defined scope of operations, and prudent corporate governance structure  Optimization of risk and capital allocations for NCG  Adoption of sound corporate governance principles in NCG  Market-based operations for NCG  High standard of internal control within NCG, particularly regarding risk management  Highest degree of professionalism among NCG staff  Minimum government interference with NCG  Competitive selection of professional fund management company(ies) and custodian(s) for NCG	Progress reports by consultants and EA  Supervision by review missions	<b>Assumptions</b> Acceptance and implementation of sound recommendations by relevant government agencies  Close coordination between relevant government agencies
<b>Activities with Milestones</b> 1.1 Review existing policy and regulatory environment for special purpose funds such as NCG and recommend a strategy for its speedy establishment, while ensuring prudent corporate governance standards and institutional sustainability and accountability (December 2005) 1.2 Examine supply and demand of private enterprise credit guarantees, the competitive landscape of credit guarantee companies (CGCs), and their cost of capital (December 2005) 1.3 Evaluate major costs and benefits of NCG, and measure development effectiveness, including business performance, economic sustainability, private sector development, foreign capital utilization, streamlining of government functionalities (December 2005)			<b>Inputs</b> Three international consultants for a total of 9 person-months and six domestic consultants for a total of 18 person-months  Implementation of various tasks by

Design Summary	Performance Targets/Indicators	Data Sources/Reporting Mechanisms	Assumptions and Risks
<p>1.4 Conduct thorough financial and economic analyses and poverty analysis for NCG, and formulate a capacity-building and training program for NCG staff (March 2006).</p> <p>2.1 Ensure only fund managers with proven track records and good internal risk controls are selected to manage NCG, and adopt international guidance on management standards (June 2006)</p> <p>2.2 Establish effective monitoring and supervision mechanism for fund managers and custodians (June 2006)</p> <p>2.3 Identify key management issues and potential legal risks in implementing contracts with fund management companies and custodians (June 2006)</p> <p>2.4 Recommend policies to ensure efficiently coordinated information exchange within NCG, and monitor investment managers and custodians, performance review, and external audit (September 2006)</p> <p>3.1 Analyze various types of risks faced by NCG and recommend risk mitigation measures. These will include, but not limited to, macroeconomic risk, market risk, key personnel risk, exit risk, legal and regulatory risks, risk of government intervention, and general business risks (June 2006)</p> <p>3.2 Develop eligibility criteria for obtaining NCG support in forms of equity debt, reguarantee and coguarantee, and assistance for institutional strengthening, based on sound banking, commercial, and financial principles (June 2006)</p> <p>3.3 Prepare operational guidelines for CGC credit analysis and provide a uniform set of norms embracing internal controls and prudential/operational standards (September 2006)</p> <p>3.4 Prepare business plans for investee guarantee/reguarantee companies; implement a comprehensive training program for CGC investee staff with special emphasis on risk assessment, rating, pricing, and management concepts; and ensure social and environmental safeguards (September 2006)</p>			<p>international and domestic consultants</p> <p>Training sessions and seminar for NCG staff and policy makers</p> <p>Project administration and supervision by ADB</p> <p>Participation by stakeholders such as government agencies, financial institutions and private enterprises</p>

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**COST ESTIMATES AND FINANCING PLAN**  
(\$'000)

Item	Foreign Exchange	Local Currency	Total Cost
<b>A. Asian Development Bank (ADB)</b>			
<b>Financing<sup>a</sup></b>			
1. Consultants			
a. Remuneration and Per Diem			
i. International Consultants <sup>b</sup>	270.0	0.0	270.0
ii. Domestic Consultants <sup>c</sup>	0.0	160.0	160.0
b. International and Local Travel	30.0	10.0	40.0
c. Reports and Communications	0.0	10.0	10.0
2. Equipment <sup>d</sup>	0.0	20.0	20.0
3. Training, Seminars, and Conference			
a. Facilitators (Interpreters and Translators)			
	0.0	20.0	20.0
b. Domestic Workshop	0.0	20.0	20.0
c. Overseas Training	50.0	0.0	50.0
4. Miscellaneous Administration and Support Costs	10.0	0.0	10.0
5. Contingencies	60.0	40.0	100.0
<b>Subtotal (A)</b>	<b>420.0</b>	<b>280.0</b>	<b>700.0</b>
<b>B. Counterpart Financing</b>			
1. Office Accommodation and Transport	0.0	90.0	90.0
2. Remuneration and Per Diem of Counterpart Staff	0.0	70.0	70.0
3. Contingencies	0.0	40.0	40.0
<b>Subtotal (B)</b>	<b>0.0</b>	<b>200.0</b>	<b>200.0</b>
<b>Total</b>	<b>420.0</b>	<b>480.0</b>	<b>900.0</b>

<sup>a</sup> Financed by the Asian Development Bank's technical assistance (TA) funding program.

<sup>b</sup> \$30,000 is earmarked for additional international specialists and will be identified during TA implementation as the need arises.

<sup>c</sup> \$20,000 is earmarked for additional domestic specialists and will be identified during TA implementation as the need arises.

<sup>d</sup> Equipment to be purchased includes notebook computers, fax machines, scanners, data storage devices, and photocopiers. Upon completion of the TA, equipment will be transferred to National Fund for Development of Credit Guarantees for Private Enterprises (NCG).

Source: Asian Development Bank estimates.

## OUTLINE TERMS OF REFERENCE FOR CONSULTANTS

1. International consultants will introduce international expertise and best practices in credit guarantee company (CGC) fund formulation, provide advisory services on key technical issues to the National Development and Reform Commission (NDRC) team, disseminate lessons learned, and provide recommendations to policy makers and regulatory agencies regarding CGC development. Domestic consultants will assist NDRC's team in all technical aspects of the fund operation.

### A. International Consultants (9 person-months)

#### 1. Team Leader and Fund Governance Specialist (3 person-months)

2. The consultant will assume the role of team leader with responsibility for overall management of implementation of the technical assistance (TA), timely delivery of good quality interim and final reports, recruitment and management resource persons for various technical tasks, and organization of workshops and training activities. The consultant should take the lead in identifying NCG funding sources and scope of operations (aimed at supporting the CGC industry nationwide), design fund governance structure, and estimate the fund's economic and social impact. The fund governance specialist should possess deep knowledge of and sufficient experience in small and medium-sized enterprise finance and guarantees in the People's Republic of China (PRC) and other countries in a similar development stage. Specifically, the consultant will carry out the following tasks:

- (i) Review existing policy and regulatory environment for special purpose funds, such as NCG, and recommend a strategy for its speedy establishment, while ensuring prudent corporate governance standards and institutional sustainability and accountability.
- (ii) Review the credit guarantee market in terms of supply and demand for various guarantee and other products, competitive landscape, and cost of capital; and identify measures that facilitate private enterprises' access to financing through use of foreign capital, by (a) identifying problems that impact on CGC's financial sustainability, considering different characteristics of government-sponsored and private sector CGCs; (b) examining past and projected financial performance through surveys of selected guarantee companies—in terms of solvency, liquidity, profitability, portfolio quality, and operational efficiency,<sup>1</sup> credit appraisal capabilities, and corporate governance practices; tracking their achievement against internationally accepted standards; and recommending any changes required to achieve financially sustainable operations; and (c) evaluating options to expand CGC operations through capital injections and the use of reguarantee and coguarantee schemes, and developing eligibility criteria to obtain NCG support.
- (iii) Evaluate major NCG costs and benefits, and measure development effectiveness (including business performance, economic sustainability, private sector development, foreign capital utilization, and streamlining of government functionalities).
- (iv) Identify funding source (including local banks), organizational structure of NCG, institutional arrangements, and exit strategies, including (a) structure and size of NCG, as well as terms, tranches, different types of investment, and loan options;

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<sup>1</sup> Indicators may include, but are not limited to, capital adequacy, gearing ratio, return on assets, return on equity, loss provisions, maximum exposure to a single borrower or group of borrowers, and maximum exposure to any sector.

- (b) relationships, responsibilities, rights, and obligations of parties involved; (c) clear scope of business, investment strategy, and policies; (d) investment terms (such as fees paid to fund managers, and distribution of operational expenses and investment earnings among investors in NCG); (e) report and monitoring requirements (such as requirements for annual reports and audited financial statements in accordance with international accounting standards); and (f) exit strategies for investments to NCG (including direct sales, and redemption of shares purchased by investee companies' management and/or major shareholders).
- (v) Identify corporate governance issues and recommend improvements to ensure institutional sustainability and accountability, including adoption of a (a) sound corporate governance structure and practices; and (b) proper accounting and internal control and monitoring system to make financial conditions and external audit reports available.
  - (vi) Develop and implement a training program for NCG staff with emphasis on risk assessment, rating, pricing, and management concepts.<sup>2</sup>
  - (vii) Perform financial analysis for NCG, in particular (a) identify and confirm objectives and suitability of NCG operations; (b) prepare and assemble financial analysis data to provide qualitative and quantitative examination of proposed NCG operations, assess adequacy of funding plan, and advise on application of conditions or covenants required; (c) forecast for at least the first five years of NCG operations; and (d) calculate financial internal rate of return.<sup>3</sup>
  - (viii) Perform economic analysis to ensure sustainability of developmental effects, adequate incentive for all stakeholders, and fair distribution of benefits. Forecast demand for NCG funding, choose least-cost options, and, where possible, calculate economic internal rate of return of reguarantee operations.
  - (ix) Perform poverty impact analysis, identify policy constraints and administrative constraints, and strategize poverty intervention measures through NCG investment and advisory services to support local level poverty alleviation programs.
  - (x) Draft investment prospectus for NCG fund-raising campaign, and prepare information packages for multilateral and bilateral financial institutions.

## **2. Fund Operations Specialist (3 person-months)**

3. The consultant should take the lead in tasks to improve NCG's operational efficiency, optimize risk and capital allocations, and ensure regulatory compliance. The consultant will cover the selection of the fund management company and custodians. Specifically the consultant will do the following:

- (i) Formulate strategy to ensure that only fund managers with proven track records and good internal risk controls are selected to manage NCG, and adopt international guidance on management standards.
- (ii) Establish effective monitoring and supervision mechanism for fund managers to (a) recommend methodologies for performance evaluation and management of contractual relationship, identify the need for targeted benchmarks, review investment mandates and guidelines, and balance the structure and investment

<sup>2</sup> Training courses will use relevant case studies appropriate for local conditions.

<sup>3</sup> Measured as the discount rate that equalizes the present value of investment cash outflows associated with the project to the present value of the project's net operating cash inflows.

- style of fund managers; (b) develop peer group comparison methodologies (including identification of peer groups) and conduct risk-adjusted return analyses; (c) ensure adequate compliance by fund managers of NCG investment mandates and operation guidelines; and (d) ensure strict compliance with all relevant laws and regulations.
- (iii) Recommend mechanisms to monitor performance of custodian banks to ensure compliance with all relevant banking and securities market regulations, including (a) comprehensive introduction of services offered by custodians (including types of services, fee structure, contractual arrangement, reporting, responsibility and accountability, emergency handling, etc); (b) recommendation of due diligence procedures for custodians (including review of an emergency-handling system based on international best practices); (c) development of benchmarks to monitor and evaluate quality of custodian services; and (d) recommendation of mechanism to systematically detect erroneous reporting.
  - (iv) Identify key management issues and potential legal risks in implementing fund management contracts, including (a) identification of overall contract framework and main factors to be considered; (b) discussion of pros and cons of short-term contract vis-à-vis longer term contracts and indefinite termed contacts; (c) clarification of whether specific investment guidelines should be clearly specified and what factors should be included; (d) explanation of proxy voting policies in the equity investment through fund managers; (e) consideration of factors that will decide fund managers' management and performance fees; and (f) decision on the format and content of outsourced fund managers' weekly, monthly, and yearly reports to NCG.
  - (v) Identify key issues in management of legal contracts with custodians to: (a) identify the overall framework of the contract and main factors to be considered; (b) decide whether custodian should receive a performance fee; (c) develop custodians' role in risk evaluation, investment performance analysis, corporate action, and information accumulation and transmission; (d) develop independent institutional roles in evaluating custodians' internal control; and (e) decide on formats for information reporting to NCG.
  - (vi) Recommend policies to ensure efficiently coordinated information exchange within NCG; and monitor investment managers and custodians, performance review, and external audit.

### **3. Risk Management Specialist (3 person-months)**

4. The consultant will enhance the fund's risk management capability and achieve financial sustainability. Specifically the consultant will do the following:

- (i) Identify various types of risks faced by NCG and recommend risk mitigation measures. These will include, but are not limited to, macroeconomic risk, market risk, key personnel risk, exit risk, legal and regulatory risks, risk of government intervention, and general business risks.
- (ii) Develop eligibility criteria for risk management purposes to obtain NCG support in forms of equity debt, reguarantee and co-guarantee, and assistance for institutional strengthening based on sound banking, commercial, and financial principles.<sup>4</sup>

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<sup>4</sup> Including financial criteria such as minimum equity contribution from borrowers, estimated financial internal rate of return, debt service coverage ratio, minimum return on assets, loan coverage ratio, adequate level of working capital, state ownership, and compliance with all government regulations.

- (iii) Prepare operational guidelines for credit analysis of CGCs and provide a uniform set of norms for internal controls and prudential/operational standards, including (a) how to determine the upper limits of investment amount for each CGC; (b) coverage of reguarantee; (c) how to monitor CGC activities (e.g., reporting requirements and on-site visits or notification to supervisory authorities in case of suspicious defaults or reporting).
- (iv) Prepare business plans for pilot guarantee/reguarantee companies.
- (v) Develop and implement a comprehensive training program for investee CGC staff with special emphasis on risk assessment, rating, pricing, and management concepts.<sup>5</sup>
- (vi) Ensure environmental safeguards stipulating that all investee CGCs will (a) comply with national environmental laws, regulations, and standards; (b) agree to adopt a compliance program; or (c) reasonably mitigate any noncompliance with such laws, regulations, and standards, as soon as possible.
- (vii) Ensure social safeguards stipulating that (a) fund investments will consider involuntary resettlement, indigenous peoples, and labor issues; (b) CGC will follow the International Labor Organization's fundamental conventions; and (c) the fund will not invest in businesses that employ forced labor of any kind or harmful child labor.
- (viii) Recommend a prudent strategy for managing the 30% of NCG investments for income generation (e.g., direct investment, stocks, and bonds), and ensure such investments are conservative and will not conflict with NCG's main mandate of supporting the CGC industry nationwide.

## **B. Domestic Consultants (18 person-months)**

5. Domestic consultants with in-depth country and sector knowledge and good contacts with the Government and enterprises will be recruited. The domestic consultants will help the international consultants quickly become familiar with their tasks by translating various documents into English and researching and compiling a set of government policies, regulations, and procedures adopted. The domestic consultants are expected to possess sufficient experience in their relevant fields.

### **1. Fund governance specialist (3 person-months)**

6. The fund governance specialist will help the international consultant (i) review the existing policy and regulatory environment for special purpose funds (such as NCG) and recommend a strategy for its establishment; (ii) review in detail the private enterprise CGC operations and identify policy, institutional, legal, and regulatory impediments; (iii) review supply and demand for various guarantee and other products, competitive landscape, and cost of capital; (iv) evaluate major costs and benefits of NCG, and measure development effectiveness (including business performance, economic sustainability, private sector development, foreign capital utilization, and streamlining of government functionalities); (v) identify funding source, NCG organizational structures, institutional arrangements, and exit strategies; (vi) implement a training program for NCG staff with emphasis on risk assessment, rating, pricing, and management concepts; and (vii) perform financial and economic analyses for NCG.

### **2. Legal specialist (3 person-months)**

7. The legal specialist will help the international consultant (i) identify key management issues and potential legal risks in implementing fund management contracts and custodians;

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<sup>5</sup> Training courses will use relevant case studies appropriate for local conditions.

(ii) draft and make effective all relevant legal contracts; (iii) draft investment prospectus for NCG fund-raising campaign, and prepare information packages for multilateral and bilateral financial institutions; and (iv) liaise with central government agencies—such as NDRC, Ministry of Finance, China Banking Regulatory Commission, and China Insurance Regulatory Commission—to ensure NCG’s regulatory compliance.

### **3. Fund management company specialist (3 person-months)**

8. The fund management company specialist will help the international consultant (i) formulate a strategy to ensure that only fund managers with proven track records and good internal risk controls are selected to manage NCG, and adopt international guidance on management standards; (ii) compile information on fund managers and evaluate their credentials against NCG requirements; (iii) establish effective monitoring and supervision mechanism for fund managers; and (iv) recommend policies to ensure efficiently coordinated information exchange within NCG, and monitor investment managers and custodians, performance review, and external audit.

### **4. Custodian specialist (3 person-months)**

9. The custodian specialist will help the international consultant (i) formulate a strategy to ensure that only custodians with proven track records and good internal risk controls are selected to manage NCG, and adopt international standards; (ii) compile information on custodians and evaluate their credentials against NCG requirements; (iii) recommend mechanisms to monitor performance of custodian banks to ensure compliance with all relevant banking and securities market regulations; and (iv) recommend policies to ensure efficiently coordinated information exchange within NCG, and monitor investment managers and custodians, performance review, and external audit.

### **5. The risk management specialist (3 person-months)**

10. The risk management specialist will help the international consultant (i) identify various types of risks faced by NCG and recommend risk mitigation measures—these will include, but are not limited to, macroeconomic risk, market risk, key personnel risk, exit risk, legal and regulatory risks, risk of government intervention, and general business risks; (ii) develop eligibility criteria for obtaining NCG support in forms of equity debt, reguarantee and coguarantee, and assistance for institutional strengthening based on sound banking, commercial, and financial principles; (iii) prepare operational guidelines for CGC credit analysis and provide a uniform set of norms embracing internal controls and prudential/operational standards; (iv) prepare business plans for pilot guarantee/reguarantee companies; (v) develop and implement a comprehensive training program for investee CGC staff with emphasis on risk assessment, rating, pricing, and management concepts; and (vi) recommend a prudent strategy for managing the 30% of NCG investments for income generation, (e.g., direct investment, stocks and bonds), and ensure such investments are conservative and will not conflict with NCG’s main mandate of supporting the CGC industry nationwide.

### **6. Social impact and safeguard specialist (3 person-months)**

11. The social impact and safeguard specialist will help the international consultant (i) conduct poverty analysis; (ii) ensure environmental safeguards stipulating that all investee CGCs (a) will comply with national environmental laws, regulations, and standards, (b) agree to adopt a program to comply with them, or (c) reasonably mitigate any noncompliance with them as soon as possible; and (iii) ensure social safeguards stipulating that that (a) fund investments will consider involuntary resettlement, indigenous peoples, and labor issues, (b) CGC will follow the International Labor Organization’s fundamental conventions, and (c) the fund will not invest in businesses that employ forced labor of any kind or harmful child labor.