Chinese bankers survey 2011
Executive Summary
Preface

Enclosed is the Chinese Bankers Survey Report for 2011, jointly presented by the China Banking Association (CBA) and PwC.

This survey endeavours to:
1. gain insights into the strategies, opportunities, and challenges for the Chinese banking industry as it embarks on economic structure optimisation, business innovation and transformation programmes from the standpoint of Chinese bankers;
2. share the views and recommendations of Chinese bankers on areas such as reform, liberalisation, and business development, amid the regulatory oversight of the Chinese banking industry;
3. promote mutual understanding and dialogues between the regulatory authorities, domestic and overseas market participants, and the Chinese bankers.

This survey targeted the senior management of both the head offices and branches of Chinese banks. It was primarily conducted between April and June of 2011 through electronic questionnaires, with 818 valid responses received from participating banks. In addition, the project team conducted face-to-face interviews with 72 senior banking executives, which included Board Chairmen, Presidents, Vice Presidents and department heads. We would like to take this opportunity to extend our sincere thanks to the respondents for their time, efforts and insights that made this survey possible. We are confident this report will provide readers with a comprehensive understanding of the professional opinions of senior management in the banking industry.

Under the impact of slowed growth, debt crisis, inflation and unexpected events, the global economic recovery in 2011 appears to be exceptionally fragile and unbalanced.

Views of bankers on global economic developments are not so optimistic. Many bankers have also shown concerns over the real economy in China, and believe enterprises in the eastern region are having greater challenges than those in the central and western regions.

As a whole, the evaluation of the bankers on macro economic policy since the second half of 2010 is less favorable than the preceding year, reflecting, to some extent, their concerns over the economic retrenchment, prolonged high inflation, and real estate market control falling short of expectations. The continued tight monetary policy environment has put them under pressure in managing their banks and according to the bankers, the successive increases of the deposit reserve rate has created constraints on their operations.

Against the backdrop of implementing the new Basel Capital Adequacy Accord (hereinafter referred to as BASEL III) in China, bankers have responded with increased investment in new businesses and products and business structure optimisation to reduce capital consumption. It has been a top priority in the development strategies of banks since 2011 to optimise capital allocation, adjust business structure, reduce capital occupation of unit asset and establish capital-efficient banks. More than half of the bankers surveyed believe that the focus of the industry’s strategic adjustments in 2011 shall be to “Adjust customer structure and develop SE (small enterprise) business with less capital required” and “pay attention to capital consumption and increase capital efficiency”.

Due to the numerous increases of deposit reserve rate by the People’s Bank of China and the rigid requirement on deposit-loan rate by regulatory authorities, competition in deposit market tends to be more intensive and liability management becomes the primary problem in the operations of Chinese banks. More than 80% of bankers say that in 2011, the biggest challenge for banks is the “increasing pressure for deposit-taking”. Financing through capital market, asset securitisation, innovative deposit-taking and financial planning products are funding options being considered by bankers. In addition, financial advisory, wealth management and private banking have become new alternatives for bankers to respond to tightening monetary policy and operating pressures.
Bankers remain calm and objective regarding interest rate marketisation and over 80% of them are of the opinion that interest rate marketisation can “cause banks to speed up transformation and help optimise business structure”. Most of the bankers believe that the timing for interest rate marketisation will be in the coming three to five years.

Regional financial risk also draws the attention of bankers. The survey indicates that the financing difficulties facing SMEs have not yet been substantially resolved. In the opinion of the bankers, there is still room for a bigger role for policy-making to play in addressing SME financing issues. Key factors underlying this concern over regional financial risk include inadequate liquidity positions of SMEs, excessively high interest rates for financing from non-governmental channels, local government financing vehicle and real estate regulation.

Operational risk for the first time tops the list of priorities for Chinese bankers, indicating their collective alertness to the potential outbreak of fraud cases due to operational risk which underlies their commitment to strengthening internal controls. Many banks have established the internationally leading practice of “three-defense-lines” system of internal control and set up relevant risk management framework, with an increasing focus on applying internal control measures in daily management of their business operations.

Intensive banking with greater focus on details, as through process reengineering, has become where banks are headed in their internal reform of banking practices. Most of the bankers believe process reengineering has improved the efficiency of their internal operations, heightened their responsiveness to customer demands and better positioned the banks to meet the diversified demands of their customers. Banks have focused their process reengineering on strengthening the centralised processing capability of middle and back offices and optimising organisational structures at different levels.

Setting up proper IT governance structure and stepping up IT construction are also key components in Chinese bankers’ initiatives to strengthen internal management and improve efficiency through better management. Meanwhile, applications of new technologies such as mobile banking and Internet banking and their potential risks are being considered by the bankers. During the 2011 survey, the IT progress of small and medium commercial banks is remarkable. 

Facing the fierce market competition, improving HR management and building a solid talent base for bank development are critical factors that Chinese banks need to consider in optimising their internal resources. Bankers also show increasing attention to succession planning, performance measurement and incentives in their HR management.

The bankers generally approve of the regulatory policies of CBRC, with special praises on the adaptation of the four major regulatory instruments to the Chinese market and the suitability and the scope of applicability of these instruments. Also, the bankers recommend stronger supervision over systemically important financial institutions and inclusion of the shadow banking system into the financial regulatory framework.

We look forward to hearing your invaluable feedback on this report to help us make it a better product. For further information, please contact PwC Financial Services, China Banking Association, or the project leader.

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October 2011, Beijing
Participating Banks

There are a total of 50 participating banks through survey or interviews (listed in no particular order):

1) Large-size commercial banks (6)
   - Industrial and Commercial Bank of China
   - Agricultural Bank of China
   - Bank of China
   - China Construction Bank
   - Bank of Communications
   - Postal Savings Bank of China

2) Joint-stock commercial banks (7)
   - China Bohai Bank
   - Hua Xia Bank
   - Evergrowing Bank
   - Shanghai Pudong Development Bank
   - China Merchants Bank
   - China Everbright Bank
   - China Minsheng Banking Corp. Ltd.

3) City commercial banks (urban credit unions) (17)
   - Baoshang Bank
   - Bank of Beijing
   - Bank of Chengdu
   - Bank of Dalian
   - Bank of Fudian
   - Bank of Guangzhou
   - Huarong Xiangjiang Bank
   - Huishang Bank
   - Ping An Bank
   - Bank of Shanghai
   - Bank of Tianjin
   - Bank of Xi'an
   - Bank of Xiamen
   - Bank of Xinyang
   - Zhanjiang Commercial Bank
   - Zhangjiakou City Commercial Bank
   - Bank of Zhengzhou

4) Rural financial institutions (15)
   - Beijing Rural Commercial Bank
   - Tianjin Rural Commercial Bank
   - Shanghai Rural Commercial Bank
   - Hebei Rural Credit Union
   - Liaoning Rural Credit Union
   - Shandong Rural Credit Union
   - Jiangsu Rural Credit Union
   - Zhejiang Rural Credit Union
   - Hubei Rural Credit Union
   - Hunan Rural Credit Union
   - Guangxi Zhuang Autonomous Region Credit Union
   - Qinghai Rural Credit Union
   - Xinjiang Uygur Autonomous Region Credit Union
   - Dai Jiaoyin Xinmin Village Bank
   - Zhejiang Anji Jiaoyin Village Bank

5) Policy Banks (3)
   - China Development Bank
   - Import Export Bank of China
   - Agricultural Development Bank of China

6) Foreign capital banks (2)
   - United Overseas Bank
   - HSBC (China)
The stimulus policies implemented by China in response to the financial crisis began to shift its focus in the second half of 2010, with the monetary policy moving from being ‘moderately loose’ to being more ‘prudent’. At the same time, the regulatory authority has also stepped up its efforts in regulating local government-backed financing vehicle (LGFV) loans and managing liquidity risk. Consequently, the Chinese banking industry has experienced a radical change in its operating environment, including the overall tightening of liquidity, increasing capital constraints, limitations over scale of lending and growing concerns over credit quality.

Facing a new retrenchment cycle, in addition to speeding up business innovation and structural adjustment, the Chinese banking industry has responded actively through reforms and transformations in maximising its organic growth potential, made continuous efforts in the promotion for the application of internal controls, IT build out, process reengineering and HR management, and endeavored to explore new opportunities for value creation. After the crisis, both re-evaluation and consideration for the future outlook of financial innovations have become a common challenge for bankers. The Chinese Bankers Survey 2011 outlines for you the thoughts and efforts among the bankers during the current period of austerity.

**Economic environment**

Due to the combined effects of stagnant growth, debt crisis, inflation and unexpected events, the global economic recovery in 2011 appears to be exceptionally fragile and unbalanced. Bankers’ views on developments in the global economy are not optimistic. In their opinion, the major challenges for the global economy are in the order of: excess liquidity due to quantitative easing policies, difficulties in economic recovery prospects, high risk of inflation in emerging economies and European debt crisis, among others.

Bankers have also showed certain concerns over the real economy in China. Since the beginning of 2011, SMEs (small and medium enterprises) have experienced difficulties in their productions and operations due to the increasing cost of raw materials, labor force and capital, which have been profoundly felt by the bankers. 53.3% of bankers regard the operation status of these enterprises as “average”, while 7.4% believe the status is “getting worse” or “hard to assess”. Additionally, bankers believe enterprises in the eastern region are having a harder time than those in the central and western regions.

**Macroeconomic policy**

Bankers are under increased pressure by the continued tightening of monetary policy. 62.3% of bankers cite “return to prudent monetary policy and limitations on credit origination” and “uncertainties about economic growth and inflation” as the biggest strain in their current operations.

According to the bankers, the continuous uplifts in the deposit reserve ratio have placed constraints on their operations. By the end of July, the deposit reserve ratios for medium and large financial institutions have reached the highest level in history to 21.5%.

**Capital management**

Optimisation in the allocation of capital has become one of the most important priorities for banks in 2011. Operational restructuring, reductions in capital employed per unit asset and establishment of capital-efficient banks are some of the ways they intend to achieve this. “Adjust customer structure and develop SE (small enterprise) business with less capital required” and “pay attention to capital consumption and increase capital efficiency” have become the keynotes for strategic adjustment of the Chinese banking industry in 2011, as responded by 56.6% and 52.0% of bankers respectively.

Financing through the capital markets is the preferred method of bankers for supplementing their capital. As illustrated in the survey, the proportion of bankers selecting “financing by issuing subordinated bonds” and “financing by issuing stocks” had reached 46.8% and 45.8% respectively.

Bankers propose to carry out pilot projects for securitisation of assets. Through asset securitisation and sales, banks can transform loans and other assets with a relatively high risk weighting into working capital, reduce both the risk on their assets and total weighted risk assets, which in turn can help reduce their needs for capital and improve their capital adequacy ratios. 59.8% of bankers favor the approach of “select pilot banks to move forward prudently in consideration of the possible risks”
Liability management

As a result of the repeated increases to the deposit reserve ratio by the People’s Bank of China (PBOC) and the rigid requirement on deposit-loan ratio by regulatory authorities, competition in the deposit market tends to be more intensive and liability management has become the primary problem in the operations of Chinese banks. More than 80% of bankers have responded that in 2011, the biggest challenge for banks is the “increasing pressure for deposit-taking”.

Banks have taken various measures in response to meet the challenge of increased pressures on deposits, including vigorous developments in the wealth management business, expansion of savings business through cross selling to both corporate and consumer clients, provision of value-added services and increases in marketing efforts. As the survey shows, 88.5% of the bankers indicate that they will increase their competitiveness in deposit business through “deposit and wealth management product innovation”.

According to the bankers, the current reduced ability for deposit-taking is also one of the key reasons for increased competition for deposits. Implementation of certain measures, including “loan drawdown by actual use and needs” and “entrusted payment”, has weakened the ability of banks to generate deposits through loans and significantly affected the marketing model adopted by banks to promote the growth of liability-based products through with asset-based operations. Additionally, such measures have imposed a bigger risk of loss of deposits on small and medium sized banks with smaller basic customer bases.

Interest rate liberalisation

Contrary to expectations, rather than displays of opposition and resistance, bankers have remained calm and objective with regards to the liberalisation of interest rates. Over 80% of bankers are of the opinion that interest rate liberalisation can “cause banks to speed up transformation and help optimize business structure”. Nevertheless, challenges are also obvious. 64.4% of bankers expect that interest rate liberalisation may lead to “hostile competition, soliciting deposits with high interest rates and hostile lending”.

Regarding the timing for interest rate liberalisation, only 16.9% of the bankers expect it to be this year or the next 2 years, while 55% expect it to be in the coming 3~5 years, consistent with the strategy of the People’s Bank of China to “firmly promote interest rate liberalisation step by step in a properly-planned manner” during the “12th five-year” period.

Business transformation

Against the backdrop of implementing the new Basel Capital Adequacy Accord (hereinafter referred to as BASEL III) in China, bankers have responded with increased investment in new businesses and optimisation of business structure to reduce capital consumption.

As one of the new businesses, cross-border RMB business faces challenges, but has developed rapidly as one of the priority areas in the eyes of the bankers. The bankers hope to address some of these restricting factors for cross-border trade settlement in RMB, including “non-market driven mechanism for RMB exchange rates” (71.5%), “limited investment channels for offshore RMB” (47.2%) and “restriction son RMB conversion” (38.4%).

Development in financial advisory, wealth management and private banking have become major initiatives for bankers to respond to fiscal tightening and operational pressures. By prioritising in the development of corporate banking, the ranking of financial advisory starts from the 4th place in 2010 to 2nd in 2011.

Credit origination, driven by economic transformation, is also experiencing rapid modification. In the survey on external environmental factors to which the banks are exposed, 82.3% of bankers are concerned with “transformation of economic development and adjustment of industrial structure”. High-tech manufacturing and service industry receive greatest focus from banks in their credit origination. As the survey shows, in the choice of top industries for credit support in 2011, 46.0% of bankers select machinery manufacturing, and in lending to the service industry, the bankers would favor mostly logistics (45.8%), commerce and trade (32.2%), IT (28.0%), social service (26.4%), pharmaceutical (24.9%), and tourism (17.4%).

SME financing

SME businesses has been on bankers’ top agenda for a number of years, but the 2011 survey indicates that the financing difficulties facing SMEs have not yet been substantially resolved. In the opinion of the bankers, there is still room for a bigger role for policy-makers to address SME financing issues. For instance, the rigid review of banks’ compliance with the loan-to-deposit ratio requirements makes it harder for small and medium banks that are under liquidity stress to further support SMEs, taking in consideration of the weakened potential of SME loans in generating deposits.

Potential regional financial risk arising from inadequate SME liquidity and the excessively high interest rates for financing from non-governmental channels in certain regions also draws the attention of bankers. As the survey shows, 50% of bankers believe it is possible that there may be a break out in risky regional situations, and key factors underlying this concern include local government financing vehicle and real estate regulations. This concern is most prominent in the eastern region.
Real estate market and affordable housing projects

In January 2011, China started to adopt strict policies to curb housing purchases in order to control the housing prices to a reasonable range. 54.9% of the bankers expect that the local real estate market will experience “decline in sales volume”, while 54.2% of the bankers believe the house prices will remain stable, indicating there may be a long way to go in achieving the regulatory target.

More than 70% of the bankers believe a decline of less than 30% in real estate prices is endurable. In view of this situation, the bankers have become more prudent with loans for real estate development. More than 60% of the bankers are inclined to reduce loan origination for real estate development.

Difficulty in obtaining assurance in loan repayment, lack of guarantee and supporting measures, inadequate risk mitigation for low-rent housing and public rental housing and investment returns, among others, are all critical issues bankers need to consider in supporting affordable housing projects.

Local government financing vehicle loans

The government’s clean up of local government financing vehicle (LGFV) loans, regulation of real estate market and uncertainties surrounding the macro economy have intensified the bankers’ concerns over asset quality.

70% of the bankers consider the principal risk of LGFV loans to be the inability of local governments to meet their loan repayment obligations due to mismatch between their financial resources and the size of debts, in addition the risk of delay in repayment, policy risk, centralisation risk, financial risk and legal risk are also critical factors the bankers need to consider. In an effort to cautiously manage LGFV loan risks, 46% of the bankers indicate that they will be more rigorous in the control of the origination of LGFV loans in 2011, while 26% of the bankers will take a further step to reduce their LGFV loan portfolio. Only 10.1% of the bankers expect to expand their LGFV loan portfolio.

Bankers have also mentioned difficulties in the clean-up of LGFV loans. More than half of the bankers believe that local governments are in a relatively strong bargaining position and their inadequate understanding of the policy makes it more difficult than it should be to drive forward the cleaning exercise. 42.1% of the bankers consider that lack of transparency in financial information of LGFVs makes it difficult for banks to collect all relevant data on the loans and subsequently impossible to assess accurately the platforms’ ability to repay loans and the loan risks. In the meanwhile, 40.5% of the bankers are concerned about the adverse effects of unfinished projects may have on their loan quality if they discontinue the loans. Additionally, nearly 40% of the bankers would like to see further clarification of the policies and detailed requirements with respect to the cleaning of LGFV loans.

Some of the bankers have also proposed recommendations for clarification of regulatory measures. For instance, the policy currently requires calculation of risk weightings to be based on the extent loan principal and interest are covered by operating cash flows from the LGFVs without considering other repayment sources, including fiscal subsidies and collateral. Therefore the outcome may show greater stress on loans to those LGFVs which are weak in self-generated cash flows but strong in fiscal subsidies or collateral. Also, the different criteria and methods applied in calculating cash flows may produce inconsistent outcomes. In order to address the issue of not being able to properly and accurately assess the exposure to LGFV loans due to their rollover, the regulatory authorities require the banks not to extend or refinance any matured LGFV loans regardless of any form it may take. This policy may help in the effective management of these financing vehicles, but may also increase the repayment pressure on certain county-level financing vehicles where finances are inefficiently managed.

Internal control

The retrenchment period is often when various risks tend to be more exposed, while internal control failures in the form of policies and procedures, people and management are an important factor giving rise to these risks. As the survey shows, following an overall improvement of risk management capabilities, operational risk for the first time tops the list of priorities for Chinese bankers. This indicates their collective alertness to the potential outbreak of fraud cases due to operational risk and contributing to their commitment to strengthening internal controls.

Internal control has always been a major task on the bankers’ agenda in the course of the Chinese banking reform and especially in the wake of implementation of international regulatory standards and guidelines in China, however the attention bankers have shown in this area is unprecedented. Many banks have established the internationally leading practice of “three-defense-lines” system of internal control and set up relevant risk management framework, with an increasing focus on applying internal control measures in daily management of their business operations. Additionally, it should be noted that against the current austerity measures and increasing concerns over risks, regulation by multiple regulators and repeated inspections can be appreciated by most bankers, indicating their collective support of joint efforts in risk mitigation internally and externally.

Process reengineering

Represented by process reengineering and great focus on details, has emerged as where banks are headed in their reform of banking practices. 68.5% of the bankers believe process reengineering has improved the efficiency of their internal operations, 60.9% believe it has heightened their responsiveness to customer demands, and 56.7% believe it has better positioned the banks to meet the diversified demands of their customers.

In the course of process reengineering, customer-centric banking is always at the core of the bankers’ philosophy. For this purpose, banks have focused their efforts on the strengthening of centralised processing capabilities of middle and back offices and optimising organisational structures at different levels. Bankers have also listed the challenges they are facing, including roles and responsibilities, integration of management work, and cultivation of talent. Nearly 30% of the bankers view lack of effective performance measurement mechanisms as the primary barrier to achieving their goals.
**Information technology**

Stepping up IT construction and establishing proper IT governance structure are also key components in Chinese bankers’ initiatives to strengthen internal management and improve efficiency through better management. As the survey shows, there is now a greater consensus with regards to increases in IT investments among the bankers, as favored by 71.1% in comparison to 49.7% in 2010. Meanwhile, applications of new technologies such as mobile banking and internet banking and their potential risks are being considered by the bankers.

Reflected in the 2011 survey, the IT progress of small and medium commercial banks is remarkable. Despite the varying extent of implementation of IT initiatives and the difficulties facing them, including lack of IT talents and gaps in meeting some regulatory and industry standards, there is no denying that their senior executives are now fully aware of the importance of IT governance. It is their common practice to design and set up robust IT framework and IT governance structure by focusing on the needs of business development.

**Human resources**

Facing fierce market competition, improving HR management and building a solid talent base for bank development are critical factors Chinese banks need to consider in optimising their human resources. As the survey shows, in the coming 3 years from 2010, 84.9% of the bankers expect a nearly 3 percentage point increase in the number of their employees. Bankers have also shown increased focus to succession planning, performance measurement and incentives in their HR management. As the survey results show, branches are more attentive to succession planning, while the head offices are more concerned about their compensation structure. Related to improvement of performance measurement, how to effectively measure people’s comprehensive contributions and balance short-term and long-term incentives are key considerations. In the meantime, more banks are beginning to establish a multi-dimensional performance measurement system and endeavor to put in place more lasting HR mechanisms through innovative and additional incentives.

**The regulatory regime**

Since the beginning of 2011, the Chinese regulators have closely followed international developments in introducing a series of regulatory policies to meet macro regulation needs and control and improve financial stability. As part of the efforts in implementing the New Basel Capital Accord (hereinafter referred to as BASEL II) and BASEL III in China, the China Banking Regulatory Commission (CBRC) has clearly set forth the criteria for prudent and robust banking operations for Chinese banks in terms of capital adequacy, loan loss provisioning, liquidity and leverage ratio, and built a complete set of prudential regulation rules for sustaining the long-term stable and robust operation of banking system.

The bankers generally approve of the work of Chinese regulators, with special praises on the adaptation of the four major regulatory instruments to the Chinese market and the suitability and scope of applicability of these instruments. Also, they have shared objective observations on the potential positive effects of and any issues with these four instruments. In spite of the retrenchment policy and relevant regulatory measures since 2010 that have increased the overall operating pressure on the Chinese banking industry, the bankers generally approve of the regulatory policy and indicators. Favorable comments go mostly to “strict control of credit to energy-intensive, high-pollution, resource-based and overcapacity sectors”, “cleaning of improper bank-trust cooperative operations” and “whitelisting of borrowers for real estate developer loans”.

As to how to determine which banks are systemically important, 83.6% of the bankers cite size as the most important factor. In the eyes of the respondents, the candidates for systemically important banks in China are undisputedly large commercial banks including Industrial and Commercial Bank of China, Bank of China, China Construction Bank, Agricultural Bank of China and Bank of Communications.

**Bankers as a group**

The bankers are generally satisfied with the current working conditions, giving a rating of more than 3.7, with 5 being most satisfactory. Highest ratings go to working environment, scope of work and sense of achievement. The rating for compensation is low, while overall ratings are average for workload and intensity, social position and time spent on work.

For most bankers, public holidays do not necessarily mean rest and relaxation. 65.8% of the surveyed bankers spend their spare time on acquiring new knowledge and skills, 56.5% on working overtime, and nearly 50% on client relationship and business entertainment. This indicates the tremendous workload that Chinese bankers need to take on in order to meet the high demand for shareholder value, and survive and succeed in the heated market competition and complicated operating environment during the transformation period.

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