China Bond Market
Risk Management

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Index

- Sound and Rapid Development of China Bond Market
- Challenges Facing China Bond Market
- Ongoing Development of China Bond Market System
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Sound and Rapid Development of China Bond Market

- Review of China Bond Market Development
- Bond Issuers
- Bond Investors
1.1.1 Rapid Growth of China Economy

GDP Growth during 2000 – 2010

CPI during 2000 - 2010

Unit: 100 Million RMB

Unit: Percentage Point

* Source: Wind Information Co., Ltd.

Rapid GDP growth during 2000-2010 whilst a low inflation rate is maintained.
1.1.2 Improved Risk Management of China’s Banking System

Assets Volume of Major Chinese Banks

Unit: 100 Million RMB

NPL Volume and NPL Rate

Unit: 100 Million RMB

* Source: Wind Information Co., Ltd.

Total assets of Chinese banks exceeded 10 trillion RMB as of June 2011, and NPL rate fell to only 1%, reflecting an improvement of risk management.
1.1.3 Rapid Growth of Chinese Bond Market

Overall Bond Issuance Volume during 2005-2010

Bond Issuance Structure

* Source: Wind Information Co., Ltd.

2010 issuance volume amounted to USD253mn and achieved CAGR of 50.23% during 2005 to 2010. 67% of overall issuance were contributed by debt financing instruments.
1.2.1 Bond Issuers: Core Clients of Banks (Take China CITIC Bank’s Data For Example)

- **Corporate Customers**: In total 300,000 corporate customers of China CITIC Bank.
- **Credit-granted Customers**: 30,000 credit-granted customers, accounting for 10% of overall corporate customers.
- **Bond Issuers**: 105 bond issuers, accounting for 0.35% of credit-granted customers of China CITIC Bank.
1.2.2 Bond Issuers

Credit Ratings of the Issuers

Source: www.ChinaBond.com.cn

90.82% of bond issuers being rated above AA-.
1.3.1 Bond Investors

Majority of Investors (86%): risk-averse institutions including commercial banks, funds and insurance companies

Largest Investor Group (47%): commercial banks in terms of holding position

Source: www.ChinaBond.com.cn
1.3.2 Bond Investors

Investment Strategy

- Explore Alternative to Bank Loans
- Increase Proportion of Quality Credit Assets
- Improve Assets Liquidity
- Upgrade Service Level to High End Customers
2. Challenges of China Bond Market

- 2.1 Macro Economy
- 2.2 Local Governmental Investment Vehicle (LGIV)’s Bond
- 2.3 Over-Capacity Industries
- 2.4 Investor Structure
- 2.5 Credit Rating System
- 2.6 Risk Allocation Channels
2.1 Challenges– Macro Economy

**Challenges**
- Uncertainties in Global Economy
- Slow Down of China’s Economy
- Domestic Inflation
- Sustained Stringent Monetary Policy

**Mitigants**
- Economy Structure Adjustment during the 12th Five-year Plan
- Economy Growth Driven by Consumption
- Lower Risk of Economy Hard-Landing
2.2 Challenges–Local Governmental Financing Platform (LGIV)’s Bond

**Challenges**
- LGIV Bond Issuance: RMB169.2bn in 2010
- LGIV’s Proportion in Total Bond Issuance: 10.64% in 2010
- Recent Event of LGIV’s Bank Loan Default

**Mitigants**
- Less than 7% of LGIV Companies Ever Issued Bonds
- Priority of Repayment for Bonds
- Enhanced Collaterals
- Strong Support from the Local Government
- Low Possibility of Large-Scale Breach of Contact
2.3 Challenges– Over-Capacity Industries

**Challenges**

- Over-Capacity Industries, e.g., Steel, Cement and Coal Chemical
- Dropping Gross Profit Margin
- Vulnerability to Macro Economy Adjustment

**Mitigants**

- Raising Entry-Barriers
- Economy Structure Adjustment in Supply and Profitability
- Industry Consolidation and Production Cost Saving
2.4 Challenges – Investor Structure

**Challenges**
- Imbalanced Investor Structure
- Restriction of Investment in Certain Bond Products

**Mitigants**
- Permission for Bond Trade and Arbitrage
- Non-Bank Financial Institution (NBFI) and Private Equity (PE) as bond investors
- Admittance of Overseas Investors
- Foreign banks licensed for bond underwriting
2.5 Challenges– Credit Rating System

Challenges

- Lagging Behind Regulations
- Insufficient Independence of Rating Agencies
- Insufficient Supervision
- Lack of Internal Control System

Mitigants

- Cooperation with Moody’s, S&P and Fitch
- Enhanced Independence and Precision of Credit Rating
- Charge-on-Investor Rating Services
2.6 Challenges– Risk Allocation Channels

Challenges

- Early Stage of Credit Enhancement System
- Lack of Credit Risk Mitigation Instruments

Mitigants

- Rapid Growth of Financial Market
- Establishment of China Bond Insurance Co., Ltd.
- Introduction of Credit Risk Mitigation Instruments
3. Ongoing Development of China Bond Market System

- 3.1 Legislation & Regulation
- 3.2 Self-Discipline
- 3.3 Market-based Restraint Mechanism
- 3.4 Investor Protection
- 3.5 Bond Market Infrastructure Construction
### 3.1 Legislation & Regulation

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<td>《Bank Law》、《Commercial Bank Law》、《Company Law》、《Securities Law》, etc.</td>
<td>《Regulations on Enterprises Bond》 and related regulations</td>
<td>《Administrative Regulation of Non-Financial Company’s Financing Tools》、《Administrative Regulation on Bond Trading》、《Administrative Regulation on Register of Bond and Settlement》, etc.</td>
<td>7 Guidance, 3 Rules, 2 Standard Agreements and 1 Rule of Conduct</td>
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3.2 Self-Discipline

Dimensional Self-Discipline System

Underwriters’ Self-Discipline
- Internal Operation Procedure
- Internal Risk Management
- Professional Qualification

Market-Based Restraint Mechanism
- Industry Disciplines
- Market Construction and Innovation
- Regulation of Market Operations
- Investors Protection

Governmental Supervision
- Long-term Planning
- Framework Designing
- Systematic Construction
3.3 Market-based Restraint Mechanism
3.3.1 Information Disclosure

- Nafmii (Non-financial Company Financing Tools)
  - Full disclosure
  - Due diligence, public offering and risk-management

- China Foreign Exchange Trade Center (Inter-bank Borrowing Platform)
  - Risk alert and management
  - Regulation on trading parties

- Shanghai Exchange House
  - Publish of Valuation Curve of Interest Rate

Public Offering → Trading → Register/ Custody/ Settlement
3.3.2 Credit Rating System

- PBOC Regulations related to Rating Agencies:
  - 《Guidance on Credit Rating》
  - 《Notice on Enhancing Inter-bank Bond Market Credit Rating》
  - 《Standard of Credit Rating for Lending and Inter-bank Bond Market》

- National Association of Financial Market Institutional Investors (NAFMII) and NAFMII Professional Committee of Credit Rating (established in October 2010).

- Charge-on-investors mode adopted by China Credit Rating Co., Ltd. (established in September 2010).
3.3.3 Risk Allocation

- Establishment of China Bond Insurance Co., Ltd. in October 2009.

- Introduction of Credit Risk Mitigation Instruments for Inter-bank Market in October 2010.
3.4 Investor Protection


3.5 Bond Market Infrastructure Construction

- Establishment of Shanghai Exchange House for Netting Settlement Services, Management of Registration, Custody and Settlement of Bonds.

- New PRC GAAP’s Integration with IAS, Memorandum between China Account Standard Committee and IASB in January 2008 to Enhance the Cooperation.
To Strengthen the Cooperation with SIFMA.