EMERGING ISSUES IN FINANCE SECTOR INCLUSION, DEEPENING, AND DEVELOPMENT IN THE PEOPLE’S REPUBLIC OF CHINA
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Foreword

The financial system of the People’s Republic of China (PRC) has undergone substantial evolution during three decades of economic growth, starting in the early 1980s. ADB has supported both the deepening and widening of the PRC’s financial sector, which is dominated by banks. Since the late 1990s, ADB has been supporting the development of capital markets and the insurance industry, reform of the pension system, restructuring of state-owned banks, resolution of non-performing loans through asset-management companies, strengthening of corporate governance in financial institutions (regarding equity investments), and the improvement of legal and regulatory frameworks for the financial sector.

There are many challenges confronting financial regulators in the PRC, among them: structural deficiencies of the state-owned financial institutions, deterioration of asset quality, rapid growth of shadow banking, the management of capital inflows and potential sudden outflows, and vulnerabilities due to the PRC’s globally connected financial market.

ADB’s finance sector operations in the PRC are focused on: (i) financial inclusion; (ii) financial innovation in such areas as structured finance, local government finance, public-private partnerships, and climate-change finance; and (iii) regional financial integration and financial stability through regional surveillance, the implementation of macroprudential regulations, Basel III,1 and the development of a consolidated regulatory framework, among other means.

This report aims to raise awareness of ADB’s support for finance sector reform in the PRC. It explains how the above-mentioned aspects of the deepening and widening of the PRC’s financial sector could be supported by ADB through a balanced approach focusing on financial deepening and financial inclusion.

I would like to thank the Promontory Financial Group Australasia and Mr. Jeffrey Carmichael for their significant contributions to the preparation of this report.

Ayumi Konishi
Director General
East Asia Department

1 Basel III is a comprehensive set of reforms approved by the Basel Committee on Banking Supervision to strengthen regulation, supervision, and risk management in the banking sector. The committee published the first version in 2009.
Executive Summary

The Asian Development Bank (ADB) contracted Promontory Financial Group Australasia to produce a report that:

(i) includes a compendium of finance-sector issues in the PRC;
(ii) presents an overview of key finance sector reforms by the government;
(iii) offers observations and suggestions that could assist in the implementation of the PRC's finance-sector reform agenda, with support from ADB loans, investments, and technical assistance (TA) projects;
(iv) summarizes relevant ADB loans, investments, and TA projects that have been implemented in the finance sector;
(v) raises awareness of ADB’s support for finance sector reforms in the PRC;
(vi) helps target this support, and encourages follow-up on priorities, especially where ADB could add value; and
(vii) describes the outputs of finance sector initiatives supported by ADB since 2000, with a very detailed assessment of the effectiveness of those initiatives.

The report also reviews the alignment of ADB’s TA projects, investments, and loans with the strategic priorities of the PRC and ADB, finding a strong alignment of these ADB activities with the priorities of both. The most successful ADB projects have tended to emphasize financial inclusion, though many projects had multiple priorities. Of particular note is the fact that the number and value of ADB TA projects, investments, and loans have been greatest in areas in which there was the strongest overlapping of priorities. This pronounced alignment with both ADB and PRC strategic priorities is commendable, and points to consistent and coherent approaches in the future.

Despite its success to date, the PRC faces some major challenges. Like all success stories, the PRC is finding it increasingly difficult to maintain momentum. The transformation from a suddenly awakened giant into a mature economy capable of sustained, steady growth requires a shift to a more market-oriented system. The finance industry needs greater involvement from the private sector, including input in decision making. These issues are central to the strategy of the Government of the People’s Republic of China. Achieving the desired outcomes will require careful balancing between the pace at which controls are removed and the pace at which the regulatory and legal infrastructure is strengthened. Without a solid regulatory framework, and informed and discerning investors, a market-driven financial system will be prone to potentially destabilizing swings. The achievement of the desired outcomes will also require that economic growth be inclusive, with financial services available to all members of society.
With so many potential areas for support and development, the greatest synergies are likely to be found in the areas in which the PRC and ADB have the same priorities. Ideally, ADB should continue to draw upon its experience in identifying and developing pilot programs that could be implemented in more than one province or market. Opportunities to deliver outcomes in support of the PRC’s and ADB’s strategic priorities could arise in the following areas:

Financial Inclusion

(i) development of community banking models or “franchises” to support the creation of a sustainable multitiered financial system, and the provision of credit and financial services to under-banked communities and to micro, small, and medium-sized enterprises (MSMEs) lacking access to finance;

(ii) review of the supervisory and legal frameworks for microfinance institutions; and

(iii) improvement of the credit system, as many financial institutions do not have sufficient information on the credit histories of clients, and so cannot accurately assess credit risks. The authors suggest that ADB help develop localized cooperative credit-reference agencies to provide credit scores on individuals and entities in their communities.

Legal, Regulatory, and Supervisory Structures

(i) support for the China Securities Regulatory Commission (CSRC), which is responsible for regulating market conduct, by developing a universal licensing regime, as well as a sound disclosure regime, for collective investment products.

(ii) establishment of a licensing regime for financial advisors and brokers who sell the products, regardless of their distribution channels (for example, through the banks’ capital market divisions, insurance companies, or via the internet); and

(iii) development of a regime based on the fair treatment of customers that would include a standardized disclosure risk measure for all retail financial products (e.g., a simple, standardized framework similar to the Netherlands GUISE measure); a dispute-resolution scheme; and timely, robust, and appropriate enforcement action.

Pension Funds and Insurance

(i) review of the various pension schemes in terms of their rules, contribution and benefit levels, their administration, and funding situations. The authors of this report believe that future ADB work in this area should focus on the long-term goals of harmonizing, and then centralizing, the PRC’s pension system.

Equity, Debt and Capital Markets

(i) the continued development of Asian bond markets, potentially with PRC participation;

(ii) a focus of ADB support on municipal finance; capacity building; and governance processes, including long-term budgeting, service demand and forecasting, asset management, and infrastructure development and planning; and
(iii) capacity building for the staff of the National Equities Exchange and Quotations (NEEQ) board, in the wake of its recent expansion to include non-technological companies, to improve the supervision and monitoring of listing and trading activities, disclosure, selling and brokering practices, and market abuse; and to develop a strong investigation and enforcement capability to maintain the integrity of this expanded bourse.

**Green and Climate Change Finance**

(i) further support for the development of a national carbon-trading market by applying lessons learned from pilot schemes in the PRC;

(ii) financing for small and medium-sized enterprises (SMEs) in the energy field, as ADB support for energy efficiency could continue to focus on strengthening guarantees for the financing of energy service companies (ESCOs).

(iii) support for the development of the PRC’s green bond market; and

(iv) assistance to the PRC in developing a national statistical database to collect, analyze, and report on environmental data, given that one of the challenges in the development of carbon trading is the lack of emissions estimates.
### Abbreviations

<table>
<thead>
<tr>
<th>Abbreviation</th>
<th>Description</th>
</tr>
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<tbody>
<tr>
<td>ADB</td>
<td>Asian Development Bank</td>
</tr>
<tr>
<td>ABMI</td>
<td>Asian Bond Markets Initiative</td>
</tr>
<tr>
<td>ABS</td>
<td>asset-backed securities</td>
</tr>
<tr>
<td>ADBI</td>
<td>Asian Development Bank Institute</td>
</tr>
<tr>
<td>AMC</td>
<td>asset-management company</td>
</tr>
<tr>
<td>AML</td>
<td>anti-money laundering</td>
</tr>
<tr>
<td>ASEAN</td>
<td>Association of Southeast Asian Nations</td>
</tr>
<tr>
<td>BIS</td>
<td>Bank for International Settlements</td>
</tr>
<tr>
<td>CBRC</td>
<td>China Banking Regulatory Commission</td>
</tr>
<tr>
<td>CCDMF</td>
<td>China Clean Development Mechanism Fund</td>
</tr>
<tr>
<td>CDM</td>
<td>Clean Development Mechanism</td>
</tr>
<tr>
<td>CER</td>
<td>certified emission reductions</td>
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<tr>
<td>CFT</td>
<td>combatting the financing of terrorism</td>
</tr>
<tr>
<td>CGC</td>
<td>credit guarantee company</td>
</tr>
<tr>
<td>CIRC</td>
<td>China Insurance Regulatory Commission</td>
</tr>
<tr>
<td>CNY</td>
<td>yuan (currency of the People’s Republic of China, also “renminbi” or “Yuan Renminbi”)</td>
</tr>
<tr>
<td>CPS</td>
<td>country partnership strategy</td>
</tr>
<tr>
<td>CSRC</td>
<td>China Securities Regulatory Commission</td>
</tr>
<tr>
<td>DIS</td>
<td>deposit insurance system</td>
</tr>
<tr>
<td>DMC</td>
<td>developing member country (ADB)</td>
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<tr>
<td>EEER</td>
<td>energy efficiency and emission reduction</td>
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<tr>
<td>ESCO</td>
<td>energy service company</td>
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<tr>
<td>FATF</td>
<td>Financial Action Task Force</td>
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<tr>
<td>FDIC</td>
<td>Federal Deposit Insurance Corporation (US)</td>
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<tr>
<td>FIRP</td>
<td>Financial Industry Reform Plan (PRC)</td>
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<tr>
<td>FMI</td>
<td>financial market infrastructure</td>
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<tr>
<td>FOF</td>
<td>fund of funds</td>
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<tr>
<td>FSAP</td>
<td>Financial Sector Assessment Program (World Bank-IMF)</td>
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<td>FSOP</td>
<td>Financial Sector Operational Plan (ADB)</td>
</tr>
<tr>
<td>FX</td>
<td>foreign exchange</td>
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<tr>
<td>GDP</td>
<td>gross domestic product</td>
</tr>
<tr>
<td>GFC</td>
<td>global financial crisis of 2008–2009</td>
</tr>
<tr>
<td>GS&amp;DS</td>
<td>generation scheduling and dispatch system (energy)</td>
</tr>
<tr>
<td>IADI</td>
<td>International Association of Deposit Insurers</td>
</tr>
<tr>
<td>IAIS</td>
<td>International Association of Insurance Supervisors</td>
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<tr>
<td>IT</td>
<td>information technology</td>
</tr>
<tr>
<td>Abbreviation</td>
<td>Full Form</td>
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<tr>
<td>IMAR</td>
<td>Inner Mongolia Autonomous Region</td>
</tr>
<tr>
<td>IMF</td>
<td>International Monetary Fund</td>
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<tr>
<td>IOSCO</td>
<td>International Organization of Securities Commissions</td>
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<tr>
<td>IPO</td>
<td>initial public offering</td>
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<tr>
<td>LGFV</td>
<td>local government financing vehicle</td>
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<td>MCC</td>
<td>microcredit company</td>
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<td>MFI</td>
<td>microfinance institution</td>
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<tr>
<td>MOU</td>
<td>Memorandum of Understanding</td>
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<tr>
<td>MSMEs</td>
<td>micro, small, and medium-sized enterprises</td>
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<tr>
<td>NaCSSeF</td>
<td>National Council for the Social Security Fund</td>
</tr>
<tr>
<td>NCG</td>
<td>National Fund for Development of Credit Guarantees for Private Enterprises</td>
</tr>
<tr>
<td>NDRC</td>
<td>National Development and Reform Commission</td>
</tr>
<tr>
<td>NEEQ</td>
<td>National Equities Exchange and Quotations</td>
</tr>
<tr>
<td>NPL</td>
<td>nonperforming loan</td>
</tr>
<tr>
<td>NSSF</td>
<td>National Social Security Fund</td>
</tr>
<tr>
<td>OTC</td>
<td>over-the-counter (derivatives)</td>
</tr>
<tr>
<td>P2P</td>
<td>peer-to-peer (lending)</td>
</tr>
<tr>
<td>PBC</td>
<td>People’s Bank of China</td>
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<tr>
<td>PPP</td>
<td>public-private partnership</td>
</tr>
<tr>
<td>PRC</td>
<td>People’s Republic of China</td>
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<tr>
<td>PS</td>
<td>private sector</td>
</tr>
<tr>
<td>RCC</td>
<td>rural credit cooperative</td>
</tr>
<tr>
<td>RCCU</td>
<td>rural credit cooperative union</td>
</tr>
<tr>
<td>SAFE</td>
<td>State Administration of Foreign Exchange</td>
</tr>
<tr>
<td>SIA</td>
<td>Social Insurance Administration</td>
</tr>
<tr>
<td>SMEs</td>
<td>small and medium-sized enterprises</td>
</tr>
<tr>
<td>SOE</td>
<td>state-owned enterprise</td>
</tr>
<tr>
<td>SRO</td>
<td>self-regulatory organization</td>
</tr>
<tr>
<td>TA</td>
<td>technical assistance</td>
</tr>
<tr>
<td>TRCB</td>
<td>Tianjin Rural Commercial Bank</td>
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<tr>
<td>WB</td>
<td>World Bank</td>
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<tr>
<td>WMP</td>
<td>wealth management product</td>
</tr>
<tr>
<td>WTO</td>
<td>World Trade Organization</td>
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</tbody>
</table>
Introduction

1.1 Background

The People’s Republic of China (PRC) was the second-largest economy in the world in 2013, as well as the largest holder of foreign exchange reserves ($3.8 trillion in December 2013) and the largest trader of goods (overtaking the United States).

Through political commitment and economic and financial reforms, the PRC has transformed its economy from low-income to middle-income status in just three decades. The leadership change and policy debate in 2012 signaled a repositioning of the economy, with goals such as: (i) strengthening domestic consumption, (ii) promoting greater equality between rural and urban levels of economic development and income distribution, and (iii) striking a new balance between government and private activity in the economy. The leadership also reaffirmed its commitment to ensuring that development incorporates environmentally sustainable practices.

The financial system is a key facilitator for a country’s development. In the PRC, the economic adjustments being made under the current 12th Five-Year Plan (covering 2011–2015), and in support of the upcoming 13th Five-Year Plan, include finance-related reforms.

The structure of a country’s financial system is a product of its history, political system, social values, and other particularities. Whatever its structure, however, any financial system needs to perform certain key functions involving the transfer of risk to people and entities best placed to manage it. These functions include: the efficient formation and allocation of capital; transactions through the payments system; the matching of investors and borrowers directly or through credit intermediation; maturity transformation of short-term investments into long-term financing; and risk pooling, usually through insurance. The strength of an economy is usually a reflection of the strength, depth, efficiency, and integrity of its financial system.

The financial system is dominated by banks, with ownership and activities mainly controlled by the Government of the People’s Republic of China through its funding of state-owned enterprises (SOEs). The PRC’s financial system has nevertheless performed the key functions listed above well enough to support extraordinary growth and economic transformation. But significant structural weaknesses remain, and these need to be addressed. It is also important to note that the country’s financial industry, and economic development in general, continues to be shaped by urgent policy responses to the effects of the global financial crisis of 2008–2009 (GFC).
The Asian Development Bank (ADB) has supported the PRC through loans, investments, and technical assistance (TA) projects since 1986. ADB is currently in the second half of its PRC country partnership strategy (CPS) for 2011–2015. Although finance is no longer a priority sector, as it was under the previous CPS, ADB continues to support targeted reforms of the financial system, particularly those with a poverty-reduction impact that could be replicated by government, other development agencies, or by the private sector. As a result, ADB engagement continues to focus on the financing of micro, small, and medium-sized enterprises (MSMEs); green finance; and municipal finance.

1.2 Terms of Reference

The knowledge product:

(i) includes a compendium of finance-sector issues in the PRC;
(ii) presents an overview of key finance sector reforms by the government;
(iii) offers observations and suggestions that could assist in the implementation of the PRC’s finance-sector reform agenda, with support from ADB loans, investments, and TA projects;
(iv) summarizes relevant ADB loans, investments, and TA projects that have been implemented in the finance sector;
(v) raises awareness of ADB’s support for finance sector reforms in the PRC;
(vi) helps target this support, and encourages follow-up on priorities, especially where ADB could add value; and
(vii) describes the outputs of finance sector initiatives supported by ADB since 2000, with a very detailed assessment of the effectiveness of those initiatives.1

The compendium of ADB investments, loans, and TA projects includes the mapping of their alignment with current government reforms and with ADB’s strategic agenda for the development and reform of the PRC’s finance sector. To support their analysis, the authors reviewed a large number of documents relating to the relevant ADB programs. In reviewing this material, however, they encountered the following limitations:

(i) Many of the TA projects are ongoing, with expected completion dates in the coming years. The authors were unable to comment on the success of these projects or on how well the actual outputs map to current (as of 2014) ADB and PRC reforms and strategies. The authors included these projects in the compilation, however, summarizing each project and its mapping based on the terms of reference or on the expected outputs of the project.

(ii) The authors based their analysis on program documents received from ADB, but the types of documents received varied widely. For some completed projects, the authors received the TA report and the TA completion report, as well as other supporting material, such as reports produced as part of the project. For other projects, they received more limited information (e.g., the TA report only).

1 The assessments of effectiveness are based on post-project reviews provided by the Asian Development Bank (ADB), rather than through direct investigations and reviews by Promontory Financial Group Australasia.
Whenever possible, the authors supplemented the documents they received with additional information found on the ADB website, but they could not comment on the success or outcomes of any project for which the TA completion report was not available.

(iii) A number of TA projects build on earlier projects that began before 2004 and were relevant to ADB and PRC strategies and policy priorities at the time. In these cases, it was difficult to provide meaningful commentary on how well these projects align with strategies that evolved after the initial projects’ completion. ADB and PRC strategies have changed over time, with the financial sector becoming a lower priority in many instances. However, many of these projects can still be mapped to certain elements of current strategies, especially those that apply more broadly to Asia. For these projects, the authors provided comments based on current strategies whenever possible.

(iv) A recommended structure of report, with chapters based on special topics, was provided in the Terms of Reference and then refined through subsequent email discussions. But two of the chapters—on financial market infrastructure and the internationalization of the yuan—did not include the relevant TA projects, nor any relevant loans or investments. For these chapters, the authors provided an overview of the topic, as well as possible future development opportunities, where applicable.

1.3 Structure of the Report

The rest of this report includes the following chapters:

- Chapter 2 – The PRC’s Finance Industry Reform Agenda, and Recent Developments
- Chapter 3 – Financial Inclusion
- Chapter 4 – Legal, Regulatory, and Supervisory Structures for the Financial System, Financial Stability, and Banking Reforms
- Chapter 5 – Finance Market Infrastructure
- Chapter 6 – Pension Funds and Insurance
- Chapter 7 – Equity, Debt, and Capital Markets
- Chapter 8 – Internationalization of the Yuan
- Chapter 9 – Green and Climate-Change Finance
- Chapter 10 – Conclusions and Recommendations
The PRC’s financial sector development and reform agenda has been changing as quickly as the Shanghai skyline. In fact, there is no single cohesive agenda, possibly because financial activities in the PRC are multidimensional and multilayered. They can be organized according to (i) sector (banking, insurance, capital markets, etc.); (ii) responsible regulatory agency (State Council, China Banking Regulatory Commission [CBRC], China Securities Regulatory Commission [CSRC], China Insurance Regulatory Commission [CIRC], State Administration of Foreign Exchange [SAFE], and provincial government agencies); (iii) the nature of the activity (lending, payments, trade and settlement, risk pooling, etc.); and even (iv) the sources of project financing (ADB, GTZ, United States Agency for International Development [USAID], World Bank, etc.).

The dimensions and layers of these activities reflect the Chinese development principle of “crossing the river by feeling for stones,” which is appropriate given the need to deliver outcomes on the required scale. Replication is a feature of the Chinese reform agenda, with successful projects multiplied across provinces and across countries.

While a comprehensive and accurate review of current finance-sector development and reform activities is beyond the scope of this report, the communiqué issued in 2013 by the Third Plenum of the 18th Central Committee of the Communist Party of China provides useful guidance for aligning ADB engagement policies with stated PRC development objectives. A tabular summary of that alignment, or mapping, is provided in section 2.5, below.

2.1 The Financial System of the People’s Republic of China—Total Social Financing

The PRC’s financial system contains the main elements found in most financial systems: banking, securities, insurance, pensions, payments, etc. The system in the PRC is particularly difficult to analyze, however, due to problems with data availability and transparency, and because it changes so rapidly. Development and reforms are closely aligned to political positions and directives on economic development. In 2013 there were major changes in government policies, development priorities, regulations, and methods of coordination. The financial system, or at least substantial parts of it, can be affected by the actions of every level of government and the regulatory agencies.

Even trying just to assess the size and composition of the PRC finance sector would be difficult, due to problems in collecting data and capturing finance-related activities. The data
generally considered to be the most accurate are those on banking activities (deposits and lending), although these activities may also be conducted by insurance and securities firms. Banks do dominate lending, however, providing around 60% of loans to the private sector. The banking system is concentrated, with the five largest banks providing about 50% of the loans (30% of total banking services), and it is concentrated with respect to ownership as well. All of the five largest banks are majority-owned by the central government, which also has stakes in many other banks.

In 2011 the People’s Bank of China (PBOC) introduced a unique approach to measuring and reporting the overall size and composition of the finance sector, “total social financing,” which looks at bank loans; foreign-currency loans; designated loans; trust and entrusted loans; bank acceptance bills; corporate bond financing; domestic equity financing; nonfinancial-enterprise equity financing; foreign debt; and other funding sources such as insurance,

Table 1. Total Social Financing Indicator for the People’s Republic of China—Major Sources of Funding, 2002–2013

<table>
<thead>
<tr>
<th>Year</th>
<th>Loans (Yuan)</th>
<th>Foreign-Currency Loans (Yuan)</th>
<th>Designated Loans</th>
<th>Trust Loans</th>
<th>Undiscounted Bank Acceptances</th>
<th>Corporate Bonds</th>
<th>Domestic Equity Financing</th>
<th>Total Social Financing (CNY100 million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>2013</td>
<td>88,900</td>
<td>5,848</td>
<td>25,500</td>
<td>18,400</td>
<td>7,751</td>
<td>17,968</td>
<td>2,219</td>
<td>172,900</td>
</tr>
<tr>
<td>2012</td>
<td>82,000</td>
<td>9,163</td>
<td>12,800</td>
<td>12,900</td>
<td>10,500</td>
<td>22,498</td>
<td>2,508</td>
<td>157,700</td>
</tr>
<tr>
<td>2011</td>
<td>74,715</td>
<td>5,712</td>
<td>12,962</td>
<td>2,034</td>
<td>10,271</td>
<td>13,658</td>
<td>4,377</td>
<td>128,286</td>
</tr>
<tr>
<td>2010</td>
<td>79,451</td>
<td>4,855</td>
<td>8,748</td>
<td>3,865</td>
<td>23,346</td>
<td>11,063</td>
<td>5,786</td>
<td>140,191</td>
</tr>
<tr>
<td>2009</td>
<td>95,942</td>
<td>9,265</td>
<td>6,780</td>
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<td>1,064</td>
<td>5,523</td>
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<td>2004</td>
<td>22,673</td>
<td>1,381</td>
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<td>(290)</td>
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<td>2002</td>
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<td>731</td>
<td>175</td>
<td>(695)</td>
<td>367</td>
<td>628</td>
<td>20,112</td>
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</table>

... = data not available, CNY = yuan.

Note: Negative values are placed inside parentheses.

a Designated loans (also known as entrusted loans) are company-to-company credits for which a bank or other financial institution (such as a trust company or lease company) acts as broker. The bank typically manages the credit process, disbursements, and repayments. It receives fees but bears no credit risk, and the loan is off balance sheet.
b Trust loans are provided by trust companies, which do not accept deposits but manage assets for entities and individuals. Often associated with a bank, they offer “bank-trust cooperation wealth management products,” which are essentially notes issued by trust companies that offer more attractive yields than bank deposits.
c Bank acceptances are drafts or bills issued by a company and endorsed by a bank.
d Domestic equity financing is the least transparent part of the shadow banking system, so it is unlikely to be captured accurately. Participants are entities and individuals that function as lenders or borrowers. As these interactions do not occur within the formal banking sector, there is little regulation. This private lending market reportedly offers rates of around 18–23%, compared with bank lending rates of 7–8%.

Source: People’s Bank of China.
Emerging Issues in Finance Sector Inclusion, Deepening, and Development in the People’s Republic of China

RMB = renminbi (the full name of the PRC currency is “Yuan Renminbi”).

Source: People’s Bank of China.

Total social financing is an indicator that measures the total funding that the real economy obtains from the financial system; and it aggregates traditional sources of credit with non-credit items such as equity, foreign direct investment, corporate bonds, and trust credits. A breakdown of some of the major sources of funding included in the total social financing indicator for 2002–2013, along with the total amounts, is provided in Table 1; and the market shares of funding sources for 2006–2013 are shown in the figure below.

While the total social financing indicator is quite broad, it does not include informal lending channels, which provide much of the lending to micro and small enterprises, including family loans and curbside lending. Total social financing in the PRC is not exactly comparable to indicators used in other countries, which often have wider data capture that is adjusted to limit the double counting of lending activities. For example, in the PRC a firm may arbitrage its credit standing by borrowing low from banks and then investing in a trust vehicle or lending directly to a small or medium-sized enterprise in the real economy. The values of both these types of loans are included in the total social financing aggregate.

There are signs of movement toward a more market-driven system in the PRC, but the government (and party leaders) still exerts influence over lending and other banking decisions, often promoting loans to particular companies, industries, or provinces, and even

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Total Social Financing Indicator for the People’s Republic of China—
Market Shares of Funding Sources, 2006–2013

RMB = renminbi (the full name of the PRC currency is “Yuan Renminbi”).

Source: People’s Bank of China.
engaging in hiring decisions for senior management. The central bank also controls many aspects of banking that are left to markets in other countries, such as the setting of maximum interest rates on deposits and loans (though this practice has recently been relaxed), and the determination of target levels for loan volumes, preferred lending segments, and ratios.

In addition to the central government, regional and local governments play an active role in the financial system, directing the activities of banks, overseeing the establishment and regulation of local nonbank lenders, and generally participating and intervening in financial activities.

The financial system and its associated risks in the PRC are a challenge to understand, partly because off-balance sheet activities are frequently used to avoid banking regulations, and partly because there is a wide variety of explicit and implicit guarantees that are not accounted for. Such guarantees include: central government guarantees for borrowing by SOEs, support for state-owned banks, implied deposit guarantees, implied bank guarantees for wealth-management products offered through related-party trusts, and various guarantees provided to financial products by different levels of government.

Given the formal sector’s tendency to lend to large state-owned corporations, or in accordance with political direction, micro and small enterprises are forced into the informal, unregulated lending market. Every major town in the PRC has a curbside market for loans. Peer-to-peer (P2P) lending sites have developed rapidly on the internet, and formal and informal government policies have led to an exponential growth in the number of smaller village financial institutions. Little information about this informal lending market is collected, however, so this market is excluded from official economic and financial reporting.

These weaknesses in the PRC’s financial system provide the government with considerable opportunities for policy and regulatory reforms that could support its economic priorities.

2.2 The Third Plenum of the 18th Central Committee of the Communist Party of China

The government released the Communiqué of the Third Plenum of the 18th Central Committee of the Communist Party of China on 12 November 2013. This was the first policy blueprint unveiled by the new leadership under President Xi Jinping and Premier Li Keqiang.

The communiqué changes the role of the market in the PRC’s economy from “basic” to “decisive,” stipulating that the country will deepen its economic reforms to ensure that the market will play a more decisive role in the allocation of resources. Meanwhile, it promises progress; accomplishment; and the construction of structurally complete, scientifically standardized, and effective institutions and systems in all areas by 2020.

While the communiqué does not describe future reforms in detail, it does indicate the broad policy directions and specific policy measures to be expected. Some key reforms concerning the finance sector and economic development relate to ADB’s three strategic complementary
agendas of engagement: inclusive economic growth, environmentally sustainable growth, and regional integration. These key reforms include:

(i) Establishing a unified, open, competitive, and ordered market system by:

(a) accelerating the formation of a modern market system in which enterprises can make their own business decisions, while fair competition, consumers’ free choice, autonomous consumption, the free flow of products and factors, and equal exchange will be encouraged;
(b) striving to eliminate market barriers and to improve the efficiency and fairness of resource allocation; and
(c) creating a set of fair, open, and transparent market rules, and perfecting a mechanism under which prices are largely decided by the market.

(ii) Integrating urban and rural development by:

(a) formulating a new type of relationship in which industry promotes agriculture and cities lead the countryside; and
(b) creating a new agricultural management system and endowing farmers with more property rights, to realize an equal exchange of urban and rural production factors and achieve a balanced allocation of public resources.

(iii) Adapting to the new trend of economic globalization by:

(a) promoting the orderly and free flow of international and domestic production factors and relaxing investment entry requirements; and
(b) accelerating the construction of free trade zones and offering better access to inland and coastal areas.

(iv) Sharing the benefits of economic growth by:

(a) resolving issues that the population is most concerned about, to better satisfy people’s demands;
(b) deepening comprehensive reforms in education;
(c) improving systems and mechanisms to stimulate employment and entrepreneurship;
(d) creating a rational and orderly income-allocation structure;
(e) establishing a fairer and more sustainable social security system; and
(f) deepening structural reform in the medical and health-care sectors.

(v) Building an ecological society by:

(a) establishing a systematic and integral ecological societal system;
(b) improving the natural-resource property-rights system and usage-management system;
(c) implementing a system of compensated use of natural resources; and
(d) reforming the environmental protection and management system.

The reform agenda is more fully spelled out in the 12th Five-Year Plan, which has been used for mapping ADB projects, investments, and loans targeting the plan’s priorities.
The PRC’s Financial Industry Reform Agenda, and Recent Developments

While the December 2013 communiqué focused on issues beyond the finance sector, guidelines issued by the State Council a few months earlier had provided a relatively simple and direct outline of the financial reforms that were included in the communiqué (see the box, below).

### State Council Measures for Financial System Reform

In July 2013, the State Council of the People’s Republic of China issued the following ten measures to serve as a guideline for the reform of the financial system:

1. Maintain a prudent monetary policy and a reasonable money and credit supply to support economic restructuring;
2. Use credit flows to guide the country’s economic restructuring, supporting emerging strategic industries, the information technology (IT) industry, the service sector, and other labor-intensive industries, and curbing sectors riddled with overcapacity;
3. Integrate financial resources to support the development of small and micro enterprises, and increase financial support to technology- and innovation-oriented small and micro businesses;
4. Increase credit support for agriculture and expand financial services in rural areas;
5. Boost domestic consumption by improving the environment for consumer finance;
6. Support companies that are seeking overseas expansion by providing various financing channels;
7. Develop a multilevel and mature capital market;
8. Expand insurance coverage in agriculture and for those companies with plans to go global, among others;
9. Encourage private capital to invest in the finance sector, such as private banks, financial leasing firms, and consumer finance companies; and
10. Guard against financial risks, especially those associated with local government debt and property financing.

Source: China Briefing, 2013.

2.3 The 12th Five-Year Plan for the Development and Reform of the Finance Industry

The 12th Five-Year Plan for the Development and Reform of the Financial Industry—also known as the Financial Industry Reform Plan (FIRP)—was developed by the PRC’s major financial regulators, and has a prominent place in the overall 12th Five-Year Plan.²

FIRP sets out in greater detail the priorities and policy directions for the reform and development of the financial industry during 2011–2015. The policy objectives provide a solid starting point for discussing ADB’s TA projects (completed or ongoing) and for developing

proposals regarding the future alignment of ADB’s engagement with the PRC’s objectives, including those focusing on its finance sector.

FIRP identifies seven key strategies for development and reform,3 which were re-affirmed, for the most part, by the State Council’s 10-measure guideline for financial-system reform (see the box, section 2.2). The long-term objectives of FIRP’s reforms include a steady and rapid growth of the financial industry across a broad range of activities (banking, insurance, capital markets, pensions), as well as the emergence of products and financial services that would be more sophisticated and international in scope. FIRP also established the following shorter-term objectives, to be achieved during the life of the 12th Five-Year Plan. These include:

(i) Quantitative objectives:

(a) financial services to account for an additional 5% of the gross domestic product (GDP), compared with 4.4% during 2001–2010; and
(b) greater disintermediation, with funding of the real economy to increase to 15%, compared with 11% during the 11th Five-Year Plan.

(ii) Qualitative objectives:

(a) major financial sectors such as banking, securities, and insurance becoming more market-driven in terms of governance and competitive activities, and subject to international principles of good regulation, including those regarding risk management;
(b) better market-based financial resource allocation, including market-based reforms of interest rates;
(c) internationalization of the yuan through market-pricing freedom, gradual easing of capital account restrictions, and promotion of the use of yuan for international payments;
(d) deepening of the financial markets through multilayered development, with significant advances in innovation and market-oriented mechanisms;
(e) financial-inclusion programs that deliver full financial services, with a greater emphasis on the finance industry serving the real economy, as well as support for technological innovation, economic restructuring, manufacturing, and above-average growth rates in lending in rural areas (particularly to farmers) and to small and micro enterprises (in rural and urban areas);
(f) strong supervision, regulation, and risk management for the finance sector through improved laws, the implementation of international regulatory practices, prevention and warning systems, and assessment and resolution mechanisms designed to address systemic financial risks; and
(g) improved consumer and investor protection through stronger enforcement and greater disclosure, development of financial safety nets, and the establishment of a deposit insurance system (DIS).

3 These seven key strategies included: (i) improving macro adjustment and control and facilitating steady and sound economic development, (ii) optimizing the deployment and establishing a modern financial system, (iii) encouraging innovation and speeding up the development of a multi-tiered financial market, (iv) continuously improving financial operations through reform, (v) deepening and further opening up the financial system, (vi) enhancing regulation for financial stability and security; and, (vii) optimizing the environment for financial development.
2.4 ADB’s Engagement Strategy

ADB’s current engagement strategy and policy directions for the PRC are set out in a number of documents:

(ii) **Financial Sector Operational Plan (FSOP),** and
(iii) **Country Partnership Strategy: People’s Republic of China, 2011–2015.**

In addition, Strategy 2020 and the FSOP both set out strategic frameworks for Asia as a whole. It was Strategy 2020 that identified the three strategic agendas—inclusive economic growth, environmentally sustainable growth, and regional integration—that support ADB’s vision of an Asia and Pacific region free of poverty by 2020. Strategy 2020 also emphasizes five drivers of change in the region: (i) private sector development, (ii) good governance and capacity development, (iii) gender equity, (iv) knowledge solutions, and (v) partnerships. The five core areas of operations are (i) infrastructure, (ii) the environment, (iii) regional cooperation and integration, (iv) finance sector development; and (v) education.

The FSOP aims to articulate the finance sector agendas of Strategy 2020 and to guide their implementation by ADB.

ADB uses a country-specific approach, tailoring the strategic agendas of Strategy 2020 and the FSOP to the priority areas of each country as identified in the relevant country partnership strategy (CPS). The strategic framework of the CPS for the PRC overlaps with that of Strategy 2020 in that the CPS highlights the following three “pillars,” based on the three agendas of Strategy 2020:

(i) **Pillar 1** is “inclusive growth,” to foster balanced and equitable development supported by the promotion of integrated rural and urban development in ways that expand livelihood opportunities for the poor. Among the goals under pillar 1 is improving access to finance for micro, small, and medium-sized enterprises (MSMEs) in rural areas.

(ii) **Pillar 2** is “environmentally sustainable growth,” under which ADB assistance is viewed through an environmental lens, with a priority on greening the portfolio and integrating climate-change considerations into future operations.

(iii) **Pillar 3** is “regional cooperation and integration,” with the regional orientation of the CPS strengthened so as to complement ADB’s support for regional-cooperation programs.

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7 Footnote 10, p. 6.
Under the CPS for the PRC, the drivers of change are knowledge solutions, private sector development, good governance and capacity development, and gender equity. The CPS also identifies the four priority sectors as (i) natural resources and agriculture, (ii) energy, (iii) transport, and (iv) urban development.

Although the finance sector is no longer a priority, as it was under the previous CPS (2008–2010), support for innovative financing solutions and for access to finance in the current priority sectors remains an important operational objective. In particular, ADB continues to support finance for MSMEs, green finance, and municipal finance.

### 2.5 A High-Level Mapping of ADB’s Engagement Strategy

Table 2 provides a summary mapping of ADB projects vis-à-vis the objectives of relevant ADB and the PRC strategic plans. The projects, which are grouped in the table by topic area, are discussed in the following chapters.

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<sup>a</sup> When the figure for the utilized amount is not available, the approved amount is provided instead.


<sup>c</sup> This refers to the PRC State Council’s 10 recommended measures for financial system reform.

<sup>d</sup> This loan was for CNY130 million, and the dollar figure in the table is based on the conversion rate of CNY1 = $0.1586, as indicated in: ADB. 2012. Report and Recommendation of the President to the Board of Directors: Proposed Loan, Microfinance Wholesale Lending Facility (People’s Republic of China). Manila.

<sup>e</sup> The loan amounted to €20,717,000, and the dollar figure in the table is based on the approximate conversion rate in mid-February 2006 of €1 = $1.18807.

2.6 Current Issues

2.6.1 Shadow Banking

Shadow banking is especially relevant in the context of ADB’s engagement policies regarding financial inclusion, microfinance, SME lending, and municipal finance.

Substantial policy, regulatory, and media attention has been given to “shadow banking” in the wake of the global financial crisis of 2008–2009 (GFC). While the term “shadow banking” has had a negative connotation since the GFC, it actually differs slightly from country to country, and often emerges as a “market solution” to the failure of the regulated financial industry to meet total demand. Despite the reference to “banking” in the title, shadow banking often has nothing to do with the core banking functions of accepting savings or checking account deposits.

Shadow banking in the PRC can be classified according to two basic drivers:

(i) **Unsatisfied credit demand.** This demand is met through unregulated lending in the form of curbside markets, pawn shops, payday lenders, peer-to-peer (P2P) lenders, village cooperatives, and family lending. These informal lending channels have emerged to meet the funding needs particularly of micro and small enterprises, which are poorly serviced by the formal banking sector. Loans are often made from the resources of the lender (rather than through investors), and usually at rates significantly higher than bank lending rates.

(ii) **Regulatory arbitrage.** This is a means of circumventing regulatory restrictions such as interest rate controls, deposit ratios, capital requirements, and lending restrictions. It often involves taking the activity off balance sheet.

As noted by commentators on the PRC, and acknowledged by the Chinese authorities, shadow banking that circumvents regulation has systemic risk implications. It also undermines the effectiveness of monetary policy and the ability of the government and its agencies to effect financial industry development and reform.

There appear to be three key shadow banking activities of concern in the PRC:

(i) **Local government financing vehicles.** In January 2014, a report on the PRC’s audit of local governments exposed an increased reliance on “local government financing vehicles” (LGFVs), which are higher-interest, shorter-term shadow banking sources. They swell the risk of default on local government debt, which totals CNY17.9 trillion. As of June 2013, more than 10% of that debt was nonperforming.

(ii) **Trust companies arbitraging regulatory restrictions.** Many of the larger trust funds are controlled by banks and borrow from the parent company at preferred rates (trust funds cannot accept retail deposits). Trust funds then make loans that would have been restricted if they had been on bank balance sheets. Some trusts

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8 The Financial Stability Board defines shadow banking as “credit intermediation involving entities and activities outside the regular banking system that could potentially cause systemic risks and regulatory arbitrage due to maturity or liquidity transformation, leverage, and poor credit management.”
are owned by large state-owned companies that use them as a way to obtain cheap bank loans that are under guarantee and rate-capped; the funds are then on-lent to small and medium-sized enterprises (SMEs) at much higher interest rates.

(iii) **Wealth management products.** Wealth management products (WMPs) are often marketed by banks through trust vehicles that are held off balance sheet. These are mostly short-term savings products that offer much better interest rates than those offered by banks, but without the implicit guarantee of deposits that would be provided by a government-owned bank. Many of the assets underlying WMPs are real estate or long-term infrastructure projects that are unlikely to generate sufficient cash flow to keep up repayments.

In December 2013, the People’s Bank of China (PBOC) stated that internet financing businesses, such as P2Ps, would also be classified as shadow banking.

The government and regulatory authorities recognize the potential threat of shadow banking on financial stability and the integrity of the financial industry. Policy objectives now include dealing with emerging risks and developing a more robust financial industry that can meet the demand for credit within the regulated system. The objective of moving to more market-based interest rates, in order to encourage lending and deposit competition, will help eliminate regulatory arbitrage. New incentives for local governments include the control of debt, which should limit some of the current demand for credit. Recent government announcements have affirmed the objectives of increasing access to finance, deepening financial markets, and building a diversified and multilayered financial system. And these objectives should result in the availability of alternative financing options in the regulated markets—and at lower costs.

### 2.6.2 Interest Rate Liberalization and a Multitiered Financial System

Part of the regulatory arbitrage equation that has driven shadow banking is the close regulatory control of the interest rates on both sides of commercial bank balance sheets.

While the reforms of market-based interest rates have generally been more progressive than the reforms of institutional borrowing and lending rates (e.g., Shibor benchmarking of enterprise bonds⁹), the decision in July 2013 to remove the cap on lending rates for commercial banks and rural credit cooperatives now allows greater discretion in pricing loans commensurate with the credit risk of the borrower (with the exception of mortgage lending, which is still subject to a cap).

However, the cap has been retained for deposit rates, which remains the area most in need of reform.

The goal of interest rate liberalization is to achieve more efficient market-based decision making and allocation of capital, and as well as market discipline. The goal is to improve access to capital and finance by private corporations, either directly or through bank-funded financing vehicles.

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⁹ Shibor = Shanghai Interbank Offered Rate.
The move to liberalize lending rates was received positively by market observers, but the government’s objectives can be achieved only slowly due to the difficulty of changing the culture of the state-influenced commercial banks. In the wake of the reforms, the banks will have to take responsibility for decisions on credit and pricing, rather than simply implementing directed lending. It may take many years to effect the necessary cultural changes and to create a cadre of experienced credit managers and loan officers, and it may take a long time for the current loans to work their way through the system.

Recognition of these issues by policy makers may be behind their support for a multitier financial system, and behind their policies to encourage the entry and licensing of privately owned financial and banking enterprises to meet rural, micro and small enterprise credit demand.

These policies align with ADB’s engagement goals regarding financial inclusion. The challenge is determining how to establish a large number of well-capitalized, well-governed, and efficient financial institutions over a large geographic area.

2.6.3 Internationalization of the Yuan

Britain’s Chancellor of the Exchequer, George Osborne, stated his belief that the yuan will “become almost as familiar as the dollar.” While the statement may have been meant to promote London as a hub for offshore trading of the yuan, there is clearly a potential for the currency of the world’s largest trading nation to be a major reserve currency. However, the yuan is missing many of the necessary characteristics that maintain the dollar as a reserve currency despite the extraordinary level of indebtedness of the issuing country.

The PRC’s policy makers identify internationalization of the yuan as a priority that ties in with their objectives of creating more market-based mechanisms and liberalizing capital. The process has been going on for some time, with the appointment of extraterritorial clearing banks, yuan trade settlements, and the availability of yuan-denominated investment products. The PBOC has established more than 25 bilateral arrangements with counterparts for providing swap facilities, with off-shore yuan centers now located in Hong Kong, China; Taipei, China; Singapore; and London. Some central banks now hold small yuan reserves, although, according to the International Monetary Fund (IMF), more than 60% of foreign reserves held by central banks remain dollar-denominated. The yuan is included among other minor currencies that account for just 3% of the total.

However, there are actually “two” yuans: the onshore mainland yuan, which is a standard fiat currency in a controlled economy (in which exchange and interest rates are regulated); and the off-shore yuan, the use of which is subject to substantial restrictions. The off-shore yuan settles only around 10% of the PRC’s trade, and there are only limited yuan-denominated investment opportunities, with little secondary market activity, and therefore limited liquidity and price discovery.

10 In an interview with the BBC on 15 October 2013, Britain’s Chancellor of the Exchequer, George Osborne, stated his belief that the yuan will “become almost as familiar as the dollar.”
The government’s objective of promoting the orderly and free flow of international and domestic production factors and relaxing investment entry requirements aligns with yuan internationalization, but the yuan is unlikely to be dominant enough to qualify as a reserve currency. The yen never did despite the global economic strength of Japan. The internationalization of the yuan would, however, serve to reduce costs for importers and exporters, facilitate the globalization of Chinese companies, and reduce dependence on the greenback.

The government has recognized that further internationalization will require capital account liberalization. Ultimately, this would allow Chinese citizens the freedom to take yuan out of the country to invest or to exchange for other currencies. This would also allow the settlement of a far greater proportion of Chinese trade deals, enabling central banks to rebalance their baskets and motivating them to hold yuan-denominated assets to protect against adverse movements in exchange rates.

Ultimately, the successful internationalization of the yuan and the realization of the yuan’s potential as a reserve currency will require more than cross-border movement and international demand. Reserve currency status requires deep, liquid, and active markets so that central banks (and other investors) can sell assets quickly, without a deep discount. It will be a challenge for the yuan market to replicate the depth and liquidity of US treasuries in the absence of deficits and of any need to borrow. How quickly the PRC’s policy makers move depends on other objectives and priorities relating to market-based mechanisms, capital liberalization, the floating of the yuan, and even the PRC’s management of its own US dollar holdings.

2.6.4 Deposit Insurance

Deposit insurance can enhance financial stability by reducing the probability of bank runs. A deposit insurance system (DIS) with explicit rules will provide transparency and add certainty to the resolution process for failed banks. As of 30 June 2013, 112 jurisdictions globally have instituted some form of explicit deposit-insurance rules, and another 41 jurisdictions are studying or considering the implementation of explicit DISs.

The PRC has been in the process of developing an explicit DIS for more than 10 years. The PBOC established a Deposit Insurance Division in 2004, and in 2007 signed a Memorandum of Understanding (MOU) with the US Federal Deposit Insurance Corporation (FDIC) to strengthen communication and cooperation regarding deposit insurance and other areas related to financial stability. This MOU was updated in October 2013 to further expand mutual cooperation through enhanced information sharing, dialogue, and policy coordination.

However, progress in developing the DIS has been slow, hampered by the fallout from the GFC and by implementation problems. The PBOC presented an initial framework to the

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11 According to the International Association of Deposit Insurers (IADI), a key element in maintaining confidence in the banking system and promoting financial stability is deposit insurance.


State Council in 2008, but work toward the development of the system has only gained momentum since around 2010. The IADI and the Basel Committee on Banking Supervision released the core principles for the development of an effective DIS in June 2009.14 The IMF noted in 2011 that “an explicit deposit insurance scheme presently under consideration should be established promptly to finance the orderly resolution of failed depository institutions and protect insured depositors, while minimizing the cost to the public purse.”15

The PRC faces some unique challenges in developing its DIS, including:

(i) the high level of government ownership of banks;
(ii) asset concentration in the top five banks, which may be seen as systemically important and “too-big-to-fail”; and
(iii) the large number of financial institutions and the diversity in their operations and supervisory structures.

It is important that the PRC’s DIS clarify the contingent liability of the government (and of the PBOC) in light of these issues. ADB assisted the PRC in developing its DIS since 2009 (see subsection 4.2.11). During this time, the PRC has been refining the mechanisms for the establishment and financing of the DIS and drafting the legislation and rules required for its implementation. PBOC officials have repeatedly said in 2014 that it is ready to launch the DIS. While details of the DIS have yet to be formally announced, its implementation is expected shortly.

2.6.5 Bankruptcy Law

Linked to the establishment of an explicit DIS in the PRC is the implementation of a bankruptcy law for banks, and its implications for the extent of government support in the event of a bank failure. The implementation of corporate bankruptcy laws in the PRC has historically encountered roadblocks. The original corporate bankruptcy law was approved in 1986, but applied only to state-owned enterprises (SOEs). An updated and more comprehensive law with broader applications came into effect in 2007. This law was in line with the laws of other jurisdictions, and more in keeping with a market-based economy. However, the provisions of this law have yet to be robustly tested, given the small number of corporations filing for bankruptcy (despite hundreds of thousands of enterprises exiting the market every year).

There is currently no bankruptcy law for financial institutions in the PRC. In light of other recent developments associated with the opening up of the financial sector (such as interest rate liberalization), the PRC is planning to introduce a bankruptcy law for banks.16 This law will regulate market-exiting procedures for financial institutions. It may be a sign that the PRC will, for the first time, allow banks to go bankrupt in line with market forces. The introduction of the bankruptcy law is expected to be timed to follow the establishment of the DIS.

16 China Securities Journal reported the statement made by Yan Qingmin, vice chairman of the CBRC, at the Beijing University Economy And Wealth Forum, in December 2013.
3.1 Overview

Improving access to financial services for the poor and disadvantaged—especially those in rural areas and/or engaged in micro, small, or medium-sized businesses—has become a key priority for a number of countries around the globe. According to the World Bank, more than half the world’s poor are unbanked and have limited or no access to financial services (such as savings, loans, credit, insurance, or payments). An increasing number of countries have introduced comprehensive measures to improve access to and use of tailored financial services. In many countries, this has involved focusing on the development of microfinance institutions.

Despite efforts to promote development and urbanization, many parts of the PRC remain poor, especially rural areas.

Rural communities have traditionally been serviced by rural commercial banks and rural credit cooperatives (RCCs). While RCCs have been subject to a period of reform and restructuring, however, the changes appear to have been largely ineffective. Alternative forms of rural finance have emerged, such as village banks, rural mutual finance societies, and loan corporations. This development is supported by the China Banking Regulatory Commission (CBRC), given its objective of cultivating new types of rural financial institutions, and by the guidance issued in July 2010 by the PBOC, CBRC, China Securities Regulatory Commission (CSRC), and CIRC to facilitate innovation in rural financial products and services.

However, the legal standing of rural microfinance institutions is low, though they are subject to certain prudential requirements imposed by the CBRC. Pilot programs were started in 2005 to create microcredit companies (MCCs), which are lending-only institutions, with private capital investment and ownership, that are subject to non-prudential regulation by provincial government agencies. MCCs target micro and small enterprises, but rarely lend to rural households.

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Village and township banks have seen the most rapid expansion: from 349 in 2010 to over 1,000 in 2014.\(^{21}\) This growth has been boosted by changes in the CBRC’s supervisory requirements and by the desire of commercial banks to expand their operations into rural areas.

Rural finance in the PRC is nevertheless characterized by a lack of competition, and remains the least developed part of the country’s finance sector.\(^{22}\) Financial outreach to rural households remains far from adequate. Moreover, the regulation of microfinance institutions is inconsistent, market entry remains difficult, and the institutions are subject to many restrictive requirements that have unclear foundations in prudential policy (including territorial and policy constraints).

Private enterprises were not permitted in the PRC until 1988. In 2002, the government passed a law to promote small and medium-sized enterprises (SMEs). As of 2014, micro, small, and medium-sized enterprises (MSMEs) account for about 80% of manufacturing jobs and of new job creation in urban areas. More importantly, MSMEs employ more low-income workers and socially vulnerable groups, and are sometimes the only source of employment in poorer regions.

Although MSMEs are a major source of the PRC’s economic miracle, access to funding continues to be a challenge for them, particularly for micro and small enterprises (it should be noted that “medium-sized” enterprises in the PRC are large compared with similarly classified companies in other countries). There are issues related to politically directed lending by the major banks. There is also the problem that too many SMEs are unable to satisfy the requirements of a formal credit decision process due to their lack of collateral, proper accounting procedures, and sound business track records—all of which result in higher administrative costs for banks and risk for credit officers unwilling to make “bad loan” decisions.\(^{23}\) And there are important limitations—due in part to legal or implementation obstacles—on the use of collateral (especially inventory), receivables, and land.

The success of micro and small enterprises is critical for achieving greater economic equality and for sharing the fruits of economic growth. Finding innovative solutions to their financing challenges will be key.

### 3.2 ADB Engagement and Achievements

ADB has undertaken six technical assistance (TA) projects with the aim of improving financial inclusion in rural areas. In addition, it has undertaken six TA projects, one loan, and two investments with the aim of improving access to finance for MSMEs. A summary of these projects is provided in Table 3, followed by descriptions of all of them, including assessments of their mapping to current ADB and PRC priorities and strategies.

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<td>Rural Finance Reforms and Development of Microfinance Institutions</td>
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<td>TA 7322</td>
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<td>TA 7525</td>
<td>Establishment of Microinsurance</td>
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<td>TA 8099</td>
<td>Capacity Building on Statistical Competence for County-Level Financial Institutions</td>
<td>To build on TA 7322 by establishing methods of integrating computerized data systems into small financial institutions in rural areas and by arranging for electronic submission and monitoring by local PBC offices</td>
<td>Jun 2012–June 2016 (ongoing)</td>
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<td>TA 8496</td>
<td>Innovations in Credit Risk Management and Financial Service Capabilities for Rural Commercial Banks in Tianjin Municipality</td>
<td>To create a benchmark rural credit risk appraisal and management system and a rural financial product strategy</td>
<td>Oct 2013–Mar 2015 (ongoing)</td>
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<td>TA 3930</td>
<td>Development of SME Alternative Financing Mechanism</td>
<td>To review and summarize experiences and policy environments in other countries, and to make recommendations regarding government policies in support of SME access to finance</td>
<td>Sep 2002–Jun 2004</td>
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<td>TA 4350</td>
<td>Development of Small and Medium-Sized Enterprise Credit Guarantee Companies</td>
<td>To support the institutional reform and financial strengthening of CGCs, strengthen the regulatory and supervisory framework for CGCs, and help establish a government-owned re-guarantee company</td>
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<td>TA 4725</td>
<td>National Fund for Development of Credit Guarantees for Private Enterprises</td>
<td>To provide support in setting up the NCG, with outputs including the establishment of an effective and sustainable mechanism for the use of foreign and local private sector capital, improved administration and operational efficiency of the NCG, and prudent risk management standards for the NCG</td>
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<td>Capacity Development of Partner Banks in Microfinance Wholesale Lending</td>
<td>To help partner banks improve their processes for microfinance wholesale lending to MCCs, deliver capacity-building activities for personnel involved in microfinance wholesale lending, and prepare knowledge products for policy makers and the general banking and microfinance communities</td>
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<td>TA 8282</td>
<td>Credit and Social Rating System Development for Microcredit Companies</td>
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<td>TA 8461</td>
<td>Innovative Small and Medium-Sized Enterprise Bond Financing and Investor Protection Mechanism</td>
<td>To conduct a comprehensive study of overall SME bond financing in the PRC and of international best practices in order to (i) identify preconditions for the successful development of a high-yield bond market, (ii) prepare a road map for establishing effective policies, (iii) report on appropriate investor-protection mechanisms, and (iv) to provide capacity-building activities</td>
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<td>Project 45907</td>
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<td>PS 7159</td>
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<td>Investment in a fund established to provide credit to small and medium-sized consumer-related enterprises in their development or expansion phase</td>
<td>Oct 2000</td>
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<td>PS 7216</td>
<td>Business Development Bank (private sector loan to the United Commercial Bank [China] Ltd.)</td>
<td>Loan to a wholly foreign-owned bank focused on lending to medium-sized enterprises in the PRC</td>
<td>Aug 2005–Feb 2006</td>
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<td>TOTAL</td>
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<sup>a</sup> This column includes the start date (approval date) and actual or estimated completion date. Projects that are ongoing are noted as such.

<sup>b</sup> When the figure for the utilized amount is not available, the approved amount is provided instead.

<sup>c</sup> This loan was approved at CNY130 million, and the dollar figure in the table is based on the conversion rate of CNY1 = $0.1586, as indicated in: ADB. 2012. Report and Recommendation of the President to the Board of Directors: Proposed Loan, Microfinance Wholesale Lending Facility (People's Republic of China). Manila.

<sup>d</sup> This loan was approved at €20,717,000, and the dollar figure in the table is based on the approximate conversion rate in mid-February 2006 of €1 = $1.18807.

3.2.1 Rural Finance Reforms and Development of Microfinance Institutions

The reform of RCCs has been a major policy objective of the government. In June 2003, the State Council issued a policy directive to initiate a reform program aimed at fundamentally restructuring RCCs. The reforms included changing the legal structure of RCCs and transferring all administrative responsibilities to the provincial governments, with recommendations to establish provincial rural credit cooperative unions (RCCUs) and to provide them with financial incentives.

A number of problems were encountered during the implementation of the reforms (via pilot programs), with policy makers having to contemplate alternative forms of financing, primarily through microfinance institutions (MFIs), which the government had previously not encouraged for fear of financial instability. RCCs and microfinance pilots had played a significant role in the Inner Mongolia Autonomous Region (IMAR) and in Guizhou Province (with strong support from the IMAR and Guizhou governments), but several concerns remained, such as geographic distance, economic disparities, limited operational scale, poor financial performance, weak institutional capability, policy constraints, and poor corporate governance.

The TA project for Rural Finance Reforms and Development of Microfinance Institutions (TA 4430) was designed to address key RCC reform issues and to support the creation of a legal structure for MFIs in the two target areas (IMAR and Guizhou). TA 4430, which operated from November 2004 to December 2007, had two components, each responsive to the particular needs of the location concerned and to its unique timing of RCC reforms. Component A, in IMAR, was to (i) assess the performance of RCCs and identify and help implement a comprehensive strategy for RCC policy and institutional reforms; (ii) prepare pilot RCCs and RCCUs with the potential to be restructured into agricultural commercial banks or agricultural commercial cooperative banks; and (iii) establish a policy framework for microfinance development. Component B, in Guizhou Province, was to (i) build capacity for RCC staff; (ii) develop provincial and county governments’ understanding of microfinance policy, regulatory, and institutional development, as well as the capacity to support it; and (iii) develop and implement a competitive bidding process to establish a licensed model MFI in Jiangkou County and in the adjacent counties.

Under TA 4430, a wide range of options for reform and licensing was tested by various interest groups (including national-level regulators), thus increasing the level of engagement and openness to change. The TA project included numerous intensive training and workshop sessions, which ended with agreements on RCC reform implementation. A bidding process was conducted in both IMAR and Guizhou Province, with an MCC license issued in each as a result. This methodology, developed for the successful licensing of MCCs, was adopted by other provinces as well.

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The outputs of both the RCC reforms and bidding procedures were used as a market discovery process by the CBRC and PBOC to facilitate improvements in licensing and regulation at the national level, and to educate local governments. The PBOC added IMAR to the list of four areas designated for pilot MCCs. Partly as a result of the extensive research and learning under this TA project, in December 2006 the CBRC issued a set of principles governing the expansion of access to finance in rural areas. Both components of the TA project were rated highly successful by reviewers, and it was designated as one of the ten top donor projects in the country for 2006. The project was extended for 25 months due to the high level of engagement with stakeholders.

Inclusive and balanced economic growth has been a key strategic objective for the ADB for a number of years, and the PRC reforms aim to minimize the gaps between rural and urban populations. Details of the key strategies and policy priorities concerning financial inclusion are provided in section 3.3. Despite the fact that TA 4430 began in 2004 and ended in 2007, it aligned well with current ADB and PRC policies and priorities for financial inclusion in the following ways:

(i) As mentioned above, pillar 1 of the country partnership strategy (CPS) is inclusive growth. The restructuring of RCCs and the establishment of new MFIs (specifically, MCCs) in rural provinces directly support the CPS goal of improving access to microfinance and SME finance in rural areas, especially given that MFIs typically target MSMEs. As a result of this project, livelihood opportunities for the poor in these regions will be expanded. Under the CPS, ADB will continue to support microfinance, SME finance, green finance, and municipal finance.

(ii) TA 4430 promoted the objective set out in ADB’s Financial Sector Operational Plan (FSOP) of financial inclusion by improving access to credit for the traditionally underserved, particularly poor households and MSMEs. Moreover, through its support for policy development, TA 4430 contributes indirectly to the strengthening of nonbank financial institutions that provide MSMEs with financing.

(iii) Inclusive economic growth is one of the three strategic agendas of ADB’s Strategy 2020, with the goal of creating an enabling environment for microfinance, rural financial institutions, and finance for SMEs.

(iv) The TA project supported a number of the State Council’s recommended measures by encouraging financial institutions to provide credit to small and micro enterprises, and to make credit more available in rural regions and the agriculture sector by encouraging the development of new financial products.

(v) An objective set out in the PRC’s 12th Five-Year Plan is to minimize the gap between urban and rural standards of living by improving the rural population’s access to financial services and by promoting the expansion of the financial industry through innovative approaches with a focus on micro enterprises. TA 4430 directly contributed to the accomplishment of these objectives.

In addition to aligning with the PRC and ADB strategies for financial inclusion, this TA project dovetailed into other current priorities, such as institutional development, regulation, and capacity building. The State Council’s finance policy measures also involve the restructuring of financial institutions, including the exploration of supervisory mechanisms for various
types of banking. Under the FSOP, ADB will support efforts to improve macroprudential and microprudential regulation and supervision of financial institutions and markets, and will promote their accountability and transparency. This includes the strengthening of risk management and corporate governance of individual financial institutions and the restructuring of banks. The FSOP calls for ADB to “support the enhancement of the regulatory framework and supervisory capacity,” and “to provide [technical assistance] on risk management by and promote sound corporate governance of both banks and nonbank financial institutions.”

Finance sector development is a core area of operations in ADB’s Strategy 2020, which specifies that ADB will “continue to help build the capacity of financial institutions—and of their regulators—by introducing international best practices.”

3.2.2 Rural Finance Development and Supervision

The PRC has recognized that rural financial-market development requires committed public support. But public support in the past did not generate sustainable results or encourage improved institutional behavior. The CBRC needs to ensure that its regulatory practices facilitate rural financial services so that a balance can be achieved between effective regulation and a healthy and stable rural financial system. The TA project for Rural Finance Development and Supervision (TA 7187) included a review of public support and regulatory practices in the PRC and of experiences in a selected number of developed countries. It also offered recommendations for an effective public policy support program and for adaptive regulatory practices to assist the development of rural financial markets.

The expected outcomes included improvements in policy formulation, institutional coordination, and in the regulation of rural financial markets, with the objective of improving the depth and breadth of rural financial services. The final report and policy notes were accepted by the CBRC, and almost all the recommendations (except one) were incorporated into the CBRC’s new policies on a range of key banking issues, including the issuance of community reinvestment rules, rural bank supervisory systems, and secured transaction legislation. TA 7187 was rated successful by reviewers.

TA 7187 mapped well to all the strategic agendas of ADB and the PRC because it supported inclusive growth, particularly by improving living standards in rural areas by increasing the access of rural residents to microfinance and SME finance (see subsection 3.2.1).

In addition, there is the shared focus on regulation. Many PRC and ADB priorities encourage the development of regulatory practices in line with international standards. For instance, the FSOP states that ADB should promote the adoption of international standards and best practices such as those set by the Basel Committee on Banking Supervision, the International Organization of Securities Commissions (IOSCO), and the International Association of Insurance Supervisors (IAIS). Finance sector development is also a priority for Strategy 2020, with ADB expected to continue to help build the capacity of financial institutions.

25 Footnote 9, p. 16.

26 Footnote 8 p. 20.

institutions and their regulators by introducing international best practices. TA 7187 mapped well to all these strategic goals, in addition to those concerning financial inclusion.

### 3.2.3 Rural Finance Innovation and Rural and Agriculture Financial Statistical System Development

Rural finance policy research in the PRC has long had a macro-level focus. Consequently, researchers have rarely looked at rural micro-level financial-market issues such as financial product innovation. There was, however, an identified need to improve the rural and agricultural statistical system to meet the demand from various government agencies and other stakeholders for micro-level information relevant to policy making on rural and agricultural finance. Existing statistical systems were limited in their coverage, classification methods, and institutional capacity.

There were two components of the TA project for Rural Finance Innovation and Rural and Agriculture Financial Statistical System Development (TA 7322). Component 1 focused on how to encourage innovation in rural finance and ensure that the government’s top-down policy objectives and bottom-up initiatives could be consistently combined for the sustainable development of the rural financial market. Component 2 provided recommendations on designing and establishing a rural and agriculture financial statistical system at the PBOC for the proper monitoring of rural financial flows for policy-support purposes. Both components used a range of surveys and case studies, as well as reviews of local and international practices.

TA 7322 mapped well to ADB’s and the PRC’s inclusive-growth agendas, particularly by improving living standards in rural areas through better access to finance and innovative financing solutions. In addition to financial inclusion, TA 7322 advanced the PRC and ADB strategic agendas for improving regulatory practices (see subsection 3.2.1).

### 3.2.4 Establishment of Microinsurance

Microinsurance is an emerging market in the PRC, as it is in many other developing countries. The global program “Access to Insurance Initiative” was launched in October 2009 as a new collaborative approach between international development agencies and insurance supervisors through the IAIS. The TA project for Establishment of Microinsurance (TA 7525) applied the methodology of the Access to Insurance Initiative in the PRC and Mongolia, and generated the following outputs: (i) country assessment reports of the market and policy environments for microinsurance; (ii) an evaluation of the existing microinsurance pilots; (iii) a road map for policy and regulatory improvements; and (iv) the implementation of the first set of reforms and the initial removals of market barriers.

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29 ADB. 2010. *Establishment of Microinsurance*. Manila (TA 7525-REG, $750,000 [$690,838 utilized], approved on 26 April, completed on 31 October 2013, financed by the Regional Cooperation and Integration Fund under the Regional Cooperation and Integration Financing Partnership Facility).
TA 7525 mapped well to ADB and PRC strategies, as it supported inclusive growth by assisting in the development of insurance coverage that would be accessible to the low-income population in rural areas and add to the range of services for these poorer households (see subsection 3.2.1). As part of its support for inclusive growth, the FSOP notes that microfinance should extend beyond credit to encompass other types of finance, such as insurance. The 12th Five-Year Plan provides for the expansion of the range of insurance services, the exploration of innovative ways to market insurance, and the establishment of an improved insurance system.

The TA project also aligned with the focus of both the FSOP and Strategy 2020 on improving the regulatory framework and supervisory capacity. The FSOP includes the adoption of international standards and best practices such as those set by the IAIS (see subsection 3.2.1). The FSOP supports developing member countries (DMCs) in their efforts to devise legal, regulatory, and supervisory frameworks (as well as investment and risk-management policies) for pensions and insurance.

### 3.2.5 Capacity Building on Statistical Competence for County-Level Financial Institutions

The TA project for Capacity Building on Statistical Competence for County-Level Financial Institutions (TA 8099) is building on the TA project for Rural Finance Innovation and Rural and Agriculture Financial Statistical System Development (TA 7322) by establishing methods for integrating computerized data systems into existing accounting systems in small rural financial institutions, and by arranging for electronic submission and monitoring by local PBOC offices. TA 8099 included a pilot program to develop a methodology for the computerized submission of rural credit data to the PBOC, and used the results of the pilot program to develop an information technology (IT) framework (including a template) for rural financial institutions, so that they can manage their statistical data as a knowledge product. This is being supported with training courses, materials, and workshops. Better comprehension and use of data by small rural financial institutions should follow, and the data will allow regulators to analyze risk exposures and other aspects of the insurance industry.

Although TA 8099 is an ongoing project, its outcomes are expected to align with the PRC’s and ADB’s strategic agendas by supporting inclusive growth with better information on financial flows to rural areas. The outcomes of TA 8099 will thus enable policy makers to improve the rules governing the finance industry so as to increase access to credit in rural areas (see subsection 3.2.1). In addition to financial inclusion, TA 8099 supports ADB’s and the PRC’s strategic agendas for improving regulatory practices and supervisory capacity (see subsection 3.2.1).

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3.2.6 Innovations in Credit Risk Management and Financial Service Capabilities for Rural Commercial Banks in Tianjin Municipality

The Tianjin Rural Commercial Bank (TRCB) was formed in 2010 from the merger of the Tianjin Rural Cooperative Bank and nine rural county and district credit cooperatives. The TRCB had weak credit-risk appraisal systems, undeveloped finance-risk management and control practices, and a lack of innovative finance products geared to rural areas (these were also major challenges for other rural-based financial institutions across the PRC). The expected outcome of the TA project for Innovations in Credit Risk Management and Financial Service Capabilities for Rural Commercial Banks in Tianjin Municipality (TA 8496) is increased access to credit for rural residents and rural small businesses in the Tianjin area through an expanded offering of financial products and services. The outputs of TA 8496 are expected to include: (i) an assessment of the TRCB’s rural credit processes in light of international best practices and the preparation of a new system and strategy; (ii) the design and development of a data-management and IT system plan; (iii) a rollout schedule for supporting credit for rural residents and SMEs, and for rural financial products; and (iv) the institutionalization and dissemination of an effective rural credit-risk appraisal system, financial product strategy, and risk-management system within the TRCB and other rural commercial banks in the Tianjin area.

TA 8496 is an ongoing project, but the expected outcomes will align well with ADB and PRC strategies by supporting inclusive growth, particularly by improving the living standards of rural areas through better access to microfinance and SME finance (see subsection 3.2.1). They also align with the ADB and PRC strategies regarding credit processes and risk management. With the aim of financial stability and integrity, ADB is providing assistance through the FSOP to banks and nonbank financial institutions to promote better risk management and sound corporate governance. The PRC’s 12th Five-Year Plan notes the need to strengthen the internal control and risk management of the country’s financial institutions. And finance sector development is a priority for ADB’s Strategy 2020, with the goal of increasing the capacity of institutions and regulators.

3.2.7 Development of SME Alternative Financing Mechanism

The TA project for Development of SME Alternative Financing Mechanism (TA 3930) assisted the SME department of the National Development and Reform Commission (NDRC) by studying the policy environment, government functionality, and finance-support mechanisms in four countries (India, Japan, the United Kingdom, and the United States), and by reviewing the situation in the PRC. The report made recommendations on government policy in support of SME access to finance, including:

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(i) building the capacity of the SME department of the NDRC for institutional structure and functionality;
(ii) enhancing access to debt capital by forming an SME policy bank, providing incentives to banks and nonbank financial institutions for SME finance, establishing a pilot program for local SME-focused banks, and strengthening SME credit guarantees;
(iii) enhancing access to equity capital by developing an effective legal and regulatory environment for equity investment, and by promoting venture capital firms and small business investment companies; and
(iv) developing SME support systems and SME-related intermediaries.

TA 3930 mapped well to ADB and PRC strategies regarding inclusive growth, particularly by improving SME access to financing mechanisms (see subsection 3.2.1). In this regard, the TA project mapped specifically to the FSOP and to the 12th Five-Year Plan. Under the five-year plan, the PRC is working to establish a sound financial service and credit-guarantee system for SMEs, increase the size of loans and the percentage of total lending to SMEs, and to broaden the channels of direct financing in the manufacturing sector.

3.2.8 Development of Small and Medium-Sized Credit Guarantee Companies

To address the difficulties of SMEs in accessing finance, many local governments and business communities established SME-oriented credit guarantee companies (CGCs) in the mid-1990s. The CGC market failed to develop as successfully as expected, however, sparking a range of negative responses. The TA project for the Development of Small and Medium-Sized Enterprise Credit Guarantee Companies (TA 4350) built on this prior effort by recommending the establishment of an effective policy, regulatory, and operational framework for SME-oriented CGCs. It recommended improved and standardized operational modalities for CGCs; a revised CGC regulatory and supervisory framework; and suggested a revision of past and outdated laws and regulations covering CGCs. The TA project also examined various options for the design of a mature re-guarantee system, and suggested solutions involving the publicly funded National Re-Guarantee Institution, as well as private provincial and urban re-guarantee companies, whose risks are all assumed by National Re-Guarantee Institution.

TA 4350 was rated successful by reviewers. The recommendations were broadly accepted and helped relevant agencies amend laws, regulations, and administrative measures concerning SME-oriented CGCs. It also helped to strengthen the institutional capability of the NDRC.

This TA project mapped well to the ADB and PRC strategies for inclusive growth, particularly by improving the access of SMEs to finance mechanisms through the use of CGCs (see subsection 3.2.1). TA 4350 mapped specifically to the 12th Five-Year Plan (see subsection 3.2.7).

Footnote 24 (TA 4350-PRC, $550,000 [$549,987 utilized], approved on 18 June 2004, completed on 30 April 2007).

Footnote 24 The NDRC was designated as the primary regulator, responsible for monitoring CGC auditing, accounting, licensing, regulatory reporting, and inspections.
3.2.9 National Fund for Development of Credit Guarantees for Private Enterprises

This TA project (TA 4725) supported the establishment of the National Fund for Development of Credit Guarantees for Private Enterprises (NCG), which was intended to be an effective and sustainable mechanism for the use of foreign and private sector capital for businesses. The NDRC developed the NCG proposal in a concept paper endorsed in 2004. The fund’s objective was to support private sector development in the PRC by facilitating access to finance, and to establish an effective institutional framework and funding mechanism at the central government level to streamline the CGC market.

The NDRC received the approval of the State Council in May 2009 to form the NCG through a joint venture between foreign investors and local financial institutions. TA 4725 assisted by developing an effective and sustainable mechanism for the use of foreign and private sector capital for private enterprises, improving the administration and operational efficiency of the NCG, and promoting prudent risk-management standards for the NCG. Technical reports were prepared covering all aspects of NCG operations, including an analysis of the legal environment, governance of the NCG, risk assessment and control, the development of a custodian system, and the NCG legal structure. Many of the outputs from the TA project were used in the development of the NCG, including the operating business plan.

TA 4725 was rated successful by reviewers. The operationalization and implementation plans developed under the TA project addressed the challenges that would accompany the establishment of the NCG, which was planned for the end of 2010.

The TA project mapped well to the PRC and ADB inclusive-growth strategies, particularly by improving the access of SMEs and other private enterprises to finance mechanisms through the NCG (see subsection 3.2.1). It also mapped well to the 12th Five-Year Plan (see subsection 3.2.7).

3.2.10 Capacity Development of Partner Banks in Microfinance Wholesale Lending

The TA project for Capacity Development of Partner Banks in Microfinance Wholesale Lending (TA 7765) was designed to help partner banks improve their business processes for wholesale lending to microcredit companies (MCCs), deliver capacity-building activities to relevant personnel, and prepare knowledge products in the form of best practices reviews and policy recommendations for policy makers and the general banking and microfinance communities. Tasks included reviewing PRC and international practices, developing effective business strategies to manage wholesale lending start-up and operations, promoting good practices, creating a credit-review process, developing a scorecard for MCC loan


evaluations, and implementing capacity-building training sessions. The final report provided policy recommendations for addressing the concerns of the partner banks (e.g., shortage of dependable data), as well as other issues concerning implementation that may be the focuses of follow-up TA projects.

TA 7765 mapped well to all the PRC and ADB strategic and policy priorities by supporting inclusive growth, particularly because it improved the access of SMEs to finance mechanisms by increasing funding to MCCs that finance SMEs (see subsection 3.2.1).

In addition to its aims regarding financial inclusion, this TA project mapped to ADB and PRC strategies regarding finance sector development. The FSOP highlights the need to provide risk-management assistance to and promote sound corporate governance in banks and nonbank financial institutions. Finance sector development is a core area of Strategy 2020, with an emphasis on building the capacity of financial institutions by introducing international best practices. The PRC’s 12th Five-Year Plan includes measures to deepen the reform of financial institutions by strengthening internal control and risk management.

3.2.11 Microfinance Wholesale Lending Facility

The Microfinance Wholesale Lending Facility (Project 45907) was designed to promote access to credit for households and micro and small enterprises, particularly in the underdeveloped regions of the PRC. Despite its rapid growth, the MCC market lacks wholesale funding from banks for on-lending. There has been some lending to MCCs from large state-owned banks, but these banks have been unable to sustain their loans to MCCs due to limitations in bank branch networks and a lack of efficient decision making at the local level. Local commercial banks are potentially strong wholesalers to MCCs, as they are licensed to operate in local markets and have a better understanding of and access to MCCs.

The ADB facility for the loan totaling CNY130 million was approved for qualified local partner banks that would on-lend to MCCs. The facility is intended to develop the banks’ capacity to engage in wholesale lending to MCCs, enhance MCC financial and institutional capabilities, and reinforce regulatory oversight of the MCC market (through strengthened relationships among MCCs, local banks, and local government regulators). The lending facility was established in tandem with the TA project for Capacity Development of Partner Banks in Microfinance Wholesale Lending (TA 7765). To ensure proper risk management, financial performance, and social impacts for this new type of wholesale lending, eligibility criteria and due diligence processes will be applied to partner banks (including ADB’s internal ratings for banks) and to MCCs (by partner banks in accordance with ADB requirements). MCCs that borrow facility funds from partner banks will be required to make loans that satisfy certain criteria such as meeting environmental standards or supporting employment of women.

This loan facility supports the PRC and ADB strategies for inclusive growth, particularly as it will improve SME access to finance mechanisms (see subsections 3.2.1 and 3.2.7).

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37 ADB. 2012. Report and Recommendation of the President to the Board of Directors: Proposed Loan to the People’s Republic of China for the Microfinance Wholesale Lending Facility. Manila (Project 45907, CNY130 million [$20,600], approved on 28 March).
3.2.12 Credit and Social Rating System Development for Microcredit Companies

MCCs are limited by the sizes of their capital bases and geographic coverage (they are restricted to one county each), and they are primarily financed by the owners’ equity investments. MCC borrowing from commercial banks is severely limited, as banks are wary of these unrated financial operators, and investors are equally hesitant about placing equity in MCCs. Independent ratings of MCCs would thus significantly improve equity investments and lending capacity. In addition to helping MCCs attract funds, a ratings system would assist regulators in tracking performance, and would help the government determine the social impact of MCCs and develop policies to promote them. However, there is currently no established system of rating agencies to provide assessments of MCCs on financial and social performance.

The aim of the TA project for Credit and Social Rating System Development for Microcredit Companies (TA 8282) is to develop systems for rating the financial and social performance of MCCs, starting with Heilongjiang Province. Three rating agencies were selected to develop dual financial and social credit ratings for MCCs, and to work with provincial regulators to help them understand the rationale, systems, and use of the ratings. Under the TA project, 15 microcredit companies were selected—based on loan portfolio size and operating history—to receive ratings based on the methodologies developed by the ratings agencies. The provincial regulators then approved the rating agency or agencies they deem qualified to rate the MCCs.

Although TA 8282 is an ongoing project, its expected outcomes will map well to current PRC reforms and to ADB’s strategy of supporting inclusive growth, particularly by improving the access of SMEs to finance mechanisms (see subsections 3.2.1 and 3.2.7).

3.2.13 Innovative Small and Medium-Sized Enterprise Bond Financing and Investor Protection Mechanism

SME access to bond markets has remained limited due to the underdevelopment of markets for high-yield bonds. Despite government efforts to promote SME bonds—introducing an SME collective bond scheme, SME bonds from local governments, and SME private placement bonds—the PRC’s corporate bond market remains dominated by large enterprises. Developing a sustainable high-yield bond market with investor-protection mechanisms is critical for providing secure and longer-term financing to SMEs (as a complement to bank financing). The major expected outputs of the TA project for Innovative Small and Medium-Sized Enterprise Bond Financing and Investor Protection Mechanism (TA 8461) include:

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39 Footnote 24 (TA 8461-PRC, $400,000 approved on 25 September 2013, completion expected on 30 June 2015).
(i) a comprehensive report on innovative SME bond financing, including a review and assessment of the corporate bond market in the PRC compared with international best practices, to identify the preconditions for a successful high-yield bond market;

(ii) a road map with specific policy recommendations for developing market infrastructure, high-yield bond markets, and an appropriate legal and regulatory framework, with measures for diversifying and expanding the investor base, building a proper legal framework, and designing an efficient regulatory and enforcement system;

(iii) a report on investor-protection mechanisms, including a review of the existing investor-protection mechanism in the PRC compared with international best practices and case studies, as well as policy recommendations; and

(iv) improved capacity of regulatory authorities, and the promotion of knowledge sharing through an international conference.

TA 8461 is an ongoing project, but its expected outcomes will align well with ADB and PRC strategies by supporting inclusive growth, particularly by improving SME access to finance mechanisms (see subsections 3.2.1 and 3.2.7).

Under Strategy 2020, ADB is facilitating the creation of a harmonized regulatory framework for the emerging Asia and Pacific regional bond market, a common credit guarantee mechanism, and a regional clearing and settlement system. Through such initiatives, ADB will continue to assist in channeling the region’s savings into the most productive investments, particularly into the development of capital markets.

### 3.2.14 PRC: Liberty New World Fund (Private Sector Investment)\(^{40}\)

Under PS 7159, $25 million was approved for investment in the Liberty New World China Enterprises Investments, LP, which was established to help spur the growth of SMEs in the PRC. The fund invests in small-to-medium-sized consumer-related companies that are in the development or expansion phase. It aims to help transform these companies into financially and operationally sound businesses.

This project aligns well with the ADB and PRC strategies of supporting inclusive growth by providing funding for SMEs (see subsections 3.2.1 and 3.2.7).

### 3.2.15 Business Development Bank (Private Sector Loan)\(^{41}\)

Under PS 7216, a private sector loan of €20.7 million was approved for the United Commercial Bank (China) Ltd., a wholly foreign-owned bank focused on lending to medium-sized enterprises in the PRC.

This project aligned well with the ADB and PRC strategies of supporting inclusive growth by providing funding that was directed at SMEs (see subsections 3.2.1 and 3.2.7).

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\(^{41}\) ADB. 2005. *Business Development Bank*. Manila (PS 7216, €20,717,000, approved on 11 August, completed on 23 February 2006). This was a loan to the United Commercial Bank (China) Ltd.
3.3 Fulfilling Policy Priorities

ADB’s work on financial inclusion can be mapped to the key ADB and PRC strategy and guideline documents as follows:

3.3.1 ADB’s Country Partnership Strategy (2011–2015)

ADB’s country partnership strategy (CPS) for the PRC for the period from 2011 to 2015 describes its pillar 1 as inclusive growth. The objective is to foster balanced and equitable growth supported by integrated rural and urban development in ways that will expand livelihood opportunities for the poor. Improving the access of micro, small, and medium-sized enterprises (MSMEs) to financing is a goal of rural development support.

Private sector development is recognized in the CPS as a driver of change, with ADB’s public sector operations seeking to strengthen the enabling environment for private sector development by supporting policy and regulatory reforms and improving access to finance. One aspect of ADB’s nonsovereign operations is the continued financing of catalytic projects focusing on innovative financial solutions for MSMEs. Another driver of change is good governance and capacity development, with ADB supporting the government’s efforts to strengthen the policy, legal, fiduciary, and regulatory frameworks and practices in the interest of improving the environment for private sector development.

Although finance is not deemed a priority sector under the current CPS, access to finance in the priority sectors remains an important operational objective, including continued support for microfinance and SME finance.

In the priority sector of “natural resources and agriculture,” major areas for support include rural social and financial services, particularly rural pension reform, and microfinance and SME finance to enhance rural livelihood opportunities.

3.3.2 ADB’s Financial Sector Operational Plan (2011–2014)

The FSOP recognizes that financial inclusion is an important theme for most ADB developing member countries (DMCs), and is key to achieving inclusive and balanced economic growth. ADB concentrates on promoting financial access for the traditionally underserved, particularly poor households and SMEs. It also notes that microfinance should go beyond credit to include savings, payments and remittance services, insurance, and pensions.

To improve SME access to finance under the plan, ADB is helping its DMCs enhance their secured and unsecured lending regimes, including those in trade finance. ADB has also supported credit guarantee subsectors, and has helped DMCs strengthen their nonbank financial institutions that provide SME finance; ADB’s support in this domain is both direct, through nonsovereign operations (including investment via private equity funds), and indirect, through policy support. And ADB has helped DMCs develop equity markets for SMEs, as well as venture capital and private equity funds.
3.3.3 ADB’s Strategy 2020 (2008–2020)

The ADB issued its long-term strategic framework, Strategy 2020, to guide its operations in pursuit of its vision of an Asia and Pacific region free of poverty. Along with the three strategic agendas (inclusive economic growth, environmentally sustainable growth, and regional integration), Strategy 2020 identified the finance sector as one of the five core areas of ADB operations, together with infrastructure, environment, education, and regional cooperation and integration. To promote inclusive growth, the ADB is working to create an enabling environment for microfinance, rural finance institutions, and SMEs; and it is exploring the use of technology to expand the reach of the formal financial system into rural areas.

3.3.4 PRC State Council Financial Policy Measures

One of the finance policy measures set out by the State Council is to encourage financial institutions to provide services to small and micro enterprises. This is to be done by helping qualified banks to issue special financial bonds and to channel funding into these enterprises.

Another measure set out by the State Council is to expand credit to rural regions, especially in the agriculture sector, by encouraging financial institutions with exposure in these markets to open new outlets and develop new financial products. The intention is to initiate at least the same number of new loans as in 2012, and to increase the number of loans under the San Nong (agricultural or rural) reform so that their growth rate is at least equal to the average growth rate for all loans.

3.3.5 The PRC’s 12th Five-Year Plan (2011–2015)

Under the 12th Five-Year Plan, the PRC focuses on rural development, including minimizing the gaps between urban and rural living standards and public services. Although the plan does not specifically target the improvement of rural financial services, ADB’s work in rural finance will contribute to better living standards for rural populations by expanding their access to credit.

With regard to manufacturing, the plan promotes SME development by establishing sound financial services and a credit guarantee system for SMEs, increasing the size and percentage of lending to SMEs, and by broadening the channels of direct financing.

The plan also seeks an orderly expansion of the financial industry by, among other things, encouraging development and innovation in organizational structures, products, and services so as to raise the overall quality of financial services. Scientific innovation is also promoted, with a focus on micro enterprise development.

3.3.6 Overall Assessment

All the TA projects (and loan and investments) focusing on financial inclusion align very well to all the key strategy and policy priorities of the PRC and ADB. In particular, financial
inclusion is a major policy priority, with improved access to finance for SMEs and rural residents highlighted in all the policy documents as key objectives.

In addition to mapping to the PRC and ADB strategies with regard to financial inclusion, many of the projects summarized in this chapter also map to other areas of reform, including those relating to regulatory and supervisory practices, risk management in individual institutions, and capacity building for regulators and institutions (see section 4.3).

### 3.4 Development Opportunities

The PRC has been successful in encouraging savings and investment, but access to finance—especially for MSMEs and residents of rural areas—remains a central challenge for re-balancing and sustaining economic development. Particular issues include:

(i) **Rural finance.** Despite impressive development, rural areas (as well as many parts of urban areas) are still poor, and rural finance remains a weak link in the PRC’s overall financial system.

(ii) **Finance for micro, small, and medium-sized enterprises.** Although the government has implemented a range of policies in support of microfinance and SME finance, MSMEs continue to face financing constraints that limit the PRC’s potential for more inclusive, balanced, and sustainable economic growth.

(iii) **Entry of new private sector providers.** In light of the government’s announced support for the development of a multitiered financial system, PRC policy makers are committed to opening markets to new participants. However, the challenges are many, including ensuring that:

(a) operators are fit and proper;
(b) new entrants are well run and meet all licensing and prudential requirements;
(c) new institutions borrow and re-lend to the community rather than simply collecting deposits and investing in highly rated corporate paper (i.e., taking the margin with no credit assessment costs); and
(d) new entrants are properly regulated and supervised.

In view of the high priority given to financial inclusion by both ADB and the PRC, there appear to be excellent development opportunities for ADB. Any future support by ADB should seek to build on the successes of earlier projects in this area. Some of the lessons that have emerged from previous experiences include:

(i) the importance of working closely with regulators when designing and executing policy reforms;
(ii) the importance of pilot studies for making implementation more effective; and
(iii) the value of focusing on practical issues that add significant value, such as improving data capture and removing specific road blocks in legislation or capacity.
Specific areas in which ADB resources might add value include:

(i) **The development of community banking models and franchises.** While it may be possible to develop a community banking model through commercial banks or rural credit cooperative unions (RCCUs), it should also be possible to use franchise principles to enable the entry of new financial institutions. Under the franchise approach, prospective franchisees or communities would obtain access to banking platforms, use common systems and controls, and receive training. Each franchisee would be subject to quality assurance and examination according to standard systems. A condition of franchise licenses could be the reinvestment in the local community of funds borrowed from the community.

One of the advantages of this approach for the regulator would be greater efficiency in assessing new licence applications. The licensing process can take many months, involving assessments of financial strength, governance, management, and systems, in addition to on-site visits. With the franchise approach, applicants will have already been screened by the franchisor to gauge financial strength and integrity and to ensure that the franchisee’s systems are adequate and the staff well trained. In this situation, regulatory due diligence could focus on adherence to fit and proper requirements, financial strength, and quality of the business plan.

(ii) **Supervisory and legal frameworks for microfinance institutions.** There should be reviews of regulatory requirements, laws, and supervisory practices to support an environment that enables and encourages the development of inclusive finance. Whenever possible, road blocks to inclusion and innovation should be identified and removed.

Although MCCs function according to rules set by the China Banking Regulatory Commission (CBRC), they are overseen by the provincial governments, which appoint financial or other authorities as regulators. The supervision, regulation, and reporting requirements for MCCs are not standardized nationally, and are not always adequate. Moreover, as non-deposit-taking institutions with restrictions on borrowing, MCCs face funding constraints. The possibility of a two-tiered supervisory framework within the CBRC could be explored to address these issues.

Reviews of regulatory regimes should also focus on the requirements concerning corporate governance, internal control, and risk management. And there should be more training in these areas for MCCs and local regulators. Credit-risk-management skills should be a key focus, given the lack of collateral of micro and small enterprises and the unsecured nature of many of their loans. The development of a credit-risk-assessment system and associated training may be an avenue for ADB to consider. In an environment of interest rate liberalization, effective corporate governance and risk-management capabilities will be essential.

(iii) **Improvement of the credit system.** Many institutions do not have sufficient information on the credit histories of clients to adequately assess the associated credit risk. ADB could assist in the development of localized cooperative credit reference agencies that would provide both positive and negative credit scores on local individuals and entities.
4.1 Overview

Since the early 1990s, the PRC has made significant reforms in its financial system. While the system is still tightly controlled compared with those of other G20 countries, there is a demonstrated commitment to move to a market-based approach, with market-driven allocation of capital and international regulatory practices.

Reforms have included the recapitalization of the government-owned banks and partial listings, selected adoption of international regulatory principles, opening of the financial system, and the acceptance of greater innovation in capital markets. Moreover, under the PRC’s World Trade Organization (WTO) accession agreement, the PRC committed to opening its banking market.

Following extensive legal and regulatory developments, the PRC has put in place the main elements of a financial regulatory structure similar to those found in other G20 economies to help make financial markets more efficient and to support financial stability. The current regulatory structure of the financial system includes the following:

(i) **People’s Bank of China**. The People’s Bank of China (PBOC) is the PRC’s central bank. Prior to 2003, the PBOC was also responsible for regulating the banking sector.

(ii) **The China Banking Regulatory Commission**. The China Banking Regulatory Commission (CBRC) was established in 2003 to strengthen banking supervision and regulation. The CBRC oversees banks as well as credit cooperatives, asset-management companies (AMCs), finance companies, and trust and investment companies.

(iii) **The China Securities Regulatory Commission**. The China Securities Regulatory Commission (CSRC) was established in 1992 to regulate the PRC’s securities and futures markets. Its functions were expanded on 1 July 1999, with the enactment of the Securities Law.

(iv) **The China Insurance Regulatory Commission**. The China Insurance Regulatory Commission (CIRC) was established in 1998 (with increased functions in 2003) to administer, supervise, and regulate the PRC’s insurance market.

Historically, problems in the banking sector included the high levels of nonperforming loans (NPLs), capital shortages, poor governance and risk-management skills, weak commercial orientation, and low productivity. The prudential banking reforms in 2003 gave the CBRC...
the authority to approve new banks and to formulate prudential rules and regulations, as well as the powers of examination and enforcement. The CBRC has been active in carrying out its responsibilities, and significant progress has been made toward strengthening banking supervision.42

However, banking sector supervision needs to be strengthened even further, and financial liberalization must be managed with careful sequencing and monitoring. In addition, banks continue to dominate the financial sector, which remains government-centric in terms of ownership and activities.

Beyond the regulatory structure and implementation of risk-based prudential supervision, the PRC has acknowledged the need to reduce government intervention in commercial banking operations (“deregulation”) and to encourage a more market-based approach to credit decision making, for instance by reducing or eliminating interest rate controls, for more efficient capital allocation and greater discipline on the part of industry participants.

The move to a more market-based financial system will need to be accompanied by greater clarity regarding the nature of guarantees for the various financial instruments. Reference was made in Chapter 2 to the evolving deposit insurance model for the PRC. Investors will need to be informed about the extent and limitations of such safety-net arrangements. They should be provided with clear statements regarding the risk of loss, and proceed with the understanding that they bear the risk of any credit default. In particular, the government will need to minimize false perceptions of guarantees, while understanding the difference between situations calling for intervention to avert financial crisis and situations in which investors must bear the risk. The dangers of misperception were illustrated in the recent use of public funds to bail out investors in failing trust companies.

According to PBOC figures, trust loans and designated loans made by trust companies account for nearly 30% of new credit and more than 70% of gross domestic product (GDP). While some trust companies have well-managed portfolios, a considerable portion of the growth appears to have resulted from attempts by commercial banks to avoid regulations that limit their ability to make such loans. This is an example of “regulatory arbitrage,” i.e., the use of loopholes to get around government regulations that block opportunities for profit. Trust companies are not subject to the same capital and leverage ratios as banks, nor to the interest rate limits or other restrictions on loans to sectors that have been identified as too risky.

Most trust companies are associated with banks, a situation that increases the potential for regulatory arbitrage. Trust companies provide “bank-trust cooperation wealth management products,” which are usually short- to medium-term notes (up to 3 years) offering more attractive yields than bank deposits. Typical borrowers have been property developers, mining companies, and local governments using “local government financing vehicles” (LGFVs). The associated bank usually handles the credit process, disbursements, and repayments; and often markets these investments to its clients. The bank receives fees, but bears no credit

risk, as the loan is usually off balance sheet; and it is not clear how the guarantees provided to early issues of such products are treated.

In January 2014, investors in Credit Equals Gold No. 1, a 3-year note issued in 2011 by the China Credit Trust and marketed by the Industrial and Commercial Bank of China, were bailed out when the underlying loans could not be repaid after the collapse of a coal mining company that had been the major borrower. Despite the failure of the coal mining company after the loan had been made, the promised annual returns of 10% were paid during the first two years. On maturity, the principal was paid out, but not the third and final interest payment. The source of the bailout funding was presumed to be the government. While the bailout may have averted a potential crisis, an opportunity was lost to impose market discipline on investors.

The perception of an implicit guarantee for wealth management products (WMPs) such as trust securities is a concern to policy makers. According to Bank of America Merrill Lynch, there was about $660 billion in trust notes due for repayment or refinancing in 2014. While the exact figure is unknown, a disturbingly high proportion of these borrowers will not be able to meet principle repayments, and they should not be refinanced.

This experience suggests that PRC policy makers may need to move quickly to:

(i) develop a clear framework and guidelines for dealing with future failures of trust products;
(ii) improve the implementation and enforcement of laws relating to disclosure of investment risks associated with various financial products, the training and licensing of financial advisors, fair treatment of customers, mis-selling of investment products, dispute resolution, and compensation mechanisms; and
(iii) accelerate the reviews and implementation of market-based mechanisms for credit decision making by commercial banks, including decisions on further interest rate liberalization.

In addition, the PRC’s regulators should advance their application of international accounting standards and enforce consolidated supervision to reduce regulatory arbitrage. They should also implement financial-stability initiatives regarding the identification and prudential regulation of systemically important financial institutions.

4.2 ADB Engagement and Achievements

The ADB has undertaken 15 TA projects and 1 investment with the aim of improving the legal, regulatory, and supervisory structures within the PRC and enhancing the performance of the banking sector. A summary of these projects is provided in Table 4.
### Table 4. ADB Projects to Improve Legal, Regulatory, and Supervisory Structures and Banking Sector Performance

<table>
<thead>
<tr>
<th>ADB Reference</th>
<th>Title</th>
<th>Brief Description</th>
<th>Dates</th>
<th>Amount Utilized ($'000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>TA 3302</td>
<td>TA 3302 Capacity Building for the Insurance Sector Regulatory and Supervision System</td>
<td>To transform the supervisory system of the CIRC into a sound prudential regulatory system fully compatible with best practices for developing markets, including IAIS standards</td>
<td>Nov 1999–Sep 2001</td>
<td>578</td>
</tr>
<tr>
<td>TA 3304</td>
<td>TA 3304 Capacity Building of the Capital Markets’ Regulatory System</td>
<td>To strengthen the oversight, market surveillance, and enforcement functions of the CSRC; develop SRO governance and regulatory standards; and develop training programs for CSRC and SRO staff</td>
<td>Nov 1999–Sep 2002</td>
<td>690</td>
</tr>
<tr>
<td>TA 3098</td>
<td>TA 3098 Strengthening the Banking Supervision and Liquidity Risk Management System</td>
<td>To strengthen the PBC’s supervision and liquidity-management capabilities, using the Shanghai branch for a pilot project</td>
<td>Nov 1998–Jun 2002</td>
<td>685</td>
</tr>
<tr>
<td>TA 3890</td>
<td>TA 3890 Banking Laws and Regulations</td>
<td>To document progress and make recommendations regarding the introduction of new financial laws and the potential consolidation and refinement of the finance sector’s legal framework</td>
<td>Jun 2002–Aug 2004</td>
<td>755</td>
</tr>
<tr>
<td>TA 4240</td>
<td>TA 4240 Foreign Bank Rating and Risk Management System</td>
<td>To establish an effective supervisory framework for foreign financial institutions and to strengthen the CBRC’s capacity for effective supervision</td>
<td>Dec 2003–Jun 2005</td>
<td>270</td>
</tr>
<tr>
<td>TA 4349</td>
<td>TA 4349 Strengthening of the Statistical System of the China Banking Regulatory Commission</td>
<td>To establish a statistical system that would be consistent with risk-based supervision principles and meet the needs of off-site surveillance, on-site inspections, risk assessment, early warning, and information disclosure</td>
<td>Jun 2004–May 2006</td>
<td>337</td>
</tr>
<tr>
<td>TA 4618</td>
<td>TA 4618 Development of Asset-Backed Securities Market and Restructuring of Asset Management Companies</td>
<td>To assist in the preparation of ABS issuances; facilitate the restructuring and corporatization of AMCs; and to advise on the legal, policy, and regulatory environment for domestic and international ABS transactions</td>
<td>Jul 2005–Jul 2010</td>
<td>697</td>
</tr>
<tr>
<td>TA 4746</td>
<td>TA 4746 Bank of China Ltd. for Improving Corporate Governance</td>
<td>To formulate and review relevant policies and procedures on corporate governance, and to conduct training workshops</td>
<td>Dec 2005–Dec 2008</td>
<td>300</td>
</tr>
<tr>
<td>TA 4824</td>
<td>TA 4824 Strengthening the Legal and Implementation Framework for Anti-Money Laundering</td>
<td>To draft an AML law and design an improved regulatory and implementation framework for the AML system</td>
<td>Aug 2006–Jun 2009</td>
<td>295</td>
</tr>
<tr>
<td>TA 7337</td>
<td>TA 7337 Deposit Insurance Establishment</td>
<td>To develop and help establish a deposit insurance system that would be consistent with IADI core principles and country-specific conditions</td>
<td>Aug 2009–Dec 2012</td>
<td>402</td>
</tr>
</tbody>
</table>

*continued on next page*
Table 4  continued

<table>
<thead>
<tr>
<th>ADB Reference</th>
<th>Title</th>
<th>Brief Description</th>
<th>Datesa</th>
<th>Amount Utilizedb ($’000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>TA 7454</td>
<td>Strengthening the Legal Framework for Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)</td>
<td>To build on TA 4824 by proposing legislative reforms to implement the AML/CFT framework</td>
<td>Dec 2009–Jan 2013</td>
<td>124</td>
</tr>
<tr>
<td>TA 7835</td>
<td>Developing a Legal System for the Credit Market</td>
<td>To recommend a legal structure for a multitermed credit market that would be both consistent with international standards and adapted to the needs of the PRC</td>
<td>Jul 2011–Sep 2014</td>
<td>190</td>
</tr>
<tr>
<td>TA 8082</td>
<td>Promoting Private Investment for Social and Economic Development in Shaanxi Province</td>
<td>A report offering recommendations for private sector development, with a focus on increasing investment in identified priority areas in Shaanxi Province</td>
<td>May 2012–May 2015 (ongoing)</td>
<td>64</td>
</tr>
<tr>
<td>TA 8355</td>
<td>Strengthening the Stress Testing Capacity of the Banking System</td>
<td>To develop a stress-testing framework as an integral part of forward-looking risk management of commercial banks, as well as for microprudential and macroprudential supervision by the CBRC</td>
<td>Apr 2013–Nov 2014 (ongoing)</td>
<td>400</td>
</tr>
<tr>
<td>TA 8498</td>
<td>Promotion of a Legal Framework for Financial Consumer Protection</td>
<td>To design a regulatory framework and cooperation mechanism for financial consumer protection</td>
<td>Oct 2013–Apr 2015 (ongoing)</td>
<td>400</td>
</tr>
<tr>
<td>PS 7196</td>
<td>Yangtze Special Situations Fund (equity investment)</td>
<td>Equity investment in a distressed asset fund for nonperforming loans to state-owned enterprises</td>
<td>Mar 2004–Jan 2013</td>
<td>36,300</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td></td>
<td></td>
<td></td>
<td><strong>42,487</strong></td>
</tr>
</tbody>
</table>


a This column includes the start date (approval date) and actual or estimated completion date (projects that are ongoing are noted as such).
b When the figure for the utilized amount is not available, the approved amount is provided instead.


4.2.1 Capacity Building for the Insurance Sector Regulatory and Supervision System

The CIRC was set up in December 1998 and took over the responsibilities of the former Insurance Department of the PBOC. Its mandate was to promote the healthy and orderly growth of the insurance sector in order to facilitate long-term contractual savings. At

the time, the PRC insurance sector was facing a number of constraints (including a weak regulatory and supervisory framework) that were adversely affecting its growth potential.

The TA project for Capacity Building for the Insurance Sector Regulatory and Supervision System (TA 3302) produced a report how to transform the CIRC’s supervisory framework into a sound prudential framework fully compatible with best practices for developing markets, including the standards of the International Association of Insurance Supervisors (IAIS). The report provided a comprehensive list of recommendations for life and non-life insurance coverage, including such areas as statistics collection, solvency, supervisory guidelines, information technology (IT) systems, CIRC structure, and insurance law amendments.

Like a number of other projects discussed in this chapter, TA 3302 did not map specifically to current reforms, as it covered regulatory reforms implemented in the early 2000s. But it would have mapped to PRC and ADB reform strategies at that time, as it contributed to a significant overhauling of the regulatory and supervisory structure. PRC and ADB strategies have since changed, with the insurance industry becoming a lower priority.

This TA project maps to certain elements of current ADB strategies, especially those applying to Asia as a whole. The Financial Sector Operational Plan (FSOP), for example, highlights the need to strengthen regulatory frameworks and supervisory capacity, in particular by promoting the adoption of international standards and best practices such as those set by the IAIS, the International Organization of Securities Commissions (IOSCO), and the Basel Committee on Banking Supervision. Strategy 2020 notes the need to build the capacity of financial institutions, and of their regulators, by introducing international best practices.

4.2.2 Capacity Building of the Capital Markets’ Regulatory System

In 1999 the PRC enacted the Securities Law, which led to the establishment of a separate securities market regulator, the CSRC, designed to provide the comprehensive supervision of the PRC’s capital markets.

The objective of the TA project for Capacity Building of the Capital Markets’ Regulatory System (TA 3304) was to promote the sound and orderly growth of the PRC’s capital markets by (i) strengthening the oversight, market surveillance, and enforcement functions of the CSRC; (ii) developing governance arrangements for self-regulatory organizations (SROs) and regulatory standards for the securities markets in line with guidelines issued by the IOSCO; and (iii) developing training programs for CSRC and SRO staff in the critical areas of international regulatory standards, market supervision, and surveillance operations.

This TA project included an analysis of a broad range of relevant capital-market issues, and the resulting report offered recommendations in line with the best practices for developing securities markets. The report was followed by a policy workshop.

TA 3304 was rated successful by reviewers, although there were some issues concerning the lack of access to relevant stakeholders, which prevented the completion of some of the specified tasks. The report also had some presentational weaknesses, though they did not affect the quality of recommendations.

With regard to the TA project’s mapping to ADB and PRC strategies, see subsection 4.2.1.

4.2.3 Strengthening the Banking Supervision and Liquidity Risk Management System

Despite market reforms, the regulatory and supervision capabilities of the PBOC were seen to be lagging behind market practices. In particular, it was recognized that the PBOC’s banking supervision and liquidity management procedures needed strengthening.

The TA project for Strengthening the Banking Supervision and Liquidity Risk Management System (TA 3098) was intended to (i) develop a system to diagnose and alleviate the temporary liquidity problems that commercial banks can face; (ii) determine the PBOC’s criteria for assisting commercial banks suffering from only a temporary liquidity problem; and (iii) strengthen the PBOC’s banking-supervision capabilities, with appropriate systems for the timely monitoring and control of a commercial bank’s liquidity.

The design of an early-warning system for detecting liquidity problems in commercial banks was a highly critical component of TA 3098. The TA project was rated partly successful by reviewers. The main problem was that crucial preparation for the early-warning system could not be completed due to difficulties in accessing data (caused by confidentiality issues) and to a lack of software support.

With regard to the TA project’s mapping to ADB and PRC strategies, see subsection 4.2.1.

4.2.4 Banking Laws and Regulations

Many laws and regulations governing the PRC’s banking industry were enacted since the mid-1990s, with many inconsistencies and some provisions in conflict with finance sector development.

The objectives of the TA project for Banking Laws and Regulations (TA 3890) were to (i) assist the PBOC in strengthening the legal and regulatory framework of the banking system, (ii) streamline laws and regulations within a systematic banking-oversight framework, (iii) identify legislation that is clearly in conflict with the development of the finance sector, and (iv) amend legislation to align it with the PRC’s World Trade Organization (WTO) commitments. Key areas included coordination among financial regulators, conglomerate

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supervision, the prevention of money laundering, the establishment of a credit information bureau, and policies regarding bank insolvencies.

TA 3890 was rated successful by reviewers despite issues with some individual consultants and the impact of the outbreak of SARS during implementation. Many of the recommendations were intended for inclusion in draft laws. The TA project was supported by training seminars for a number of regulatory bodies on international practices and on tools for the regulation of financial institutions.

With regard to the TA project’s mapping to ADB and PRC strategies, see subsection 4.2.1. In addition to mapping to regulatory reforms in general, the project mapped partly to issues raised by the more recent strategies in the area of anti-money laundering (AML). For example, under the FSOP, along with assistance on risk management and corporate governance in banks and nonbank financial institutions, ADB is supporting AML measures, as TA 3890 identified AML as a key area of concern. The PRC’s 12th Five-Year Plan acknowledges the need to strengthen internal control and risk management in financial institutions, and is addressing this issue by updating regulatory requirements and practices. Strategy 2020 also supports the establishment of AML regimes.

4.2.5 Foreign Bank Rating and Risk Management System

Under its WTO accession agreement, the PRC committed to opening up the Chinese banking market by December 2006; this meant gradually removing restrictions on the activities of foreign banks and enforcing equal treatment of foreign and domestic banks. As a surge in foreign bank activity was expected, possibly increasing the risk to the banking sector, the newly established CBRC needed to develop a modern supervisory framework for foreign banks operating in the PRC.

These issues were addressed by the TA project for Foreign Bank Rating and Risk Management System (TA 4240). The expected outputs of this TA project were: (i) a supervisory rating system for evaluating risk levels and identifying weak areas, (ii) a supervisory information system for sharing information between CBRC headquarters and regional offices, (iii) an adaptation of supervisory activities according to risk level, (iv) supervisory manuals and guidelines for on-site and off-site supervision, (v) a mechanism for cooperation and information sharing with the supervisors of the headquarters of foreign banks, and (vi) a team of CBRC staff equipped with the necessary skills to effectively supervise foreign banks.

TA 4240 was rated successful by reviewers due to the TA project’s high-quality outputs and an effective training program that substantially strengthened the capacity of CBRC staff. Many of the recommendations were incorporated into the CBRC’s supervisory framework documents, regulations, manuals, and guidelines.

With regard to the TA project’s mapping to ADB and PRC strategies, see subsections 4.2.1 and 4.2.4.

4.2.6 Yangtze Special Situations Fund (Equity Investment)\(^{48}\)

The Yangtze Special Situations Fund was designed to capitalize on the efforts of the government to resolve the substantial number of nonperforming loans (NPLs) and to rehabilitate state-owned enterprises (SOEs). This fund was one of the first distressed-asset funds in the PRC.

Under private sector investment PS 7196, ADB committed equity up to $45 million to the fund (or 25% of paid-up capital, whichever was less).

ADB’s Strategy 2020 notes that, to ensure the stability and efficiency of the finance and banking sectors, distressed banks must be restructured.

4.2.7 Strengthening the Statistical System of the China Banking Regulatory Commission\(^{49}\)

When the CBRC was established in 2003, it inherited a statistical system from the PBOC that lacked a comprehensive design, was compartmentalized, did not consolidate information, and did not allow timely interrogation and information sharing. The CBRC gave high priority to establishing a new risk-based statistical system that would adhere to international standards and meet the CBRC’s needs for off-site surveillance, on-site inspections, risk assessment, early warning, and information disclosure.

The TA project for Strengthening of the Statistical System of the China Banking Regulatory Commission (TA 4349) applied international standards and best practices in addressing the system’s weaknesses. The TA project produced a set of statistical indicators, an instruction book for training, and recommendations regarding a decision-tree model as a prudent analytical framework for risk-based supervision. This work was supported by training workshops.

A major achievement was the adoption by the CBRC of a set of carefully designed statistical indicators and reporting formats, as well as a prudent analytical framework for risk-based supervision, which formed a solid basis for a statistical system tailored to the CBRC’s functions of regulating and supervising the rapidly developing Chinese banking sector.

TA 4349 was rated successful by reviewers, largely because of the strong ownership by the CBRC.

With regard to the TA’s mapping to ADB and PRC strategies, see subsections 4.2.1 and 4.2.4.

\(^{48}\) ADB. 2004. Yangtze Special Situations Fund. Manila (PS 7196, equity investment, $45 million [around $36,340,000 invested], approved on 19 March, fund officially dissolved in January 2013).

4.2.8 Bank of China Ltd. for Improving Corporate Governance

The expected outputs of the TA project for Bank of China Ltd. for Improving Corporate Governance (TA 4746) included: (i) reviewing, redrafting, and formulating the Bank of China’s policies and procedures for internal risk management and internal control; (ii) reviewing, redrafting, and formulating AML, anti-terrorism, and anti-corruption policies and procedures, as well as conducting related training workshops; and (iii) coordinating and conducting a workshop on environmental safeguards, initiating a discussion to formulate an appropriate environmental management system, and then finalizing that system.

The TA project mapped directly to a number of key ADB and PRC strategy and policy priorities (see subsections 4.2.1 and 4.2.4). Improved corporate governance is the key to improving the Bank of China’s internal risk-management practices.

4.2.9 Development of Asset-Backed Securities Market and Restructuring of Asset Management Companies

The China Cinda Asset Management Co., Ltd. was established in 1999 as a state-owned enterprise (SOE) managing NPLs stripped out by the state-owned commercial banks. China Cinda faced risks from asset–liability mismatches, and considered mitigating those risks by issuing asset-backed securities (ABS) supported by NPL collection in international and domestic markets.

The TA project for Development of Asset-Backed Securities Market and Restructuring of Asset Management Companies (TA 4618) had three closely related components: (i) assisting the ABS project team of China Cinda in preparing the ABS issuance; (ii) facilitating the restructuring and corporatization of China Cinda and, based on the experience, providing proper restructuring recommendations for other state-owned asset-management companies (AMCs); and (iii) working with the government and finance-sector regulators to streamline the legal, policy, and regulatory environment for ABS transactions.

The first component was put on hold due to the slow progress in establishing an enabling legal and regulatory framework for a domestic ABS issue. Eventually, China Cinda made an international ABS issue, though without the support of ADB. Additional activities were added to the third component, including hosting conferences. With the support of TA 4618, China Cinda successfully managed its corporatization process in July 2010, adopting a financial holding company structure. The fallout from the global financial crisis of 2008–2009 (GFC) eventually halted the proposed attempts to further develop the ABS market in the PRC. TA 4618 was rated partly successful by reviewers, with the second and third components rated successful.


With regard to mapping this project to ADB and PRC strategies, see subsections 4.2.1 and 4.2.4. The TA project aligned with the objectives of the FSOP, which recommends that, to ensure the stability and efficiency of the financial sector, distressed banks should be restructured. The PRC’s 12th Five-Year Plan sets out strategies for deepening the reform of the financial system. The plan mentions pressing on with the strategy of commercializing the AMCs, and identifies progress in asset securitization as an important step toward the establishment of a system of multilevel financial markets.

4.2.10 Strengthening the Legal and Implementation Framework for Anti-Money Laundering

As noted above, the need to strengthen AML practices and regulations has been a consistent theme of PRC and ADB strategies. The principal objective of the TA project for Strengthening the Legal and Implementation Framework for Anti-Money Laundering (TA 4824) was to help the government bolster the legal and institutional frameworks for AML. TA 4824 was driven by the timing of the legislative drafting of an AML law and of the government’s preparations for the membership and “mutual evaluation” procedures of the Financial Action Task Force (FATF), an intergovernmental organization that promotes effective legal, regulatory, and operational measures against money laundering, terrorist financing, and other problems. The first phase of the TA project contributed to the enactment of the AML law by supporting consultations with stakeholders. After the enactment of the law, which went into effect 1 January 2007, the government’s focus shifted to the FATF mutual evaluation process and the weaknesses that the evaluation identified in the AML system of the PRC.

The second phase of the TA project was designed to support the development of the AML regime in three main ways: (i) reinforcing the criminal law aspects of the AML legal framework; (ii) strengthening the AML regulations for the finance sector, including those pertaining to the reporting of suspicious transactions; and (iii) making recommendations for the application of AML requirements in selected parts of non-finance sectors. In addition to assisting with the enactment of the draft AML Law, TA 4824 produced a comprehensive list of recommendations for amendment to the related legislation, an implementation manual that included a comprehensive action plan, and training materials. The TA project also sponsored an international symposium and a domestic workshop. TA 4824 was rated successful by reviewers.

The TA project’s focus on strengthening the AML framework aligned with many of the key ADB and PRC strategies relating to the development of regulatory practices, which include a number of references to AML policy (see subsections 4.2.1 and 4.2.4).

4.2.11 Deposit Insurance Establishment

The implicit government guarantee of deposits in the PRC creates significant levels of contingent government liabilities and uncertainty. The PRC’s intention to convert to an explicit, separately funded deposit insurance system (DIS) will limit government liabilities and reduce moral hazard.54

The focus of the TA project for Deposit Insurance Establishment (TA 7337), which was implemented in the PRC and Mongolia, is on developing a holistic road map consisting of: (i) a plan for each country’s transition from an implicit scheme to a DIS that would include establishing an appropriate regulatory framework, installing institutional structures, and providing financing; (ii) a capacity-building plan for managers and staff; (iii) a public information program to facilitate the transition by fostering social harmony and confidence; and (iv) a timeline for a suitable DIS to be implemented. The DIS in both the PRC and Mongolia must conform to the core principles of the International Association of Deposit Insurers (IADI). The outputs of TA 7337 for each country include a situational analysis presenting public policy objectives, a guideline document for DIS discussions, and a detailed implementation plan. The preparation of important project documents has involved extensive discussions with key stakeholders.

Although TA 7337 is an ongoing project, expected outcomes in the PRC will map well to ADB and government strategies, including those concerning the revision of the regulatory framework to align with international standards and best practices; the improvement of risk-management and corporate governance practices (see subsections 4.2.1 and 4.2.4); and the establishment of a DIS, a goal listed as a policy priority in a number of strategy documents. The PRC’s 12th Five-Year Plan specifically mentions the establishment of a DIS as one of the key strategies for deepening the reform of the financial system. Under the FSOP, ADB is supporting developing member countries (DMCs) in their efforts to determine the need for deposit insurance, choose a model for a DIS (e.g., “pay box” versus “risk minimizer”), and design and implement a DIS as appropriate.

4.2.12 Strengthening the Legal Framework for Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT)55

The TA project for Strengthening the Legal Framework for Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT), TA 7454, was designed to build on the outputs of TA 4824 (see subsection 4.2.10) by proposing legislative reforms to implement the AML/CFT framework. The outputs of TA 7454 were to include: (i) revisions of the

53 ADB. 2009. Deposit Insurance Establishment. Manila (TA 7337-PRC, $500,000 [about $402,000 utilized], approved on 27 August, financed by the People’s Republic of China Regional Cooperation and Poverty Reduction Fund). This TA project closed December 2012.

54 “Moral hazard” is the idea that if a party is protected from risk, it may be more likely to engage in irresponsible risk-taking, as there is no prospect of negative consequences to serve as a deterrent.

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criminal law and adoptions of judicial interpretations to enable the prosecution of “self-
laundering,” and (ii) the enactment of a law and a set of procedures for implementing
under the first output revealed inconsistencies in the FATF’s country assessments regarding
self-laundering, so further clarification from the FATF was required before any revision of
the criminal law could be contemplated. Following the activities under the second output,
there was a consensus that the legal basis for such activities should be formalized. On
30 October 2011, the Standing Committee of the National People’s Congress of the PRC
issued a decision supporting the establishment of a legal framework for implementing the
United Nations sanctions. As of mid-2014, the PRC is fulfilling the requirements of those
sanctions. TA 7454 was rated successful by reviewers.

Regarding the mapping of TA 7454 to current ADB and PRC reforms and strategies, see
subsection 4.2.10.

4.2.13 Developing a Legal System for the Credit Market

The recognition of the legal status of the credit market and the development of a suitable
regulatory system have been issues for many years in the PRC. Despite the recent emergence
of small and medium-sized enterprises (SMEs) and of financial institutions such as city
commercial banks, microcredit companies, and village banks, the absence of a legal
framework with rules governing market conduct has placed severe constraints on credit
access for rural households and SMEs.

The proposed outcome of the TA project for Developing a Legal System for the Credit
Market (TA 7835) is an established legal basis (at the national and local government levels)
for credit definition, market entry, delivery, trade, and the exit of financial institutions.

TA 7835, which is still being implemented as of mid-2014, will: (i) complete analytical
studies on finance-related legislation in key international jurisdictions and provide a study
tour of the most relevant locations; (ii) conduct a national review, including consultations
with formal and informal lenders, regulators, and other stakeholders to see what lessons
have been learned and what changes could encourage the formalization of the credit
market, expansion of services, and consumer protection; (iii) assess the current legal and
regulatory systems to determine which improvements would be the most appropriate,
and combine the findings with the results of (i) and (ii) to generate a policy and to draft
instructions for legal changes; and (iv) share the proposed results at an international
conference to allow validation and further input before finalization.

Although the TA project is still ongoing, its terms of reference align well with PRC and ADB
policy priorities. TA 7835 is addressing legal and regulatory issues affecting the financial
industry as a whole. More specifically, it also aims to reduce some of the constraints on credit
access for SMEs and rural households, thereby contributing to financial inclusion. Both the

56 “Self-laundering” refers to instances in which money is laundered not by a third party, but by those who
had committed the crimes that generated the illegal proceeds in the first place.
57 ADB. 2011. People’s Republic of China: Developing a Legal System for the Credit Market. Manila (TA 7835-
PRC, $450,000 [about $190,000 utilized], approved on 18 July, completed on 30 September 2014).
PRC and ADB regard financial inclusion as a policy priority, with improved access to finance for rural areas and SMEs specified as key objectives in all the relevant policy documents. In addition, the FSOP aims to enhance prudential regulation and supervision, and Strategy 2020 addresses the need to build the capacity of financial institutions and their regulators.

### 4.2.14 Promoting Private Investment for Social and Economic Development in Shaanxi Province

The Government of Shaanxi Province has identified priority areas crucial to the province’s future social and economic development. For many years, development in these areas has relied mainly on government financing, but provincial government budgets are limited, and cannot fully meet development needs. At the same time, there are insufficient incentives to encourage the private sector to invest in the identified priority areas, despite a policy document and implementation decree.

The TA project for Promoting Private Investment for Social and Economic Development in Shaanxi Province (TA 8082) will assist the provincial government in working out a strategy for developing the private sector and mobilizing private sector investment, with detailed measures to help enforce the relevant policies and the implementation decree. The expected outputs of TA 8082 include: (i) a general report on promoting private investment for social and economic development in Shaanxi Province, based on four themes (innovative financial instruments, the legal environment for private sector development and investment growth, the Shaanxi capital market, and industry demand in Shaanxi); and (ii) a policy note to be prepared after the report is finalized. The TA methodology includes data collection and surveys, workshops, report development, a final symposium, and policy recommendations.

The project is ongoing, but the expected outputs of TA 8082 will map to a number of current PRC and ADB strategic priorities. Private sector development is recognized in the country partnership strategy (CPS) as a driver of change. The CPS emphasizes ADB’s support for the government’s efforts to strengthen the policy, legal, fiduciary, and regulatory frameworks and practices in order to foster an enabling environment for private sector development. With regard to urban development, a priority area under the CPS, ADB is encouraging public-private partnerships (PPPs) and private sector participation.

The encouragement of private investment was included as a policy directive under the 12th Five-Year Plan as part of the optimization of the investment structure. The FSOP recognizes the province’s need to invest extensively in infrastructure, and notes that infrastructure finance calls for the mobilization of long-term savings from developing capital markets and institutional investors.

ADB’s Strategy 2020 identified private sector development and private sector operations as two of the drivers of change. ADB’s tools for generating change in the DMCs through increased private investments include: direct financing; credit enhancements; risk-mitigation

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guarantees; and new, innovative financial instruments. These tools will create value by attracting private capital and deploying business management and/or technical expertise to specific sectors and transactions. Infrastructure is also a core area of ADB support, and ADB’s infrastructure operations emphasize PPPs and private sector engagement.

4.2.15 Promotion of a Legal Framework for Financial Consumer Protection

The central government recently indicated the high priority it places on financial consumer protection, including financial literacy and inclusion. It required each of the PRC’s top four financial regulators—the China Banking Regulatory Commission (CBRC), China Insurance Regulatory Commission (CIRC), China Securities Regulatory Commission (CSRC), and the People’s Bank of China (PBOC)—to establish their own units dedicated to financial consumer protection. The PBOC created the Financial Consumer Protection Bureau in June 2012. However, there is still the need for an overall legal framework and cooperation mechanism.

The TA project for Promotion of a Legal Framework for Financial Consumer Protection (TA 8498) is promoting the establishment of a consistent financial-consumer-protection framework in the PRC. Outputs include: (i) a review of domestic conditions and practices, and a compilation of global best practices; (ii) the establishment of a legal and regulatory framework for the Financial Consumer Protection Bureau; and (iii) the promotion of coordinated financial-consumer-protection activities. Under TA 8498, there are also national and international workshops and conferences with key stakeholders.

TA 8498 is an ongoing project, but the expected outcomes will align with many ADB and PRC strategies concerning the enhancement of the regulatory framework, supervisory capacity, and risk-management practices (see subsections 4.2.1 and 4.2.4). The FSOP includes the promotion of financial literacy and consumer protection for the users of microfinance services. The other PRC and ADB strategies and policy priorities do not specifically address consumer protection, but this TA project nevertheless supports their key objectives: inclusive growth and improved access to finance. Consumers with adequate protection will be more financially literate, and will thus have the ability and motivation to access financial products and services.

4.2.16 Strengthening the Stress Testing Capacity of the Banking System

In 2012, the CBRC issued a new capital regulatory framework with the objective of simultaneously implementing the Basel II and Basel III requirements for all commercial banks,

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starting in January 2013.\textsuperscript{61} Pillar II of the new framework requires stress testing. The CBRC and PBOC conducted a stress-testing exercise in 2011 that included 17 major commercial banks, and the CBRC sought advanced stress-testing techniques and applications for itself as well as for commercial banks.\textsuperscript{62}

The outputs of the TA project for Strengthening the Stress Testing Capacity of the Banking System (TA 8355) are expected to include: (i) new stress-test operations, with a stress-testing unit and strengthened databases; (ii) in-depth stress-test training for the CBRC and commercial banks, particularly for small and medium-sized banks; and (iii) actual stress tests conducted by the CBRC and the application of the results to risk management in the banking sector.

Although still an ongoing project, TA 8355 maps directly to a number of key ADB and PRC strategies and policy priorities regarding the enhancement of the regulatory framework, supervisory capacity, and the banks’ risk-management practices (see subsections 4.2.1 and 4.2.4).

4.3 Fulfilling Policy Priorities

ADB’s work on legal, regulatory, and supervisory structures can be mapped to the key strategy and policy documents, as follows:

4.3.1 ADB’s Country Partnership Strategy (2011–2015)

While the CPS for the PRC during 2011–2015 does not identify finance as a priority area, it does recognize private sector development as a driver of change; and ADB’s public sector operations seek to strengthen the enabling environment for private sector development by supporting policy and regulatory reforms and by improving access to finance. The CPS also refers to ADB’s objective of supporting the government’s efforts to strengthen the policy, legal, fiduciary, and regulatory frameworks and practices that promote an enabling environment for private sector development.

4.3.2 ADB’s Financial Sector Operational Plan (2011–2014)

The FSOP recognizes the importance of financial stability and integrity. Under the plan, ADB has been supporting efforts by the DMCs to improve macroprudential and microprudential regulation and supervision of financial institutions and markets, and to promote their accountability and transparency. This includes the enhancement of the risk management and corporate governance of individual financial institutions. ADB is also supporting: (i) the restructuring of banks and the establishment or strengthening of DISs; (ii) capacity building for financial crisis prevention, management, and resolution; and (iii) AML measures.

\textsuperscript{61} The three Basel Accords are sets of recommendations concerning banking regulations issued by the Basel Committee on Bank Supervision, which comprises representatives of central banks and regulatory agencies of the G-20 countries. Basel II was issued in June 2004, and Basel III in December 2009.

\textsuperscript{62} Stress tests are simulations of unfavorable scenarios to gauge whether a bank has enough capital to withstand the impact of adverse developments.
As part of the FSOP, the ADB is supporting the enhancement of the regulatory framework and supervisory capacity for financial institutions and markets. Specifically, ADB is (i) promoting the adoption of international standards and best practices, such as those set by the Basel Committee, International Organization of Securities Commissions (IOSCO), and the International Association of Insurance Supervisors (IAIS); and (ii) providing assistance on risk management and promoting sound corporate governance for both banks and nonbank financial institutions.

Also under the FSOP, ADB is helping the DMCs to examine their need for a DIS, determine which type of DIS (e.g., “pay box” versus “risk minimizer”) would be the best choice, and then to develop the DIS where appropriate. It will also support efforts to improve financial-system integrity by promoting transparency and accountability and by supporting AML measures.

Given the region’s need to invest aggressively in infrastructure in the years ahead, ADB recognizes the necessity of developing capital markets and an institutional investor base that will be capable of generating long-term financing and risk capital.

With regard to financial consumer protection, the FSOP promotes financial literacy and consumer protection for the users of microfinance services (see subsection 4.2.15).

To ensure the stability and efficiency of the finance and banking sectors, the FSOP recommends that distressed banks be restructured.

### 4.3.3 ADB’s Strategy 2020 (2008–2020)

Finance sector development is one of the five core areas of Strategy 2020. Under the strategy, ADB continues to participate in the capacity building of financial institutions and their regulators by introducing international best practices in cooperation with the International Monetary Fund (IMF) and the World Bank. ADB is also supporting the establishment of AML regimes in partnership with other aid agencies.

Strategy 2020 identifies private sector development and operations as one of the drivers of change. ADB is working to generate more private investment in DMCs through direct financing, credit enhancements, risk-mitigation guarantees, and innovative financial instruments. These tools create value by attracting private capital and deploying business-management and/or technical expertise to specific sectors and transactions. Infrastructure is another core area of Strategy 2020, and ADB’s infrastructure operations under the strategy emphasize PPPs and private sector engagement.

### 4.3.4 PRC State Council Financial Policy Measures

While the State Council’s financial policy measures do not explicitly include legal, regulatory, and supervisory reforms, such reforms underpin current efforts to achieve ADB and PRC policy objectives. Moreover, there are well-documented instances in which legislative and regulatory reforms are “on the books,” but have yet to be fully implemented.
4.3.5 The PRC’s 12th Five-Year Plan (2011–2015)

The PRC’s 12th Five-Year Plan highlights the need to deepen the reform of financial institutions by strengthening internal control and risk management. The plan recognizes the need to commercialize the financial asset-management companies (AMCs) and to establish deposit insurance. It also identifies progress in asset securitization as an important step toward the establishment of a system of multilevel financial markets.

The encouragement of private investment, under optimizing investment structures, was included as a policy directive in the 12th Five-Year Plan.

4.4 Development Opportunities

In its 2011 financial sector assessment of the PRC, the World Bank noted that after two decades of reforms and opening up, the PRC’s financial market has developed to a stage where it shares a common set of issues and faces the same vulnerabilities as other countries and there are still significant gaps in the PRC’s legal and regulatory framework as compared to international standards and norms. However, there is potential for the TA program to assist the authorities to strengthen the overall legal framework in the financial market.63 The Financial Sector Assessment Program (FSAP) identified several areas for high-level reforms, many of which are currently subject to studies, TA projects, and policy reviews by PRC regulators. Matters identified include:

(i) strengthening the overall legal framework of the financial market;
(ii) developing systems to support financial stability;
(iii) creating a framework for the prudential regulation of conglomerates64;
(iv) implementing the Financial Stability Board’s recommendations regarding the establishment of a Resolution Authority, as well as the regulation and supervision of systemically important financial institutions and financial conglomerates; and
(v) developing and implementing a DIS.

ADB could engage in any of these activities, but the authors suggest that the legal and regulatory reforms that would best align with ADB’s engagement strategies and with the PRC’s objectives of implementing stronger market-driven mechanisms while improving

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Notes: This report was published under the Financial Sector Assessment Program (FSAP), a joint venture of the World Bank and the IMF. The Asian Development Bank recognizes China by the name People’s Republic of China.

64 As was mentioned earlier in this report, The PRC uses a “separation principle” when supervising and regulating financial activities in commercial banking, securities (mostly capital market activities), and insurance. In practice, there is increasing overlap among these sectors, a situation that may well lead to gaps characterized by loose regulation, which could result in systemic risks and thus present a great challenge to regulatory authorities. In this case, what may be needed is adherence to international good practices.
consumer and investor protection (through stronger enforcement as well as greater
disclosure) would be:

(i) support for the CSRC’s market-conduct capacity by developing a universal
licensing regime and a disclosure regime for collective investment products;
(ii) the licensing of financial advisers and brokers who sell the products, regardless
of the distribution channels (e.g., through banks, capital-market firms, insurance
companies or via the internet); and
(iii) the development of a “treating customers fairly” regime, including: standardized
disclosure and risk-measurement features for all retail financial products (e.g.,
a simple risk indicator similar to the Netherlands GUISE); a dispute-resolution
scheme; and timely, robust, and appropriate enforcement actions.

Then there is the issue of shadow banking, as noted previously (see subsection 2.6.1). The
authors of this report consider the two main drivers of shadow banking to be (i) the poor
servicing of rural, micro, and small enterprises by the regulated financial sector (banks and
rural credit cooperatives [RCCs]); and (ii) regulatory arbitrage through special-purpose
vehicles established to circumvent government regulations.

A natural decline of shadow banking could be achieved by implementing regulations and
reforms to liberalize interest rates; enable the efficient allocation of credit; reduce barriers
to entry for credit institutions and further develop a multitiered financial system; and
determine the correct treatment of off-balance sheet exposures, particularly explicit and
implied guarantees.

Finally, another issue confronting the PRC’s financial system are the newly emerged internet
financing activities, which are growing rapidly due in large part to their innovative ways and
means of conducting business. They pose a growing challenge to the formal banking sector,
especially deposit and consumer banking, because they erode the banks’ deposit base by
offering much higher returns and more efficient service. Formal institutions, led mainly by
commercial banks, have called for a strict control of these activities. However, regulatory
authorities will need to strike a balance between the stability of the formal (traditional)
finance sector and the ongoing innovation of internet finance.
5.1 Overview

Financial market infrastructures (FMIs) facilitate the clearing, settlement, and recording of monetary and other financial transactions. But these “background” institutions also play a critical role in the smooth operation of the finance sector as a whole. As financial markets become more sophisticated, the burden imposed on these institutions rises, and so does the vulnerability of the financial system to any lapses in their safe and efficient operation.

Payment systems enable the lending and repayment of money, allow businesses to receive payments for goods and services, and facilitate the payment of wages and other money transfers. Securities settlement systems enable the purchase and sale of equities and bonds on primary, secondary, and unlisted exchanges. Central counterparties guarantee settlements of derivatives transactions, even if the original counterparty defaults. Trade repositories collect and maintain the records of over-the-counter (OTC) derivatives, enhance the transparency of pricing and volumes, and help reduce risks to investors and to financial stability.

In the environment after the global financial crisis of 2008–2009 (GFC), the link between the integrity of FMI operations and financial stability and market confidence has been well recognized, with global regulators uniting to develop operating and supervisory principles. Moreover, members of the G20 have made commitments to strengthen the regulatory oversight of FMI operations in their own economies.65 The continued development of the PRC’s financial system will depend critically on the parallel development of FMIs to support the growing market activity and complexity.

Beyond the supervision and financial-stability imperatives, the State Council has reaffirmed its commitment to strengthening markets, encouraging innovation, and speeding up the development of a multi-layered financial market system.

The supporting Financial Industry Reform Plan (FIRP) provides for the continued establishment of FMIs and for their controlled development and sophistication, in the clear expectation that all FMIs will be subject to proper operating rules and strong and robust oversight.

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65 The G20, or Group of Twenty, is a forum including representatives of governments, trade ministries, and central bank governors from the world’s major economies.
5.2 ADB Engagement and Achievements

ADB’s engagement policies concerning the PRC are not geared toward providing technical assistance for the development or establishment of FMIs.

5.3 Fulfilling Policy Priorities

Efficient and robust FMIs support the government’s policy objectives of deepening and improving the sophistication and globalization of the PRC’s financial system, as well as the development of a multi-layered financial market system.

While FMIs can differ significantly in organization, function, design, and ownership, government policy announcements to date have shown recognition of the need for a clear set of operational and reporting rules applicable to all FMIs.

5.4 Development Opportunities

While ADB will always be open to requests for assistance in matters not among its established priorities, the authors expect these requests to be initiated by an executing agency and considered on a case-by-case basis.
6.1 Overview

The PRC has made significant progress since 2010 in developing its social security system, which has expanded the population covered to include farmers, the unemployed, and migrant workers. It is comprised of four main subsystems:

(i) Civil service pension system. This system covers most employees of government agencies and related government bodies.

(ii) Urban enterprise pension system. This covers urban workers, mainly employees of large private enterprises and state-owned enterprises (SOEs), with employee contributions (into their individual accounts) and employer contributions as part of a defined benefit scheme funded at the local level.

(iii) Rural pension system. Begun in 2009, it allows rural workers to make voluntary contributions to accounts subsidized by the local and central governments, but only offers basic payouts.

(iv) Urban pension system. This includes unemployed and other urban residents not otherwise covered, but only offers basic payouts.

Although the extension of coverage to more recipients has been an important achievement, the pension system still faces a number of challenges. For instance, in the past the PRC experienced favorable demographics: the contributions from the working-age population easily funded pension benefits for retirees. But the PRC now faces the prospect of a rapidly aging population, with the percentage aged 65 or older expected to roughly double by the early 2030s, and the number of workers for every retiree projected to decrease from 4.9 in 2013 to as low as 1.6 by 2050.

Other challenges include:

(i) Lack of portability. Pension benefits are often tied to an individual’s residency.

(ii) Fragmented system. There are multiple funds, even within schemes, that are managed by different bodies in each jurisdiction, often with different rules.

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(iii) **Inequities.** Civil service pension benefits are higher than urban pensions, and civil workers are not required to contribute, whereas urban pensions require contributions from participants.

(iv) **Funding shortfalls.** Most local governments have severe funding shortfalls in their urban enterprise insurance systems, often necessitating “borrowing” from individual accounts.

(v) **Investment issues.** Investment options are limited, and the returns on investment are generally poor.

A number of reforms have recently been contemplated to address these challenges, such as increasing the retirement age; centralizing the management of pension funds; harmonizing the various types of plans; and improving the returns on both public and urban pension systems, as well as narrowing the gap between them.

The State Council announced on 7 February 2014 that it will unify the pension schemes for rural residents and unemployed urban residents to allow better access to social benefits.\(^{67}\) It noted that pension funds sustained by individuals, employers, and various levels of government will be pooled, and that the central government will provide more money to beneficiaries in the less-developed central and western regions. A reform of the pension scheme for civil servants had been proposed in 2013, but it attracted adverse media attention and public opinion was divided.

While the insurance industry in the PRC has shown steady growth since 2005, the market remains small, representing less than 5% of finance sector assets. It is also underdeveloped in comparison with the banking industry. Although new products are being developed, and restrictions on investments of funds have been relaxed, insurance companies continue to face the challenges of poor profitability, weak capital positions, and poor governance and internal control. Rural insurance markets, such as the market for microinsurance, are also in need of further development.

### 6.2 ADB Engagement and Achievements

With the exception of the TA 7525, which involved microinsurance (see subsection 3.2.4), ADB has not been involved in the development of the insurance sector in the PRC. However, it has undertaken six TA projects to support social security and pension reform. A summary of these projects is provided in Table 5.

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Table 5. ADB Projects Supporting Pension Funds and Insurance

<table>
<thead>
<tr>
<th>ADB Reference</th>
<th>Title</th>
<th>Brief Description</th>
<th>Dates</th>
<th>Amount Utilized ($'000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>TA 3733</td>
<td>Policy and Institutional Support for the Social Security Reform Pilot Program</td>
<td>To support a pilot program in Liaoning Province, replicate the pilot program nationwide, and help the NaCSSeF strengthen its capacity to manage social security funds</td>
<td>Oct 2001–Dec 2003</td>
<td>938</td>
</tr>
<tr>
<td>TA 4206</td>
<td>Advisory Support for the National Council for the Social Security Fund</td>
<td>To strengthen the institutional capacity of the NaCSSeF, with a focus on the selection and monitoring of external investment managers and custodians</td>
<td>Oct 2003–Jul 2006</td>
<td>277</td>
</tr>
<tr>
<td>TA 4201</td>
<td>Policy and Institutional Support for Social Insurance Administration</td>
<td>To provide advice on how to improve the implementation of the PRC’s “Five Insurances” through better management structures, systems, and operational procedures; and through more efficient and relevant training programs</td>
<td>Oct 2003–Dec 2005</td>
<td>522</td>
</tr>
<tr>
<td>TA 7317</td>
<td>Rural Pension Reform and Development</td>
<td>To improve the policy and regulatory framework of the rural pension system, and strengthen its financing mechanisms</td>
<td>July 2009–Dec 2011</td>
<td>394</td>
</tr>
<tr>
<td>TA 7606</td>
<td>Capacity Development for Rural Pension Administration and Services</td>
<td>To support the implementation of the pilot projects, focusing on the following key issues: better financing strategy, appropriate human resource allocation, and strengthened institutional capacity of local governments; also to provide policy recommendations</td>
<td>Sep 2010–Nov 2012</td>
<td>271</td>
</tr>
<tr>
<td>TA 8463</td>
<td>Study on the Sustainable Development of Urban Pension Insurance</td>
<td>To review the framework of the urban pension system in order to make it more sustainable</td>
<td>Sep 2013–Oct 2015 (ongoing)</td>
<td>400</td>
</tr>
<tr>
<td>TOTAL</td>
<td></td>
<td></td>
<td></td>
<td>2,802</td>
</tr>
</tbody>
</table>


* This column includes the start date (approval date) and actual or estimated completion date (projects that are ongoing are noted as such).

6.2.1 Policy and Institutional Support for the Social Security Reform Pilot Program

As part of the government’s social security reform program, the State Council Task Force recommended that individual accounts be fully funded by the government (with Liaoning Province pilot-testing this approach), and that the National Social Security Fund (NSSF) be established to meet the funding requirements for implicit pension debt. In Liaoning Province, the Liaoning Provincial Department of Human Resources and Social Security was...
responsible for the day-to-day administration of the provincial social security system and, at the central government level, the NSSF was administered by the National Council for the Social Security Fund (NaCSSeF).

The TA project for the Policy and Institutional Support for the Social Security Reform Pilot Program (TA 3733) was designed to help implement the State Council Task Force’s recommendations by supporting the pilot program in Liaoning Province (component A) and by assisting the NaCSSeF in strengthening its institutional capacity to manage funds raised for social security (component B). Component A generated recommendations regarding the administrative processes for implementing the pilot program and regarding overall governance and supervision. It also provided actuarial expertise to the Liaoning Province social security department and designed an integrated information technology (IT) system, with training provided in both. Component B produced a report that analyzed key impediments to effective portfolio management and made specific recommendations for addressing them. The report also proposed an organizational structure for the NaCCSeF and advised on functions and responsibilities according to best practices.

TA 3733 was rated successful by reviewers, with the outputs and activities contributing to the capacities of both the Liaoning Province social security department and the NaCCSeF.

The continued development of social security (both urban and rural pension schemes) remains a key priority for current ADB and PRC strategies. As a precursor to the current reforms, TA 3733 met the relevant targets of the early 2000s in that it launched the development of a social security system in the heavily urbanized province of Liaoning. The knowledge and experience underlying social security reform in the PRC has grown significantly since then, but while TA3733 ended in 2003, its main objective was consistent with the current ADB and PRC strategy of extending pension coverage as widely as possible in both urban and rural areas to improve the quality of life there (see subsection 6.2.4).

### 6.2.2 Advisory Support for the National Council for the Social Security Fund

By 2003, NaCSSeF had selected, through competitive bidding, six fund management companies to oversee the NSSF; and it had engaged two custodian banks to conduct all the payment and settlement operations of the investment managers. However, the NaCSSeF’s capabilities in terms of investment operations and risk management were limited due to restrictive government policies and regulations concerning the investment and management of SOE shares. In response to this problem, the NaCSSeF started developing a comprehensive risk-management and performance-evaluation framework, combined with an on-site and off-site monitoring and supervision framework, for external fund managers and custodians.

The objective of the TA project for Advisory Support for the National Council for the Social Security Fund (TA 4206) was to strengthen the institutional capability of the NaCSSeF

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by helping to establish a sound risk-management framework supported by an efficient management information system to prudently supervise external investment managers and custodians, and to examine the soundness of allocating non-tradable state shares to the NSSF.

TA 4206 was rated successful by reviewers, with effective training seminars conducted to support the outputs.

With regard to the mapping of TA 4206 to current ADB and PRC reforms and strategies, see subsection 6.2.1.

6.2.3 Policy and Institutional Support for Social Insurance Administration70

The National Social Insurance Administration is the central government agency mandated to provide policy and operational guidance for the management and administration of the social security system nationwide. It was hampered by the inconsistencies and inefficiencies of its decentralized network, the Social Insurance Administration (SIA), under which each level of government operated its social security system independently. There were also inconsistencies across the country in operational procedures, basic performance criteria, and in the adequacy of staffing and facilities.

The TA project for Policy and Institutional Support for Social Insurance Administration (TA 4201) was designed to support social security reform in the area of administration. The key outputs of the TA project were: the standardization of SIA operational procedures for all aspects of social insurance services; surveys and policy research on the experience of two provinces in which SIA management had been consolidated at the provincial level; recommendations on SIA consolidation; and systematic professional training and human resource development programs for the SIA.

TA 4201 was rated successful by reviewers, with the final report prioritizing necessary future actions. However, the consolidation of SIAs was not seen to be a feasible goal, given the complicated government structure.

With regard to the mapping of TA 4201 to current ADB and PRC reforms and strategies, see subsection 6.2.1.

6.2.4 Rural Pension Reform and Development71

Reforms of the pension system for the rural population have lagged behind those for urban residents. In 2009, more than 50% of the PRC’s population was rural, and almost two-thirds of the total workforce was employed in rural areas, but only 10% of the rural workforce was

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covered by pension schemes. Prior attempts to implement a rural old-age insurance system had not been successful, as the benefits were too low due to the lack of government fiscal support and of local funding. In 2009, the State Council issued the Instruction on Developing Pilot Programs for the New Rural Old-Age Insurance System, with a view to establishing a new rural insurance scheme. It is a two-tiered system, encompassing individual accounts and a subsistence pension supported by the central and local governments. However, the transition to the new system was hindered by inconsistencies among regulators and administrative arrangements.

The TA project for Rural Pension Reform and Development (TA 7317) was designed to address these issues. The outputs of TA 7317 included a report on the sustainability of the rural pension system nationwide and three sub-reports, including (i) a quantitative analysis and projection regarding the sustainability of the rural pension system nationwide, (ii) a quantitative analysis and projection regarding the sustainability of the pension system in typical rural areas in western and central PRC, and (iii) a database design for monitoring the operation of rural pensions.

TA 7317 was rated successful by reviewers, with the major achievement consisting of a set of recommendations for improving the design of the rural old-age insurance system based on extensive field studies and careful actuarial modeling.

Pension reform has been a concern for the PRC and ADB for a number of years. The prior country partnership strategy (CPS), for 2008–2010, designated finance as a priority sector; and a key finance-sector operation was the building of an inclusive rural pension system. Although the finance sector is no longer a priority under the CPS for 2011–2015, rural pension reform remains an objective. In fact, PRC and ADB strategies continue to reflect the importance of achieving full participation nationwide in urban and rural pension systems: ADB’s Financial Sector Operational Plan (FSOP) and Strategy 2020 both recognize the importance of sustainable pension schemes, and the PRC’s 12th Five-Year Plan includes a policy directive to improve the social security system for urban and rural residents.

TA 7317 was a crucial project for achieving the strategic priorities of both ADB and the PRC in the area of rural pension reform.

6.2.5 Capacity Development for Rural Pension Administration and Services

As recognized in the TA project for Rural Pension Reform and Development (TA 7317), the successful establishment of a rural pension system relies on the strengthening of institutional capacity to implement pension services. One recommendation in the TA project’s report on rural pension-system sustainability was for follow-up action and support in this respect.

The TA project for Capacity Development for Rural Pension Administration and Services (TA 7606) provided follow-up. The objective of TA 7606 was to help establish an efficient rural pension-administration system with an appropriate level of resources, well-developed standards of practice, and well-designed systems for performance measurement and internal control. The TA project had five major outputs: a final report, three technical reports (on the evaluation of operational agencies, operational and business procedures, and operational regulations), and policy proposals addressing challenges in operational management.

TA 7606 was rated highly successful by reviewers, despite some delays. Its major achievement was the strengthening of institutional capacity in a number of provinces for managing pension administration and service delivery. The TA project, together with increased government funding, contributed to an expansion of pilots for the new rural pension scheme, which started in 10% of the counties in the PRC in 2009, increased to 60% in 2011, and reached 100% of the counties in 2012.

This has been a key project in the implementation of the new rural pension scheme, which, as was noted above with reference to TA 7317, is a key strategy for ADB and the PRC. It also contributes to achieving the objective of inclusive growth that expands livelihood opportunities for the poor.

6.2.6 Study on the Sustainable Development of Urban Pension Insurance

The country’s urban and rural populations are covered by separate pension systems, with the urban scheme consisting of a pay-as-you-go system based on individual accounts (defined contribution74). Sustainability is not a major concern for the rural pension scheme, as it relies on significant subsidies from the central and local governments, reflecting the fact that it was designed largely as a social welfare system. The sustainability of the urban pension system, however, is currently under pressure due to the aging population of the PRC, rapid urbanization, and the short contribution period required before qualifying for pension benefits. The lack of reliable projections on aggregated liabilities, given that urban pension schemes are managed at the provincial and municipality levels, makes it difficult to properly assess the sustainability of the urban pension system. There are also concerns about whether the NSSF has sufficient reserves to meet its obligations.

The TA project for Study on the Sustainable Development of Urban Pension Insurance (TA 8463) is examining the following key issues: (i) the optimal retirement age; (ii) the number of required years of contributions, and the adequate levels of contributions and benefits; (iii) disincentives to early retirement; (iv) predictions regarding pension liabilities and the NSSF’s future assets; and (v) public opinion on potential pension reforms.


74 “Defined contribution” refers to a system in which the participant must contribute a certain amount of money into his or her retirement plan, whether a specified sum or a percentage of his or her salary.
As with the other pension-related TA projects, this study on the sustainability of the urban pension insurance system maps well to ADB and PRC strategic reforms. It aligns with the CPS strategic pillar of inclusive growth by contributing to the availability of pensions for the elderly in urban areas. It is also in line with the 12th Five-Year Plan's objective of providing widespread social security coverage for urban and rural residents, with ensured basic benefits, multilevel service, and sustainability.

While TA 8463 is a relatively new and ongoing project, its outputs are expected to form the basis of key reforms in the urban pension system.

### 6.3 Fulfilling Policy Priorities

#### 6.3.1 ADB’s Country Partnership Strategy (2011–2015)

The “inclusive growth” pillar of the CPS for 2011–2015 emphasizes balanced and equitable growth supported by integrated rural and urban development to expand livelihood opportunities for the poor. The financial industry is not a priority sector under this CPS, but agriculture is, and within this sector certain rural social and financial services, including rural pension reform, are identified as priorities for enhancing rural livelihood opportunities. A national development goal is to extend the coverage of public pension schemes to all rural residents by 2015.

#### 6.3.2 ADB’s Financial Sector Operational Plan (2011–2014)

Under the FSOP, ADB is committed to supporting its developing member countries (DMCs) in their efforts to reform their social security systems. To improve the management of the reserves in their systems, ADB is working with DMCs to reduce the need for precautionary savings, smooth consumption, and mobilize long-term savings to finance infrastructure requirements.

#### 6.3.3 ADB’s Strategy 2020 (2008–2020)

Strategy 2020 notes that, without access to formal financial services and sustainable social insurance, including pensions, the poor will be excluded from economic growth and its benefits.

#### 6.3.4 The PRC’s 12th Five-Year Plan (2011–2015)

The 12th Five-Year Plan includes a policy directive to improve the social security system and to gradually minimize the gaps in living standards and public services between urban and rural areas and among regions. The plan identifies as a strategic objective the extension of the social security system to include a greater number of urban and rural residents, ensuring basic benefits and a wide range of services. It is to steadily increase the number of participants while remaining sustainable.
The development of the social security system is to be accelerated to achieve full coverage for the new rural pension scheme and improvements in the urban pension scheme (in terms of the number of people covered and the quality of benefits). In addition, the links between the urban and rural pension schemes are to be gradually strengthened.

6.4 Development Opportunities

Social insurance and pensions are a critical area in which ADB and PRC strategies overlap. To the extent that reforms in this domain also address issues of inclusion and rural poverty, they must be regarded as among the top priorities for ADB support in coming years. They also have the potential to add very high value relative to the resources committed. ADB projects already completed in this area appear to have been exceptionally successful, and future work should seek to build on that excellent start.

Pension coverage has greatly increased with the introduction of a rural pension scheme in 2009 and an urban pension scheme for the unemployed in 2011. The proportion of people enrolled in pension schemes almost doubled between 2009 and 2012, from 30% to 55%.\(^75\) By 2012, approximately 60% of the total population aged 60 and over were reported to be receiving a regular monthly pension. In absolute terms, the PRC’s Ministry of Human Resources and Social Security reported in February 2013 that 484 million people were enrolled in one of its pension schemes. Despite this impressive progress, the PRC still faces many hurdles in its pension reform program, especially given its rapidly aging population. The challenges include funding shortfalls, lack of portability, poor investment performance, and inconsistencies across schemes (e.g., in terms of rules, benefits, and required contributions). The recent announcement by the State Council of its intention to unify the schemes for rural and unemployed urban residents is a positive development, but more significant reform will be required to fully address the PRC’s pension challenges.

While a fully unified national pension system would address many of the current challenges, many believe that the PRC is decades away from achieving this goal. The reform will need to be implemented in stages, with the unification of schemes for rural and urban residents as the first big hurdle, followed by a full integration of all schemes, including those for civil servants.

As mentioned above, the TA project for Study on the Sustainable Development of Urban Pension Insurance (TA 8463) recently started to examine key issues such as the retirement age, contribution and benefit levels, potential funding shortfalls, and public opinion on potential pension reforms (see subsection 6.2.6). The project is expected to run until October 2015.

The authors believe that future work by ADB in this area should focus on the longer-term goals of first harmonizing and then centralizing the pension systems. This work could take a holistic approach to reviewing all the various pension schemes in terms of their rules.

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contribution and benefit levels, administration, and funding situations. An analysis of this type could:

(i) provide a stocktake of inconsistencies among schemes, sub-schemes, and provincial systems;
(ii) compare contribution and benefit levels with those in social pension schemes in similar countries;
(iii) quantify projected funding shortfalls and consider the methods and implications of moving toward pre-funded approaches;
(iv) document the benefits of a centralized administration (for the collection of contributions, benefit payments, customer service, and member database maintenance), which would presumably include administrative efficiency and associated cost savings, as well as increased portability between schemes (e.g., between rural and urban), which, in turn, would help address labor mobility issues within the PRC;
(v) document the benefits of pooling funds, such as more efficient fund management, improved fund performance due to wider investment options, and greater incentives for higher voluntary contributions;
(vi) provide a road map toward harmonization, with suggested time frames and prioritization of issues; and
(vii) identify barriers that could hinder the success of the proposed solutions in integrating the various pension schemes.

The work should incorporate the outcomes from TA 8463 and relevant improvements in international practice.
7.1 Overview

Banking dominates the PRC financial sector. Capital markets remain relatively underdeveloped, although there has been significant growth in the bond market since 2010. Historically, issues with capital-market development have included restrictive regulations, underdeveloped information services, lack of institutional investors, and the poor risk-management capabilities of banks.76

Expanding the institutional investor base has been an important means of developing capital markets. At present, securities investment funds are the largest category of institutional investors, followed by the Social Security Fund, insurance companies, corporate annuities, Qualified Foreign Institutional Investors,77 and securities firms.

The PRC’s overall capital market comprises two stock exchanges (Shanghai Stock Exchange and Shenzhen Stock Exchange), three commodities futures exchanges, and one financial futures exchange. The PRC is committed to building a multi-layered securities market that will encompass the Main Board (including the SME Board); the Growth Enterprise Board (designed for smaller-scale emerging companies, often innovative high-tech companies, with lower entry requirements in terms of profitability and asset size); and the National Equities Exchange and Quotations (NEEQ) board, also known as the “New Third Board,” an over-the-counter (OTC) market for unlisted shares, aimed at innovative, start-up, or growing micro, small, or medium-sized enterprises.78

The NEEQ was expanded when the State Council issued a statement on 14 December 2013 allowing all qualifying domestic micro, small, and medium-sized enterprises (MSMEs) to be listed on that board.79 As the NEEQ has no profitability requirements, it can serve as a...

77 The Qualified Foreign Institutional Investors (QFII) is a system of certification allowing foreign institutional investors (such as asset-management companies, insurance companies, securities firms, commercial banks, pension funds, charity foundations, endowment funds, and sovereign wealth funds) to trade yuan-denominated securities in PRC capital markets by converting a government-authorized quota of foreign currency into yuan.
direct financing channel for enterprises that fail to reach the listing standards of the Main Board. Previously, only small and medium-sized enterprises (SMEs) in four hi-tech industrial parks (in Beijing, Tianjin, Shanghai, and Wuhan) could be traded on the board, and that was only under pilot programs. Companies listed on the New Third Board must meet disclosure requirements, but this rule will encourage SMEs to establish sound corporate governance.

By the end of 2012, there were 2,494 listed companies on the two stock exchanges, with a total market capitalization of CNY23 trillion and tradable shares totaling CNY18 trillion. However, state-owned enterprises (SOEs) dominate this market capitalization, with an estimated 75% of the capitalization of the A-share market.

The initial public offering (IPO) market in the PRC was reopened in early 2014, after a suspension of IPO approvals that had lasted over a year. In late 2012, amid concerns over the quality and number of companies waiting to list, and over potential fraud and misconduct among advisers and companies, the China Securities Regulatory Commission (CSRC) blocked new listings and committed itself to reforming the IPO system. The reform will increase the oversight by the stock exchanges and give investors more access to information about listed companies. The reform aims to improve the quality of information disclosure by issuers so as to clarify and rationalize the relationship between the government and the market during IPOs, reinforce market discipline, and facilitate the performance of due diligence by market participants. To this end, the CSRC issued new guidelines in December 2013, when there were more than 760 companies waiting in the queue for approval. The CSRC stated that it might take a year to review all the applications.

The bond market has three main segments: government bonds, bonds issued by policy banks, and corporate bonds. During 2002–2012, the bond markets underwent tremendous changes driven by innovation, with the value of outstanding debt securities increasing rapidly from CNY2.8 trillion to CNY26 trillion, and the ratio of these securities to gross domestic product (GDP) increasing from 24% to 50%. Corporate bonds have developed significantly, with the value of corporate debt securities increasing from CNY123.3 billion in 2004 to CNY6 trillion in 2012. The PRC’s bond market is now one of the largest in the world (the fourth largest in December 2012). Notwithstanding the appearance of sophistication created by this growth, the majority of investors in the bond market are commercial banks.

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83 The government created three policy banks in 1994 to take on policy mandates traditionally handled by the state commercial banks: the Agricultural Development Bank of China, China Development Bank, and the Export-Import Bank of China.
(particularly national banks), which account for approximately 69% of bond holdings. Insurance institutions are the next-largest category, with approximately 10% of holdings. Many of the bonds held by institutions are not traded, so liquidity is lower than might be expected for such a large market.

The interbank bond market, which accounts for most of the trading volume, is supervised by the People's Bank of China (PBOC); and the exchange bond market is supervised by the CSRC. The National Development and Reform Commission (NDRC) approves enterprise bonds issued by institutions affiliated with government departments and state-owned or state-controlled enterprises. In 2012, an inter-agency mechanism including the PBOC, CSRC, and NDRC was launched to review and approve corporate bond issuances. This mechanism will also work to improve the rules on issuance, trading, and information disclosure.

### 7.2 ADB Engagement and Achievements

ADB has undertaken four TA projects and one investment in the area of capital markets, with a particular focus on the development of regional bond markets for the ASEAN+3 region. ADB’s Office of Regional Economic Integration (OREI) drives much of this work by assisting the DMCs (both individually and collectively) in harnessing the full benefits of global financial integration and international capital flows, while at the same time minimizing any disruptive effects of those flows. A summary of these projects is provided in Table 6.

#### 7.2.1 Minimizing Foreign Exchange Settlement Risk in the ASEAN+3 Region

Foreign exchange (FX) settlement risk is a major deterrent to the growth of cross-border bond settlements throughout the ASEAN+3 region. In cross-border transactions, different time zones result in different operational hours for national payment systems, leaving trading parties with potential FX loses in the event that a counterparty fails to settle.

Building on prior activity in regional settlement linkages by a working group of the ASEAN+3 Asian Bond Markets Initiative (ABMI), The TA project for Minimizing Foreign Exchange Settlement Risk in the ASEAN+3 Region (TA 6338) further explored and analyzed ways to minimize FX settlement risk for cross-border transactions in the region. The outputs of TA 6338 included: (i) recommendations of options for minimizing FX settlement risks across ASEAN+3 markets, and (ii) the creation of an enabling environment for the efficient clearing and settlement of cross-border bond transactions.

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87 ASEAN+3 refers to the member countries of the Association of Southeast Asian Nations (ASEAN) plus the PRC, Japan, and the Republic of Korea.

Table 6. **ADB Projects to Develop Regional and Domestic Capital Markets**

<table>
<thead>
<tr>
<th>ADB Reference</th>
<th>Title</th>
<th>Brief Description</th>
<th>Dates(^a)</th>
<th>Amount Utilized(^b) ($'000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>TA 6338</td>
<td>Minimizing Foreign Exchange Settlement Risk in the ASEAN+3 Region</td>
<td>To offer policy recommendations for removing impediments to the clearing and settlement of bond transactions, thereby encouraging local-currency bond market development</td>
<td>Aug 2006–June 2009</td>
<td>666</td>
</tr>
<tr>
<td>TA 6514</td>
<td>Harmonization of Bond Standards in ASEAN+3</td>
<td>To promote the development of domestic and regional bond markets by harmonizing standards in the secondary government and corporate bond markets, thereby facilitating the participation of issuers and investors</td>
<td>Dec 2008–Mar 2012</td>
<td>889</td>
</tr>
<tr>
<td>TA 6464</td>
<td>Asian Bonds Online Website Project (Phase II)</td>
<td>To improve the information flow in ASEAN+3 bond markets by managing and enhancing the “AsianBondsOnline” website, and by financing the publication of Asia Bond Monitor, which uses data and analyses from the website</td>
<td>June 2008–Dec 2011</td>
<td>1,359</td>
</tr>
<tr>
<td>TA 7052</td>
<td>Asset-Backed Securitization for Expressway Financing and Corporate Debt Restructuring in Yunnan Province</td>
<td>To provide a detailed executable plan for a debt restructure in order to formulate and implement an asset-backed security transaction in Yunnan</td>
<td>Jan 2008–Dec 2010</td>
<td>106</td>
</tr>
<tr>
<td>PS 7204</td>
<td>PRC: Actis China Fund 2, L.P.</td>
<td>Equity investment in Actis China Fund 2, L.P. to target private sector companies that had demonstrated sustainable long-term growth and were in need of expansion capital</td>
<td>Nov 2004–Dec 2010</td>
<td>45,000</td>
</tr>
<tr>
<td><strong>TOTAL</strong></td>
<td></td>
<td></td>
<td></td>
<td><strong>48,020</strong></td>
</tr>
</tbody>
</table>

ADB = Asian Development Bank; ASEAN+3 = Association of Southeast Asian Nations plus the People’s Republic of China (PRC), Japan, and the Republic of Korea; L.P. = limited partnership; PS = private sector; TA = technical assistance.

\(^a\) This column includes the start date (approval date) and actual or estimated completion date (projects that are ongoing are noted as such).

\(^b\) When the figure for the utilized amount is not available, the approved amount is provided instead.


TA 6338 also produced a final report that offered: (i) a review of various settlement risks; (ii) a review of existing options, as well as proposed new options, regarding mechanisms and institutions for clearing and settling bonds; and, (iii) case studies reviewing various models for regional settlement intermediaries; and (iv) a set of recommendations for policy makers.

The policy recommendations resulting from TA 6338 can be summarized as follows: (i) boost the use of the Continuous Linked Settlement (CLS) system in the ASEAN+3 region by increasing the number of eligible local currencies\(^{89}\); (ii) undertake a rigorous examination

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\(^{89}\) The Continuous Linked System (CLS) is a multicurrency cash-settlement system that mitigates settlement risk for the foreign-exchange transactions of its members and their customers, and reduces cost by streamlining and standardizing foreign-exchange operations.
of the business cases for the various regional settlement intermediary proposals; and (iii) set up a Group of Experts to discuss and shape these ideas further. The outputs were supported by a regional conference and the formation of the Group of Experts.

TA 6338 was rated successful by reviewers, and the outputs and activities were well received.

This TA project mapped to many of the PRC’s and ADB’s strategies and polices. Support for the regional cross-border bond market is an ADB strategy under the Financial Sector Operational Plan (FSOP) and Strategy 2020. ADB is uniquely positioned to support efforts to develop bond markets because of its role as the secretariat for the ABMI. Under Strategy 2020, ADB is facilitating the creation of a harmonized regulatory framework, a common credit guarantee mechanism, and a regional clearing and settlement system for the emerging regional bond market.

The project aligned with the PRC’s 12th Five-Year Plan, which includes the goals of establishing cross-border, cross-market financial rules and of strengthening financial regulations in general. In addition, the plan highlights the orderly expansion of the finance sector as a strategy, especially the improvement of the financial market’s registration, management, trading, and settlement systems.

TA 6338 also aligned with the strategic pillar of “regional cooperation and integration” in ADB’s current country partnership strategy (CPS) for the PRC, which complements its domestic goals for the PRC with programs supporting regional cooperation and integration.

7.2.2 Harmonization of Bond Standards in ASEAN+3

The ASEAN+3 Finance Ministers’ Meeting in 2008 agreed on a new ABMI road map to boost momentum for work to be undertaken under the ABMI. This new, comprehensive ABMI road map encouraged member countries to further develop local-currency-denominated bond markets, as well as a regional bond market, that would be more accessible to issuers and investors. Among the issues that needed to be addressed in developing an integrated bond market (and attracting issuers and investors) was the lack of harmonization of bond standards and practices.

The objective of the TA project for Harmonization of Bond Standards in ASEAN+3 (TA 6514) was to promote the development of domestic and regional bond markets in four ways: (i) harmonizing standards (including those for regulations, practices, and infrastructure) in secondary government bond markets; (ii) harmonizing standards for corporate bonds, to facilitate cross-border issuance; (iii) strengthening self-regulatory organizations (SROs) and/or establishing new ones, as appropriate, to facilitate the harmonization of corporate bond standards and regional bond market integration; and (iv) providing institutional investors with updates on the bond market situation and on steps taken to achieve an efficient bond market.

ADB. 2008. Harmonization of Bond Standards in ASEAN+3. (TA 6514-REG, $950,000 [$889,166 utilized], approved on 16 December, completed on 31 March 2012, co-financed by the Republic of Korea e-Asia and Knowledge Partnership Fund and by the Investment Climate Facilitation Fund under the Regional Cooperation and Integration Financing Partnership Facility, funds administered by ADB).
The TA project aligned with many of the PRC’s and ADB’s strategies and polices, in a similar manner to that of TA 6338 (see subsection 7.2.1).

7.2.3 Asian Bonds Online Website Project (Phase II)\(^91\)

Regional and national initiatives have focused on removing obstacles and building up infrastructure to support bond market development, including the reduction of information asymmetry. One of the critical requirements for efficient bond markets is that both issuers and investors have access to accurate information.

The TA project for Asian Bonds Online Website Project (Phase II), TA 6464, continued ADB’s support for the expansion and improvement of information flows, and for increased transparency, liquidity, efficiency, and depth in ASEAN+3 bond markets. The “AsianBondsOnline” website was launched in 2004, and is now considered the only “one-stop” clearinghouse for information on sovereign and corporate bond issues in the region, and for reports on the economic and legal circumstances surrounding these issues. The *Asia Bond Monitor* is a quarterly publication that reviews recent developments in local currency bond markets in the ASEAN+3 region using data and analysis from the AsianBondsOnline website.

The objective of TA 6464 was to improve the flow of information on ASEAN+3 bond markets by (i) maintaining the AsianBondsOnline website, (ii) enhancing the website content, (iii) expanding the coverage of the website’s “Credit Risk Watch” feature, and (iv) publishing *Asia Bond Monitor*.

Given the importance of information flows for the efficiency of bond markets, this TA project aligned well with the PRC’s and ADB’s policies and strategies for promoting a cross-border bond market, in a similar manner to that of TA 6338 (see subsection 7.2.1).

7.2.4 Asset-Backed Securitization for Expressway Financing and Corporate Debt Restructuring in Yunnan Province\(^92\)

The Yunnan Province has embarked on an aggressive expressway investment and construction program. The Yunnan Provincial Highway Development and Investment Corporation (Development Corporation), is an SOE responsible for constructing and managing expressways in Yunnan Province. Asset-backed securities (ABSs) issued against future toll revenues were considered a useful means for the Development Corporation to raise long-term financing efficiently from the capital market and, in the process, to streamline the corporation’s debt structure, thereby reducing both the funding requirements from banks and the risks borne by the central and provincial governments.

91 ADB. 2008. *Asian Bonds Online Website Project, Phase II*. Manila (TA 6464-REG, $1,400,000 [1,359,029 utilized], approved on 24 June, completed on 31 December 2011, financed by the Japan Special Fund).

The purpose of the TA project for Asset-Backed Securitization for Expressway Financing and Corporate Debt Restructuring in Yunnan Province (TA 7052) was to help the Development Corporation formulate and execute an ABS program, and to restructure and optimize its debt structure. TA 7052 was also served as a pilot case to help the CSRC further rationalize the legal framework for ABSs.

TA 7052 was rated partly successful by reviewers. The planned ABS issuance did not proceed, due to the impact of the global financial crisis of 2008–2009 (GFC). A major change in the project’s scope was approved so that it could support a local government bond issuance in Yunnan, which also did not proceed, in this case due to policy impediments. Instead, an international conference was held to discuss the finance and risk-management policies of local governments, and to raise awareness of international best practices. The conference was well received, with further work identified for the development of local government financing.

In terms of mapping the TA project to key reforms, the PRC identified asset securitization as a priority area under its 12th Five-Year Plan. TA 7052 also addressed local government finance (albeit after its scope was expanded), and ADB supports municipal finance under the current CPS.

7.2.5 PRC: Actis China Fund 2, L.P.

In November 2004, ADB approved an equity investment in Actis China Fund 2, L.P., under PS 7204, of $45 million or 25% of total commitments, whichever was less (total commitments ended up amounting to $250 million). At the time of fundraising, the private equity market in the PRC had been witnessing a decline in capital availability and investments due to concerns over poor performance and a difficult business and regulatory environment. The ADB investment sought to energize the PRC private equity market by catalyzing investments, supporting high-quality fund managers, and encouraging the financing of private companies in capital-deprived sectors.

The fund was not only expected to invest in conventional small and medium-sized enterprises (SMEs), but also in medium-sized companies that were seeking expansion capital for their next stage of growth. In general, the fund’s investments fell into three categories: (i) domestic consumer-oriented businesses; (ii) emerging or sunrise industries, such as wireless technology and solar power generation; and (iii) petroleum industry equipment suppliers.

The investment was rated highly successful by reviewers, partly due to the fund’s development impact and outcome, and to its large multiplier effect of bringing new capital into the PRC’s mid-market segment.

Financing SMEs as a way to promote inclusive and balanced growth is a major theme in PRC and ADB strategy and policy documents. This TA project not only invested directly in SMEs (as well as in mid-market enterprises), it also had the effect of attracting new capital from other sources. Private sector development is another important theme, with

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the CPS supporting catalytic projects and focusing on innovative financial solutions (e.g., for microfinance and SMEs). ADB is also assisting its DMCs in developing equity markets for SMEs, as well as venture capital and private equity funds.

The PRC’s policies in this area are twofold: to provide financial support to selected industries (one of the State Council’s policy measures) and to broaden the channels of direct financing for manufacturing sectors (under the 12th Five-Year Plan). See section 3.3 for further details on PRC and ADB strategies and policy priorities with regard to SME finance.

7.3 Fulfilling Policy Priorities

7.3.1 ADB’s Country Partnership Strategy (2011–2015)

The CPS for the PRC during 2011–2015 designates its third pillar as “regional cooperation and integration,” under which the regional aspect of the strategy is meant to complement ADB’s overall support for regional cooperation (see section 2.4). In addition, ADB’s support for regional cooperation and integration will continue to reinforce CPS efforts to reduce imbalances among provinces and regions within the PRC.

Under the current CPS, the ADB will also continue to support municipal finance.

Private sector development is recognized as a driver of change under the CPS, with ADB’s public sector operations seeking to strengthen the enabling environment for private sector development by supporting policy and regulatory reforms and by working to improve access to finance. A particularly relevant aspect of ADB’s nonsovereign operations is its focus on supporting catalytic projects and on finding innovative financial solutions (e.g., for microfinance and SMEs).

Although finance is not identified as a priority sector under the current CPS, access to finance for enterprises in the priority sectors is an important operational objective, and this includes continued support for SME finance.

7.3.2 ADB’s Financial Sector Operational Plan (2011–2014)

Under the FSOP, ADB is supporting the development of debt, equity, and derivatives markets to help the DMCs diversify their finance sectors. It is also promoting the access of infrastructure projects to long-term financing from contractual savings institutions by way of corporate bond markets. ADB is uniquely positioned to support the DMCs’ efforts to develop bond markets because of its role as the secretariat for the ABMI. Its regional departments and Office of Regional Economic Integration (OREI) work closely together on a systematic basis to generate support for the ABMI and for domestic market development.

In line with the goal of promoting financial inclusion and balanced growth, the FSOP emphasizes support for SME financing, and highlights ADB support for the development in DMCs of equity markets for SMEs, as well as venture capital and private equity funds.
7.3.3 ADB’s Strategy 2020 (2008–2020)

Strategy 2020 identifies finance sector development as one of the five core areas of ADB operations. As part of the strategy, ADB is working at the regional level to support cross-border bond transactions. For the emerging regional bond market, ADB is facilitating the creation of a harmonized regulatory framework, a common credit guarantee mechanism, and a regional clearing and settlement system. Through such initiatives, ADB continues to assist in channeling the region’s savings into the most productive investments, especially into the development of capital markets.

To promote inclusive growth, ADB seeks to create an enabling environment for SMEs. Private sector development is identified by Strategy 2020 as one of the “drivers of change,” and under the strategy, ADB is doing more to help DMCs attract direct private sector investments that support inclusive growth and improve the environment.

7.3.4 PRC State Council Financial Policy Measures

One of the State Council’s financial policy measures is to ‘provide financial support to selected industries and promote industry restructuring, including more support for the advanced manufacturing sector, strategic new industries, modern information technology, labor-intensive industries, the service sector, and for an upgrade of traditional industries.

7.3.5 The PRC’s 12th Five-Year Plan (2011–2015)

The PRC’s 12th Five-Year Plan sets out strategies for deepening the reform of the financial system. With regard to the establishment of a system of multilevel financial markets, asset securitization was identified as an area on which to focus. In terms of enhancing financial regulation, the establishment of cross-border, cross-market financial regulations was identified as essential. The orderly expansion of the financial services industry is also highlighted as a strategy, with a specific reference to the improvement of the financial markets’ registration, management, trading, and settlement systems.

With regard to manufacturing, the plan seeks to promote the development of SMEs by increasing the size and percentage of lending to SMEs, and by broadening the channels of direct financing.

7.4 Development Opportunities

The TA projects in the area of equity, debt, and capital markets have so far been well targeted, both in terms of ADB and PRC priorities and of added value. In view of ADB’s role in the ABMI and its strategic interest in cross-border capital transactions, continued activities in this area appear to be justified, as they fit well within the strategic priorities of the PRC and ADB. Whenever possible, projects should be tightly targeted, as they then offer the greatest potential for adding high value, as was the case with TA 6338.
Beyond cross-border issues, there is also likely to be further scope for ADB assistance to the PRC in local government finance. There is growing international experience and expertise in the techniques for efficiently managing debt issuance. However, with concerns over the soundness of some local government financing vehicles (LGFVs) and the growth in credit through LGFVs, ADB should focus on capacity building and governance processes, including long-term budgeting, service demand and forecasting, asset management, and infrastructure development and planning.

Another area of potential ADB engagement is the National Equities Exchange and Quotations (NEEQ) board. As noted above, on 16 January 2013 the government announced possible changes that would provide access to the NEEQ board for qualifying domestic MSMEs (in addition to technological firms), and these changes are expected to open new avenues of financing (see section 7.1). The opening of the NEEQ board would necessitate the close supervision of listing and trading activities to ensure appropriate disclosure, the regulation of selling and brokering practices, and the monitoring of trading activities for potential market abuse, as well as the development of a strong investigation and enforcement capability to maintain the integrity of the expanded bourse. It is likely that the NEEQ will also require assistance in a number of areas when dealing with the potential influx of listings, including those in sectors unfamiliar to the NEEQ governance and oversight team.

Finally, while there is arguably room for assistance in refining and clarifying the roles of the government agencies involved in the national capital markets, this area is less well aligned with ADB priorities.
8.1 Overview

In the immediate aftermath of the GFC, the PRC’s State Council embarked on policy reforms aimed at reducing the risk of financial contagion from foreign currency crises. It initiated pilot programs in trade settlement in 2009, and identified the internationalization of the yuan as an objective. Five years on, the internationalization of the yuan is progressing, apparently not as a result of policy implementation, but as a by-product of the government’s market-driven reforms. Supporting this interpretation is the fact that there is no explicit mention of yuan internationalization in the State Council’s 10 measures for financial market reform, issued in July 2013 (see the box, “State Council Measures for Finance System Reform,” in section 2.2).

International use of the yuan has grown rapidly, albeit from a low base, and there are strong indications that this trend will continue. According to 2013 data from the Bank for International Settlements (BIS), the yuan had moved into the top 10 traded currencies (as number nine), although it remained dwarfed by dollars and euros. A government program launched in 2012 to simplify cross-border settlements in yuan has seen an estimated doubling in the value of yuan cross-border settlements in less than two years, to more than CNY4 trillion. In October 2013, the People’s Bank of China (PBOC) and the European Central Bank signed a CNY350 billion currency-swap agreement, bringing the volume of currency swap deals to more than CNY2.2 trillion. Since Hong Kong, China became an offshore trading hub for the PRC, yuan-denominated bank deposits have grown to more than 10% of total deposits there (probably at the expense of other foreign deposits). While this accumulation of yuan is likely to be linked to surpluses from yuan-denominated trade settlements, the deposits enable investors to benefit from the carry trade,94 based on the speculation that the yuan will appreciate against the major currencies.

Any future role for the yuan as a reserve currency will need to go well beyond trade transactions. Rather, it will probably be closely tied to the development of the Chinese financial system, especially to the move to market-driven processes, financial deepening, more flexible interest rates and currency values, and reduced restrictions on capital account flows (into and out of the PRC).

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94 “Carry trade” is when an investor sells a currency with a relatively low interest rate and uses the funds to buy a currency with a higher interest rate.
In the meantime, current progress toward internationalization has already generated positive signs, including: a reduction in currency risk for Chinese importers and exporters, lower costs of settlement between the yuan and most ASEAN+3 currencies, less need to accumulate dollar reserves, and the possibility that the PBOC will gain more influence over monetary policy (while losing some of its ability to control the currency).

8.2 ADB Engagement and Achievements

ADB’s engagement policies in the PRC and its finance-sector focus are not natural fits for reforms to support the internationalization of the yuan. Hence, ADB has indirectly supported this effort more so within the areas of capital market development, supporting a financial sector infrastructure, and performing studies on the prospects for internationalization of the yuan. Further, ADB has indirectly supported internationalization of the yuan through offshore debt issuance denominated in yuan.

8.3 Fulfilling Policy Priorities

As noted above, the internationalization of the yuan is not a direct priority for ADB support. Moreover, it is only a secondary priority for the PRC, and is likely to occur more as a result of primary finance sector reforms than from dedicated TA support.

8.4 Development Opportunities

While ADB will always be open to requests for assistance in matters not among its established priorities, the authors expect these requests to be initiated by an executing agency and considered on a case-by-case basis.
9.1 Overview

The PRC’s rapid economic growth has exerted significant pressure on the environment, with high levels of land degradation, poor air quality standards, and inadequate and unsanitary water supply. The PRC’s carbon dioxide emissions accounted for about 24% of the world’s total in 2009, and is closely linked to the largely coal-based energy sector and to the PRC’s heavy reliance on fossil fuels. Addressing the issues related to environmental management and climate change is a key objective for the government, which has set a target for reducing carbon dioxide emissions (from the 2005 levels) by 40%-45% per unit of gross domestic product (GDP) by 2020.95

The government invested about $383 billion, including public and private funds, during 2006–2010 in energy-efficiency and emission-reduction projects and in the new energy sector. The annual investment required to meet climate-change targets is expected to be about $273 billion–$305 billion a year by 2015, escalating to about $353 billion–$385 billion a year by 2020.96 To raise these amounts, it will be necessary to harness private capital investment and utilize market mechanisms.

“Green finance” refers to financial activities that support environmentally focused industries and projects, with climate-change finance a large component of green finance. Although reducing carbon emissions is a key objective for the government, it has to be balanced against the requirements of economic development.

Most efforts to reduce energy consumption to date have focused on large state-owned enterprises (SOEs), over which the government can exert direct pressure to reduce energy consumption.97 Although SMEs are vital to economic development (contributing around 60% of GDP), they lag behind the big SOEs in the utilization of energy-efficient and environmentally friendly technologies. SMEs are considered by many to be the next frontier in energy efficiency and emission reduction.

The PRC’s 12th Five-Year Plan includes a significant component on environmental management, with ambitious targets for improving energy efficiency, reducing carbon

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96 ADB. Briefing Notes to the Minister of Finance, Appendix 9. Unpublished.
emissions, and encouraging the development of clean energy resources. One of the policy directives set out in the plan is to improve the incentives for energy conservation and emission reduction. Under the plan, the PRC is pursuing green and low-carbon development ideas for energy conservation and emission reduction, improving incentive and constraint mechanisms, and working to boost resource-saving and environmentally friendly production and consumption—all to strengthen sustainable development and improve ecological standards.

Environmental management is also important to ADB. As noted above, pillar 2 of ADB’s country partnership strategy (CPS) for 2011–2015 is “environmentally sustainable growth” (see section 2.4); and energy is one of the priority sectors under this CPS. While finance is not a priority sector, support for innovative financial solutions and access to credit in the priority sectors remain major operational objectives. In particular, ADB continues to support green finance. Environmentally sustainable growth is also a key objective for ADB’s Strategy 2020, under which the environment is recognized as a core area of operation.

9.2 ADB Engagement and Achievements

ADB has undertaken six TA projects and two investments to promote a green and climate-change focus in the PRC. A summary of these projects is provided in Table 7.

9.2.1 Establishment of the Clean Development Mechanism Fund

As a developing member country (DMC) of ADB, the PRC is eligible to benefit from the Clean Development Mechanism (CDM), which was established under the Kyoto Protocol. The PRC has the potential to generate about 50% of total worldwide annual certified emission reductions (CERs), with the potential benefits achieved through the CDM by means of CER transactions between project owners or enterprises in the PRC and their counterparts in developed countries. The government regarded the CDM as important, but recognized a number of issues relating to the incentives it created. In 2005, the government introduced a levy on CER revenues generated by the CDM projects in the PRC, with the resulting funds used to support domestic climate-change-related activities. A specialized PRC facility, the China Clean Development Mechanism Fund (CCDMF), was established to manage the funds collected from the CDM projects and grants received from external agencies. By 2012 the collected levies exceeded $1.5 billion.

The TA project for Establishment of the Clean Development Mechanism Fund (TA 4812) helped the government establish the CCDMF, including an appropriately designed governance structure and initial operational-capacity development. The TA project had four components: (i) a study on and introduction of the CDM levy-collection mechanism, (ii) the CCDMF governance-structure design and operational capacity building, (iii) CCDMF operations manual, and (iv) a program to disseminate information and promote public awareness.

<table>
<thead>
<tr>
<th>ADB Reference</th>
<th>Title</th>
<th>Brief Description</th>
<th>Dates</th>
<th>Amount Utilized ($'000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>TA 4812</td>
<td>Establishment of the Clean Development Mechanism Fund</td>
<td>To establish a specialized facility to manage the fees collected for CDM projects, and to design a governance structure and initial capacity-development operation</td>
<td>June 2006–May 2009</td>
<td>522</td>
</tr>
<tr>
<td>TA 6428</td>
<td>Supporting Strategic Knowledge Products and Research Networking</td>
<td>Feasibility study under TA 6428 on innovative climate financing through a public-private partnership for the CCDMF, so as to strengthen the fund’s role in promoting low-carbon development in the PRC, to analyze the feasibility of a “fund of funds” for the CCDMF, and to clarify the preconditions for operating a fund of funds</td>
<td>Dec 2007–Jan 2016 (ongoing)</td>
<td>2,815</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Nov 2012–Nov 2013 (feasibility study)</td>
<td></td>
</tr>
<tr>
<td>TA 7202</td>
<td>Utilization of Foreign Capital to Promote Energy Conservation and Energy-Efficient Power Generation Scheduling</td>
<td>To enhance institutional capacity for planning, financing, and implementing measures to improve the efficiency of energy supply and consumption</td>
<td>Dec 2008–Dec 2011</td>
<td>1,281</td>
</tr>
<tr>
<td>TA 7212</td>
<td>China Clean Development Mechanism Fund Capacity Development</td>
<td>To help strengthen the CCDMF’s operational capacity for investment decision making</td>
<td>Dec 2008–Dec 2011</td>
<td>730</td>
</tr>
<tr>
<td>TA 7564</td>
<td>Innovative Financing Mechanisms for Energy Efficiency and Emission Reduction in Small and Medium-Sized Enterprises</td>
<td>To increase SME access to financial support for the adoption of advanced energy-efficient technologies by identifying impediments, recommending financing mechanisms, establishing criteria for project selection, and strengthening the capacity of SMEs to secure finance</td>
<td>July 2010–Dec 2012</td>
<td>735</td>
</tr>
<tr>
<td>TA 7589</td>
<td>Study on Beijing Green Finance Development Strategy</td>
<td>To conduct a study on the state of carbon finance in the PRC, make recommendations regarding enabling policies, and create a road map for the establishment of a carbon-finance center in Beijing</td>
<td>Sep 2010–Dec 2013</td>
<td>469</td>
</tr>
<tr>
<td>PS 7179</td>
<td>PRC: China Environment Fund 2002, LP</td>
<td>Investment in the PRC’s first venture capital fund dedicated to the environment</td>
<td>Oct 2002</td>
<td>3,000</td>
</tr>
<tr>
<td>PS 7220</td>
<td>China Environment Fund 2004, LP</td>
<td>Investment in the PRC’s second venture capital fund dedicated to the environment, with the fund investing equity capital in selected enterprises that have strong growth potential and are engaged in providing environmental products and services</td>
<td>Oct 2002</td>
<td>7,000</td>
</tr>
<tr>
<td>TOTAL</td>
<td></td>
<td></td>
<td></td>
<td>16,552</td>
</tr>
</tbody>
</table>

CCDMF = China Clean Development Mechanism Fund, CDM = Clean Development Mechanism, LP = limited partnership, PRC = People’s Republic of China, PS = private sector, SME = small and medium-sized enterprises, TA = technical assistance.

* This column includes the start date (approval date) and actual or estimated completion date (projects that are ongoing are noted as such).

* When the figure for the utilized amount is not available, the approved amount is provided instead.

* A “fund of funds” (FOF) is a fund that invests in other funds.

The major deliverables of TA 4812 included: (i) a draft decree on the CDM levy-collection mechanism; (ii) a draft policy paper guiding the CCDMF’s internal control and governance structure, (iii) a draft operations manual for the CCDMF, (iv) training materials for capacity building, and (v) materials for the information-dissemination and public-awareness program.

TA 4812 achieved its objectives and was rated successful by reviewers.

This TA project aligned well with the strategic objectives of both ADB and the PRC concerning environmental management.

9.2.2 Feasibility Study under Supporting Strategic Knowledge Products and Research Networking

The CCDMF was established in 2007 with a mission to serve as an integrated fund combining a government orientation and market functions. It aims to harness capital, information, and action to address climate change and promote low-carbon development in the PRC. To obtain the substantial resources needed to finance climate change mitigation, it is necessary to raise private capital. A “fund of funds” (FOF) is an innovative financial instrument for raising private capital in the field of climate change, and it has the potential to strengthen the capacity of the CCDMF. Specifically, an FOF is a fund that invests in other investment funds, rather than engaging in direct investment. An FOF’s portfolio will thus include investments in a number of commercially managed funds, each of which invests in projects or companies involved in climate change.

The purpose of the feasibility study under the TA project for Supporting Strategic Knowledge Products and Research Networking (TA 6428) was to analyze the practicality of a climate-change FOF for the CCDMF, and to clarify the pre-conditions that would enable the CCDMF to operate an FOF so as to contribute to low-carbon development in the PRC.

Based on an analysis of the external market environment and of the CCDMF’s internal conditions, the study concluded that it would be feasible for the CCDMF to operate a private equity FOF. The study then proposed four potential options for the CCDMF: (i) the CCDMF contributes a certain percentage of its total assets to set up an FOF dedicated to investment in green private equity funds; (ii) in its dual capacity as founding sponsor and anchor investor, the CCDMF teams up with a professional institution to launch an FOF in the legal form of a partnership; (iii) as a founding shareholder, the CCDMF partners with other investors to launch a corporate type of FOF, and engages a professional institution to manage it; and (iv) the CCDMF makes direct investments as a limited partner in an FOF focused on environmental protection, and asserts its influence by requesting specific terms in the FOF’s mandate and investment-decision criteria.

ADB. 2007. Supporting Strategic Knowledge Products and Research Networking. Manila (TA 6428-REG, $5.5 million [about $2,815,000 utilized], approved on 12 December, completion expected on 31 January 2016). The component described here is a feasibility study conducted November 2012–November 2013, under TA-6428, on promoting innovative financing for the China Clean Development Mechanism Fund through public-private partnerships (PPPs).
9.2.3 Utilization of Foreign Capital to Promote Energy Conservation and Energy-Efficient Power Generation Scheduling

The PRC has seen progress toward greater energy efficiency, but the institutional capacity of some of the local and provincial governments remains weak. This is particularly the case when it comes to utilizing foreign capital to run innovative energy-efficiency projects that can introduce the latest technology and practices. Power generation remains one of the most energy-intensive and polluting sectors in the PRC. In 2007, however, a new power generation scheduling and dispatch system (GS&DS) was launched to maximize the use of renewable energy.

The TA project for Utilization of Foreign Capital to Promote Energy Conservation and Energy-Efficient Power Generation Scheduling (TA 7202) had two parts: (A) a review of the utilization of foreign capital to promote energy conservation; and (B) a review of energy-efficient power generation scheduling. Part A included: (i) a summary report on the challenges and opportunities for energy conservation in key energy-intensive industries, (ii) policy recommendations for implementing the government’s energy-efficiency strategies, (iii) innovative financing and implementation mechanisms for energy-efficiency projects, (iv) suggestions of practical measures for supporting institutions and agencies in the energy-conservation market, and (v) training programs and capacity-building support.

Part B included: (i) policy recommendations for the new GS&DS; (ii) analysis of the new GS&DS in the context of power-sector reform, power-sector efficiency, and power-tariff reform; and (iii) capacity development and information sharing.

TA 7202 was rated successful by reviewers, despite delays in implementing Part B due to the Sichuan earthquake. One early result of Part B’s implementation was a sharp reduction in coal consumption in 2009.

This TA project aligned well with the strategic objectives of both ADB and the PRC concerning environmental management.

9.2.4 China Clean Development Mechanism Fund Capacity Development

The TA project for China Clean Development Mechanism Fund Capacity Development (TA 7212) built on the earlier TA project for Establishment of the Clean Development Mechanism Fund (TA 4812), which is detailed in section 9.2.1. The CDM was established under the Kyoto Protocol in 2005, and by 2009 the concept had been widely disseminated,

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with about 1,800 CDM-related projects registered worldwide, approximately 47% of total registered projects. As a new institution, the CCDMF needed capacity building in fund management and investment decision making.

TA 7212 was intended to deliver the following outputs: (i) a draft of an operations governance framework for prudent investment related to clean energy; (ii) the design and implementation of an internet-based management information system for office administration, project management, risk control, human resources management, and financial management; (iii) a draft design of a financial instrument covering potential climate-change-related financial products (e.g., debt and derivatives) and liquidity management (e.g., risk management and account management); and (iv) training and information dissemination.

TA 7212 was rated highly successful by reviewers, who found that the project had achieved its desired outcomes, and even generated additional relevant outputs. Most notably, TA 7212 had critically strengthened the CCDMF’s ability to utilize revenues in an efficient, transparent, and effective manner.

This TA project aligned well with the strategic objectives of both ADB and the PRC concerning environmental management.

9.2.5 Innovative Financing Mechanisms for Energy Efficiency and Emission Reduction in Small and Medium-Sized Enterprises

The PRC’s efforts to reduce energy consumption have been mostly aimed at large state-owned enterprises (SOEs) with the technical and financial capacity to adopt energy- and emission-efficient technologies, as the government can exert influence over them. Private SMEs have lagged behind these larger enterprises in terms of energy and emission efficiency, and many of the SME-dominated industries are becoming major polluters. Government policies and incentives have been formulated to encourage SMEs to adopt new technologies, but the SMEs’ lack of access to finance prevents many of them from embracing energy- and emission-efficient technologies.

The TA project for Innovative Financing Mechanisms for Energy Efficiency and Emission Reduction in Small and Medium-Sized Enterprises (TA 7564) was designed to: (i) identify major policy and economic impediments to SME energy efficiency and emission reduction (EEER) financing, (ii) recommend potential financing mechanisms, (iii) establish a set of criteria for selecting bankable EEER projects for SMEs; and (iv) strengthen the capabilities of SMEs to secure financing and implement EEER projects. The TA project mainly used surveys and data analyses.

TA 7564’s outputs were: Technical Report I—Case Studies for SME Financing for EEER; Technical Report II—Recommendations on Innovative Financing Mechanisms for EEER in

SMEs; Technical Report III—Operational Procedures and Selection Criteria for SME EEER Financing; Technical Report IV—Recommendations on an SME EEER Promotion Fund; the Final Report; and capacity building for stakeholders through seminars, workshops, and an international study tour.

TA 7564 was rated successful by reviewers. The TA project’s major contribution was its recommendations for improving SME financing for the EEER, including a financial scheme for bundling EEER projects across SMEs and a proposal for the establishment of a promotion fund to strengthen SME-financing guarantees. It was suggested that energy companies could play a key role in bundling EEER projects across SMEs.

The TA project aligned well with the strategic objectives of ADB and the PRC with regard to environmental management, and with the ADB and PRC priority of developing SME finance in support of financial inclusion.

9.2.6 Study on Beijing Green Finance Development Strategy\textsuperscript{103}

Although reducing carbon emissions is a key objective for the government, there is also a need to balance this objective against the requirements of economic development. Green finance, which focuses on environment-oriented projects and industries, is one way to strike this balance. And one of the largest components of green finance is “carbon finance,” the investment in enterprises and projects that develop and/or apply technologies for reducing emissions of greenhouse gases (especially carbon dioxide), thereby contributing to low-carbon development. Carbon finance allows project owners or industrial enterprises to sell “carbon assets” (also called “carbon credits”) to non-carbon-reducing entities, based on the amount of emissions they have been able to reduce. The Beijing municipal government has an ambitious strategy for positioning the capital as an international center for green finance, spearheaded by a successful development of carbon finance. The municipal government proposed the development of a Beijing pilot carbon-finance district to serve as a hub for carbon-finance and green-finance transactions in the PRC. The plan calls for the expansion of the China Beijing Environment Exchange into a major bourse for carbon trading.

The TA project for Study on Beijing Green Finance Development Strategy (TA7589) examined the state of carbon finance in the PRC, recommended enabling policies, and created a road map for the establishment of a carbon finance center in Beijing. One of the outputs of TA 7589 was a set of policy recommendations for promoting the growth of enterprises related to green or carbon finance, and attracting them to the pilot center in Beijing. The results of the TA will continue to form the basis of discussions with relevant government agencies.

TA 7589, which was completed in December 2013, mapped well to ADB and PRC strategies in the area of environmental management (see section 9.1).

\textsuperscript{103} ADB. 2010. People’s Republic of China: Study on Beijing Green Finance Development Strategy. Manila (TA 7589-PRC, $500,000 [$468,901 utilized], approved on 3 September, completed on 31 December 2013).
9.2.7  PRC: China Environment Fund 2002, LP

The China Environment Fund 2002, LP is the first venture capital fund dedicated to the environment in the PRC. The fund offers an opportunity to introduce clean technologies that reduce pollution and increase production efficiency. Under PS 7179, ADB provided $3 million to the fund, which requires all its investee companies to comply with the applicable government environmental and social policy regulations, and with the applicable ADB guidelines.

The fund is regarded as a socially responsible investment. As such, it has three principal objectives: to earn reasonable risk-adjusted returns, improve the PRC’s environment, and generate social benefits. By financing and developing sustainable private enterprises in the environmental-protection sector, the fund is enabling these enterprises to offer more competitive products and services and/or better quality environmental services, while contributing to sustainable employment.

This investment aligns well with the strategic objectives of both ADB and the PRC with regard to environmental management.

9.2.8  China Environment Fund 2004, LP

This project (PS 7220) is the second investment vehicle dedicated to the environment sector in the PRC, following the China Environment Fund 2002, LP. The China Environment Fund 2004, LP is investing equity capital into selected enterprises that have strong growth potential and that are engaged in providing environmental products and services in the PRC. The fund emphasizes investments through which the Fund Manager is expected to make a significant, strategic value contribution to the investee companies over and above the initial investment of capital.

This investment aligns well with the strategic objectives of both ADB and the PRC with regard to environmental management.

9.3  Fulfilling Policy Priorities

9.3.1  ADB’s Country Partnership Strategy (2011–2015)

ADB’s country partnership strategy (CPS) for the PRC for 2011–2015 describes its pillar 2 as “environmentally sustainable growth” (see section 2.4). The PRC’s rapid economic growth has had a significant impact on the environment, so addressing climate change is a key government objective. ADB supports the government’s efforts to foster a cleaner and more sustainable growth process by: (i) strengthening capacity for environmental management; (ii) pilot testing cutting-edge clean-energy and energy-efficiency technologies; (iii) supporting the development of low-carbon transport systems, particularly for public

transport; (iv) strengthening the protection and sustainable use of land, water, and forest resources; (v) helping to develop model livable, low-carbon cities; and (vi) promoting the development and institutionalization of green financing instruments.

The current CPS regards energy as a priority sector, and seeks to play a leadership role in introducing cutting-edge technologies for high-impact climate change mitigation, particularly when it comes to reducing coal dependence.

Under the CPS, ADB is providing support in five areas: (i) energy efficiency and conservation through innovative finance, development of energy-service companies, and the application of smart grid technologies; (ii) the expanded use of renewable energy, including wind, concentrated solar, biomass, geothermal, and small-scale hydropower; (iii) cleaner and lower-carbon technologies, as well as carbon capture and storage; (iv) urban energy efficiency and environmental improvement; and (v) the development of regional power-trading arrangements.

Although finance is no longer a priority sector, as it was under the previous CPS, support for innovative financing solutions and access to finance in the priority sectors remains an important operational objective, particularly in the case of green finance.

9.3.2 ADB’s Financial Sector Operational Plan (2011–2014)

The Financial Sector Operational Plan (FSOP) for 2001–2014 notes that, in line with Strategy 2020, finance sector development (a core area of operation) can support environmentally sustainable growth by financing environment-friendly infrastructure to reduce environmental disaster risk.

9.3.3 ADB’s Strategy 2020 (2008–2020)

As noted above, Strategy 2020 identifies three complementary strategic agendas: inclusive economic growth, environmentally sustainable growth, and regional integration (see section 2.4). The strategy notes that only growth that is environmentally sustainable can eliminate poverty, as many of the poor depend on natural resources for their livelihoods. To realize environmentally sustainable growth, ADB is supporting the use of environment-friendly technologies and the adoption of environmental safeguard measures (along with a strengthened institutional capacity to enforce them). The strategy also highlights the need for regional cooperation in this area.

Strategy 2020 recognizes the environment as a core area of operation (as is finance sector development). Under the strategy, ADB is strengthening its operational emphasis on the environment to realize environmentally sustainable growth in the ASEAN+3 region. ADB is expanding its promotion of and investment in sound environmental management, at the same time capitalizing on its own operational strengths, such as infrastructure development and finance. Under Strategy 2020, as under other strategies, programs, and policies, ADB emphasizes actions to address climate change and promote livable cities.
9.3.4 PRC State Council Financial Policy Measures

The State Council’s policy measures include the use of credit flows to support emerging strategic industries, which include energy-efficient and environmental technologies, new energy sources, and new-energy vehicles.

9.3.5 The PRC’s 12th Five-Year Plan (2011–2015)

The PRC’s Five-Year Plan includes a focus on environmental management, with ambitious targets for improving energy efficiency, reducing carbon emissions, and encouraging the development of clean energy resources. One of the policy directions set out in the plan is to improve the incentive mechanism for energy conservation and emission reduction. Specifics of the plan include optimizing the energy-consumption structure; improving the mechanism for resource pricing; implementing environmental taxation; and strengthening the relevant laws, regulations, and standards.

To promote sustainable development and improve ecological standards, the plan calls for the government to generate green and low-carbon development ideas, work on energy conservation and emission reduction, improve incentives and constraint mechanisms, and stimulate the establishment of resource-saving and environment-friendly production and consumption.

There are a number of references in the plan to environmental initiatives, among them:

(i) innovating and developing new strategic industries, such as those specializing in energy conservation and environmental protection;
(ii) promoting the development of diversified and clean energy sources;
(iii) intensifying environmental protection;
(iv) deepening the reform of pricing for resource products and fees for environmental protection services;
(v) focusing on the development of energy-conservation and emission-reduction technologies in a range of industries (automobile, transport, base materials);
(vi) actively coping with global climate change; and
(vii) strengthening energy conservation and management.

9.4 Development Opportunities

The TA projects and investments implemented by ADB in this area have been well-targeted and successful, but the task facing the PRC is nevertheless enormous, with the scale of industrialization putting significant strains on the environment in the PRC and in the region as a whole. Green finance and carbon finance are clearly important areas for further assistance. Where these can be linked to other ADB priorities, such as financial inclusion, the potential to add value will be that much greater.

Particular areas that warrant consideration as priorities include:

(i) **Carbon trading.** In 2011 the government approved carbon-trading pilot tests in seven provinces and cities (Beijing, Chongqing, Guangdong, Hunan, Shanghai,
Shenzhen and Tianjin), with a view to creating a nationwide scheme that could eventually surpass the European Union’s to become the world’s largest. ADB supported the testing in Beijing, Shanghai, and Tianjin. Five of the pilot-test venues have since started their own carbon-trading schemes: Shenzhen in June 2013; and Beijing, Guangdong, Shanghai, and Tianjin in December 2013; with Guangdong Province having the largest scheme in the PRC. Participants in a carbon-trading scheme receive free permits for set percentages of their historical emissions levels; they will then need to purchase additional permits or use offset credits for emissions exceeding their allocated quotas.

The establishment of a national carbon-trading system is not expected until nearer 2020, however, as there are significant challenges. For instance, several local exchanges are making only slow progress in rolling out their schemes. And capacity building has been hindered by issues relating to lack of experience (in measuring, reporting, and verifying emissions) and the insufficient robustness of the information technology (IT) systems.

Other challenges include: the extreme pricing differences among provincial and regional markets in the PRC; differences in the approaches of the various pilots; lack of any legal means to force enterprises to participate; lack of binding carbon caps; minimal fines for noncompliance; and a cautious attitude, due to the European Union’s problem with carbon prices that sank too low. A national climate law is being drafted to provide a legal framework for ensuring compliance. However, the Government of Shenzhen Province passed its own legislation setting out penalties for noncompliance, and is currently drafting supporting regulations.

Overly conservative regulation is also stifling the development of the carbon-trading market, with heavily restricted trading procedures, preclusion of derivatives trading, and only limited involvement allowed to financial institutions and foreign firms.

The PRC carbon-trading market is expected to suffer initially from low trading volumes, until many of these challenges are addressed. During that time, there will be a number of opportunities for ADB to contribute to the development of the national carbon market by assisting in the resolution of the challenges blocking the way.

(ii) Energy service companies and finance for small and medium-sized enterprises.

In some countries, an energy service company (ESCO) model has been used to increase the access of SMEs to financing for energy-efficient technologies. Under this model, the ESCO provides capital investments and energy-management services to energy users. The ESCO identifies and evaluates energy-saving opportunities, and then recommends improvements that would be paid for through savings.

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The indirect financing of energy-efficiency projects through ESCOs faces some challenges in the PRC. Most of the ESCOs (and their clients) in that country are SMEs, and hence face the typical financing problems that affect SMEs, such as a shortage of loan guarantees. TA 7564 suggested that ESCOs could play a key role in bundling EEER projects across SMEs. The authors of this report recommend that ADB continue to work on a mechanism for strengthening guarantees to ensure financing for ESCOs, which, in turn, will improve financing for EEER projects.

(iii) **Capital markets.** Green bonds (or climate bonds) are likely to play an important role in raising climate-change funds. Green bonds are designed to finance initiatives in energy efficiency, renewable energy, clean air and water, transportation, mitigation of greenhouse gas emissions, and similar activities. While some still consider these bonds to be a niche market, green bond global issuance hit a record $74 billion in 2012, a 34% increase over 2011, with a global outstanding bond total of $346 billion. Growth is expected to continue as these securities integrate further into the mainstream fixed-income market. The increasing international demand is evidenced by recent oversubscribed issues. Corporate issues dominate the market. The downsides to the green bond market include the absence of a benchmark index, the lack of agreement on what qualifies as a “green” bond, low yields, and insufficient liquidity.

In August 2013, the State Council announced plans to open up debt instruments as a means of financing green growth and allowing private companies to issue green bonds. The PRC has been active in the green bond market, with the largest climate-themed bond having been issued globally by the PRC Ministry of Railways ($117 billion) to finance the construction of a rail system that would generate lower emissions than air or road travel. However, in May 2013, the government announced the dismantling of the ministry, and the future home of this debt remains unclear.

Given the international interest in green bonds, and the potential for harnessing domestic savings and foreign capital to finance green activities, the authors of this report suggest that ADB support the growth of the green bond market in the PRC by addressing any barriers to its effective development.

(iv) **Environmental database.** One of the challenges in the development of carbon trading is the unavailability of emissions estimates. The authors of this report suggest that ADB assist the PRC in developing a national statistics database to collect, analyze, and report on environmental data.

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Conclusions and Recommendations

10.1 Introduction

This report provides a compendium of ADB TA projects, loans, and investments, and describes their support for both ADB’s strategic agenda and the PRC’s reform agenda with respect to the development of the PRC’s finance sector.

The report contains an overview of key finance-sector issues in the PRC, as well as a summary of the outputs of finance-sector work supported by ADB between the early 2000s and 2014. It reviews the alignment of ADB’s TA projects, loans, and investments with the current strategic priorities of the PRC and ADB, and provides a very high-level assessment of the effectiveness of these initiatives.

This purpose of this exercise is not only to review the past, but also to inform the future by identifying where and how ADB projects have added the most value, and on that basis determining where ADB support could be most effective from hereon in. In some cases, future ADB efforts will involve new areas and issues, but most will probably entail follow-up support for past projects.

The chapters providing the assessments of ADB projects, loans, and investments are each defined by a specific theme. This final chapter draws the themes together and provides additional observations where relevant.

10.2 Alignment of Projects with the PRC’s and ADB’s Priorities

The 2013 communiqué from the Third Plenum of the 18th Central Committee of the Communist Party of China outlined a new policy blueprint for the PRC. Central to that blueprint was the premise that market forces should play a greater role in the PRC’s financial system. The PRC’s 2013 reform agenda emphasized a greater role for credit decisions in resource allocation and a greater role as well for capital markets, including private sector involvement in the financial industry. It also reinforced ideas from previous blueprints, including the need to provide financing to small- and micro-sized enterprises, greater access to financial services for rural industries and communities, stronger regulation and supervision of financial institutions and markets, and energy conservation and sustainable development.
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A central objective of this knowledge product is to assess the extent to which ADB activities in the PRC have aligned with the priorities of both parties. ADB’s priorities are best summed up in the three strategic agendas of Strategy 2020: inclusive growth; environmentally sustainable growth; and regional integration (see section 2.4).

Inevitably, the strategic priorities of the PRC are much broader than those of ADB. For ADB support to have maximum potential benefit, it is essential that the TA projects, loans, and investments are targeted at those areas in which the priorities of ADB and the PRC overlap.

Table 8 gives the number of ADB projects, loans, and investments that fall under each theme covered in this report, as well as the total funding based on theme and type of activity. Most of these initiatives date from the early 2000s to 2013, but some were begun before then, under earlier sets of priorities for both the PRC and ADB.

Table 8 suggests that the TA projects, loans, and investments covered in this report have aligned with both the PRC’s and ADB’s priorities. In fact, the overlap is greater than indicated in the table, as a number of the TA projects, loans, and investments addressed or are addressing multiple areas and multiple priorities. For example, TA 7564, which dealt with innovative financing mechanisms for energy efficiency and emission reduction in SMEs, was well aligned with the PRC and ADB priority of environmentally sustainable growth; but it was also well aligned with the priority of financial inclusion, since innovative SME finance also addresses issues regarding financial access for disadvantaged sectors of society.

**Table 8. ADB Technical Assistance Projects, Loans, and Investments by Theme**

<table>
<thead>
<tr>
<th>Theme</th>
<th>Number of TA Projects</th>
<th>Amount Utilized for TA Projects(^a) ($’000)</th>
<th>Number of Loans and Investments</th>
<th>Amount Utilized for Loans and Investments(^a) ($’000)</th>
<th>Total Amount ($’000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Financial inclusion</td>
<td>12</td>
<td>4,195</td>
<td>3</td>
<td>70,200</td>
<td>74,395</td>
</tr>
<tr>
<td>Legal, regulatory, and supervisory structures, and banking-sector performance</td>
<td>15</td>
<td>5,444</td>
<td>1</td>
<td>36,300</td>
<td>41,744</td>
</tr>
<tr>
<td>Financial market infrastructure</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Pension funds and insurance</td>
<td>6</td>
<td>2,411</td>
<td>0</td>
<td>0</td>
<td>2,411</td>
</tr>
<tr>
<td>Equity, debt, and capital markets</td>
<td>4</td>
<td>3,020</td>
<td>1</td>
<td>45,000</td>
<td>48,020</td>
</tr>
<tr>
<td>Internationalization of the yuan</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
<td>0</td>
</tr>
<tr>
<td>Green and climate-change finance</td>
<td>6</td>
<td>6,552</td>
<td>2</td>
<td>10,000</td>
<td>16,552</td>
</tr>
<tr>
<td>Total</td>
<td>43</td>
<td>21,622</td>
<td>7</td>
<td>161,500</td>
<td>183,122</td>
</tr>
</tbody>
</table>

\(^a\) These totals include the allocated, rather than utilized, amounts for those cases in which the figure for utilized funds is unavailable.

Particularly noteworthy is the fact that the number and total value of TA projects, loans, and investments have been greatest in areas where there is a coincidence between the priorities of ADB and those of the PRC. In areas of lower coincidence, the projects themselves typically overlap with other projects in the priorities they encompass. This happens most frequently with financial inclusion, a point of overlap for projects concerned mainly with pension funds, banking regulation and reform, and environmental management. This strong alignment among priorities is commendable, and points to a consistent and coherent approach to the finance sector overall.

A second point emphasized by this knowledge product, especially in the earlier chapters, is the relatively high success rate of ADB’s TA projects, loans, and investments in the PRC. While not all of these projects were equally successful (for a variety of reasons, not always within the control of the executing parties), the overall level of achievement has been impressive. This high success rate has apparently occurred for several reasons:

(i) The initiatives were well targeted, with achievable objectives.
(ii) There was a practical focus in nearly all cases, resulting in tangible deliverables such as draft laws or pilot programs.
(iii) Engagement with the PRC counterparts appears to have been excellent, at least as reflected in the post-project ratings and, arguably more important, in the extent to which recommendations from the projects were adopted by the PRC counterparts.
(iv) In the case of loans, there has been a consistent pattern in which ADB funding acted as a catalyst for other investors.

The outcomes of these ADB activities, and the lessons learned regarding the reasons for their effectiveness, should be examined so that the high success rate can continue.

10.3 Development Opportunities

While the projects implemented during the period covered in this report were generally judged positively by reviewers, there is still much to be done. This section is a recap of the authors’ comments and suggestions regarding potential development activities in areas within the purview of ADB operations. The subsections below are based on the themes covered in this report, with the exception of financial market infrastructure and the internationalization of the yuan, which are not among ADB’s established priorities.

10.3.1 Financial Inclusion

It was noted in section 3.4 that, despite the remarkable economic growth in the PRC, rural areas remain impoverished, and rural finance remains the weak link in the PRC’s financial system. To promote financial inclusion in ways that would impact on rural as well as urban areas, the government implemented measures to support microfinance and SME finance. Nevertheless, micro, small, and medium-sized enterprises (MSMEs) continue to face constraints that diminish the potential for inclusive growth.
The government has announced its intention to develop a multitiered financial system that would be more open to private sector newcomers. But to accomplish this, the government must also enforce licensing and prudential requirements, ensure that new financial institutions reinvest in the community, and see that new entrants are well regulated and supervised. ADB could contribute much in this domain by working closely with regulators to design and execute policy reforms; engaging in more pilot studies; and by focusing on practical issues that add significant value, such as data capture, legislation, and capacity building.

The authors suggest that the franchise model for financial institutions would be worth exploring, as it would simplify and expedite the licensing process, which normally can take several months. There would be no need for time-consuming assessments of financial strength, governance, management, and systems, or for on-site visits. With the franchise approach, each applicant would have already been screened by the potential franchisor.

Another issue is microfinance companies (MCCs), which need a business environment that enables inclusive finance. But MCC supervision, regulation, and reporting are not standardized across the country, and are not always adequate. Moreover, as non-deposit-taking institutions, MCCs face funding constraints; and they lack credit-risk-management skills, which are very important given the unsecured nature of many of their loans. To address the problems of the MCCs, the government should review the regulations, requirements, laws, and supervisory practices in order to remove hindrances to inclusive finance. Such a review should focus on corporate governance, internal control, and risk management. The authors also recommend that there be capacity building in these areas for the MCCs and for the regulators.

With regard to the credit system, it is not just MCCs that have difficulty assessing loans. Many institutions lack sufficient information on the credit histories of clients to be able to properly assess the associated credit risk. ADB could add value by supporting the development of localized cooperative credit reference agencies to provide credit scores on local individuals and entities.

10.3.2 Legal, Regulatory, and Supervisory Structures for the Financial System, Financial Stability, and Banking Reforms

The PRC’s financial market has developed to a great degree over the course of two decades, but there are still significant gaps in the market’s legal and regulatory framework, compared with international standards and norms. In section 4.4, the authors recommend three activities through which ADB could provide assistance: (i) help improve the CSRC’s market-conduct capacity by supporting the development of a universal licensing regime, as well as a sound disclosure regime, for collective investment products; (ii) support the establishment a licensing requirement for all financial advisers and brokers who sell these products; and (iii) contribute to the development of a “treating customers fairly” regime, with standardized disclosure and risk measures for all retail financial products; a dispute-resolution system; and timely, robust, and appropriate enforcement actions. The authors note that these three activities would align best with ADB’s engagement strategies and with the PRC’s objectives of
implementing stronger market-driven mechanisms while improving consumer and investor protection (through stronger enforcement and greater disclosure).

The authors point out two further challenges to the legal and regulatory framework of the PRC’s financial system: shadow banking and internet-based financing activities. Shadow banking arose largely because rural, micro, and small enterprises have been underserved by the regulated banking sector. But the demand for shadow banking would decline naturally if the government were to liberalize interest rates; enable the efficient allocation of credit; reduce barriers to entry for credit institutions; and determine the correct treatment of off-balance sheet exposures.

Online financial services are burgeoning because they offer much higher returns and more efficient service, but they erode the deposit base of more traditional institutions. Led mainly by commercial banks, traditional institutions have called for strict controls on these activities. But the regulatory authorities must strike a balance between two desirable outcomes: stability in the traditional banking sector and the innovations generated by internet finance.

10.3.3 Pension Funds and Insurance

The PRC has also seen impressive progress in the area of pension funds and insurance, with coverage greatly increased since the introduction of a rural pension scheme in 2009 and an urban pension scheme for the unemployed in 2011. But more needs to be done, and considerable challenges lie ahead, especially given the PRC’s rapidly aging population.

Among the challenges are funding shortfalls, lack of portability, poor investment performance, and inconsistencies across schemes (e.g., in terms of rules, benefits, and required contributions). The State Council’s intention to unify the schemes for rural and unemployed urban residents is a positive first step. A fully unified national pension system would address most of the problems, but many believe that the PRC is decades away from achieving this goal. It would have to be achieved in stages, anyway, starting with the unification of rural and urban schemes as the first hurdle, followed by the full integration of all schemes, including those for civil servants.

The authors believe that ADB should focus on the long-term goals of harmonizing and then centralizing the pension system. This effort could take a holistic approach to reviewing all the various pension schemes in the PRC in terms of their rules, contribution and benefit levels, administration, and funding situations. The analysis could include: a stocktake of the inconsistencies among pension schemes, sub-schemes, and provincial systems; a comparison of PRC contribution and benefit levels with those of pension systems in other countries; and the quantification of projected funding shortfalls, along with a consideration of pre-funded approaches.

ADB should then document the benefits of a centralized pension administration, including the reduced expenditure, administrative efficiency, and increased portability between schemes. It should also document the benefits of pooling pension funds, such as more efficient fund management, better fund performance due to wider investment options, and greater incentives for higher voluntary contributions. Based on these considerations, ADB
could provide a road map toward harmonization and centralization (with suggested time frames and priorities), and identify any barriers that could prevent the success of this process.

10.3.4 Equity, Debt, and Capital Markets

In section 7.4, the authors recommend continued ADB activity in the area of cross-border capital transactions, as this would fit well within the strategic priorities of both ADB and the PRC. If projects are tightly targeted (as was the case with TA 6338), they will have the potential to add great value.

Beyond cross-border issues, the authors note that there will probably be development opportunities in local government finance, given the concerns about the soundness of some local government financing vehicles (LGFVs) and the growth in the total credit provided by LGFVs. ADB support should focus on capacity building and governance processes, including long-term budgeting, service demand and forecasting, asset management, and infrastructure development and planning. Another area of potential ADB involvement is the National Equities Exchange and Quotations (NEEQ) board, in the wake of its opening to MSMEs. This would necessitate close supervision of listing and trading activities, as well as a strong investigation and enforcement capacity to maintain integrity. The NEEQ board will also probably need assistance in dealing with the potential influx of listings, possibly in sectors unfamiliar to the NEEQ governance and oversight team.

10.3.5 Green and Climate-Change Finance

After pilot tests of carbon-trading schemes were conducted in seven provinces and cities in 2011, five of them (Beijing, Guangdong, Shanghai, Shenzhen, and Tianjin) initiated carbon-trading markets of their own. This is a promising start, but due to significant challenges, a national carbon-trading market is not expected to be established much before 2020.

Among the challenges is the fact that several of the local exchanges are making only slow progress in rolling out their schemes. Capacity building is another challenge, with issues relating to the lack of experience (in measuring, reporting, and verifying emissions) and the lack of robustness of the information technology (IT) systems. Other problems include: extreme price differences among provincial and regional markets in the PRC; differences in the approaches of the various pilots; lack of legal means to force enterprises to participate; lack of binding carbon caps; minimal fines for noncompliance; and a very cautious attitude, in light of European Union’s problem with low carbon prices. In addition, overly conservative regulation is stifling the development of carbon-trading markets due to the heavily restricted trading procedures, preclusion of derivatives trading, and the limited involvement allowed to financial institutions and foreign firms. Another problem is the unavailability of data regarding emissions.

The authors believe that there will be many opportunities for ADB to address these challenges. For instance, regarding the unavailability of emissions data, they suggest that ADB assist the government in developing a national statistics database to be used in collecting, analyzing, and reporting on environmental data.
Another issue is the energy service company (ESCO) model, which the PRC adopted as a way to help SMEs obtain financing for energy-efficient technologies. In theory, ESCOs provide capital investments and energy-management services to energy users. But ESCOs in the PRC are struggling financially because most of them are SMEs as well, and hence suffer from typical SME difficulties in accessing credit. The authors recommend that ADB focus on establishing a mechanism to strengthen loan guarantees to ensure financing for ESCOs.

Finally, the authors recommend the PRC’s green bond market as another focus for ADB support. Green bonds (or climate bonds) are designed to finance projects in such areas as energy efficiency, renewable energy, clean air and water, and mitigation of greenhouse gas emissions. The global green-bond market has grown dramatically since 2011, and is expected to continue growing, but there are downsides, including the absence of a benchmark index, the lack of agreement on what qualifies as a “green” bond, low yields, and insufficient liquidity. Given the international interest in green bonds, however, and the potential to harness domestic savings and foreign capital for the financing of green activities in the PRC, the authors suggest that ADB support the PRC’s green bond market by addressing any constraints on its effective development.

10.4 Closing Observations

The Chinese economy has been one of the most successful growth stories in history. But as in all success stories, it is becoming increasingly difficult to maintain momentum. With the maturing of the PRC economy, the historical inefficiencies of centralized control are becoming increasingly burdensome and a source of risk.

The government is well aware of the challenges that must be confronted if growth is to continue unabated. The financial system needs greater involvement from the private sector and greater commercial discipline over decision making. These two goals are central to the government’s current strategy, but realizing them will require a careful balancing act. The pace at which controls are removed must follow the pace at which the regulatory and legal infrastructure is strengthened. Market discipline is a necessary but not sufficient condition for continued growth. Without a solid regulatory framework and informed and discerning investors, a market-driven financial system will be prone to potentially destabilizing swings.

Nor does a market-driven financial system, even if well regulated, necessarily provide financial access to all sectors of society. In many well-developed financial systems, residents of rural communities and small businesses have difficulty accessing financial services, with potentially dire implications for income distribution and social cohesion. These related considerations are, appropriately, important to both the PRC and ADB.

Moving forward, ADB can best support the PRC by allocating resources to projects that align with the objectives and priorities shared by both, and by building on the successes that it has achieved since the start of the current century.


* The Asian Development Bank recognizes “China” by the name People’s Republic of China.


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Despite its success to date, the People’s Republic of China (PRC) faces some major challenges in finance sector development. Like all success stories, the PRC is finding it increasingly difficult to maintain momentum. The finance industry needs greater involvement from the private sector, including input in decision making. Achieving the desired outcomes will require a careful balance between the pace at which controls are removed and that at which the regulatory and legal infrastructure is strengthened. Long-term success will also require that economic growth be inclusive, with financial services available to all members of society.

About the Asian Development Bank

ADB’s vision is an Asia and Pacific region free of poverty. Its mission is to help its developing member countries reduce poverty and improve the quality of life of their people. Despite the region’s many successes, it remains home to approximately two-thirds of the world’s poor: 1.6 billion people who live on less than $2 a day, with 733 million struggling on less than $1.25 a day. ADB is committed to reducing poverty through inclusive economic growth, environmentally sustainable growth, and regional integration.

Based in Manila, ADB is owned by 67 members, including 48 from the region. Its main instruments for helping its developing member countries are policy dialogue, loans, equity investments, guarantees, grants, and technical assistance.