

China's Shadow Banking Sector: *System Growing at a Faster Rate; Overall Leverage Is Rising*

This presentation was provided to the market as a teleconference on 11 May 2016.
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Key Messages

- » Overall growth of leverage, as measured by total social financing (TSF), has picked up. This reflects strong growth in bank lending and bond financing, and in the range of informal credits within our definition of shadow banking activities.
- » TSF may understate the true amount of leverage in the system, as it excludes various forms of shadow banking activities that are expanding rapidly.
- » Wealth management products (WMPs), of which mid- and small-sized banks are especially active issuers, have led the growth of shadow banking in the past year, but are largely excluded from TSF.
- » The investor base in WMPs is becoming more wholesale-oriented due to an increase in interbank activity. Banks' demand for WMPs reflects their desire to boost profit margins, and to circumvent capital and regulatory restrictions.
- » The developments above point to rising interconnectedness, among banks and also between banks and the shadow banking system. Mid-sized banks are particularly exposed, as evidenced by rising investment receivables.

Shadow and Commercial Banking Sectors



Sources: Moody's Investors Service, National Bureau of Statistics and PBOC

Shadow Banking Components

	End-2015 (RMB trillion)	As % of	End-2014 (RMB trillion)	As % of	End-2013 (RMB trillion)	As % of	End-2012 (RMB trillion)	As % of	End-2011 (RMB trillion)	As % of
		total banking assets (%)		total banking assets (%)		total banking assets (%)		total banking assets (%)		total banking assets (%)
Credit Intermediation Products										
Entrusted loans	10.9	5.6	9.3	5.5	7.2	4.9	5.2	3.9	4.4	4.0
Trust loans	5.4	2.8	5.3	3.1	4.9	3.3	3.0	2.3	1.7	1.6
Undiscounted bankers' acceptances	5.9	3.0	6.8	4.0	6.9	4.6	6.1	4.7	5.1	4.5
Assets funded by WMPs										
Banks' off-balance sheet	12.4	6.4	6.0	3.6	3.5	2.4	2.8	2.1	--	--
Securities companies	9.2	4.7	4.9	2.9	3.2	2.1	1.2	0.9	--	--
Loans by finance companies	2.5	1.3	2.4	1.4	2.2	1.5	1.0	0.8	0.9	0.8
Informal lending*	3.4	1.7	3.4	2.0	3.4	2.3	3.4	2.6	3.4	3.0
Others†	3.8	2.0	2.8	1.6	1.8	1.2	1.3	1.0	0.8	0.8
TOTAL	53.4	27.5	40.8	24.3	33.1	22.3	23.9	18.2	19.2	17.2
Memorandum Items										
Credit guaranteed by financial guarantee companies	2.4	1.2	2.3	1.4	2.2	1.5	1.9	1.4	1.7	1.5
Core shadow banking as % of broad concept	41.4		52.3		57.4		59.7		58.4	

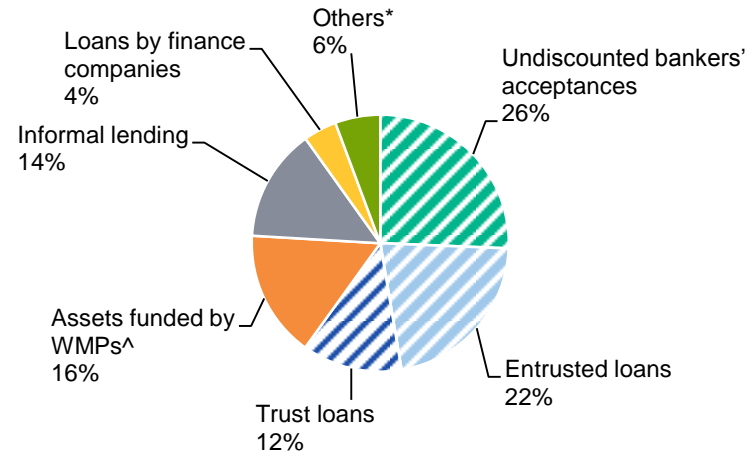
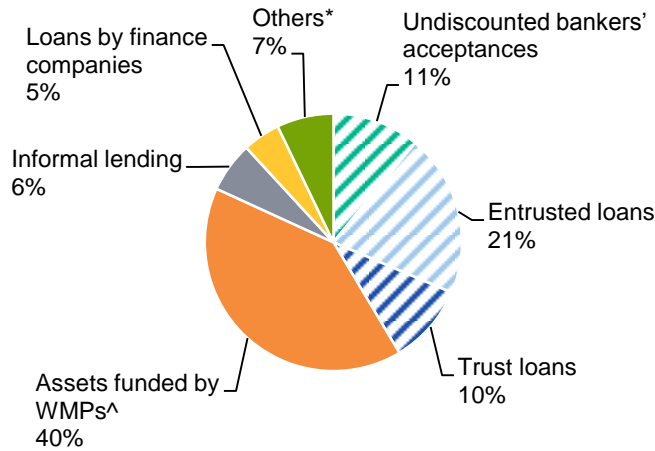
Assumes no change from 2011


Includes financial leasing, microcredit, pawn shop loans, online "peer-to-peer" lending, asset-backed securities and consumer credit companies

TSF No Longer Captures Majority of Shadow Banking

End of 2015

End of 2012



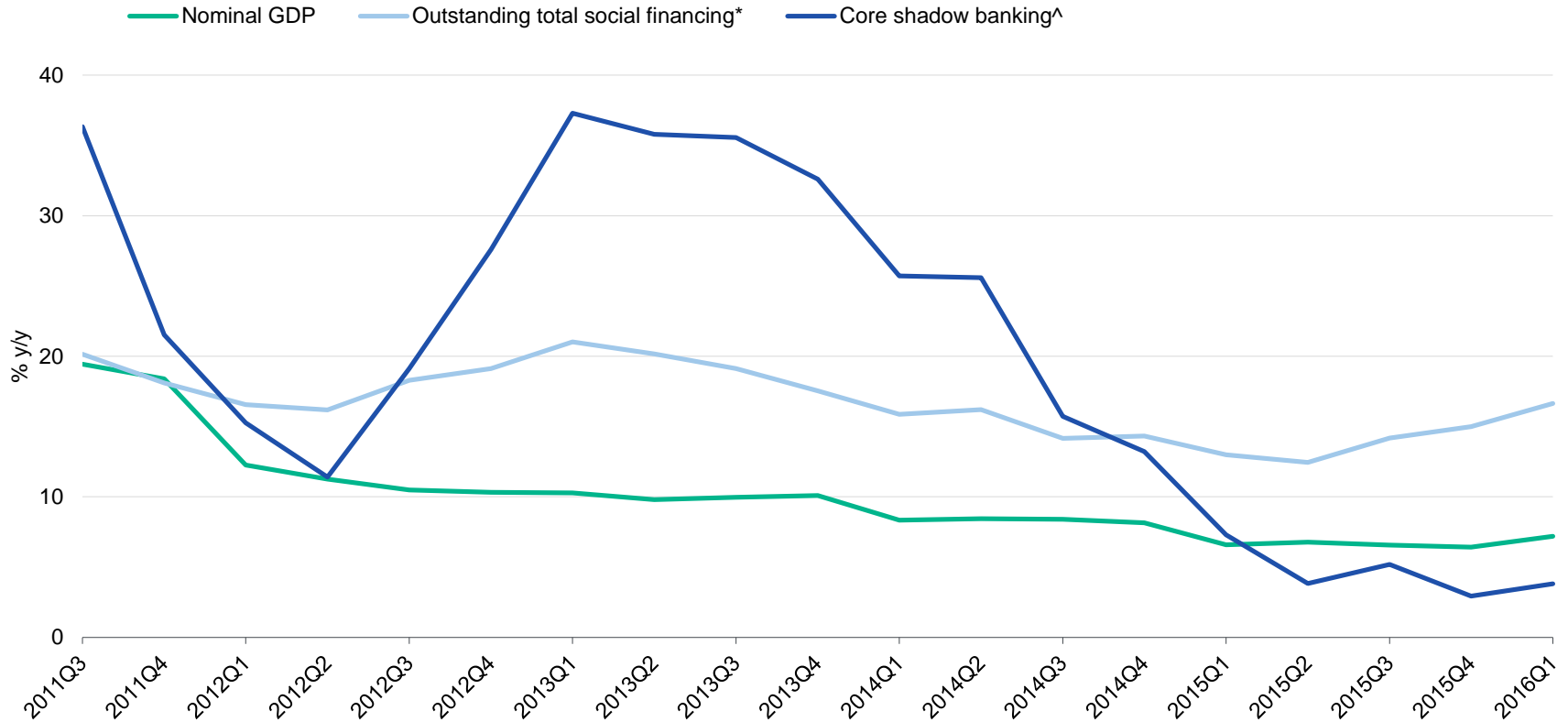
 Core shadow banking components

^ Assets include off-balance sheet bank WMPs and asset management plans by securities firms

* Includes financial leasing, microcredit, pawn shop loans, online "peer-to-peer" lending asset-backed securities and consumer credit companies

Source: Moody's Investors Service

TSF Could Understate Rise in Leverage

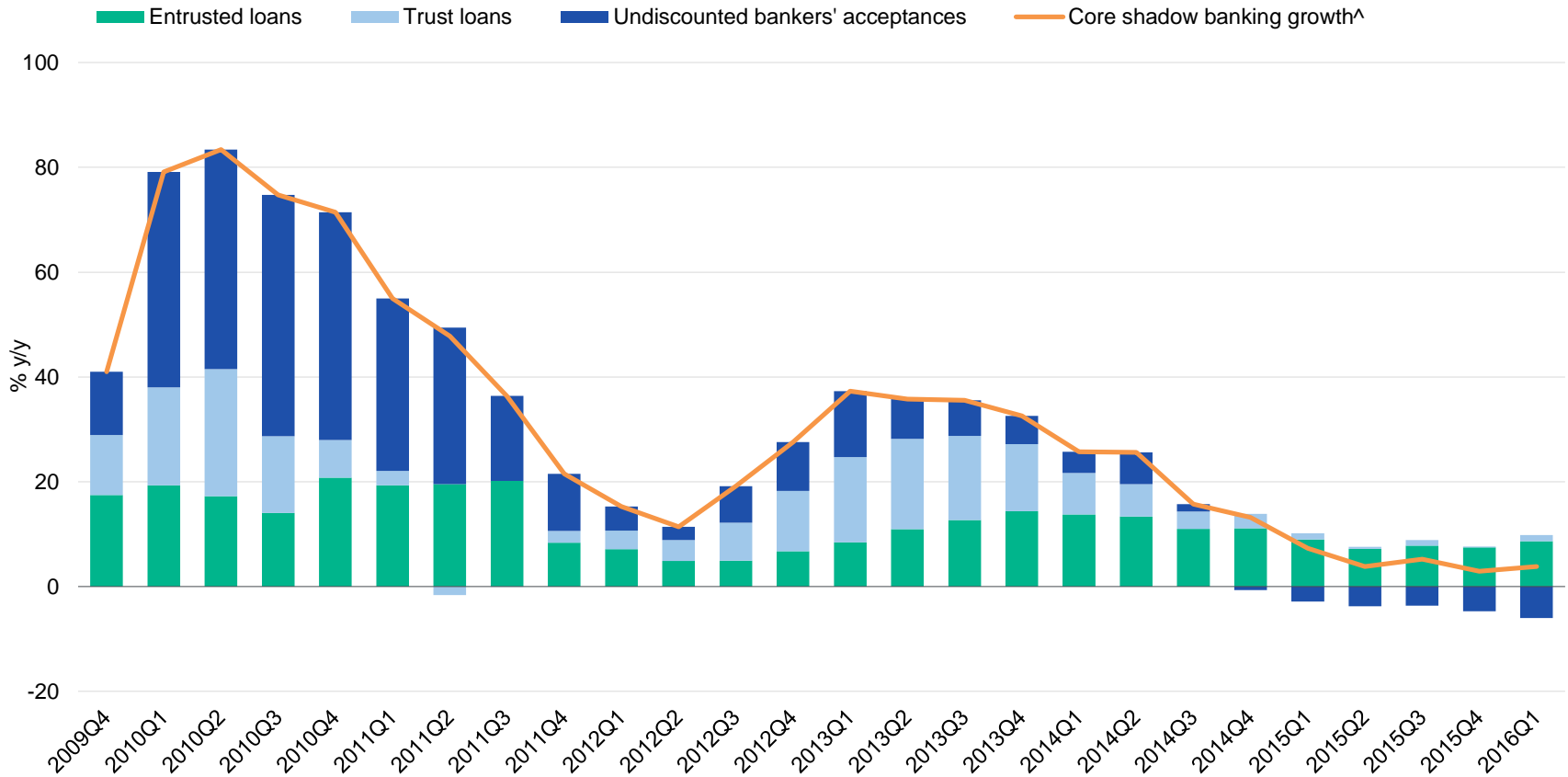


* Total social financing (TSF) is an official measure of broad credit in the financial system consisting of formal bank loans, shadow banking activities, direct financing (bond and equity issuance) and others (e.g. microcredit). The series shown above reflects our adjustments from May 2015 onwards to account for distortions from the local government debt swap program, resulting in an upward revision to the series of 3.2ppts in year-over-year growth as of Q1 2016.

^ Core shadow banking activities include entrusted loan, trust loan and undiscounted bankers' acceptances in TSF.

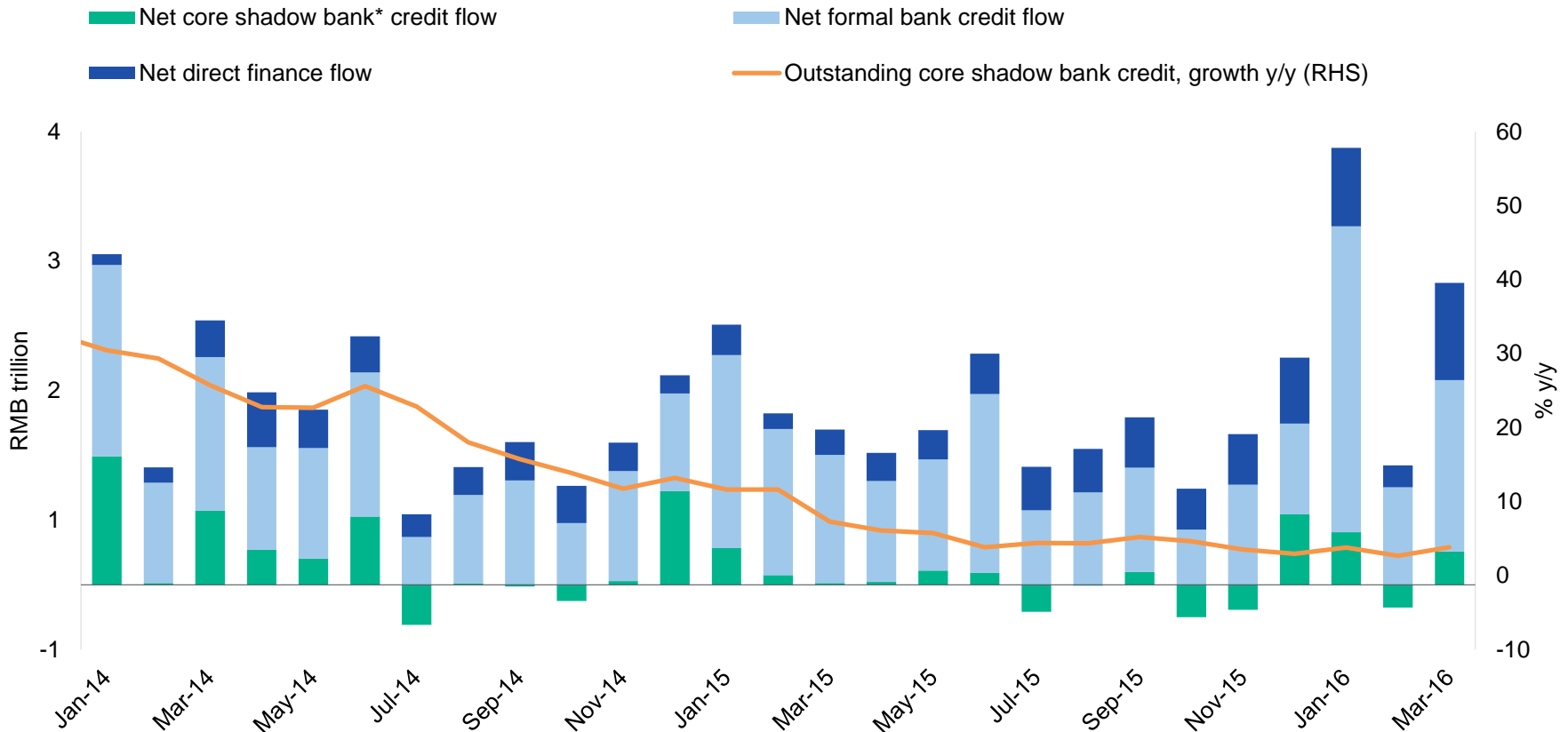
Sources: Moody's Investors Service and PBOC

Accounting for Core Shadow Banking by Components



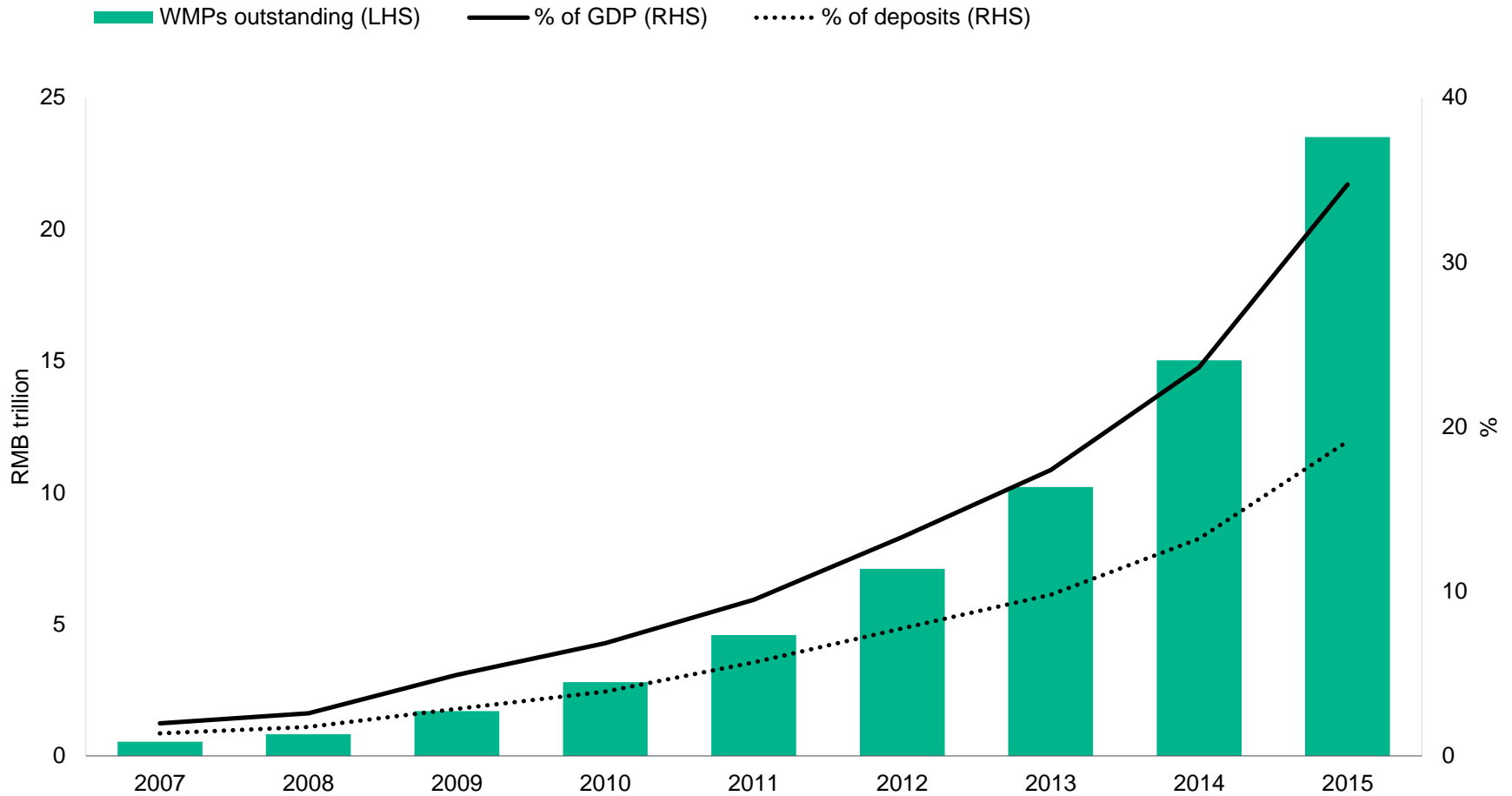
^ Core shadow banking components include entrusted loan, trust loan and undiscounted bankers' acceptances in the TSF
Sources: Moody's Investors Service and PBOC

Credit Flows Being Sustained by Bank Lending and Bonds



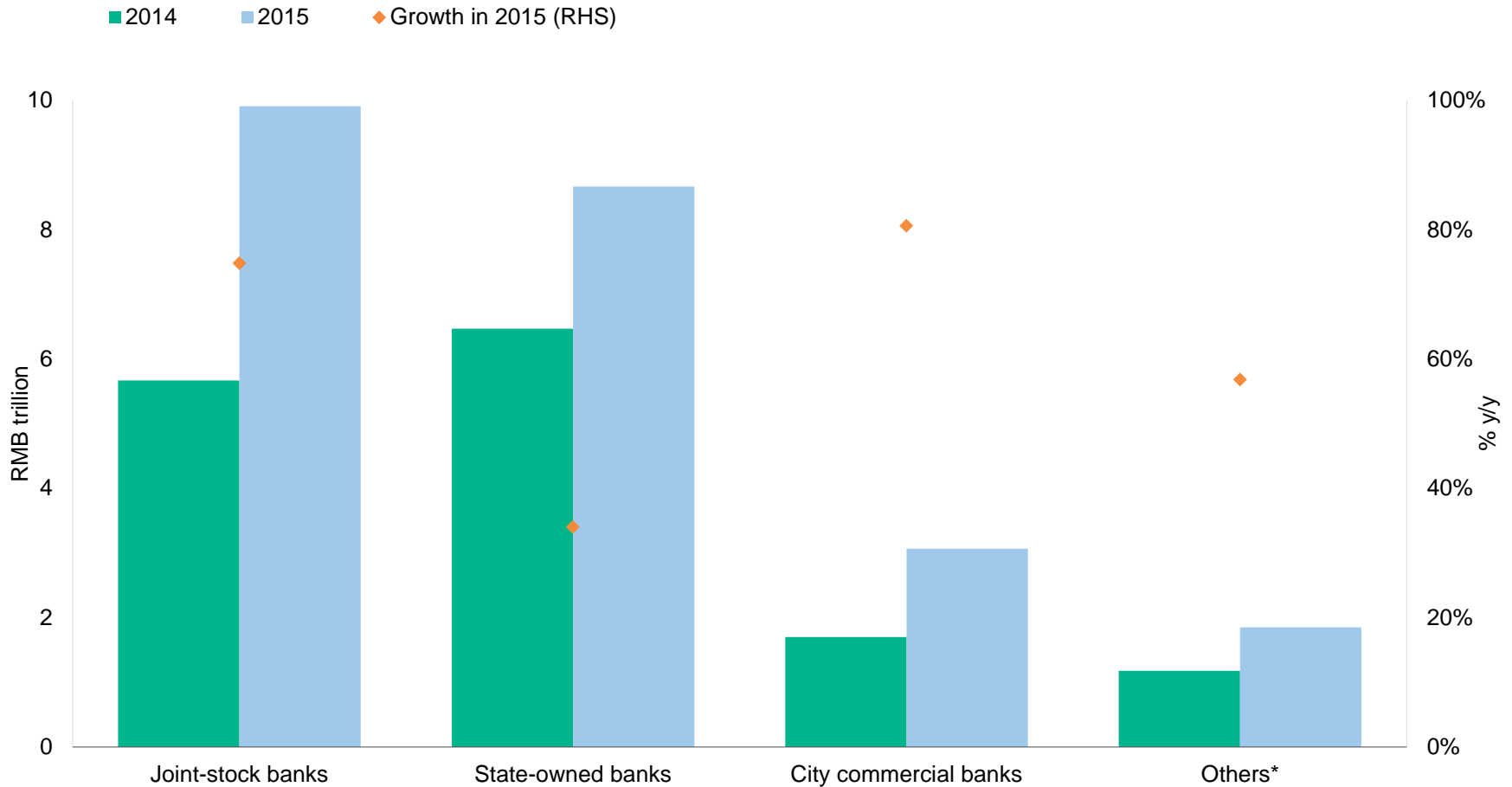
* Core shadow banking components comprise entrusted loans, trust loans and undiscounted bankers' acceptances in TSF.
Sources: Moody's Investors Service and PBOC

Issuance of WMPs Accelerated in 2015



Sources: Moody's Investors Service, China Banking Wealth Management Registration System, PBOC and China Banking Association

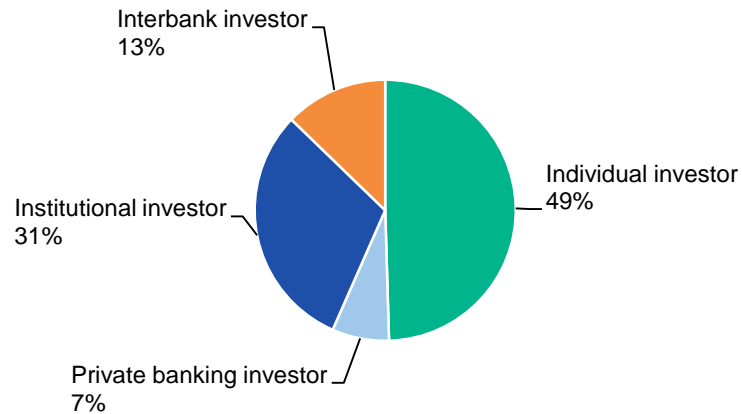
Mid-sized Banks Are More Active in WMP Issuance (stock of WMPs)



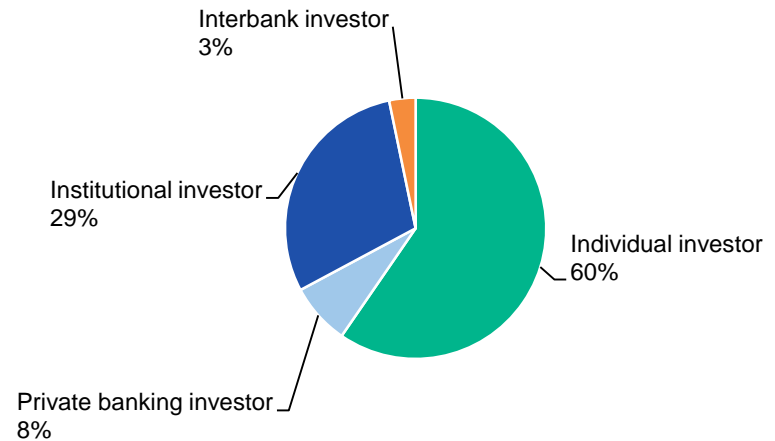
* Others refer to rural financial institutions, foreign banks and other financial institutions included by the China Banking Wealth Management Registration System.
Sources: Moody's Investors Service and China Banking Wealth Management Registration System

Share of Wholesale WMP Investors Is on the Rise

End of 2015

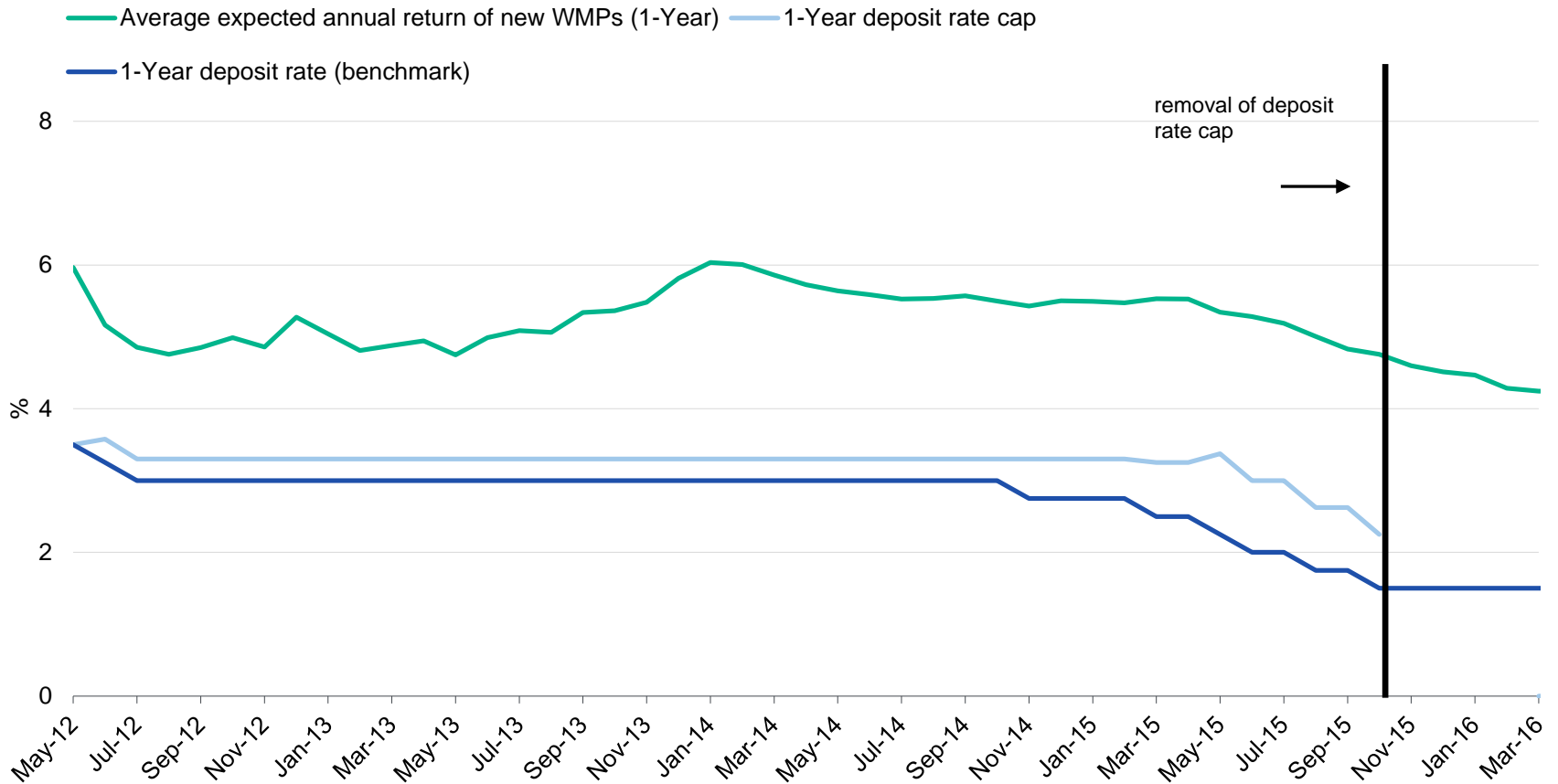


End of 2014



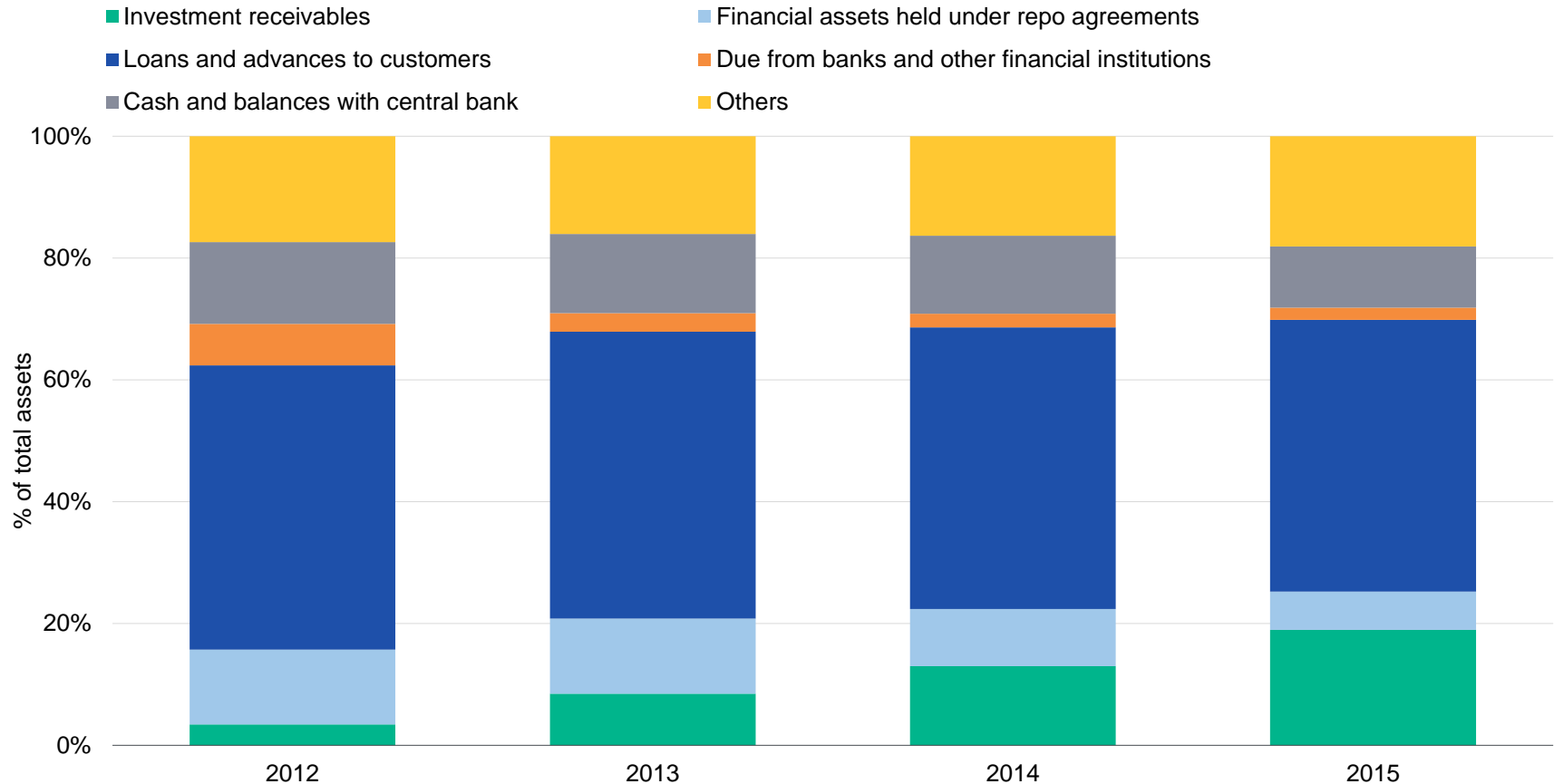
Sources: Moody's Investors Service and China Banking Wealth Management Registration System

Gap Between WMP Yields and Deposit Rates Is Narrowing



Sources: Moody's Investors Service, PBOC and Wind

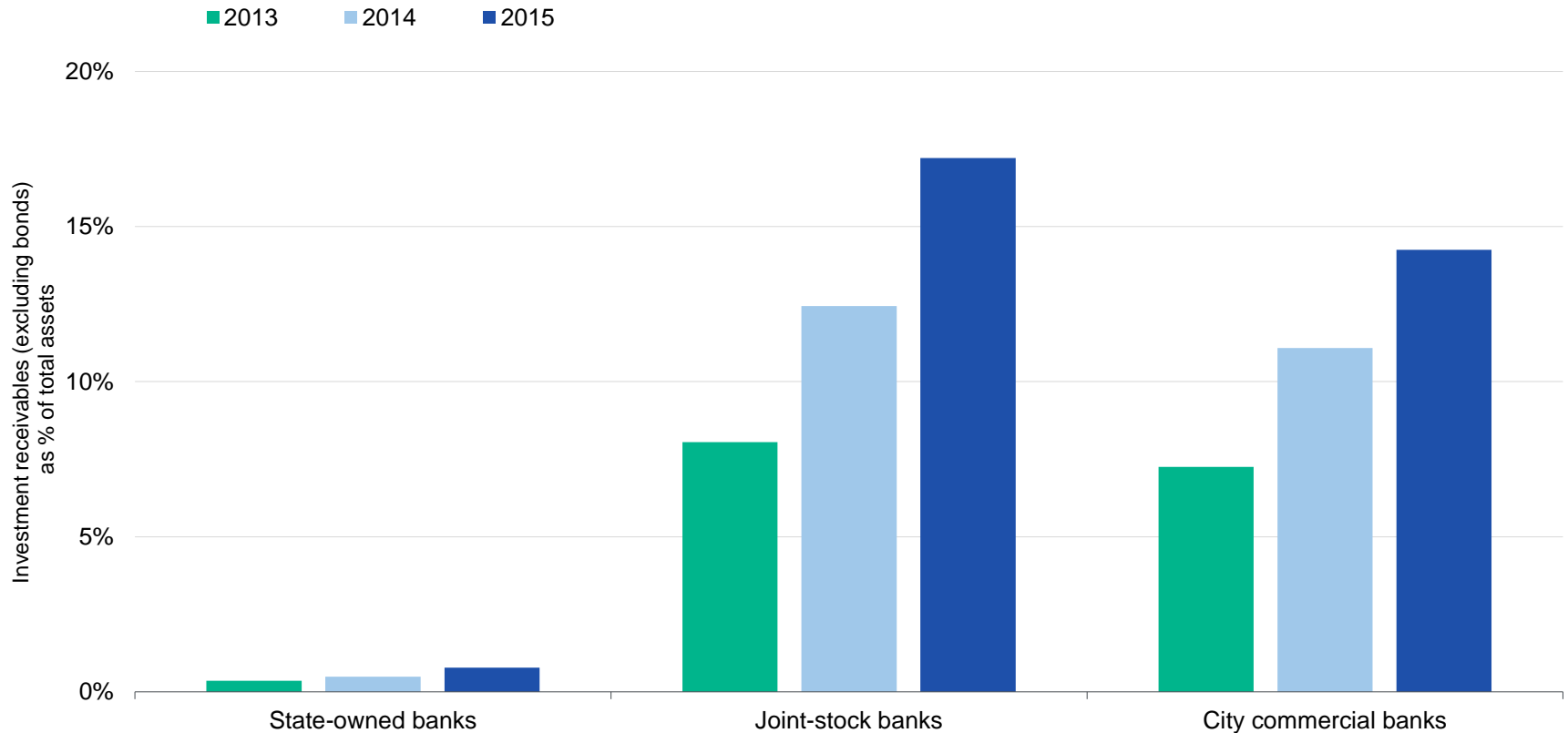
Interconnectedness and Bank “Investment Receivables”



Data for 8 listed joint-stock banks as follows: China Merchants Bank Co. Ltd. (CMB), Shanghai Pudong Development Bank Co., Ltd. (SPDB), China CITIC Bank Corp. (CITICB), China Everbright Bank Co., Ltd. (CEB), Ping An Bank Co., Ltd. (PAB), China Industrial Bank Co., Ltd. (CIB), China Minsheng Banking Co., Ltd. (CMBC) and Hua Xia Bank Co., Ltd. (HXB).

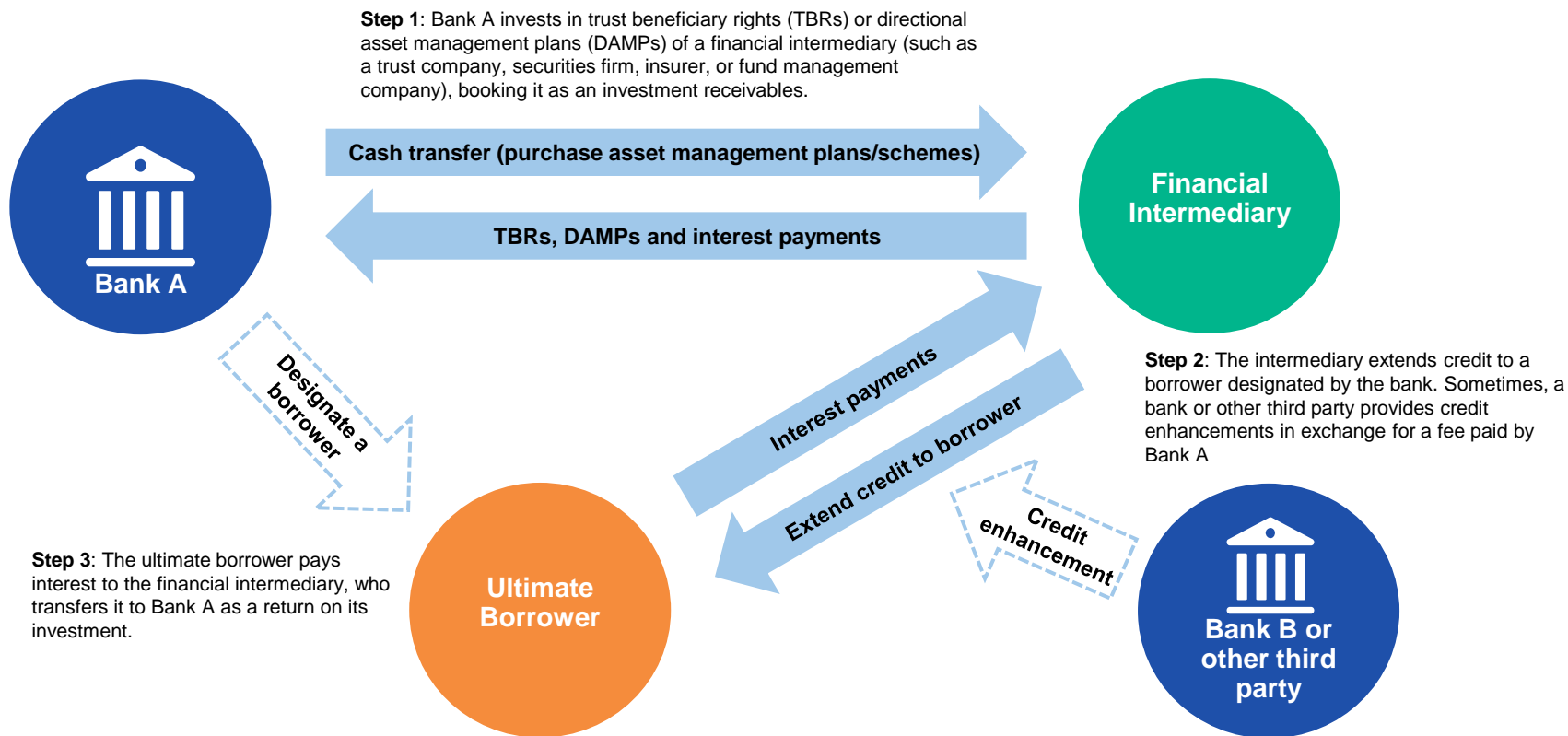
Sources: Moody's Investors Service and company data

Growth of Investment Receivables



Data for 5 listed state-owned banks consists: Industrial Commercial Bank of China Ltd., China Construction Bank Corporation, Agricultural Bank of China Ltd., Bank of Communications Co. Ltd. and Bank of China Ltd. Data for 8 listed joint-stock banks consists the same banks in previous slide. Data for 6 listed city commercial banks consists: Bank of Ningbo Co. Ltd., Bank of Beijing Co. Ltd., Bank of Nanjing Co. Ltd., Huishang Bank Co., Ltd., Harbin Bank Co. Ltd. and Bank of Chongqing Co. Ltd. Sources: Moody's Investors Service and company data

How Banks Extend Credit via “Investment Receivables”



Source: Moody's Investors Service

Regulatory Measures to Curtail Shadow Banking Risks

DATE	KEY REGULATORY DEVELOPMENTS
July 2014	The CBRC further tightens regulations on banks' wealth management products, including establishing an independent department for supervision and prohibiting banks from intra-trading WMPs with the aim of improving the performance of their portfolios. This is another step the authority has taken to break the practice of "Rigid Redemption" of WMPs and enhance the risk awareness of investors in WMPs.
December 2014	<p>The CBRC announces plans to encourage banks to invest funds raised through WMPs directly, rather than engaging the services of trust and security companies in order to reduce risky lending in the shadow banking market. Among other things, banks are to be encouraged to set up their own investment accounts for funds raised from WMPs.</p> <p>The CBRC and MOF announce plans to establish an insurance fund for the trust sector, financed through funds from trust companies.</p> <p>The Asset Management Association of China announces draft proposals to prohibit the packaging of local government debt in asset backed securities as a way of discouraging a further build up of local government debt and to enhance financial stability in the securitization market.</p>
January 2015	The CBRC seeks to tighten regulation of entrusted (company-to-company) loans through proposals to disallow firms from relending bank loans, and to prohibit borrowers of such funds from investing in financial assets such as WMPs, bonds, and equity.
March 2015	The State Council announces the long-awaited bank deposit insurance scheme to be implemented on May 1, considered an important step toward further interest rate liberalization. When fully implemented, interest rate liberalization would reduce the incentive for WMPs.
April 2015	The CSRC bans brokerage firms from using "umbrella trusts" (considered high-leverage) for margin trading in the stock market.
June 2015	The CSRC proposes amended rules on margin financing and securities lending, which includes a cap of margin trading and short selling business conducted by each securities firm at 4x their net capital.
July 2015	The CSRC eases margin rules on collateral of borrowers, and expands the permissible range of securities firms' funding channels. The CBRC allows financial institutions to renegotiate maturity terms for loans pledged with stocks and encourages banks to finance the CSFC through interbank lending and extend collateralized loans to listed companies for share buybacks. The CSRC instructs brokerage firms to review securities trading accounts and avoid any illicit trading activities operated outside the regulatory framework. Separately, the PBOC, relevant ministries, and regulators release guidelines to facilitate the healthy development of internet finance.
September 2015	The CSRC issues informal guidelines for brokerage firms to suspend suspicious trading accounts by the end of October, reflecting an intensification of its crackdown of less regulated margin financing activities such as umbrella trusts and private financing. Separately, the State Council announces new guidelines to facilitate development of the financial leasing industry.
December 2015	The CBRC releases new supervision rules to better regulate the fast growing "P2P" lending industry.
January 2016	The CBRC steps up scrutiny of banks' bill finance operations by issuing a notice requesting banks to strengthen their internal controls, and thereby reduce risk of misuse of such transactions to circumvent bank regulatory requirements.
March 2016	The CBRC steps up scrutiny of distressed asset management companies to discourage them from engaging in transactions that conceal banks' credit risks through, for example, repurchase agreements. The CBRC issues directive to strengthen risk management practices of trust companies, including by limiting leverage on products for investment in the stock market.
April 2016	The CSRC proposes modifications to risk control indicators of securities firms to help address emerging risks in the industry. State Council reportedly begins one-year crackdown on internet finance platforms, including P2P lenders.
May 2016	CBRC issues guidance on banks' loan-beneficiary rights transfers, to curb the practice of banks transferring loans off balance sheet without full risk transfer, and to enhance transparency of NPLs on their books.

Source: Moody's Investors Service

Q&A

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