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Chinese Bankers Survey 2011

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Outline

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- ***Objectives***
- ***Key findings***
 - Economic situation
 - Business development strategies
 - Risk management and internal control
 - Evaluation of supervisory system
 - The bankers' satisfaction
 - Prospective views

Background

- Jointly conducted by PwC and China Banking Association
- Fieldwork led by Dr Ba Shusong, Researcher and Deputy Director, Financial Research Institute, Development Research Center of the State Council
- 72 face-to-face interviews with senior banking executives including:
 - 6 large SOE banks
 - 7 shareholding banks
 - 17 city commercial banks
 - 15 rural financial institutions
 - 3 policy banks
 - 2 foreign banks

Objectives

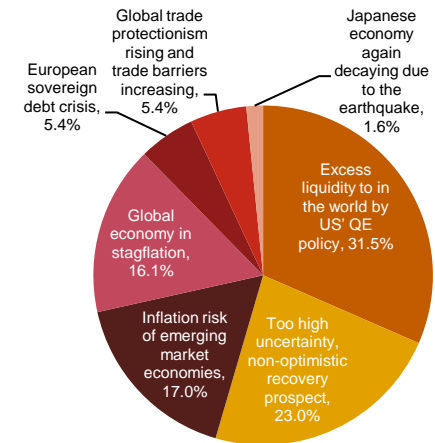
- Provide insights into strategies, opportunities and challenges of the Chinese banking industry
- Share views and recommendations of Chinese bankers on areas such as banking sector reform, liberalisation and business development amid regulatory oversight
- Promote mutual understanding and dialogue between regulatory authorities, domestic and overseas markets, and the Chinese banking industry

Economic situation

Global economic recovery appears fragile; concerns over financial position of business enterprises

- **Views on global economic situation in 2011 not very optimistic**

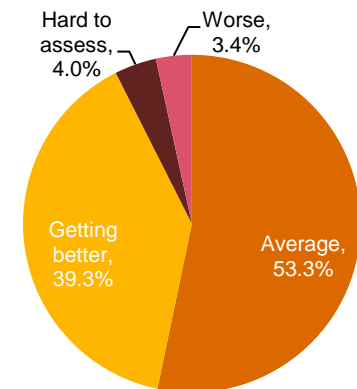
Challenges – excess liquidity due to QE policy, difficult recovery prospects, risks associated with inflation within emerging market economies & European debt crisis



Biggest challenges for global economy in 2011

- **Concerns over financial position of business enterprises**

Challenges – increasing costs of raw materials, labour force and financing. Over 50% of bankers consider operating performance of enterprises as “average”



Views of bankers on performance of SMEs in 2011

Tightening monetary policy increasing pressure on banks' operations

More than 60% of bankers believe that “the government return to prudent monetary policy and limitations on credit origination” and “uncertainties about economic growth and inflation” present the biggest pressures on their current operations

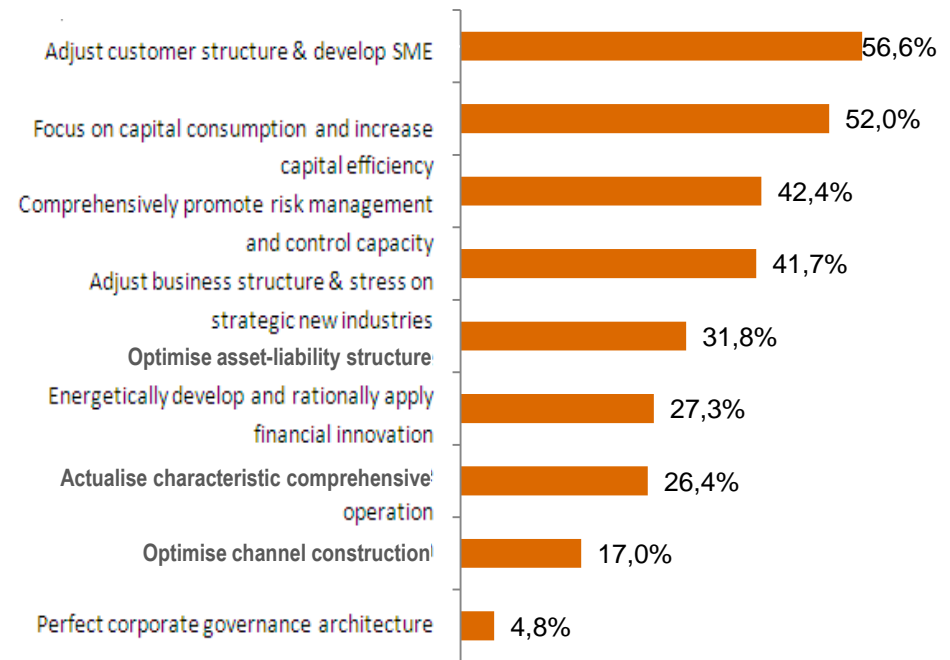


Changes in operational environment that put bankers under pressure in 2011

Development strategies

Develop new businesses and reduce capital consumption

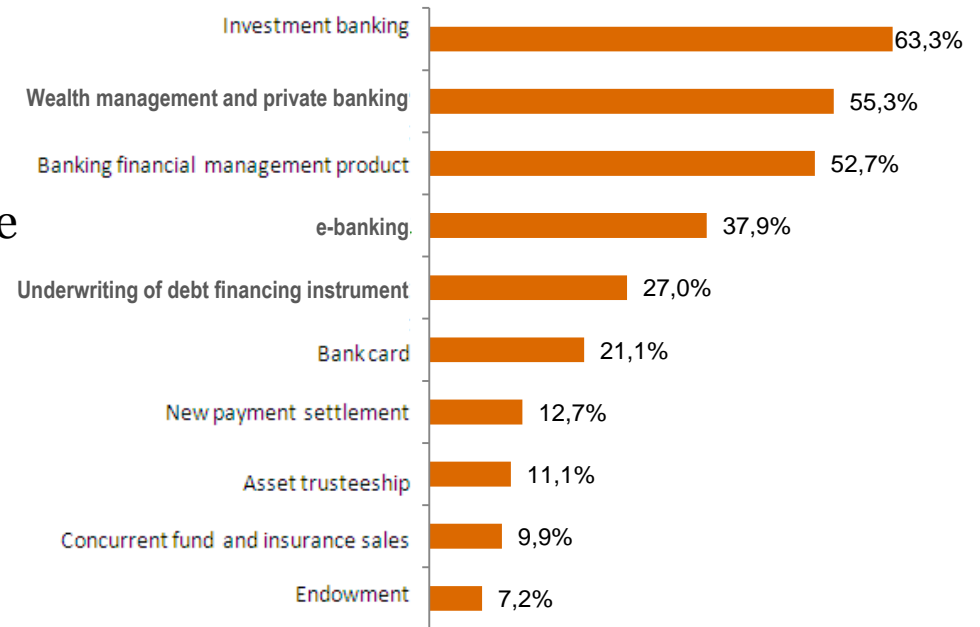
- 57% of respondents pick “adjust customer structure and develop SME business” as a strategic focus in 2011
- 52% chose “pay attention to capital and increase capital efficiency”



Three major aspects for strategic adjustment of the Chinese banking industry in 2011

Emphasis on developing new businesses of low capital consumption

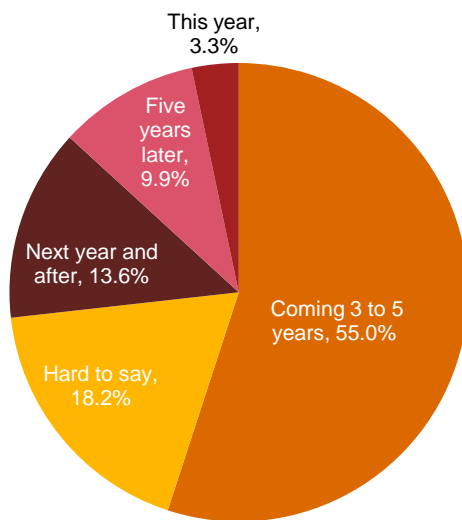
- When selecting a new business to develop, the top three are:
 - investment banking
 - wealth management and private banking
 - innovative deposit and wealth management products to improve competitiveness in attracting customer deposits



New businesses of low capital consumption to be emphatically developed by banks

Rational assessment of interest rate liberalisation

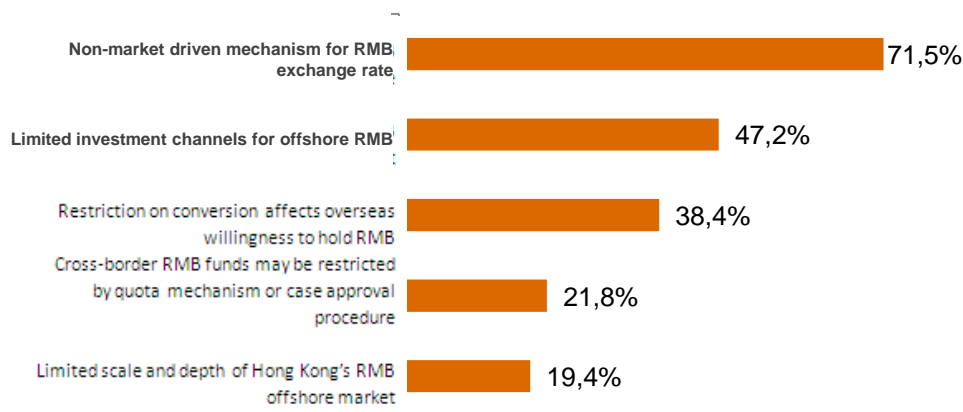
- 81% of respondents believe interest rate liberalisation can “promote banks to accelerate transformation and optimise business structure”
- 64.4% feel it may lead to “malicious competition, solicitation of deposits with high interest rate and malicious lending”
- 55% expect interest rate liberalisation to happen in the next 3 to 5 years



Time window for advancing interest rate liberalisation

Strong desire to expand overseas and cross-regional operations

- An estimated two-thirds of respondents feel overseas expansion should proceed steadily
- Nearly 60% of city commercial bank respondents have started cross-regional operations and will continue to expand
- Strong prospects in cross-border RMB trade settlement business
- However, various hurdles need to be resolved, such as “non-market driven mechanism for RMB exchange rate,” “limited investments channels for offshore RMB” and “restriction on conversion”

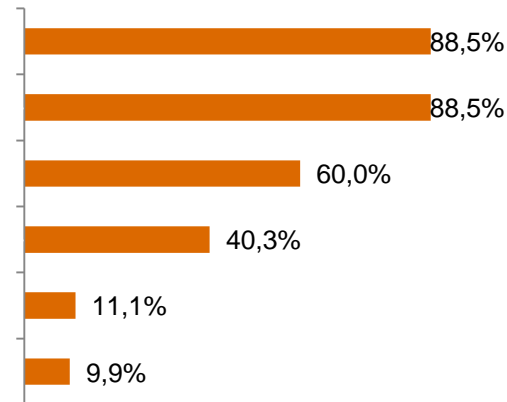


Major hurdles for cross-border trade settlement in RMB

Business development

Major challenges for Chinese banks in 2011

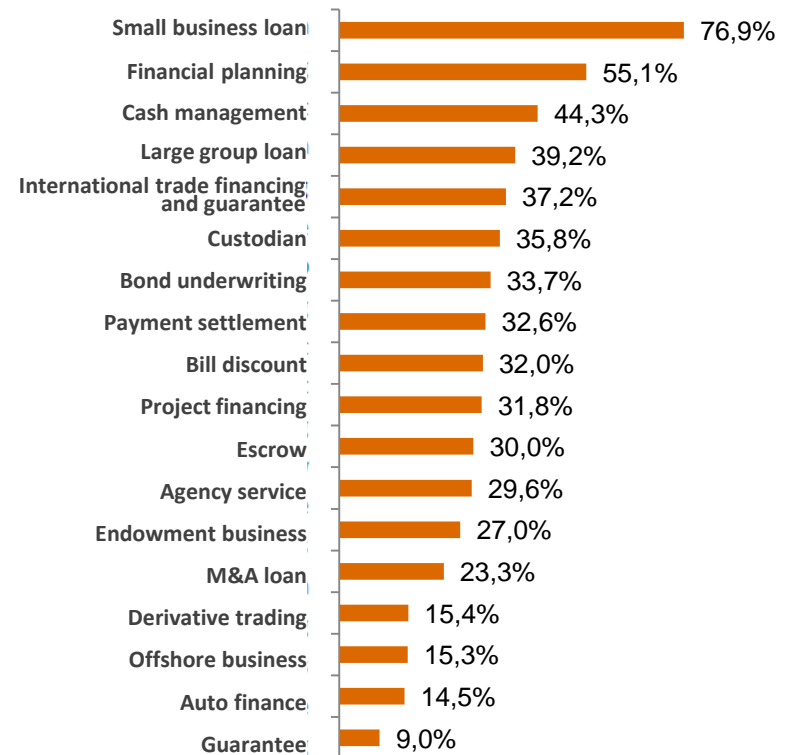
- “Increased competition to attract deposits ” viewed as critical, rising 5% from a year before
- “Increased competition among banks”, “scale of loans are reduced” and “cost of funds continue to rise” listed as other major challenges
- Responses to challenges – developing financial advisory, wealth management and private banking



Measures taken by banks to attract more deposits within the marketplace

Small business lending and financial advisory business top priorities

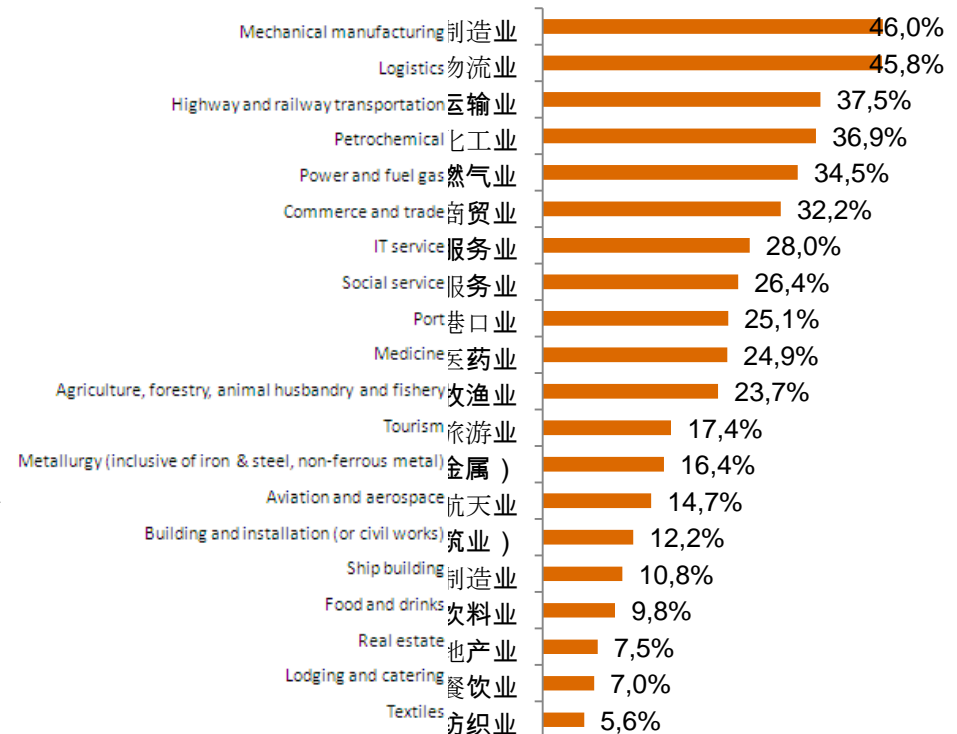
- For third year in a row, small business lending remains respondents' main driver of corporate business
- 76.9% identified developing small business loan products as the main driver of corporate business in next three years
- Importance of financial advisory rises from 4th place in 2010 to 2nd in 2011
- Financial advisory fees seen as important source of future income



Development priorities of corporate financial business

Increasing focus on energy-efficiency and environmental protection industries

- Mechanical manufacturing industry (46%) tops respondents' lending targets in 2011
- Increasing support for development of advanced manufacturing and modern services industries
- To support the government's 12th Five Year Plan, energy efficiency and environmental protection industries will be the key focus in credit extension

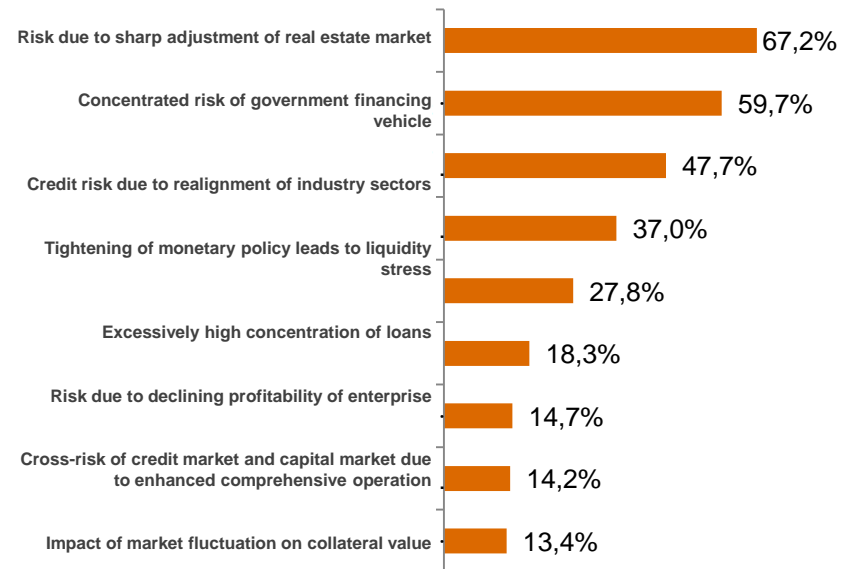


Main industry focus of credit investment in 2011

Risk management and internal control

Major risk concerns of Chinese banks

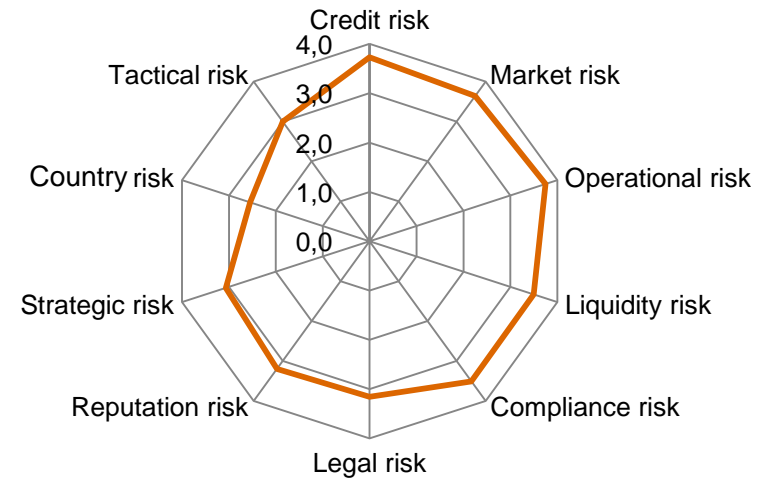
- Increasing concerns over risks in real estate market (67%) and local government financing vehicle (LGFV) loans (60%)



Risk ranking in the Chinese banking industry

Increasing focus on operational risk

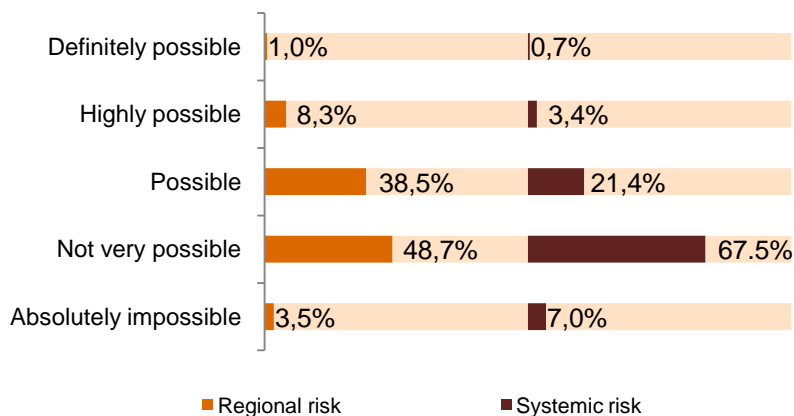
- For first time, operational risk ranks first for respondents due to fraud concerns
- Implementation of Basel II and Basel III also accelerating importance of operational risk management



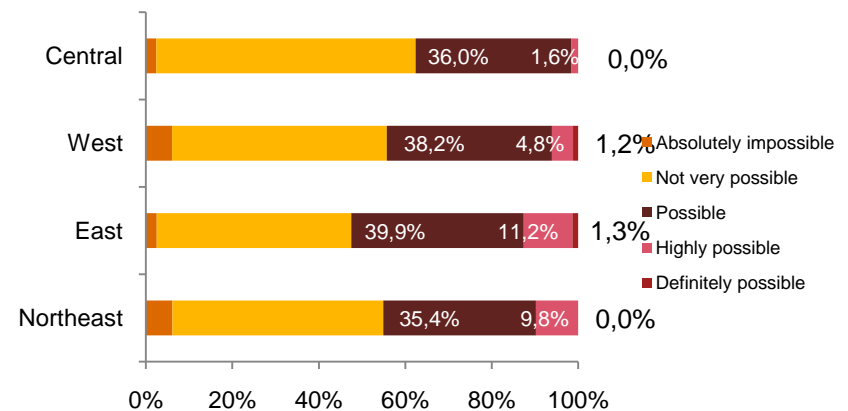
Risk by priority in 2011 survey

Systemic financial risk less likely, but regional risk a rising concern

- Improvements in risk management protocols in Chinese banks
- 74.5% of respondents believe outbreak of systemic risk as less likely
- 48% say there's a possibility of an outbreak of regional risk
- Rising concerns over concentrated exposure to local government financing vehicles and real estate, and risks arising from private sector credit extension



Possibility of outbreak of systemic risk and regional risk



Possibility of outbreak of regional risk (by regions)

Evaluation of supervisory system

Four major regulatory instruments well received

- From 1 January 2012, CBRC will completely adopt the four major regulatory instruments - capital adequacy, provision coverage, liquidity and leverage - as core indicators in the prudent regulatory system
- Respondents believe the four major regulatory instruments correspond well with implementation of Basel II and Basel III

Adequacy of the four major regulatory instruments in China's implementation of Basel II and Basel III

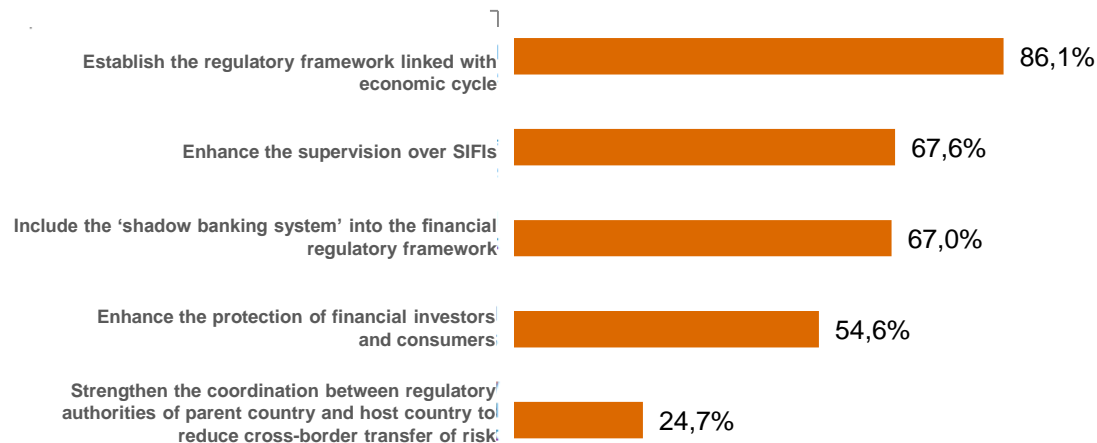
	Capital adequacy	Provision coverage	Liquidity	Leverage
Suitability to China	4.19	4.09	4.01	3.91
Timing for implementation and compliance	3.96	3.95	3.90	3.83
Scope of application	4.08	4.05	3.99	3.97

Note: maximum score is 5

- Potential negative effects of the 2.5% provision-to-loan ratio (loan provision/loan balance) - 52.1% of respondents feel the requirement ignores the varying asset quality of different commercial banks'

Benefits in drawing on latest developments in international regulatory practices

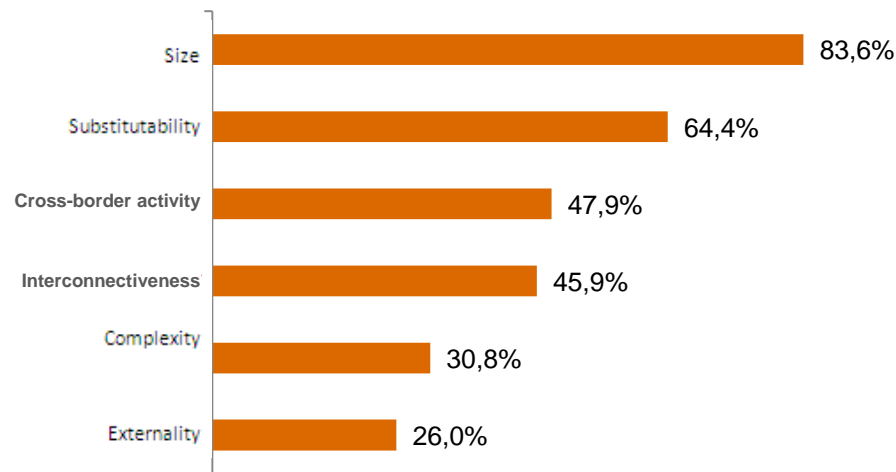
- 86.1% of respondents say regulatory framework linked with economic cycle is more appropriate for China
- Enhanced supervision of systemically important financial institutions (SIFIs) would restrict credit expansion, enhance stability of banking system and banks' risk management capacity
- Proposal to include the shadow banking system into financial regulatory framework



International regulatory reforms which are relevant in banking supervision in China

Additional capital requirement for SIFIs

- 83.6% of respondents pick ‘size’ as the most important factor for determining systemically important banks
- Industrial and Commercial Bank of China, Bank of China, China Construction Bank, Agricultural Bank of China and Bank of Communications considered by respondents as systemically important banks

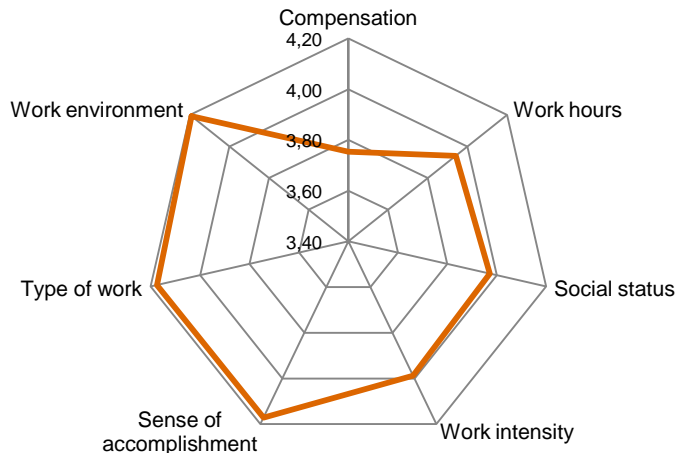


Criteria for determining systemically important banks

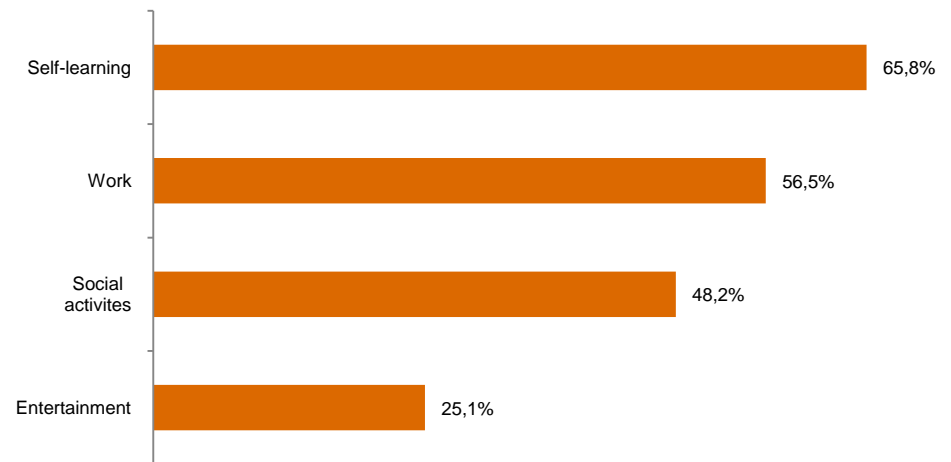
The bankers' satisfaction

High evaluation of job satisfaction

- Respondents express high job satisfaction from all aspects, especially work environment, job content and sense of achievement
- Low satisfaction on salary level
- ‘Learning’ and Working’ are the most common activities during holidays



Rating of work-related satisfactory level

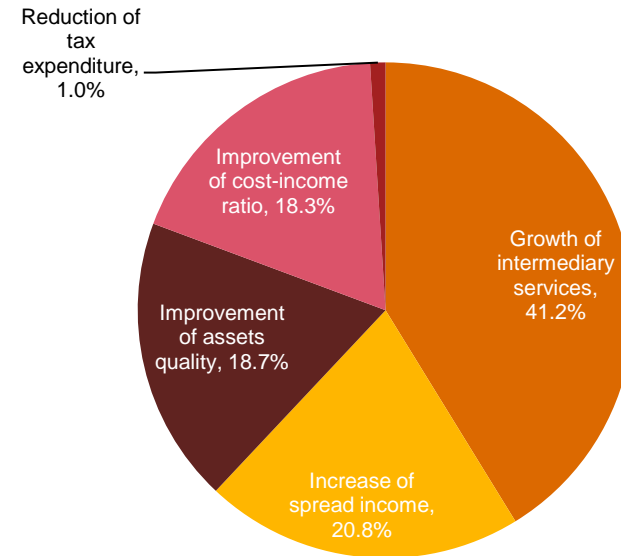
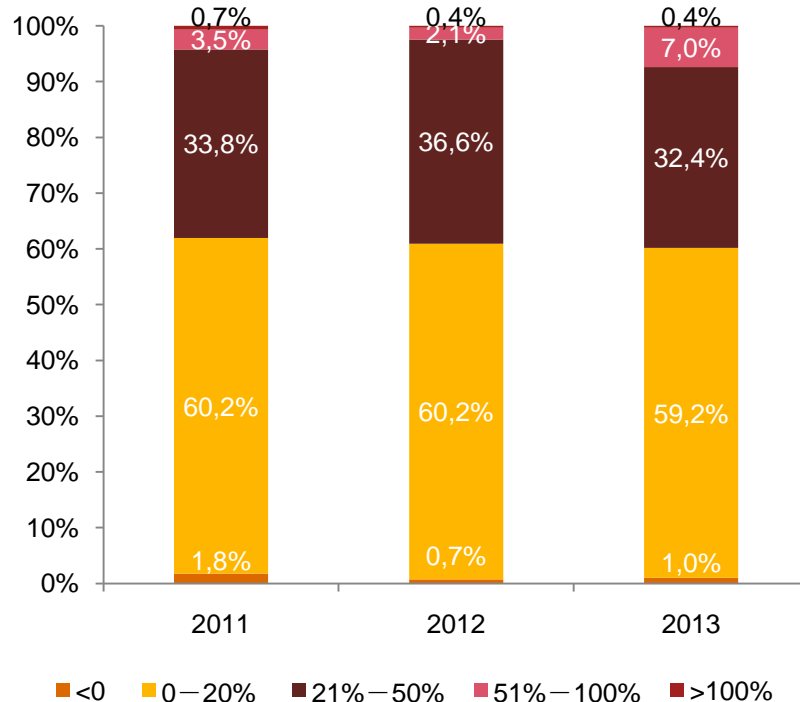


How Chinese bankers spend their holidays

Prospective views

Projection of income growth and profit

- Lower revenue and profit growth rates for next three years
- Intermediary services continues to be impetus for profit growth

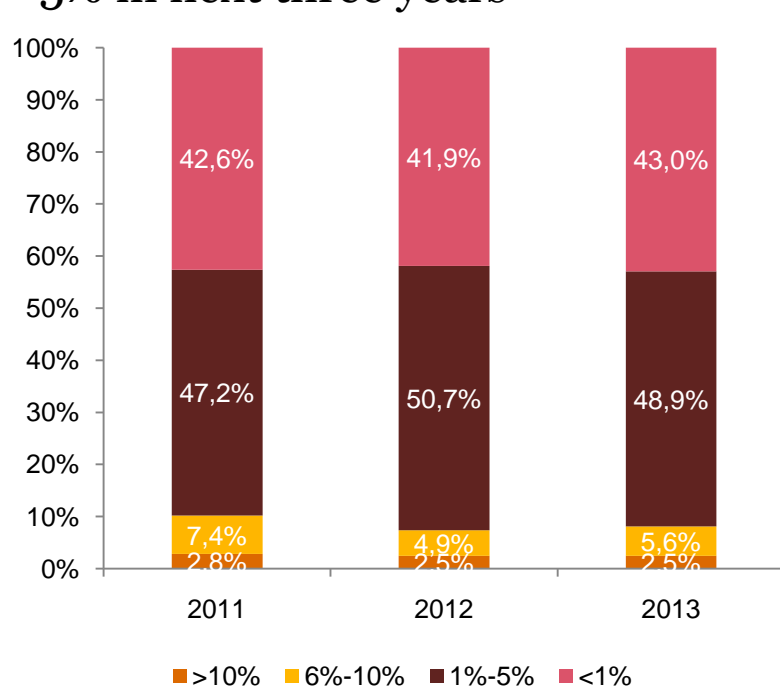


Projected revenue growth rates of interviewed banks over the next three years

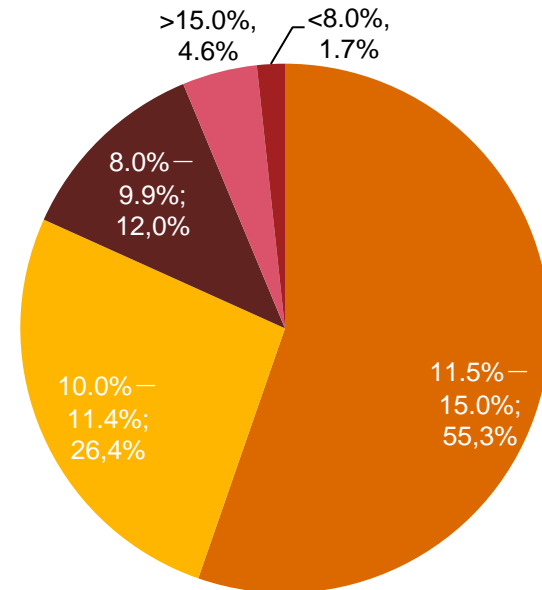
Drivers for future profit growth according to interviewed banks

Projection of non-performing loan ratio and capital adequacy ratio

- Non-performing loan ratio to remain at same level as in 2010
- 90% of respondents believe that non-performing loan ratio will remain below 5% in next three years



Projected non-performing loan ratio over the next three years



Projection of CAR by end of year 2011

Thank you

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