China Financial Stability Report 2015

Financial Stability Analysis Group of the People's Bank of China

China Financial Publishing House

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① This English edition is an unofficial translation of the *China Financial Stability Report 2015*, which was published in May 2015. In case of any discrepancies, the Chinese version shall govern.

Executive Summary

In 2014, recovery of the global economy was slow while the economic performance and monetary policies of major economies diverged significantly. In China, the economy entered into a state of new normal and growth remained stable; reform of the financial industry progressed steadily, with financial institutions strengthened, market innovation accelerated, and the building of financial infrastructure continued. Performance of the whole financial system was sound, and its capacity to serve the real sector has also enhanced.

The development of financial industry was sound. The balance sheet of the banking sector expanded further, as the sector increased credit input to the agricultural sector, rural area and farmers, to the small and micro enterprises and to the weak fields in the economy; The capital adequacy level continued to rise, provisioning remained stable in general, and the capacity of risk compensation and loss absorption was strong. The operations of securities and futures companies were sound and the sector has improved its innovation capacity; transformation of the regulation further deepened, and the institutional building for the market made steady progress; the two-way opening-up of the capital market continued. The asset size of the insurance sector continued to grow with insurance premium income increased rapidly; the investment yield of insurance fund was higher year on year; the efficiency and risk resilience of the insurance sector improved significantly.

The financial market was stable. Various reform and development measures were adopted. Trading was active, product innovation was deepened, and market institutional arrangements were improved. Steady progress was made in building a multi-layered capital market. Fluctuations of money market interest rates decreased, easing the pressure on the market. Bond market investors further diversified, and the growth of corporate debenture bond issuance accelerated. The stock indices rallied among fluctuations, and the volume of equity financing expanded. The trading volume increased on the futures market with the reopened government bond futures market functioning in a sound manner. Trading on the RMB interest rate derivatives market was increasingly active and more varieties of products were offered.

Progress was made in building financial infrastructures. The payment, clearing and settlement systems continued to improve, and the rural areas had a better payment environment. The law-making efforts continued for the financial system. A series of laws, regulations and judicial interpretation were promulgated that govern the financial industry. The efforts to formulate accounting standards continued and the accounting standard systems for the government sector and corporate sector were both improved. Improvement of the credit information industry continued and the building of a social credit system made new progress. The reform of anti-money laundering regulation was further deepened, with progress in both the institutional building and supervisory work.

With ongoing transformation of growth model and structural adjustments in China and the changing situation in the global economy and financial market, the financial system in China may face a multiple of internal and external shocks and pressures. On the international front, the world economy is in a period of profound rebalancing. Growth drivers remain weak, while the recovery and stance of monetary policies have further diverged among the major economies. The emerging market economies face the dual challenges of dealing with the changes in international financial environment and the decline in potential growth of the domestic economy. Due to large fluctuations in international capital flow, exchange rates of major currencies and commodity prices, shocks from the geo-political and other non-economic factors, the external environment became more complex and volatile for the emerging market economies. On the domestic front, the Chinese economy is changing gear, and contribution from the traditional growth engines is dwindling. The excess capacity is being removed while new industries are emerging. In the process of structural adjustments, problems concealed by rapid economic growth in the past have become acute, and some potential risks have gradually materialized. The indebtedness of the economy is on the rise. The non-performing loans of the banking sector continued to grow. The real estate market experienced some adjustments. The potential risks in local government borrowing, shadow banking and private financing business should be watched, and the cross-market risks in the innovative business of some financial institutions and emerging financial businesses are not to be neglected either.

In 2015, facing the complex domestic and international economic situation, it is necessary to implement the decisions adopted at the 18th CPC National Congress, the 3rd and 4th Plenary Sessions of the 18th CPC Central Committee, continue to follow the guiding principle of seeking progress while maintaining stability, adapt to the new normal state in economic development, attach more importance to transformation of growth model and structural adjustments, continue the pro-active fiscal policy and sound monetary policy, implement a monetary policy that is neither too tight nor too loose, and conduct fine-tuning and preemptive adjustments when necessary, in order to promote sound economic development. There will be vigorous efforts to promote reform and opening-up of the financial sector, deepen the comprehensive reform, and improve the institutional designs and the overall financial system. Measures will be taken to enhance risk monitoring and analysis in key areas, identify potential risks, and dissolve financial risks. The role of the Financial Regulatory Coordination Joint Ministerial Conference will be further tapped to strengthen coordination and implementation of financial policies. The financial environment will be improved, through stronger market discipline, implementation of the deposit insurance mechanism, and improvement of financial safety net. The bottom-line concept will be strengthened and comprehensive measures will be adopted to safeguard the bottom-line of allowing no systemic or regional risks to emerge.

Abbreviations and Acronyms

ASEAN+3	Association of Southeast Asian Nations plus China, Japan and South Korea
ABC	Agricultural Bank of China
ABS	Asset-backed Securities
ACCC	Australian Competition and Consumer Commission
ACS	Accounting Data Centralized System
APRA	Australian Prudential Regulation Authority
ASC	Australian Securities Commission
ASIC	Australian Securities and Investments Commission
BaFin	Federal Financial Supervisory Authority
BCBS	Basel Committee on Banking Supervision
BIS	Bank for International Settlements
BOC	Bank of China
BOCOM	Bank of Communications
BOJ	Bank of Japan
BOK	Bank of Korea
BOP	Balance of Payments
BRRD	Bank Recovery and Resolution Directive
CABD	County Area Banking Division
CCB	China Construction Bank
CD	Certificate of Deposit
CFPB	Consumer Financial Protection Bureau
CFSTC	China Financial Standardization Technical Committee
CFTC	Commodity Futures Trading Commission
China Clear	China Securities Depository and Clearing Co., Ltd.
CIPS	Cross-border Inter-bank Payment System
CIRC	China Insurance Regulatory Committee
CMG	Crisis Management Group
COAG	Cross-boarder Cooperation Agreement
CPC	Communist Party of China

CPI	Consumer Price Index
CPMI	Committee on Payments and Market Infrastructures
CRA	Credit Rating Agency
CRD	Capital Requirements Directives
C-ROSS	China Risk Oriented Solvency System
CSDC	China Securities Depository and Clearing Co.,Ltd.
CSI	China Securities Index
CSRC	China Securities Regulatory Commission
DTI	Debt-to-Income
EBA	European Banking Authority
ECB	European Central Bank
ECL	Expected Credit Loss
EIOPA	European Insurance and Occupational Pensions Authority
EMEAP	Executives' Meeting of East Asia-Pacific Central Banks
ESMA	European Securities and Markets Authority
ESRB	European Systemic Risk Board
ETF	Exchange-Traded Fund
EU	European Union
EUR	Euro
FCA	Financial Conduct Authority
FDIC	Federal Deposit Insurance Corporation
Fed	Federal Reserve Board
FIO	Federal Insurance Office
FMI	Financial Market Infrastructure
FMSA	Financial Market Stabilization Agency
FPC	Financial Policy Committee
FRAB	Financial Regulator Assessment Board
FRB	Federal Reserve Board
FSA	Financial Service Authority
FSAP	Financial Sector Assessment Program
FSB	Financial Stability Board
FSC	Financial Services Commission
FSOC	Financial Stability Oversight Council
FSS	Financial Supervisory Service
GBP	Great Britain Pound
GDP	Gross Domestic Product

GEB	Growth Enterprise Board
GLEIF	Global LEI Foundation
G-SIB	Global Systemically Important Bank
G-SIFI	Global Systemically Important Financial Institution
G-SII	Global Systemically Important Insurer
HICP	Harmonized Index of Consumer Prices
HKEx	the Hong Kong Exchanges and Clearing Limited
HKSCC	Hong Kong Securities Clearing Company Limited
HLA	Higher Loss Absorbency
IADI	International Association of Deposit Insurers
IAIS	International Association of Insurance Supervisors
IASB	International Accounting Standards Board
ICBC	Industrial and Commercial Bank of China
ICS	Insurance Capital Standard
IFRS	International Financial Reporting Standards
IMF	International Monetary Fund
IMRO	Investment Management Regulatory Organization
IOSCO	International Organization of Securities Commissions
IPO	Initial Public Offering
ISC	Insurance and Superannuation Commission
ISO	International Organization for Standardization
JGB	Japanese government bond
JPY	Japanese Yen
JSCB	Joint-Stock Commercial Bank
KDIC	Korea Deposit Insurance Corporation
KoFIU	Korea Financial Intelligence Unit
LCB	Large Commercial Bank
LCR	Liquidity Coverage Ratio
LEI	Legal Entity Identifier
LGD	Loss given default
LHS	Left-hand Side
LOU	Local Operating Unit
LTD	Loan-to-Deposit
LTI	Loan-to-Income
LTV	Loan-to-Value
M&A	Mergers and Acquisitions

MCB	Medium Commercial Bank
MLF	Medium-term Lending Facility
MMF	Money Market Fund
MOFE	Ministry of Finance and Economy
MOU	Memorandum of Understanding
NAV	Net Asset Value
NBNI	Non-bank Non-insurer
NBS	National Bureau of Statistics
NCUA	National Credit Union Administration
NDRC	National Development and Reform Commission
NPC	the National People's Congress
NPL	Non-performing Loan
NSFR	Net Stable Funding Ratio
OCC	Office of the Comptroller of the Currency
OMO	Open Market Operations
OPEC	Organization of the Petroleum Exporting Countries
OTC	Over the Counter
OTS	Office of Thrift Supervision
PBC	People's Bank of China
PFMI	Principles for Financial Market Infrastructure
PIA	Personal Investment Authority
PMI	Purchasing Managers Index
PPI	Producer Price Index
PPIRM	Purchasing Price Index of Raw Material
PRA	Prudential Regulation Authority
PSBC	Postal Savings Bank of China
PSL	Pledged Supplementary Lending
QE	Quantitative easing
QFII	Qualified Foreign Institutional Investors
QQE	Quantitative and qualitative easing
RAP	Resolvability Assessment Program
RBA	Reserve Bank of Australia
RCAP	Regulatory Consistency Assessment Programme
REER	Real Effective Exchange Rate
REIT	Real Estate Investment Trust
RHS	Right-hand Side

RMB	Renminbi
ROC	Regulatory Oversight Committee
RQFII	RMB Qualified Financial Institutional Investors
RRP	Recovery and Resolution Plan
RWA	Risk-weighted Asset
SCB	Small Commercial Bank
SEACEN	South East Asian Central Banks
SEC	Securities and Exchange Commission
SFA	Securities and Futures Authority of UK
SFC	Securities and Futures Commission
Shibor	Shanghai Interbank Offered Rate
SIFI	Systemically Important Financial Institution
SIFMUs	Systemically Important Financial Market Utilities
SLF	Standing Lending Facility
SLO	Short-term Liquidity Operation
SME	Small and Medium-sized Enterprise
SOE	State Owned Enterprise
SoFFin	Special Financial Market Stabilization Funds
Solvency I	China's first-generation solvency regulation system
SPHC	Steel Plate Heat Commercial
SRB	Single Resolution Board
SSB	Standard-Setting Body
SSE	Shanghai Stock Exchange
TLTRO	Targeted long-term refinancing operation
TR	Trade Repository
UK	United Kingdom
US	United States
USD	US Dollar
XBRL	Extensible Business Reporting Language
y-o-y	Year-on-year

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Boxes

Chapter Ⅰ

International Economic and Financial Environment

In 2014, the world economy was still in the process of profound adjustment, with a slow recovery and insufficient impetus. Economic performance and monetary policies in major economies diverged significantly, and the international financial markets experienced great fluctuation, with major currencies depreciating against the U.S. dollar and commodity prices generally declining. Non-economic disturbing factors including geopolitical risks also increased. Looking forward to the year 2015, it will be essential for all economies to maintain a sound economic growth by stimulating potential growth by means of structural reforms against the backdrop of weak inflation.

I. Economic Developments in Major Economies

In 2014, the world economy continued to undergo a slow recovery. Growth in major advanced economies was stronger compared with the previous year, but emerging market economies slowed down, although still faster than advanced economies. Growth momentum in the U.S. continued, and the exit from the asset purchase program by the Federal Reserve was engineered steadily. The economy in the euro area recovered tepidly, accompanied by great deflation pressure. Although Japan waged a powerful rebound before the consumption tax hike, its growth slowed down dramatically afterwards, and Japan still faced long-run challenges. Growth in emerging market economies slowed down as a whole, and weakness further emerged.

The U.S. recovery was gaining ground. Except for a temporary contraction in the first quarter, the U.S. economy continued to recover steadily since the second quarter, driven by multiple factors including strong growth of business investments, continuous improvement of the real estate market and increase of consumption and exports. GDP growth recorded 2.4 percent for the entire year, the highest for the past four years. A prolonged period of accommodative monetary policies and slowdown of fiscal consolidation helped to strengthen recovery, and the exit from the asset purchase program did not affect economic growth much, due to its good timing. The labor market improved further, with an average monthly increase of 208,000 new jobs. The unemployment rate kept declining, dropping from 6.7 percent at the end of 2013 to 5.6 percent at the end of 2014, the lowest level since June 2008. Inflation remained low throughout the year except the 2 percent level in the second quarter, and CPI registered only 0.8 percent in December. The PMI compiled by the Institute for Supply Management (ISM) was above the threshold of 50 throughout the year. In addition, the trade deficit increased a little to USD 505 billion, a y-o-y growth of 6 percent.

The economy in **the euro area** recovered tepidly, accompanied by great deflation pressure. In 2014, the euro area GDP growth rate posted 0.9 percent y-o-y, recording 0.3 percent, 0.1 percent, 0.2 percent and 0.3 percent for each quarter respectively. But the growth slowed down again since the second quarter, and investments were still weak. Although the ECB launched a range of accommodative monetary policies in June and then announced the new asset purchase plan in September, these measures did not fundamentally speed up economic recovery. The unemployment rate was still elevated above 11.4 percent, though declining slightly compared to 2013. Meanwhile, the price level in the euro area remained low throughout the year, and in December, the HICP dropped by 0.2 percent y-o-y, among which energy price dropped by 6.3 percent. HICP excluding energy and food grew by 0.7 percent y-o-y, lower than expected, which indicated increasing deflation risks.

Growth in **Japan** declined dramatically, with the real GDP growth rate of 0.0 percent for the whole year. Annualized quarterly rate rebounded to 5.1 percent in the first quarter due to sharp consumption growth, and dropped significantly to -6.4 percent, -2.6 percent and 1.5 percent respectively for the following three quarters, affected by factors including consumption tax hike, domestic demand contraction and weak investments. The y-o-y core CPI jumped to 3.2 percent on the consumption tax hike, and continued declining after May. The labor market was stable and improving, with unemployment rate in December dropping to 3.4 percent from the 3.7 percent of last December. Affected by yen depreciation, import increase stimulated by massive consumption, and manufacturing bases moved overseas, the trade deficit recorded JPY 12.78 trillion in 2014, a new historic high since 1979 when comparable record began.

Growth in **emerging market economies** as a whole further slowed down, with some economies experiencing financial market turmoil. According to IMF statistics, growth of major emerging market and developing economies registered 4.6 percent in 2014, down 0.4 percentage point y-o-y. Growth dynamics diverged in different countries. In particular, GDP growth of India was up 0.3 percentage point from the previous year, while growth of Russia, Brazil and South Africa were down 0.7, 2.6 and 0.7 percentage points respectively. Some emerging market economies were confronted with capital outflow risks because of the normalization of the U.S. monetary policies, increase in geopolitical risks, slump in international oil prices and emergence of structural problems. Countries that rely heavily on commodity exports such as Russia and Brazil were most affected, with a deteriorating balance of international payments, a drawdown of foreign exchange reserves, and grave fiscal and debt conditions. In general, vulnerabilities in emerging market economies increased further.

Table 1.1 Macro-economic and Financial Indices in Major Advanced Economies

Country	Index	2014 Q1			2014 Q2			2014 Q3			2014 Q4		
		Jan.	Feb.	Mar.	Apr.	May	Jun.	Jul.	Aug.	Sep.	Oct.	Nov.	Dec.
United States	Real GDP Growth Rate (annualized quarterly rate, %)	-2.1			4.6			5.0			2.2		
	Unemployment Rate (%)	6.6	6.7	6.6	6.2	6.3	6.1	6.2	6.1	5.9	5.7	5.8	5.6
	CPI (y-o-y, %)	1.6	1.1	1.5	2.0	2.1	2.1	2.0	1.7	1.7	1.7	1.3	0.8
	DJ Industrial Average (closing number)	15 699	16 322	16 458	16 581	16 717	16 852	16 563	17 098	17 043	17 391	17 828	17 823
Euro Area	Real GDP Growth Rate (annualized quarterly rate, %)	0.3			0.1			0.2			0.3		
	Unemployment Rate (%)	11.9	11.8	11.7	11.7	11.6	11.6	11.6	11.6	11.6	11.5	11.5	11.4
	HICP (y-o-y, %)	0.8	0.7	0.5	0.7	0.5	0.5	0.4	0.4	0.3	0.4	0.3	-0.2
	EURO STOXX 50 (closing number)	2 853	2 968	2 916	2 978	3 033	3 228	3 115	3 044	3 067	2 998	3 076	2 990
Japan	Real GDP Growth Rate (annualized quarterly rate, %)	5.1			-6.4			-2.6			1.5		
	Unemployment Rate (%)	3.7	3.6	3.6	3.6	3.5	3.7	3.8	3.5	3.6	3.5	3.5	3.4
	Core CPI (y-o-y, %)	1.3	1.3	1.3	3.2	3.4	3.3	3.3	3.1	3.0	2.9	2.7	2.5
	NIKKEI225 (closing number)	14 915	14 841	14 828	14 304	14 632	15 162	15 621	15 425	16 174	16 414	17 460	17 451

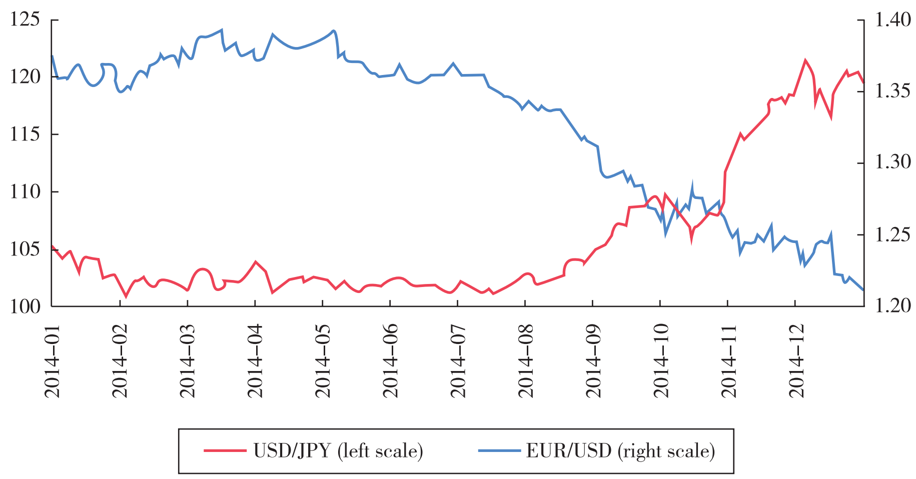
Source: Statistical Bureaus and Central Banks of the Relevant Economies.

II. International Financial Market Performance

In 2014, affected by the weaker-than-expected world recovery, monetary policy divergence in major economies and geopolitical risks, the international financial markets fluctuated dramatically. In particular, major currencies depreciated sharply against the U.S. dollar, Government bond yields lowered in most economies, and stock indices in major advanced economies fluctuated and rose. Financial markets in some emerging market economies fluctuated more wildly. The commodity prices declined, with a slump in international oil prices.

Most currencies depreciated against the U.S. dollar. As of end-2014, the exchange rate of the USD/EUR closed at 1.2097 dollar per euro, a depreciation of 11.99 percent from end-2013, and the exchange rate of the JPY/USD closed at 119.68 yen per dollar, a depreciation of 12.02 percent from end-2013. Meanwhile, most of the emerging market currencies depreciated sharply against the U.S. dollar. The Russian ruble, Argentina peso, Kazakhstani Tenge, Chilean peso, Mexican peso and Brazilian real depreciated by more than 10 percent against the U.S. dollar, being 43.34 percent, 23.69 percent, 15.57 percent, 13.37 percent, 11.61 percent and 11.11 percent respectively. The strong recovery momentum of the U.S. economy and its orderly exit from the QE monetary policies contributed to the dollar appreciation.

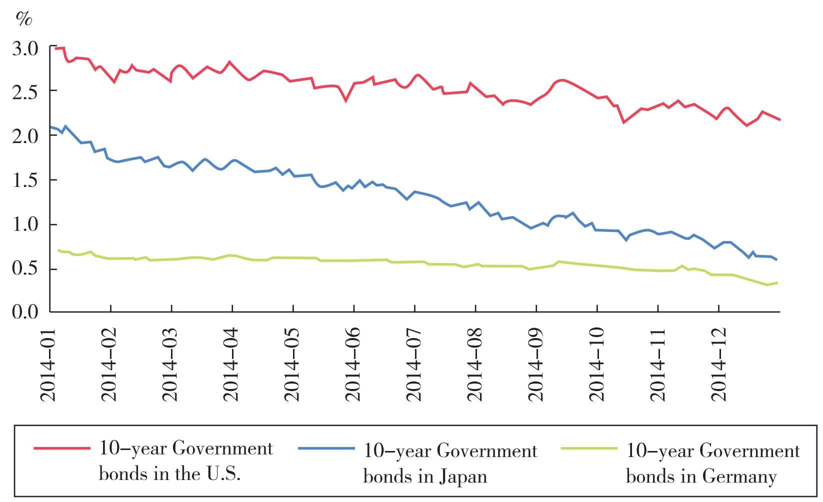
Figure 1.1 Exchange Rate Movements of Major Currencies



Source: Reuters.

Government bond yields in the U.S., Europe, Japan and some emerging market economies fell, while yields in Russia rose considerably. Since August 2014, the long-term Government bond yields in advanced economies including the U.S., Europe and Japan successively dropped to new lows of the year, and some European countries hit record lows of one hundred years. At end-2014, 10-year Treasury bond yields in the U.S., Germany and Japan closed at 2.170 percent, 0.600 percent and 0.325 percent respectively, down 87, 151 and 41 basis points compared with end-2013. Ten-year Government bond yields in some emerging market economies also declined, with Turkey, Vietnam, Thailand, India and Brazil being the most, down 218, 180, 120, 97 and 79 basis points respectively compared with end-2013. But affected by such factors as sharp depreciation of ruble, 10-year Government bond yields in Russia rose considerably by 511 basis points compared with the previous year.

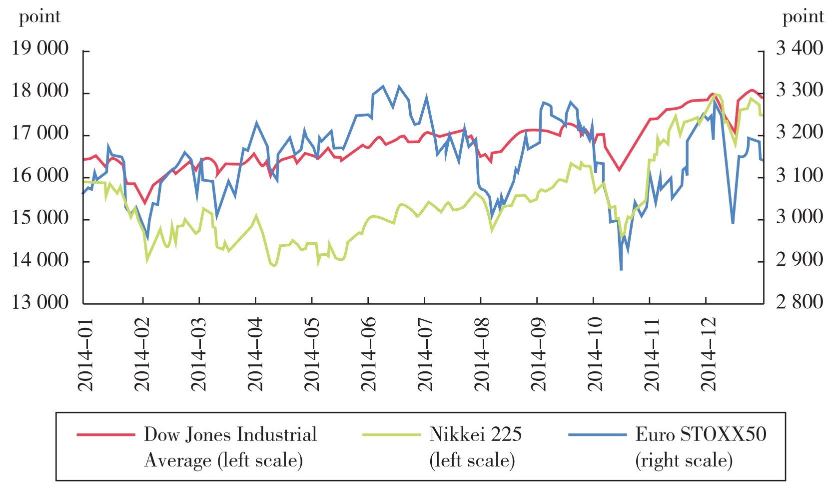
Figure 1.2 Yields of Government Bonds in Major Economies



Source: Reuters.

Stock indices in major advanced economies fluctuated and rose, but they fluctuated wildly in most of the emerging market economies. At end-2014, the Dow Jones Industrial Average Index, STOXX50 Index and Nikkei 225 Index closed at 17823.07, 2990.30 and 17450.77 points respectively, up 7.5 percent, 2.4 percent, and 7.1 percent from the end of the last year. On the other hand, stock markets in some emerging market economies, such as Indonesia and India, experienced several fluctuations during the year, and rose overall. Affected by the crisis in Ukraine and economic downturn, the stock index in Russia went down significantly, down 45.2 percent throughout the year.

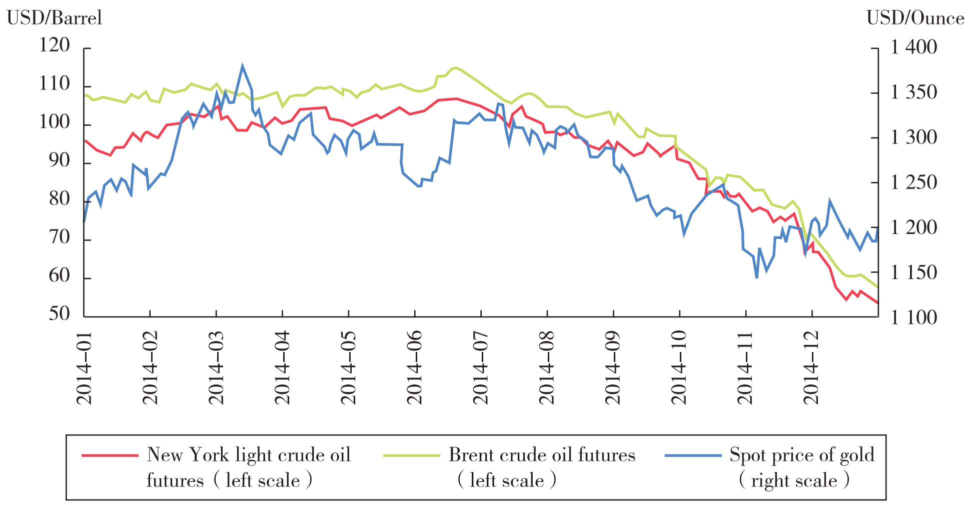
Figure 1.3 Major Stock Indices



Source: Reuters.

The international gold price fluctuated over a wide range, and crude oil price declined dramatically. As of the end of the year, the U.S. Commodity Research Bureau Spot Index, which comprises of most commodities on the international markets, closed at 437.75, a y-o-y decrease of 18.61. Meanwhile, the gold price first rose and then pulled back, and maintained a declining tendency overall. The highest gold price during the year was USD 1385.0 per ounce, and the lowest USD 1142.0 per ounce. The gold price closed at USD 1199.25 per ounce by the year-end, falling by USD 2.25 per ounce compared with the last year. Since June 2014, affected by such factors as shale gas revolution enhancing crude oil production of the North America, world economic growth slowing down and the OPEC refusing to cut output, international crude oil price declined dramatically. As of the end of 2014, the New York light crude oil futures and London Brent crude oil futures closed at USD 53 and USD 57 per barrel respectively, falling by 44.2 percent and 46.8 percent y-o-y.

Figure 1.4 Price Indices of Gold and Crude Oil on the International Markets



Source: Reuters.

Money market rates fluctuated at a subdued level. Due to the QE tapering by the Federal Reserve, the USD Libor in the London Inter-bank Market rose appreciably. At the end of 2014, the 1-year dollar Libor posted 0.6288 percent, an increase of 4.58 basis points from the previous year. As a result of the further easing monetary policies by the ECB, the Euribor declined remarkably. At the end of 2014, the 1-year Euribor registered 0.325 percent, a decrease of 23.1 basis points from the previous year.

III. Monetary Policies of Major Economies

In 2014, monetary policies diverged increasingly across major and some emerging market economies. Monetary policies in the U.S. began to normalize. Euro area and Japan reinforced their QE policies. Monetary policies became asynchronous across emerging market economies due to their different economic conditions.

The Federal Reserve ended the program of asset purchases. Due to the strong recovery of the U.S., the Federal Reserve tapered the scale of asset purchases since January 2014, and finally ended the program of asset purchases in October 2014. Meanwhile, the federal funds rate was kept at the target range of 0-0.25 percent. The Federal Reserve adjusted the forward guidance and abandoned the expression of *maintaining the current target range for the federal funds rate for a considerable time, but still emphasized that it can be patient in beginning to normalize the stance of monetary policy.*

The ECB reinforced its accommodative monetary policy. A persistent undershooting of the inflation target in euro area led the ECB to lower its key interest rates in June and September 2014. To be specific, the ECB lowered the main refinancing operations rate to 0.05 percent, marginal lending facility rate to 0.30 percent, and deposit facility rate to -0.20 percent. Meanwhile, the ECB started TLTROs in September and began outright purchases of covered bonds and asset-backed securities in the fourth quarter. What's more, in order to achieve the goal of price stability, the ECB announced to expand the asset purchase program to bonds issued by euro area governments, institutions and enterprises, which could reach the size of EUR 60 billion and last until September 2016.

The Bank of England maintained its easing monetary policies. In 2014, the Bank of England kept the benchmark interest rate unchanged at 0.5 percent, and maintained the size of its asset purchases of GBP 375 billion.

The Bank of Japan announced additional easing monetary policies. On February 18, the Bank of Japan decided to expand the Loan Support Program, where financial institutions conducting credit support to growing industries could borrow funds from the Bank of Japan at a low interest rate. Specifically, the application period for the program which was due to expire in March was expanded by one year and the Bank's fund-provisioning under the main rules will be increased to JPY 7 trillion. The Bank of Japan reinforced the QQE in October, announcing that the monetary base would increase at an annual pace of about JPY 80 trillion from the former pace of JPY 60-70 trillion, the amount outstanding of JGBs with average remaining maturity of 7-10 years would increase at an annual pace of about 80 trillion yen from the previous pace of 50 trillion yen, and the purchase amount of ETFs and J-REITs would be significantly expanded.

Monetary policies in emerging market economies diverged and it was hard to make policies. On the one hand, part of these economies tightened their monetary policies to address the pressure from inflation, currency depreciation and capital outflow. To combat inflation, the Central Bank of Brazil raised the benchmark interest rate for 5 times by 175 basis points to 11.75 percent, the Central Bank of Argentina raised its policy rate for 2 times by 930 basis points to 28.8 percent, and the South African Reserve Bank raised its benchmark rate for 2 times by 75 basis points to 5.75 percent. To deal with significant exchange depreciation, the Central Bank of the Russian Federation raised its benchmark rate for 6 times by 1150 basis points to 17 percent, and National Bank of Ukraine raised its benchmark rate for 2 times by 450 basis points to 14 percent. Meanwhile, some economies like Brazil and Russia implemented the foreign exchange market intervention to stabilize their exchange rates. On the other hand, more emerging market economies eased their monetary policies to support economic growth. The Central Bank of Hungary lowered its benchmark rate for 7 times by 90 basis points to 2.1 percent, the Central Bank of the Republic of Turkey lowered its benchmark rate for 3 times by 175 basis points to 8.25 percent, the Central Bank of Chile lowered its benchmark rate for 6 times by 150 basis point to 3 percent, the Bank of Korea lowered its benchmark rate for 2 times by 50 basis points to 2 percent, and the Bank of Mexico lowered its benchmark rate in June by 50 basis points to 3 percent.

IV. Risks and Challenges

In the process that world economy recovered slowly and global financial system adjusted soundly, each economy faced different risks and challenges. Advanced economies continued an uneven recovery, while emerging market economies might suffer from both the change of global financial environment and the slowdown of potential growth rates of themselves. Besides, world economy might also be influenced by the uncertainty of oil prices and geopolitical tensions.

The world economy faces the challenge that the policy rate of the U.S. may rise. The global financial conditions may tighten and emerging market economies may be faced with the sudden reversal of capital flows if the Federal Reserve raises its policy rate earlier than expected. In fact, the recent appreciation of the U.S. dollar and the depreciation of currencies of some emerging market economies have implicated the uneven recovery of major economies and their divergent monetary policies.

Sizable uncertainty about the oil price path in the future has added a new risk dimension to the global growth outlook. On one hand, the sharp fall in oil prices resulted in low inflation and the euro area and Japan suffered more from deflation risks. On the other hand, the balance sheet vulnerabilities of oil exporters have increased. Energy-driven emerging market economies like Russia, Malaysia and Mexico experience a high relativity between economic growth and oil prices, and thereafter the sustaining decrease of oil prices will slow down the growth of these economies, among which the financial conditions in Russia have deteriorated significantly. What’s more, oil prices could also have overshot on the downside and could rebound earlier or more than expected if the supply response to lower prices is stronger than forecast, which might weaken the support to growth of some economies.

The euro area is confronted with the threat from persistent declining inflation and low growth potential. Even with the ECB holding short-term interest rates near zero floor for a long period, the real cost of borrowing in real economy could still be substantially high in the low inflation conditions accompanied by high saving rate and demand for safe assets. Meanwhile, low growth would depress tax revenues and raise budget deficits, which would worsen concerns about sovereign solvency. The QE policies of the ECB still remains to be validated and might push up asset prices. Moreover, there are risks of vicious depreciation of currencies worldwide.

Emerging market economies might encounter with several policy risks. Monetary policies will still diverge across major economies, which indicates that global capital might redistribute more broadly and extensively, and the fluctuation of exchange rates and global capital flows could increase. As a result, emerging market economies need to adjust their monetary policies to fit for the more complicated financial environment. Meanwhile, the exports of emerging market economies may be influenced by the recovery pace of advanced economies, which in adverse makes it necessary for emerging market economies to implement structural reforms to raise their growth potential.

V. Outlook

In 2015, the world economy will still maintain a relatively slow pace of recovery. According to the estimate by IMF, global growth rate is projected to be 3.5 percent and 3.7 percent for 2015 and 2016. The mark down of medium-term growth expectation of most advanced and emerging market economies and weak investments will affect the global growth negatively, while the low oil prices will be a positive factor. It is essential for the sound development of the world economy whether advanced and emerging market economies could increase potential growth through structural reforms in the low inflation conditions.

In the U.S., the growth is expected to remain at a high speed. According to the estimate by IMF, the growth rate of the U.S. is projected to rise to 3.3 percent in 2015 from 2.4 percent in 2014. But there are still several downside risks, such as persistent undershoot of target inflation rates, the deterioration of external economic environment, and the decrease of exports due to appreciation of the U.S. dollar. But there are a number of supporting factors that may offset the downside risks notwithstanding. The strong improvement of employment and private sector's confidence indicate that the U.S. economy may grow more rapid than expected. The accompanied macro-prudential policies can also help domestic markets to adjust to the gradually tightened financial conditions.

The euro area is expected to continue to recover modestly. According to the estimate by IMF, the growth rate of the euro area is projected to rise to 1.2 percent. But it may be a negative factor for the recovery to some extent that consumers are suspicious of the de-anchored inflation back to the 2 percent target in the medium-term. In order to promote growth and improve market confidence, the euro area may adopt a series of further measures. First, monetary accommodation needs to be maintained, and fiscal policies need to be flexible in the short-term complemented with concrete medium-term consolidation plans. Second, fiscal budget should be more effective to stimulate investments. Third, structural reforms should be implemented. Forth, the euro area should make more use of the Single Supervisory Mechanism and establish the Banking Union expeditiously.

Japan is anticipated to struggle to recover in 2015. According to the estimate by IMF, the growth rate of Japan is projected to be 0.6 percent. Although a potential drag on growth in short term, fiscal consolidation measures will eventually be a necessary step towards healthy growth and restoring fiscal sustainability. To make a better balance between the growth stimulation and fiscal consolidation, Japan may implement more easing monetary policies to promote economic growth. Exposure of the Japanese banking sector to sovereign debts still remains a concern, and strengthening capital standards for regional banks and funding sources of major banks could mitigate some of these concerns.

The growth of **emerging market economies** may slow down further. According to the estimate by IMF, the growth rate is projected to be 4.3 percent in 2015, lower than previous years. In order to mitigate the economic fragility and promote growth, emerging market economies could take the following measures into consideration, such as moving on to implement structural reforms, maintaining the flexibility of exchange rate policies, conducting fiscal consolidation, enhancing the supervision of financial sector and applying macro-prudential policies, etc. Moreover, countries overly depending on foreign debts should raise the domestic saving rate to mitigate the risks from external financing.

Chapter II

China's Economic and Financial Performance

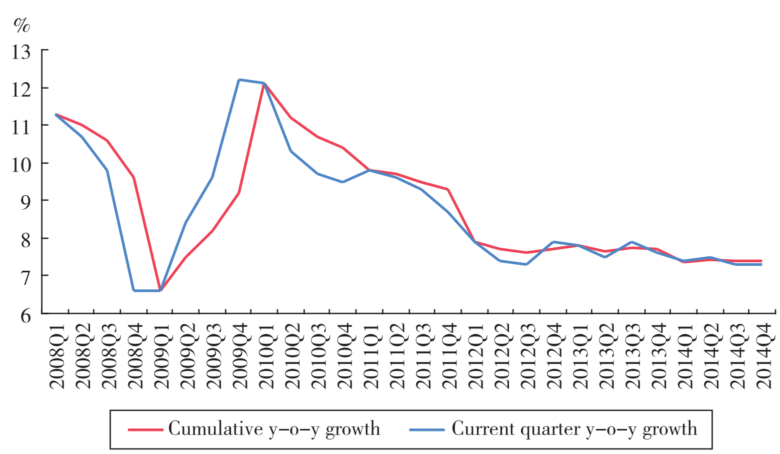
In 2014, facing a complex international environment and an arduous task to develop and reform the domestic economy, the Chinese government struck a balance among preserving stable economic growth, promoting reform, adjusting economic structure, improving people's living standards, and preventing risks. Continued efforts were made to implement an active fiscal policy and a sound monetary policy, while the market dynamism was released on an on-going basis. New growth drivers were taking shape, and the national economy performed in a steady manner under the new normal.

I. Macroeconomic Performance

1. Economic growth was generally stable and industrial structure continued to improve

According to preliminary statistics of the National Bureau of Statistics (NBS), nominal GDP in 2014 posted 63.7 trillion yuan, up 7.4% y-o-y, and a small decline of 0.3 percentage point from the previous year. GDP growth in the four quarters registered 7.4%, 7.5%, 7.3%, and 7.3% respectively (Figure 2.1), showing a stable trend. Broken down by industry, value added of the primary industry, the second industry and the tertiary industry totaled 5.8, 27.1 and 30.7 trillion yuan respectively, up 4.1%, 7.3% and 8.1% respectively y-o-y. In terms of share of added value of the three industries in the GDP, added value of the primary industry accounted for 9.2% of the GDP, down by 0.8 percentage point; that of the secondary industry took up 42.6% of the GDP, representing a drop of 1.3 percentage points; and that of the tertiary industry accounted for 48.2% of the GDP, up 2.1 percentage points, and 5.6 percentage points higher than the share of the secondary industry. After the share of the tertiary industry exceeded that of the secondary industry for the first time in 2013, the shift of the economy from industry-driven to service-driven gathered pace in 2014.

Figure 2.1 China's Economic Growth

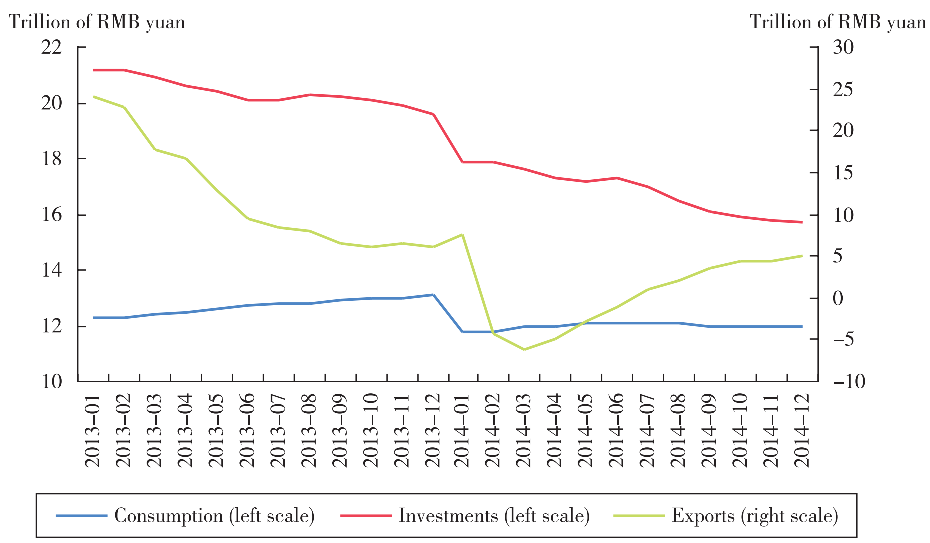


Source: The NBS.

2. Domestic demand slowed down, and BOP achieved basic equilibrium

In 2014, investments in fixed assets totaled 51.3 trillion yuan, up 15.3% y-o-y, which was a decline of 4.0 percentage points from the previous year. Retail sales of consumer goods registered 26.2 trillion yuan, up 12.0% y-o-y, a decline of 1.1 percentage points from the previous year. Total imports and exports posted 26.4 trillion yuan and increased by 2.3% y-o-y. Among this total, exports rose by 4.9% to 14.4 trillion yuan, and imports declined by 0.6 percent to 12.0 trillion yuan. The trade surplus grew by 45.6% y-o-y to 2.3 trillion yuan. The structure of the domestic demand continued to improve, with final consumption expenditure contributing 51.2% to the GDP growth, 3.0 percentage points higher than that in the previous year.

Figure 2.2 Growth of Consumption, Investments and Exports



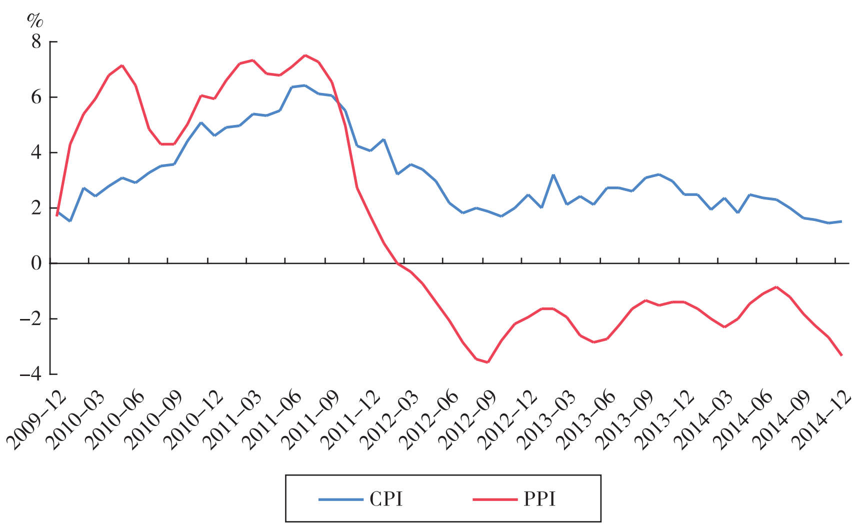
Source: The NBS.

The balance of payments (BOP) achieved basic equilibrium. In 2014, the overall BOP surplus registered USD 257.9 billion, representing a decrease of 48% y-o-y. Among this total, the current account surplus grew by 48% y-o-y to USD 219.7 billion, accounting for 2.1% of the GDP, 0.5 percentage point higher than that in the previous year, and within the range deemed as sustainable according to international standards. The balance of the capital and financial account posted USD 94 billion surplus in the first quarter, but turned into deficit starting from the second quarter, and the deficit accumulated to USD 55.7 billion in the last three quarters. The surplus of the capital and financial account as a result reached USD 38.2 billion, down by 89% y-o-y. The stock of international reserves grew USD 117.8 billion, representing a deceleration of USD 313.6 billion y-o-y, among which the foreign exchange reserves grew USD 118.8 billion, a deceleration of USD 313.9 billion y-o-y.

3. The price level remained stable, and its growth decelerated

In 2014, the CPI continued to drop, and the annual CPI was up 2.0 percent y-o-y, representing a deceleration of 0.6 percentage point from the previous year (Figure 2.3). In the four quarters, the CPI growth posted 2.3%, 2.2%, 2.0% and 1.5% respectively. Broken down into food and non-food items, food prices rose by 3.1%, a deceleration of 1.6 percentage points from the last year, and prices of non-food terms rose 1.4%, a drop of 0.2 percentage point from 2013. In terms of consumer goods and services, the prices of consumer goods and services grew 1.8% and 2.5% respectively y-o-y, representing deceleration of 0.7 and 0.4 percentage point from the previous year. As of December 2014, the Producer Price Index (PPI) registered a negative growth for 34 consecutive months, and fell by 1.9% y-o-y for the whole year in 2014, at a par with that in 2013. In particular, the prices of production materials dropped by 2.5% y-o-y, while those of consumer products remained unchanged. The Purchasing Price Index of Raw Material (PPIRM) declined by 2.2% y-o-y, 0.2 percentage point faster than that in the previous year.

Figure 2.3　Monthly movements of the major price indices, y-o-y



Source: The NBS.

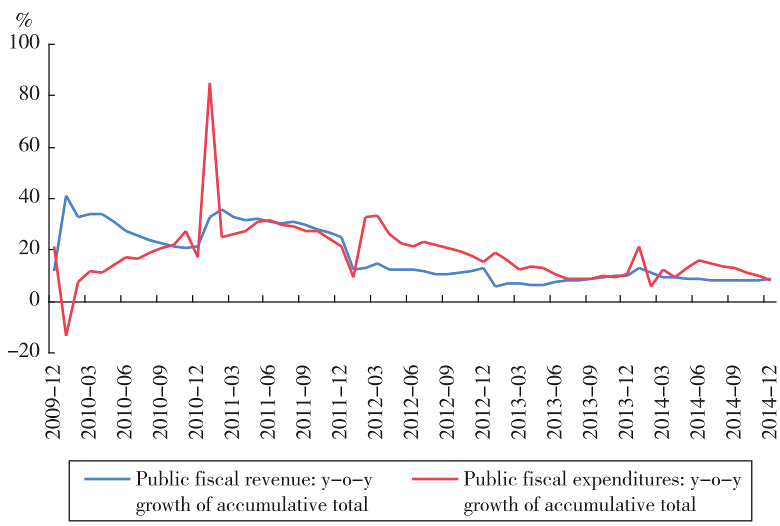
4. Fiscal revenue and expenditures were basically balanced, and management of local government debts was standardized

In 2014 fiscal revenue posted 14.0 trillion yuan, up 8.6% y-o-y, representing a deceleration of 1.6 percentage points from the last year (Figure 2.4). Among this total, fiscal revenue of the central government posted 6.5 trillion yuan, accounting for 45.9% of the total revenue and representing a y-o-y growth of 7.1%; fiscal revenue of local governments posted 7.6 trillion yuan, representing a y-o-y growth of 9.9%. In terms of the structure of fiscal revenue, tax revenue registered 11.9 trillion yuan, accounting for 84.9% of the total, and up 7.8% y-o-y; non-tax revenue registered 2.1 trillion yuan, up 13.5% y-o-y.

Fiscal expenditures were put under effective control. In 2014 fiscal expenditures reached 15.2 trillion yuan, an increase of 1.2 trillion yuan or 8.2% y-o-y, a deceleration of 2.7 percentage points from the previous year. Among this total, fiscal expenditures of central government grew by 10.2% to 2.3 trillion yuan, and fiscal expenditures of local governments grew by 7.8% y-o-y to12.9 trillion yuan. Fiscal deficit posted 1.35 trillion yuan, accounting for 2.1% of the GDP, lower than the internationally recognized alarm level of 3%.

On August 31, 2014, the Standing Committee of the National People's Congress passed the amendment to the *Budget Law*, which, in line with the reform principles of "open the front door, block the back door, and build up the fence", allows local governments to incur debts, and sets out restrictive provisions on five aspects including the borrower, use and scale of the debts, how the debt is borrowed, and risk prevention. On September 21, the State Council issued the *Opinions on Strengthening Management of Local Government Debts*, which, focusing on building a standardized local government borrowing and financing mechanism, puts size control and budget management on local government debts, clarifies the demarcation between government debts and corporate debts, and explicitly stipulates that local governments should pay for their debts whereas the central government should not bail them out. Through these provisions, the issues concerning how to borrow, govern and repay local government debts are addressed.

Figure 2.4 Growth of fiscal revenue and expenditures



Source: The NBS.

5. Growth of profits of industrial enterprises decelerated, and earnings diverged

The growth of main business revenue and profits of industrial enterprises decelerated. In 2014 revenue of main business of statistically large enterprises increased by 7.0% y-o-y[①] to 109.5 trillion yuan, down by 4.2 percentage points from the last year. Realized profits totaled 6.5 trillion yuan, up 3.3% y-o-y, representing a deceleration of 9.9 percentage points from the last year. The profit margin of main business posted 5.9 percent, a decline of 0.2 percentage point y-o-y. Among the 41 industrial categories, 28 earned more profits than in the previous year, 2 made profits comparable to those in the previous year, and 11 witnessed declines in gross profits. In particular, gross profits in the electricity and heat production and supply industry, the automobile manufacturing industry, and telecommunications and other electronic equipment industry grew rapidly, by 19.1%, 18.1%, and 17.1% respectively. Gross profits in the coal mining, washing and dressing industry, the ferrous metal mining industry, and the oil and natural gas exploration industry registered relatively sharp slowdown, by 46.2%, 23.9%, and 13.7% respectively.

Box 1 Operations of the surveyed 5,000 industrial enterprises in 2014

In 2014, according to the PBC Survey of 5,000 Industrial Enterprises (hereinafter referred to as 5,000 enterprises), business operations faced with headwinds and suffered from slowdown in profit growth, but the enterprises remained profitable and their debt burden decreased slightly.

Both the growth of main business revenue and the growth of profits decelerated. In 2014, revenue of main business of the 5,000 enterprises increased by 2.6% y-o-y, a deceleration of 2.2 percentage points from the previous year[②]. Nominal gross industrial output grew by

① As the coverage of statistically large industrial enterprises changes every year, in order to make the 2014 data comparable with that in the previous year, the coverage in 2013 used to calculate y-o-y growth and growth volume of various indicators is the same with that in the report year, but different from that of the data published in 2013.

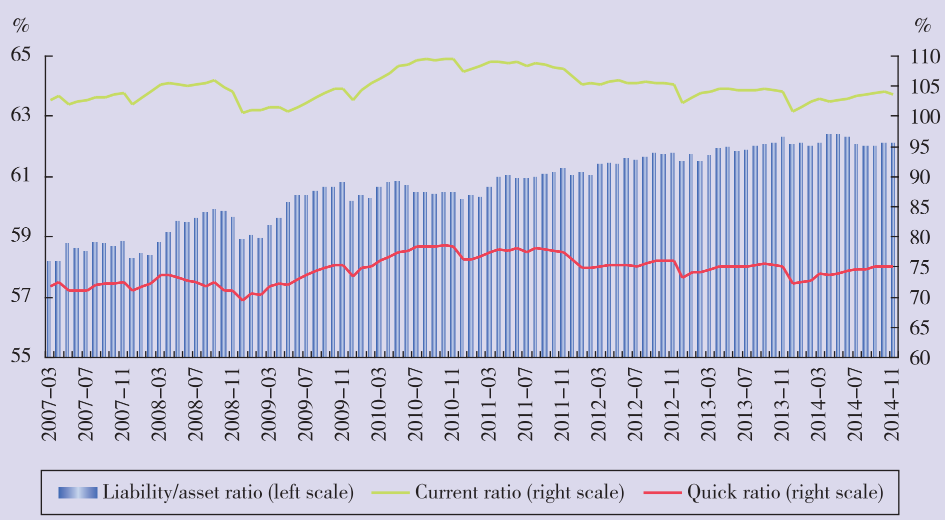
② Due to adjustment of sample enterprises, inconsistency of reporting time by different enterprises, and continuous updating of financial data reported by 5 000 industrial enterprises, the end-November 2014 data was used in lieu of end-2014 data. The same has been done for other data in this box. Data for end-2013 in this report are newly published and adjusted, and there may be some differences between these data and those used in the previous year report.

1.9% y-o-y, a deceleration of 2.1 percentage points from the previous year. Gross profits of 5000 enterprises grew by 1.2% y-o-y, a deceleration of 0.3 percentage point. The response to the survey shows that in the fourth quarter, the profitability index registered 55%, down by 2.6 percentage points y-o-y.

Asset turnover declined slightly, and the operating capability remained to be strengthened. In 2014, the inventory turnover of 5 000 industrial enterprises was 5.2 times, a decline of 0.2 time compared with that in the previous year. In particular, finished product turnover was 20 times, down 1 time y-o-y; raw material turnover was 14.4 times, down 0.7 time y-o-y. Total asset turnover was 0.83 time, down 0.04 time y-o-y. The operating cycle[①] of 5 000 industrial enterprises was 135.3 days, 4.2 days more than that of the previous year.

Debt level slid slightly, and the debt-servicing capacity declined somewhat. At the end of 2014, the current ratio of 5 000 industrial enterprises was 103.6%, down 0.5 percentage point y-o-y; the quick ratio was 75%, at a par with that in 2013; the interest coverage multiplier was 4.2 times, down 0.1 time y-o-y. The debt level was reduced slightly, with liability/asset ratio of 5 000 enterprises dropped 0.2 percentage point from 2013 to 62.1% (Figure 2.5).

Figure 2.5 Liability/asset Ratio, Current Ratio and Quick Ratio of 5 000 Industrial Enterprises



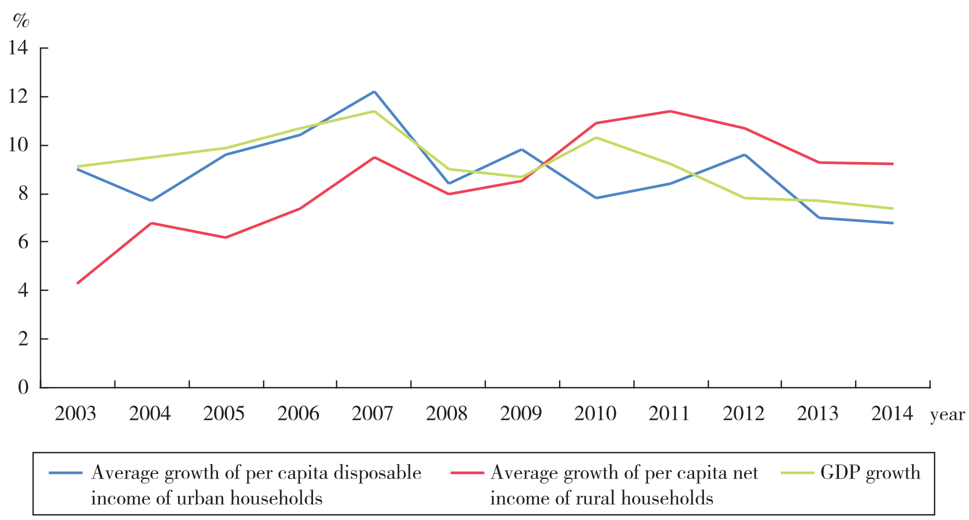
Source: The PBC.

① Operating cycle=days of inventory turnover + days of proceeds receivable.

6. Employment remained generally stable, and the trend of households shifting bank deposits to wealth management funds became more evident

In 2014, newly employed population in the urban areas reached 13.22 million, 120,000 more than that of the previous year. Urban registered unemployment rate posted 4.09%, up by 0.04 percentage point from 2013. Per capita disposable income of urban households posted 28,844 yuan, representing a price-adjusted y-o-y real growth of 6.8%, a deceleration of 0.2 percentage point from the previous year, and 0.6 percentage point lower than the GDP growth. The per capita disposable income of rural households registered 10,489 yuan, representing a price-adjusted y-o-y real growth of 9.2%. That growth was 0.1 percentage point lower than that registered in the previous year, and 1.8 percentage points higher than the GDP growth (Figure 2.6). The income gap between urban and rural households continued to narrow, reflected by the real growth of per capita disposable income of rural households in 2014 outpacing that of urban households by 2.4 percentage points, and the ratio of per capital income of urban households versus that of rural households narrowed by 0.06 time from the previous year to 2.75 times.

Figure 2.6 Growth of Per Capita Income of Urban and Rural Households and GDP



Source: The NBS.

The trend of households shifting bank deposits to wealth management funds became more evident. At end-2014, outstanding deposits of the household sector stood at 50.7 trillion yuan, up 9% y-o-y, a deceleration of 4.4 percentage points from the previous year. Outstanding wealth management funds deposited in banking wealth management products posted 13.8 trillion yuan, up 47.7% y-o-y; outstanding funds deposited in trust schemes posted 12.8

trillion yuan, up 24.4% y-o-y; funds entrusted in securities companies posted 8.0 trillion yuan, up 53.3% y-o-y; public placement funds and funds put in special wealth management accounts of fund management companies posted 9.5 trillion yuan, and market capitalization of the A-share market held by individual investors reached 7.9 trillion yuan. Outstanding non-performing loans (NPLs) and NPL ratio of individual loans increased slightly. At end-2014, outstanding NPLs of individual loans (including both non-business loans and business loans) posted 386.62 billion yuan, 66.26 billion yuan more than that at the beginning of the year, and the NPL ratio was 1.7%, up 0.1 percentage point from the beginning of the year. Outstanding NPLs in areas of individual mortgage loans, individual credit card loans and individual auto loans posted 30.03 billion yuan, 39.31 billion yuan and 4.56 billion yuan respectively, representing an increase of 6.84 billion yuan, 13.07 billion yuan and 600 million yuan from the beginning of the year. At end-2014, the NPL ratio of individual mortgage loans, individual credit card loans and individual auto loans posted 0.3%, 1.5% and 1.1% respectively.

Box 2 Real Estate Market and Real Estate Loans in 2014

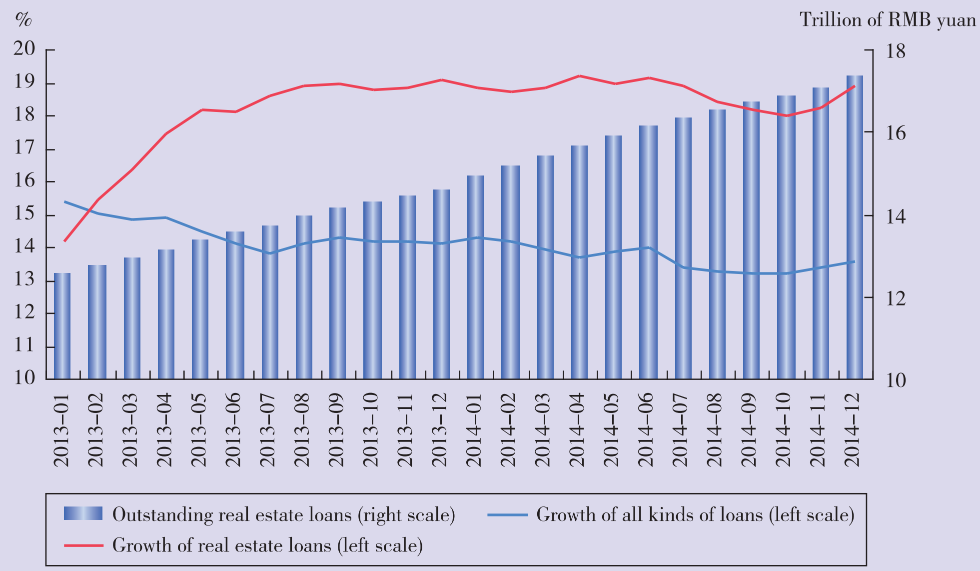
In 2014, the real estate market underwent adjustments, and sales of commercial housing dropped somewhat, yet to varying degrees among different regions. Growth of investments in the real estate sector slowed down, and loans to the real estate sector increased steadily.

Both transaction volumes of the real estate market and housing prices fell, but to varying degrees among different regions. In 2014, sold areas of commercial housing nationwide amounted to 1.21 billion square meters on cumulative basis, down 7.6% y-o-y, whereas the cumulative sold areas in 2013 posted a y-o-y growth of 17.3% in 2013. The sales value of commercial housing nationwide posted 7.6 trillion yuan, down by 6.3% y-o-y, whereas the sales value in 2013 registered a y-o-y growth of 26.3%. The sales value of commercial housing in the eastern region fell markedly in y-o-y terms, whereas the sale values in the central and western regions went up marginally. More cities reported y-o-y decreases in housing prices from the beginning of the year. In December 2014, out of 70 large and medium-sized cities, the prices of newly built commercial residential housing posted month-on-month decrease in 66 cities, 60 more than in January; and registered y-o-y drop in 68 cities, 67 more than in January. The prices of pre-occupied residential housing posted month-on-month decrease in 60 cities, 47 more than in January; and registered y-o-y decline in 67 cities, 66 more than in January.

Growth of investments in real-estate development moderated. In 2014 completed investments in real-estate development totaled 9.5 trillion yuan, up 10.5% y-o-y and representing a deceleration of 9.3 percentage points from the last year. The floor area of newly-built housing fell by 10.7% y-o-y to 1.796 billion square meters, while that in 2013 registered a y-o-y increase of 13.5%. The start of construction of government-subsidized housing projects amounted to 7.4 million units (including 5.06 million units of renovation of shanty housing). Completed units of government-subsidized housing posted 5.11 million units, and completed investments totaled 1.29 trillion yuan.

Growth of real-estate loans increased steadily. By the end of 2014, outstanding real-estate loans of major financial institutions (including foreign-funded financial institutions, the same applies hereinafter) posted 17.4 trillion yuan, an increase of 18.9% y-o-y (Figure 2.7) and a deceleration of 0.2 percentage point from end-2013. Outstanding real-estate loans accounted for 21.3% of total outstanding loans, which was 0.3 percentage point higher than that at the end of the last year. In 2014 new real-estate loans reached 2.7 trillion yuan, which was 405.65 billion yuan more than that in the last year. New real estate loans accounted for 28.1% of total new loans, at a par with that in 2013. Growth of real estate development loans accelerated steadily, and the outstanding volume reached 5.63 trillion yuan at end-2014, representing a y-o-y growth of 22.6% and an acceleration of 7.9 percentage points from end-2013. Among this total, outstanding loans for government-subsidized housing posted 1.141 trillion yuan, and new government-subsidized housing loans stood at 411.9 billion yuan, a y-o-y growth of 57.2% and 34.6 percentage points faster than that of real estate development loans. Growth of mortgage loans remained stable. At end-2014 outstanding mortgage loans posted 10.6 trillion yuan, an increase of 17.6% y-o-y. New mortgage loans extended in 2014 reached 1.6 trillion yuan, accounting for 16% of all kinds of loans, and higher than the average share of 13.8% in 2010-2013.

Figure 2.7 Outstanding Amount and Growth of Real-estate Loans of Major Financial Institutions



Source: The PBC.

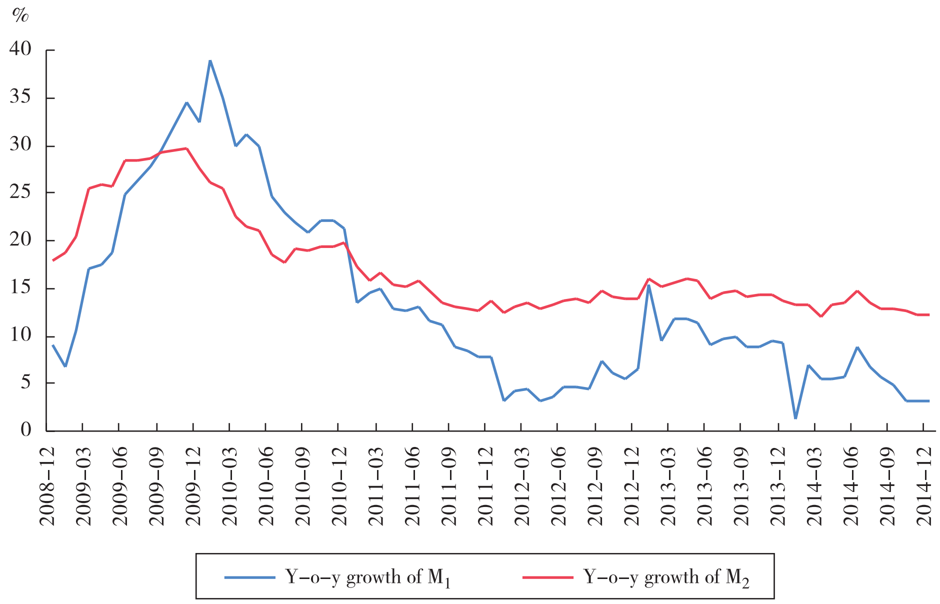
II. Monetary and Financial Performance

In 2014, the PBC continued to implement a sound monetary policy, innovated the thinking and toolkit of macroeconomic management, emphasized the support for economic restructuring and upgrading while maintaining stable economic performance, and guided the financial system to better serve the real economy in line with the general arrangements of "maintaining economic aggregates at a stable level and restructuring the economic". In 2014, liquidity in the banking system was reasonably adequate, the growth of money, credit, and all system financing aggregates remained modest, the problem of high financing costs for enterprises was eased, and the monetary and financial environment was generally stable.

1. Money supply and credit extension registered stable growth

The growth of monetary aggregates remained modest. At the end of 2014, outstanding broad money (M_2) stood at 122.84 trillion yuan, up 12.2% y-o-y, representing a deceleration of 1.4 percentage points from end-2013. Outstanding narrow money (M_1) stood at 34.81 trillion yuan, up 3.2% y-o-y, a deceleration of 6.1 percentage points over end-2013. Currency in circulation (M_0) stood at 6.03 trillion yuan, up 2.9% y-o-y, and a deceleration of 4.3 percentage points from end-2013. The central bank injected 168.8 billion yuan of cash on a net basis in 2014, about 222.7 billion yuan less than that in 2013. Since the second half of 2014, growth of monetary supply moderated, and in general the slowdown reflected economic restructuring, contraction of off-balance-sheet financing, slowdown of expansion in sectors with soft budget constraints, and strengthened supervision of inter-bank businesses.

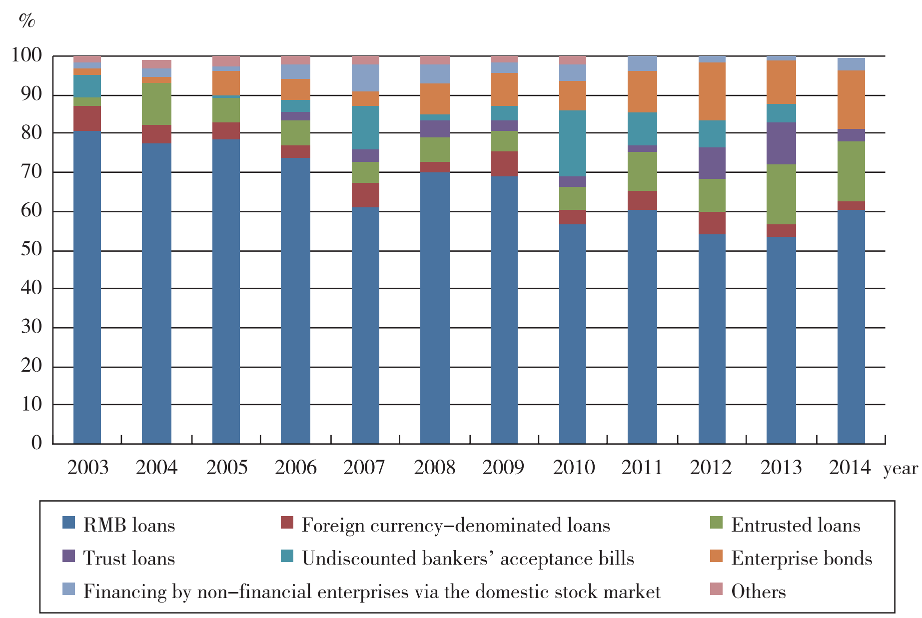
Figure 2.8 Growth of Money Supplies



Source: The PBC.

The structure of all-system financing aggregates improved. According to preliminary statistics, in 2014 all-system financing aggregates reached 16.5 trillion yuan, representing a decline of 859.8 billion yuan y-o-y. In terms of the financing structure, first, new RMB loans increased by a large margin, accounting for 59.4% of the all-system financing aggregates during the same time period and up 8.1 percentage points from the previous year. Second, the size of trust loans and undiscounted banker's acceptance bills dropped noticeably, resulting in a considerable deceleration of off-balance-sheet financing in y-o-y terms. The combined share of entrusted loans, trust loans and undiscounted bankers' acceptance bills in all-system financing aggregates was 17.5%, down 12.3 percentage points from the previous year. Third, the financing structure was improved. Direct financing through enterprise bonds and equity financing of non-financial enterprises in the domestic stock market shot up. Direct financing accounted for 17.3% of the all system financing aggregates, up 5.5 percentage points from the previous year, and hitting a historical high. Fourth, new foreign currency-denominated loans decelerated compared to the last year, accounting for 2.2% of the all-system financing aggregates during the same period, and down 1.2 percentage points from 2013.

Figure 2.9 Shares of Different Financing Modes in All-system Financing Aggregates



Source: The PBC, NDRC, CSRC, CIRC, China Central Depository & Clearing Co., Ltd. (CCDC), National Association of Financial Market Institutional Investors, and etc.

Growth of deposits of financial institutions slowed down, and lending rates declined in general. Affected by the stock market rebounding, relatively rapid growth of various wealth management products, and development of internet finance, the trend of deposits diverting to other investment channels became obvious. At the end of 2014, outstanding deposits of domestic and foreign currencies in all financial institutions posted 117.37 trillion yuan, up 9.6% y-o-y, and representing a deceleration of 3.9 percentage points from the previous year; outstanding loans in domestic and foreign currencies by all financial institutions registered 86.79 trillion yuan, up 13.3% y-o-y, and a deceleration of 0.6 percentage point from end-2013; new RMB loans posted 9.78 trillion yuan, a y-o-y increase of 890 billion yuan and hitting a historical high. Lending rates of financial institutions fell back. In December 2014, the weighted average lending rate offered to non-financial enterprises was 6.77%, down 0.43 percentage point from the beginning of the year, which to some extent helped reduce the high financing costs of enterprises.

2. Monetary Policy Operations

The monetary policy toolkit expanded and was used in a flexible manner to keep liquidity at reasonable and adequate level. Since the beginning of 2014, as foreign exchange purchase became a lesser source of base money injection, the PBC improved its ability of actively providing base money by expanding the policy toolkit. Some PBC branch offices conducted the Standing Lending Facility (SLF) operations on a pilot basis to improve the channels for providing liquidity to small and medium-sized financial institutions. The PBC introduced the Medium-term Lending Facility (MLF) as an instrument to provide medium-term base money to banks that met the macro-prudential requirements. Through the Pledged Supplementary Lending (PSL), the PBC provided long-term stable and affordable liquidity support to development finance that supported renovation of shanty housing projects. In view of volatility of short-term liquidity supply and demand, the PBC reduced the maturity of open market repo operations from 28 days to 14 days, and used the Short-term Liquidity Operation (SLO) and other instruments to make up for contingent liquidity shortage. These measures effectively curbed short-term liquidity fluctuations caused by various factors.

Price-based instruments were used as appropriate to guide interest rates to fall. The PBC strengthened the flexibility of OMO interest rates, and guided the 14-day repo interest rate to drop by 60 basis points through four operations. From September, the PBC cut appropriately the PSL interest rate, and employed MLF to set a medium-term policy rate while using it to provide base money. These measures helped unclog the interest rate transmission mechanism. On November 22, the PBC reduced the benchmark RMB lending and deposit rates of financial institutions in an asymmetric manner to guide the high financing cost to decline and keep the real interest rate at a reasonable level.

Management of desirability lending was improved, and a mechanism for dynamic adjustment of the differentiated reserve ratio was employed for counter-cyclical purposes and credit structure guidance. In view of the changing economic and financial conditions at home and abroad, capital stock and soundness of financial institutions, and implementation of credit policies, the PBC made parametric adjustments as appropriate to the mechanism for dynamic adjustment of differentiated reserve ratio. Macroprudential management indicators were adjusted, desirability lending was expanded, and financial institutions were encouraged to increase lending to micro and small enterprises, agro-linked sector, central and western regions and less-developed regions.

The PBC employed targeted reduction of reserve requirement ratio to set up an incentive mechanism that would help guide financial institutions to increase loans to the agro-linked sector and small and micro businesses. Since the outbreak of the global financial crisis, amongst the major central banks there emerged a new trend that used targeted operations to unclog the monetary policy transmission mechanism. Since 2014, the PBC started to explore the ways to fully utilize the structural guidance function of aggregate instruments, and implemented two targeted reductions of reserve requirement ratios in April and June respectively, to set up an incentive mechanism that would help guide financial institutions to increase loans to the agro-linked sector and small and micro businesses.

The new tool of credit policy supporting central bank lending was introduced, and a central bank collateral management framework was established. At the beginning of 2014, the new tool of credit policy supporting central bank lending was introduced, including central bank lending to support the agro-linked sector and the small businesses respectively. The quotas of central bank lending and discounts were increased on several occasions throughout the year, and the related quota management was improved. Quick access was granted for agro-linked financing notes and financing notes of micro and small businesses to conduct discounts and it was required that the discount rate should be lower than the average interest rate of the same maturity, so as to support financial institutions to increase lending to agro-linked sector and small and micro businesses. A pilot program of credit policy supporting central bank lending against credit asset collaterals was set up. At end-2014, the outstanding amounts of agricultural-supporting and small-enterprise-supporting loans and discounts further increased y-o-y.

The market-based interest rate reform continued to accelerate, and the pricing capacity of financial institutions was further improved. On November 22, the PBC expanded the floating band of the deposit interest rates from 1.1 times to 1.2 times the benchmark deposit rate, and also simplified the maturity brackets of the benchmark interest rate, so as to increase the autonomy of financial institutions to set interest rates. The PBC removed the ceiling on small-amount foreign-exchange deposit interest rates in the China (Shanghai) Pilot Free Trade Zone. The self-regulatory market interest-rate pricing mechanism continued to be improved, and its membership continued to expand. The issuance and trading of inter-bank certificates of deposit (CDs) were steadily promoted.

The market-based RMB exchange-rate formation regime was further improved, to strengthen the role of market supply and demand in determining exchange rate. Starting from March 17, the floating band of the RMB spot rate against US dollar was expanded from 1% to 2%. On July 1, the PBC removed the limit over the spread between USD selling and buying rate quotes of commercial banks, which signified that all the restrictions on foreign exchange quotes of banks were eliminated. In 2014, the RMB depreciated by 0.36% against the central parity of the US dollar, and the real effective exchange rate (REER) appreciated by 6.2%. The direct RMB trading against the New Zealand dollar, the British pound, the euro, and the Singapore dollar were successively launched.

Box 3 Various Measures to Address the Issue of High Financing Costs Faced by Enterprises

In 2014, in the context of downward economic pressures, enterprises' high financing costs became more acute a problem. The State Council, highly attentive to the issue, announced the *Guideline Opinions on Taking Various Measures to Address the High Financing Costs Faced by Enterprises* and *the Work Plan for Further Alleviating Enterprises' High Financing Costs* in July and November respectively. In line with the overall arrangement of the State Council, the PBC established a working mechanism jointly with other government departments concerned to tackle this problem, and urged main commercial banks to earnestly carry out the measures, and shoulder their due social responsibilities. The following measures were taken.

The growth of money and credit aggregates was kept at a reasonable and appropriate level to guide interest rates to decline modestly. OMO and multiple instruments such as SLO, SLF and MLF were employed to adjust two-way liquidity in a flexible manner, so as to keep liquidity in the banking system at a reasonable and adequate level. The PBC cut the 14-day repo operational rate by 60 basis points accumulatively to guide market interest rate to decline modestly and ensure stability of the money market. In November, the RMB lending and deposit interest rates were cut asymmetrically. In particular, the 1-year lending benchmark interest rate was cut by 0.4 percentage point to 5.6%, whereas the 1-year deposit benchmark rate was reduced by 0.25 percentage point to 2.75%. Macroprudential policy parameters were adjusted on four occasions, to increase the credit availability of financial institutions.

More emphasis was laid upon targeted regulation to make the policy better tailored. Two targeted reductions of reserve requirement ratios were made throughout the year, and an incentive mechanism was set up to guide financial institutions to continuously optimize credit lending structure. Central bank lending instruments to support small enterprises were created, quotas for central bank lending and discounts were raised on several occasions, quick access was granted for agro-linked financing notes and financing notes of micro and small enterprises to conduct discounts and it was required that the discount rate should be lower than the average interest rate of the same maturity, so as to support financial institutions to increase lending to the agro-linked sector and small and micro businesses. Differentiated financial policies for the real estate sector were adjusted to render more financial support to renovation of shanty housing, government-subsidized housing, and the purchase demand for purpose of improving living conditions. The Real Estate Investment Trusts (REITs) pilot program was pursued in a proactive and prudent manner. The PBC also promoted the China Development Bank to set up a department in charge of residential housing loans. PSL was employed to provide long-term, stable, and affordable lending to development finance that supports renovation of shanty housing.

The market-based interest-rate reform was pushed forward in an orderly way. The PBC expanded the floating band of the deposit interest rates from 1.1 times to 1.2 times the benchmark deposit rate, and simplified the maturity brackets of the deposit and lending benchmark interest rates. The market disciplinary mechanism of interest rate pricing was improved, and the binding constraints of financial institutions' finance were strengthened. Efforts were made to guide the development of the inter-bank CDs. In December, the weighted average interest rate of three-month CDs was 5.01%, which was 21 basis points lower than that of banks' wealth management products of the same maturity.

Forceful efforts were made to develop direct financing. The PBC actively supported qualified commercial banks to issue financial debts for small and micro businesses and for agro-linked sector to make sure that the funds were actually used to address financing needs of small and micro businesses and the agro-linked sector. It also guided the National Association of Financial Market Institutional Investors (NAFMII) to issue collective notes for small- and medium-sized non-financial enterprises, and promoted the centralized regional mode through introducing a credit-enhancement mechanism. Efforts were made to make the capital market more multi-layered, to diversify the trading methods of the National Equities Exchange and Quotations system, and to issue administrative regulations on crowd financing for private equity. The PBC promoted innovation and development of the securities and funds sector and securities firms, broadened the scope of institutions that could apply for the RMB Qualified Financial Institutional Investors (RQFII) scheme, and guided long-term investors to invest in China's capital market.

Financing costs of banks were reduced. The PBC guided banks to improve diversification and stability of financing sources through standardizing inter-bank deposits and increasing financing from overseas markets. Forceful efforts were made to push forward the securitization program of credit assets in order to make good use of existing loans. As of end-2014, financial institutions issued a total of 94 credit asset-backed securities (ABS) worth 383.7 billion yuan.

Unnecessary "conduits" and "bridges"

were cleaned up to shorten the financing chains of enterprises. The PBC conducted an ad hoc inspection on commercial banks about how they implemented the new regulations on inter-bank businesses, strengthened risk management of fund companies involved in asset management businesses, required banks to improve the internal governance for wealth management business, and urged banks to closely monitor the flows of loans. The PBC urged commercial banks to set up and improve the service price management system. Measures taken by banks include: exemption of commitment fee and financial counseling fee for small and micro businesses; reducing fees for settlements and providing cost-free accounts; eliminating the practice of making plans for intermediary service revenues, and rigorously punishing "interest for fee" behaviors.

Banks were encouraged to improve management of lending activities to speed up loans approval and issuance. The PBC encouraged commercial banks to conduct such businesses as loans renewal, annual approval loans, and circulating loans, and to innovate ways to provide loans for small and micro businesses. The differentiated regulation for lending to small and micro businesses was improved. Measures taken by banks include: increasing tolerance for NPL ratios of loans to small and micro businesses, quick access granted to financing notes of small and micro businesses to conduct discounts, setting up differentiated lending, and expanding the scope of the "renewal without repaying" program.

Development of small- and medium-sized financial institutions was accelerated. The first batch of five private banks was set up after being granted licenses. Permission was granted for the set up of 13 privately-controlled financial leasing companies, consumer finance companies and finance companies affiliated to corporate groups, and 162 village and township banks with private sector taking dominant shares.

Active efforts were made to explore the role of insurance and guarantee. The experiences from the Ningbo urban and rural micro loans guarantee and insurance program were spread nationwide. The credit insurance business for domestic trade was promoted. The pilot program of loans pledged with agricultural insurance policy was conducted. About 3 billion fiscal funds were granted to support guarantee institutions to provide guarantee service for small and micro businesses. Management of cross-border guarantee was substantially simplified, all kinds of *ex ante* approval was eliminated, and the areas subject to quantitative control of cross-border guarantee were narrowed.

High corporate financing cost was reduced to some extent. In December, the weighted average inter-bank lending and bond repo rates posted 3.49% and 3.49% respectively, down by 0.67 and 0.79 percentage point respectively from the end of the last year; weighted average loan interest rate offered to non-financial companies was 6.77%, down 0.43 percentage point from the end of the last year; the weighted average interest rate of enterprise bonds declined by 1.03 percentage points y-o-y to 5.97%. In end-December, the yields of 5-year and 10-year treasury bonds stood at 3.53% and 3.62% respectively, down by 0.93 and 0.94 percentage point y-o-y. The yields of trusts and wealth management products as well as private lending interest rates fell by various degrees.

III. Outlook

China is still in an important period of strategic development. With industrialization, informatization, urbanization and modernization of the agricultural sector making progress in tandem, positive changes happening in economic restructuring, and important progress made in deepening of reform and opening-up, China's economy has entered a new normal. Growth drivers become more diversified, and development outlook is more solidly based. At the same time, economic performance still faces many difficulties and challenges. Endogenous growth drivers remain to be strengthened, downward pressures build up, some economic risks become more obvious, aggregate debt levels keep rising, oversupply coexists with shortage of supply, and structural problems remain to be tackled.

The year 2015 is a crucial year in deepening reforms. It also marks the first year of pushing ahead the rule by law, and a year in which maintaining growth and restructuring the economy become urgent tasks. Efforts should be made to fully implement the principles outlined by the 18th CPC National Congress, the third and the fourth Plenary Sessions of the 18th CPC Central Committee and the Central Economic Conference, actively adapt to the new normal, maintain the general keynote of making progress while maintaining stability, maintain continuity and stability of macroeconomic policies, put shifting growth patterns and economic restructuring higher on the agenda, continue to press ahead targeted regulation and structural regulation, speed up reform and opening up, effectively turn reform measures into development momentum, continuously stimulate market vitality, release economic potentials, emphasize quality and efficiency of economic development, and promote economic transformation, upgrading, and stable and healthy development.

Continue to implement proactive fiscal policy and sound monetary policy. Macroeconomic policies should be maintained and improved. Priority should be given to intensity of fiscal policies, a monetary policy that is neither too tight nor too loose, use of targeted regulation, and timely and appropriate pre-tuning and fine tuning. Efforts should be made to innovate and improve local government debt financing mechanism, continue to carry out structural tax reduction and generalized slashing of fees, and implement tax preferential policies that aim to alleviate burdens of businesses in particular small and micro businesses. Liquidity monitoring and analysis should be strengthened, and liquidity should be maintained at a reasonable and adequate level through flexible employment of various instruments, in order to guide stable and proper growth of money and credit and aggregate social financing. Macro-prudential management should be improved and efforts should be continuously made to enhance the dynamic adjustment mechanism of differentiated reserve requirement ratios.

Beef up support from the financial system to the real economy. Efforts should be made to guide financial institutions to liquidize the stock of credit assets and make good use of new loans, and to increase credit support to key and weak areas in the economy. Targeted regulation measures should be improved, which should guide financial institutions to optimize the credit structure based on the direction of better industrial development so as to support economic restructuring, transformation and upgrading. The PBC will also promote innovation of financial products and services to beef up support to the agro-linked sector, small and micro businesses, and renovation of shanty housing, and will endeavor to do a good job in digesting overcapacity. Financial inclusion should be actively promoted to earnestly support areas pertinent to people's livelihood such as poverty reduction and development. Differentiated housing credit policies should be carried out, and housing financial services should be improved in line with the principle of categorized regulation. High corporate financing costs should be reduced in a well-targeted way through treatment of both root causes and symptoms.

Deepen reforms on all fronts and promote high-level opening up. The market-based interest rate reform will be sped up to construct a benchmark interest rate system for financial markets and to improve the interest rate transmission mechanism. Market-based pricing should be expanded to cover more liability products, and the central bank policy interest rate system will be improved to better the interest rate regulation mechanism. The PBC will exit from regular market interventions, continue to improve the exchange rate formation mechanism, make the market play a bigger role in deciding exchange rates, and strengthen flexibility of RMB two-way movements, in order to keep the RMB exchange rate basically stable at a reasonable and equilibrium level. Effort will be made to support the use of RMB in cross-border trade and investment activities, and promote direct trading between RMB and other currencies, while guard against cross-border capital flow risks. The PBC will strengthen financial cooperation with countries along the "one belt and one road", and support the implementation of national strategies such as the "one belt one road" initiative. Coordinated development of financial markets will be promoted, with more emphasis laid upon direct financing, and the multi-layered capital market will be improved. The reform of financial institutions will continue to be deepened, and the development of small and medium-sized financial institutions such as private banks will be accelerated in order to optimize resource allocation.

Strengthen financial regulation and improve regulatory coordination mechanism. Financial regulation should be strengthened while respecting the autonomy of financial institutions, encouraging financial innovation and reducing administrative approval. The PBC will actively take part in the making of international financial rules and standards, and prudently push ahead the international regulatory reform measures and prudential standards. The reform of regulatory framework will be pushed forward, and the regulatory process and resource allocation will be optimized in order to make regulation more effective. The role of the financial regulation coordination mechanism will be put into active play, which will help clarify policy principles and put into place regulatory responsibilities on cross-market and cross-product financial innovations so as to prevent from regulatory vacuum and arbitrage.

Effectively mitigate financial risks, and earnestly maintain financial stability. Efforts will be made to strengthen monitoring and analysis of financial risks arising from overcapacity industries, the real estate sector, local government financial vehicles and other priority areas, dynamically assess potential risks, and address and dispose of various risks in a timely manner. Financial environment should be improved by standardizing operations of financial institutions, and clamping down upon various criminal activities. The market disciplinary mechanism will be reinforced to make the financial system more resilient. The baseline of preventing systemic and regional financial risks should be held onto through solid efforts in implementing the deposit insurance scheme and improving financial safety net.

Chapter III

Banking Sector

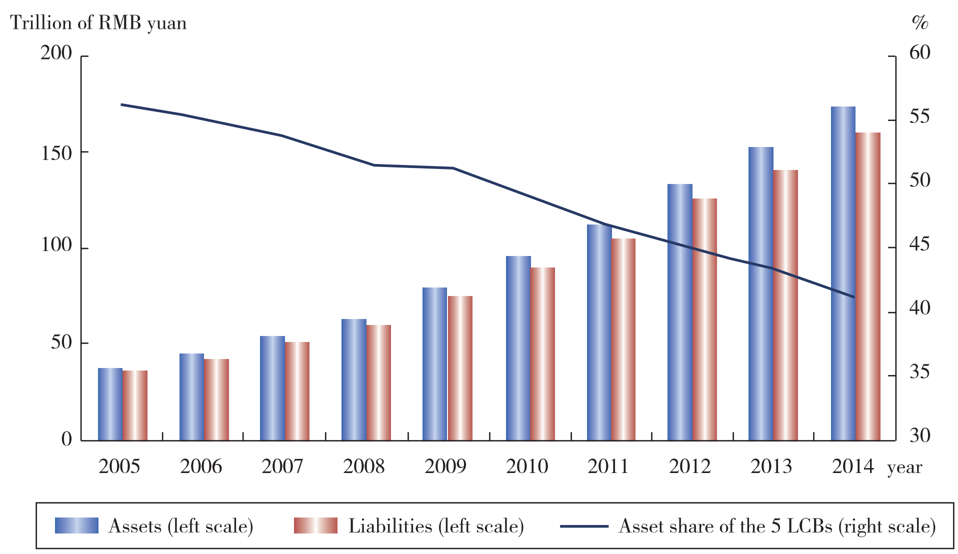
In 2014, China's banking sector has self-adjusted in line with evolving economic environment, promoted reforms and opening-up, held the bottom line of preventing systemic and regional risks, and demonstrated strong capabilities in fostering real economy and social development. Overall, the banking sector remained in good shape. However, potential sources of vulnerabilities still existed; risks were built up in some industries and regions. Waves of comprehensive reforms and financial innovations should be geared, so as to address potential risks and secure a sustainable growth.

I. Recent Developments

1. Total assets and liabilities mounted up steadily and banking structure became more robust

Total assets and liabilities sustained steady growth. At end-2014, total assets of banking institutions increased by RMB 21 trillion yuan or 13.87 percent on a y-o-y basis to RMB 172.34 trillion yuan. The growth rate was 0.6 percentage point higher compared to that of last year. Total liabilities amounted to RMB 160.02 trillion yuan, an increase of RMB 18.84 trillion yuan or a y-o-y growth of 13.35-0 percent from the previous year. The growth rate was 0.6 percentage point higher compared to that of last year. Collectively, the five large commercial banks (LCBs) accounted for 41.21 percent of total commercial bank assets, 2.13 percentage points down from 2013. The asset shares of joint-stock commercial banks (JSCBs), city commercial banks and rural financial institutions (including rural commercial banks, rural cooperative banks, rural credit cooperatives, village banks, lending companies and rural mutual cooperatives) increased by 0.41, 0.46 and 0.29 percentage point respectively (Figure 3.1).

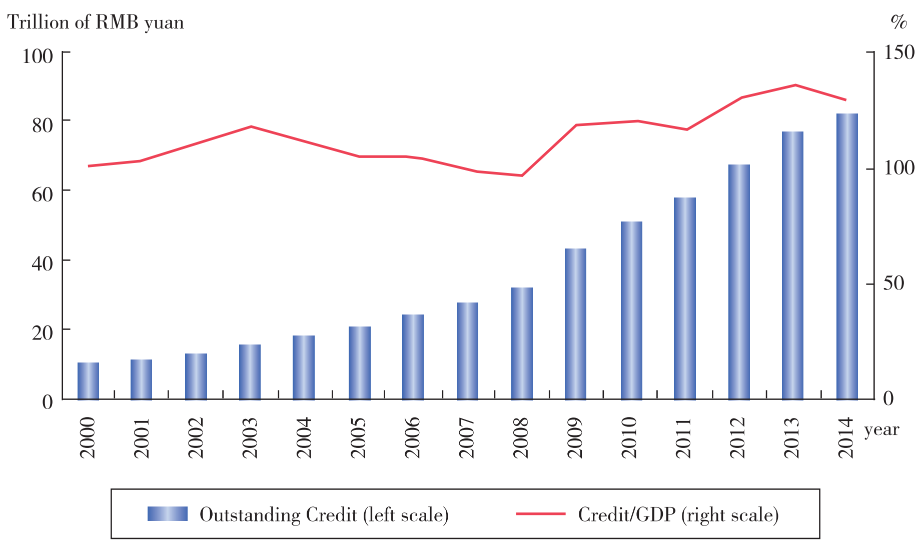
Figure 3.1 Total Assets and Liabilities of Banking Institutions



Source: The CBRC.

Total deposits and loans slowly expanded. At end-2014, the outstanding bank deposits denominated in both domestic and foreign currencies increased by RMB 10.16 trillion yuan or 9.47 percent y-o-y to RMB 117.37 trillion yuan. The growth slowed down by 3.92 percentage points compared to that of 2013. The outstanding loans were up by RMB 10.15 trillion yuan to RMB 86.79 trillion yuan. The growth rate is 13.3 percent y-o-y, 0.57 percentage point down from 2013(Figure 3.2). In terms of maturity, the increment of medium and long-term loans had a substantial increase of RMB 6.7 trillion yuan, and its share in the new extended loans climbed up by 13.89 percentage points. The increment of short-term loans rose by RMB 3.53 trillion yuan. In terms of institutions, JSCBs, city commercial banks and rural financial institutions experienced greater loan acceleration. In terms of credit orientation, fixed asset loans extended to project investments picked up by RMB 2.62 trillion yuan, while operating loans picked up by RMB 2.49 trillion yuan.

Figure 3.2 Credit Structure Change of Banking Institutions



Source: The PBC and the NBS.

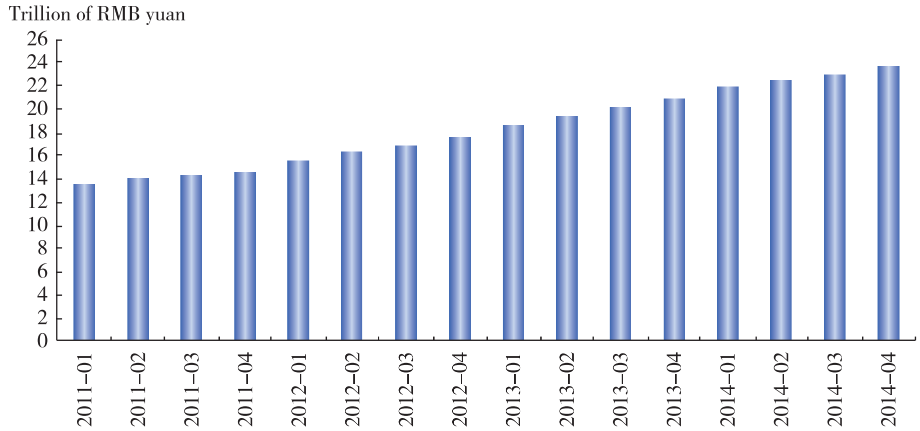
Banking structure was optimized. With the soar of small and medium-sized banking institutions, both the number and market share showed continuous expansion, leading to a lower level of market concentration and more intense competition. At end-2014, there were 133 city commercial banks, 665 rural commercial banks, 89 rural cooperative banks, 1596 rural credit cooperatives and 1153 village banks. In terms of assets, the market share of small and medium-sized banking institutions rose by 0.75 percentage point to 23.32 percent. The pilot private bank scheme demonstrated a significant step forward by giving licenses to the first 5 private banks. In Dec. 2014, the operation of private bank Webank was given green light. In the same year, relevant authorities authorized 13 pilot private financial leasing companies, consumer financing companies and finance companies, as well as 162 village banks where private capital dominated.

2. Favorable strategies were launched to bolster industrial upgrading, and credit support to weak links was intensified

Banking institutions fueled economic development and structural upgrading. In 2014, by continuously improving financial services, banking institutions became a more significant engine of real economy. Credit orientation was adjusted in line with industrial policies. To fuel economic restructuring, banking institutions implemented differentiated credit policies under the necessity of industries with overcapacity, and inclined to extend solid credit to strategically emerging industries and environmentally friendly industries. With strong efforts to improve financial innovations, banking institutions provided broad funding channels to enterprises. Incentives were cultivated to promote modern industrialization, informationization, urbanization and agricultural modernization. Securitization scale was further enlarged, and more credit resources were unwound to support real economic funding demand.

Strenuous efforts were made to foster agriculture, rural areas and farmers. At end-2014, the outstanding agriculture-related loans (excluding bill financing) reached RMB 23.6 trillion yuan, with a y-o-y growth of 13 percent. The growth rate outpaced that of total loans (excluding bill financing) by 0.7 percentage point (Figure 3.3). With improved capital capacity, financial performance and corporate governance, rural financial institutions provided firming financial support to rural sector. At end-2014, the outstanding loans of rural financial institutions amounted to RMB 1.108 billion yuan, with a y-o-y growth of 16.06 percent. Banking services marked footprints in all villages and towns nationwide.

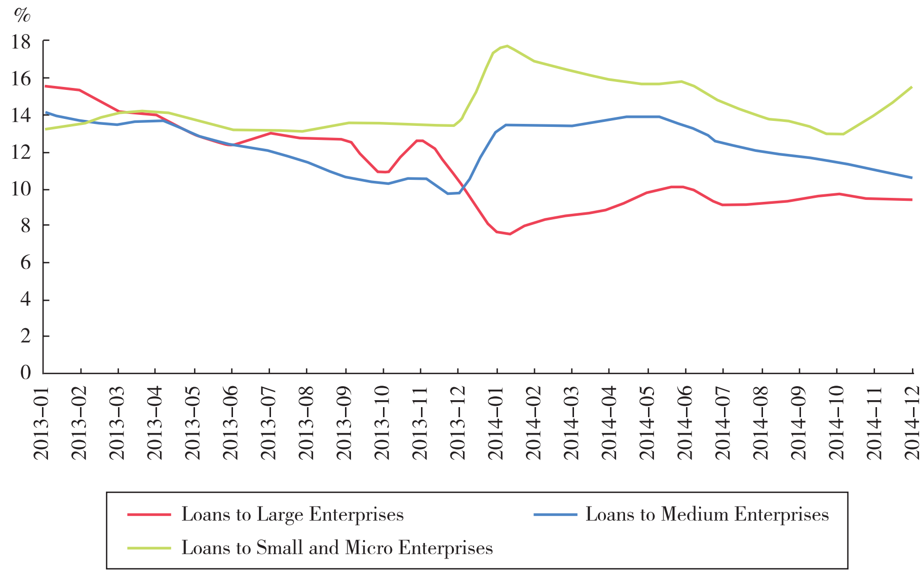
Figure 3.3 Outstanding Agriculture-related Loans



Source: The PBC.

Financial services to Small & Micro Enterprises were improved. At end-2014, the outstanding loans to small and micro enterprises reached RMB 15.3 trillion yuan, accounting for 30.4 percent of total outstanding loans. The y-o-y growth was 15.5 percent, 6.1 and 4.9 percentage points higher than the loan growth of large enterprises and medium enterprises respectively (Figure 3.4). In 2014, newly extended loans to small and micro enterprises registered RMB 2.13 trillion yuan, accounting for 41.9 percent of new corporate loans. At end-2014, there were 8791 micro-lending companies in total, with an increase of 952. Total lending balance reached RMB 942 billion yuan, with new lending of RMB 122.8 billion yuan. The prosperity of micro-lending companies played a positive role to alleviate the funding stress of small and micro enterprises.

Figure 3.4 Loan Growth Rates of Large Enterprises, Medium Enterprises and Small and Micro Enterprises



Source: The PBC.

3. Reforms were launched steadily and soundness of banking sector was improved

Reforms of policy-banking institutions made a significant progress. The State Council has approved reform plans of CDB, EXIM Bank and ADBC. After the reforms are in place, the three banks' capital adequacy and risk resistance will be improved, the CAR-oriented capital restraint mechanism will be put into effect, and capabilities to serve national strategy and real economy will be enhanced.

CDB will stick to its positioning as a development financial institution. CDB should adapt to the marketization and internationalization, take full advantages of serving national strategy, as well as favorable credit support, market-oriented operation and low profit margin requirement. Endeavor should be made to improve the development-oriented financial operation model, define a reasonable scope of business, enhance corporate governance, clarify funding support policies, replenish capital strength, reinforce capital constraint and strengthen internal control as well as external supervision. Equipped with adequate capital, disciplinary governance, rigorous internal control, sound operation, high-quality service and healthy assets, CDB is expected to play its active role in stabilizing economic growth and promoting economic restructuring. In July 2014, CDB established the residential financing department, with major business on renovation of shanty towns and urban infrastructure. This endeavor would provide legally compliant and low-cost stable funding for the renovation of shanty towns. In 2014, the overall new loans extended to renovation of shanty towns amounted to RMB 408.6 billion yuan, RMB 302.6 billion yuan or a 286 percent increase from the previous year.

ADBC would keep policy-oriented businesses as priorities and distinguish between policy-oriented businesses and self-operated businesses in accounts, responsibilities and risk compensation systems. Clear requirements of capital constraint, as well as enhanced corporate governance and decision-making process would endow ADBC with sustainable development capacities. EXIM Bank must stick to its policy positioning and focus on policy businesses. Efforts are expected to reasonably define business scope, establish risk compensation mechanism, improve capital strength, enhance capital constraint, strengthen internal control and external supervision, and streamline corporate governance and decision-making process. Growing up as a policy bank with explicit positioning, specific business scope, prominent function, adequate capital, disciplinary governance, rigorous internal control, sound operation, high-quality service as well as sustainable development capacities, EXIM Bank is believed to play a significant role in stabilizing growth, promoting economic restructuring, boosting exports and implementing the "going-out" strategy.

Reforms of large commercial banks (LCBs) were advanced. The reforms of ICBC, ABC, BOC, CCB and BOCOM were progressing well. Great achievements came into spotlight, including more efficient corporate governance, improved incentive mechanism, accelerated restructuring, effective management, and enhanced risk prevention capabilities. Overall, businesses of LCBs maintained a steady momentum, and capacity to boost real economy was enlarged. At end-2014, CARs of the 5 LCBs stood at 14.53 percent, 12.82 percent, 13.87 percent, 14.87 percent and 14.04 percent respectively. NPL ratios recorded 1.13 percent, 1.54 percent, 1.18 percent, 1.19 percent and 1.25 percent respectively. The whole year net profits registered RMB 276.3 billion yuan, RMB 179.5 billion yuan, RMB 177.2 billion yuan, RMB 228.2 billion yuan and RMB 65.9 billion yuan, with a y-o-y growth of 5.10 percent, 8.00 percent, 8.22 percent, 6.10

percent and 5.71 percent respectively. Pilot reform of ABC's Rural Area Banking Division (CABD) was steadily implemented, putting favorable policies into firm action. Financial services dedicated to rural areas extended coverage. At end-2014, total loans extended by CABDs in the 19 pilot provinces increased by RMB 234 billion yuan to RMB 2.26 trillion yuan in 2014. The y-o-y growth rate was 11.6 percent, 0.96 percentage point higher than average loan growth of these branches. Loan to deposit ratio of new CABD loans registered 84.6 percent, net profit after loan loss provisioning was RMB 43.2 billion yuan, NPL ratio lifted up from 1.50 percent to 1.88 percent, and loan loss coverage ratio recorded 289.6 percent.

Reforms of other financial institutions were sequenced. In August, Huarong Asset Management Co., Ltd. signed strategic cooperation agreements or memorandums of understanding with 8 strategic investors, including China Life, Warburg Pincus, etc. Total new strategic investments amounted to RMB 14.534 billion yuan, accounting for a 20.98 percent stake in Huarong. The State Council approved the restructuring plan of China Everbright in July. After the restructuring, China Everbright, renamed as China Everbright Group Ltd. was transformed from a wholly state-owned enterprise to a joint-stock limited company. CITIC Limited was listed in Hongkong in September.

Box 4 International Experience of Development Finance

Development finance refers to investment and financing behaviors, which are based on specific credit support to serve national strategic industries and areas. Instead of taking profit-making as its preferred objective, development finance underscores market-oriented operation, principal guarantee and small profits, and the sustainability of long-term financial conditions. As an important part of the financial system, development finance, widely used in both developed and developing countries, has made important contributions to the promotion of economic and social development. In recent years, development finance in China has made remarkable development. It has provided a lot of long-term funds for China's infrastructure, basic industries and pillar industries, played a unique role in promoting China's urbanization, industrialization and internationalization processes, and successfully explored the way of development finance with Chinese characteristics.

Institutions engaging in the development financial business have been popular in the international market. Global and regional development financial institutions include: the International Bank for Reconstruction and Development (IBRD), the Asian Development Bank (ADB), and the African Development Bank (AfDB). State-level development financial institutions include: the KfW in Germany, the CDC in France, the BNDES in Brazil, the KDB in South Korea, and the BPMB in Malaysia. Since the outbreak of the 2008 international financial crisis, development financial institutions, relying on specific credit support have played their counter-cyclical roles in serving the real economy and maintaining market stability in a more prominent manner. In many countries, they have become an important instrumentality to implement the salvation measures and help economic recovery. Overall, development financial institutions reflect the following characteristics: **(1) Constrained by special legislations.** By legislation, the nature, mandate and supporting policies of those institutions have been specified. They will be established and operated by law. **(2) Specific credit support is given.** In general, a development financial institution is wholly owned or dominantly controlled by the state and the government would provide credit support for its debt-raising, so it can obtain funds at a low cost in the capital market thanks to its high credit rating. **(3) Mainly doing mid-to-long-term investment and financing business.** Being original members of the long-term investors club, the KfW in Germany, the CDC in France, and the CDP in Italy, are all dedicated to serving the real economy and maintaining the stability of financial market through conducting medium and long-term investments and fund-raisings. **(4) Adhering to market-oriented operation.** A development financial institution's goals are to achieve the balance of its overall financial conditions and business and its long-run sustainable development. It will make independent business decisions based on market principles and direct social capital in participating in economic and social development by playing its guidance and leveraging role. **(5) Being equipped with strong supporting measures.** While making internal and external supervisions stringent, a development financial institution will establish differentiated regulatory and evaluation indicators in accordance with business characteristics and achieve organic unity of promoting development and controlling risks. Given supporting policies, like tax and dividend exemptions, it will enhance the ability to serve national strategies and sustainable development. **(6) Capital adequacy ratios are generally high.** Capital constitutes not only the basis of financial institutions to conduct business, absorb loss and resist risks, but an effective means of restraining excessive expansion. As development financial institutions have an important mandate of supporting their home nations' economic development strategy, their capital levels are generally high. What's more, to meet policy requirements, capitals can be added. At the end of 2013, capital adequacy ratios of the KfW, KDB, BNDES and BPMB stood at 22.3%, 14.64%, 19.2% and 14.4% respectively.

4. The effectiveness of supervision was intensified and fully participation in international banking supervisory reform was committed

Effectiveness of banking regulation was further ensured. The PBC made broader efforts to enrich macro-prudential toolkit, bring force creative macro-control measures, and improve the monetary policy implementation. For example, Reserve Ratio Requirement was eased in a targeted manner; Medium-term Lending Facility (MLF) and Pledged Supplementary Lending (PSL) were introduced as new macro-prudential tools. When forming policies, the PBC gave consideration to both reasonable money supply and economic restructuring, and steered financial system to positively contribute to the real economy. Underneath the financial regulatory coordination mechanism, the PBC leaded the work on interagency regulations. A successful case was the issuance of the *Notice on Regulating Interbank Business of Financial Institutions*, which regulated interbank activities and enhanced soundness of financial system. The CBRC issued a series of regulations governing liquidity risk management, supervisory grading, etc, which improved the risk resilience of the banking sector and enhanced the effectiveness of supervision. .

Relevant authorities continued to actively participate in international banking supervisory reforms. Relevant authorities, including the PBC, MOF and CBRC, were actively involved in the reforms led by FSB and BCBS, and took great efforts to bring national regulatory framework in line with international standards. With full support to FSB's peer review of member jurisdictions, China actively took part in the thematic review of G-SIBs supervisory regimes. Per FSB's request, specific requirements were in place for G-SIBs in China to establish CMGs, develop RRPs and refine resolution regimes. Relevant authorities in China were also involved in the TLAC reforms initiated by FSB and BCBS, with an aim of enhancing effectiveness of TLAC requirements and promoting a level playing field for China's G-SIBs.

Box 5 Taking Practical and Effective Measures to Promote the Healthy Development of Interbank Business

In recent years, China has comprehensively promoted the development of financial reform. Meanwhile, financial institutions have been active in making interbank business innovatively and interbank business developed rapidly, so it has played an important role in facilitating liquidity management, optimizing financial resource allocation, and serving the real economy. Nonetheless, it has also been encountered with some issues such as non-standard business development, insufficient information disclosure, and evading financial regulation and macro-control, and so on. Since May 2014, the PBC, together with relevant regulatory authorities, has taken effective measures to promote the healthy development of interbank business, in accordance with the general requirement of "encouraging innovation, preventing risks, drawing on advantages and avoiding disadvantages, and developing healthily."

Further regulating interbank business operation of financial institutions. In May 2014, the PBC, the China Banking Regulatory Commission (CBRC), the China Securities Regulatory Commission (CSRC), the China Insurance Regulatory Commission (CIRC), and the State Administration of Foreign Exchange (SAFE) jointly released the *Notice on Regulating Interbank Business of Financial Institutions*. According to the Notice, 18 regulatory proposals are presented, in which they define and regulate interbank financing and investment businesses, such as interbank lending, interbank deposits, interbank borrowing, interbank payments and buying securities for re-sales (selling securities for repurchase), item by item. Meanwhile, with the Notice jointly issued, regulators strengthen the internal and external management requirements for the interbank business of financial institutions, standardize accounting and capital measurement requirements, set the requirements for interbank business in duration and risk concentration, include interbank business into unified management of liquidity, support the normalized development of asset securitization and the pilot program of interbank certificate of deposit (CD) business, improve the initiative, standardization and transparency of financial assets and liabilities management, and promote the standard development of interbank business.

Improving governance of interbank business of commercial banks. In May 2014, the CBRC issued the *Notice on Standardizing the Governance of Interbank Business of Commercial Banks*, specifying general requirements for governing the interbank business of commercial banks and concrete requirements for establishing special operation departments, and requiring non-special operation departments (including affiliates/branches) not to operate the interbank business. In the meantime, the CBRC specifies the responsibilities of a commercial bank's corporate headquarter, requiring that the headquarter should give a centralized authorization for its special operation department whereas the special operation department should not transfer its power to others and that the headquarter should conduct a centralized and unified credit extension for its on- and off-balance interbank businesses and conduct a centralized unified list management for counterparties.

Enhancing interbank settlement account management. In July 2014, the PBC issued the *Notice on Strengthening RMB Interbank Settlement Account Management of Banking Financial Institutions*, making strict requirements for commercial banks in opening interbank settlement accounts and implementing daily management. The Notice also provides that all commercial banks should establish interbank settlement accounts' special management system and clean up and verify outstanding interbank settlement accounts, which has laid a solid foundation for strengthening interbank business management.

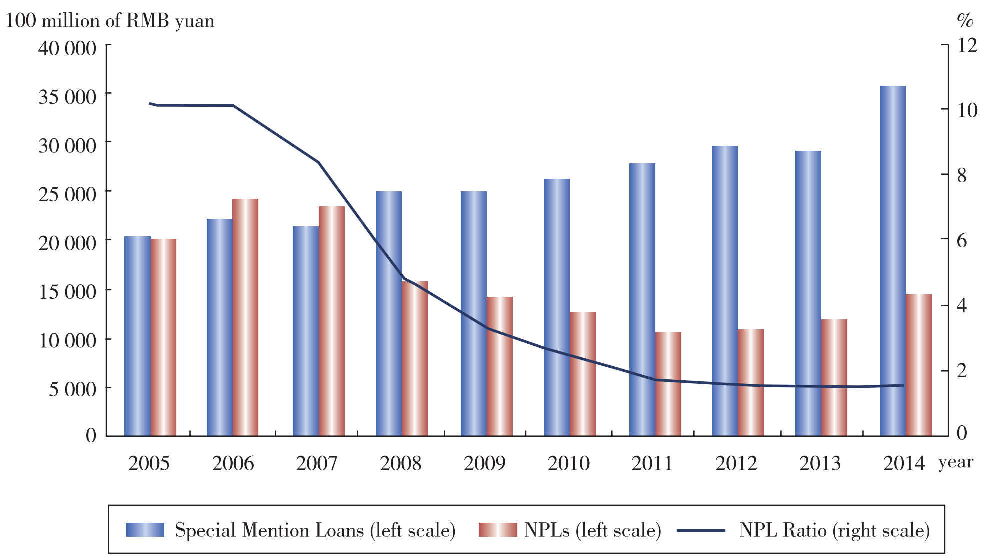
Adjusting financial statistical caliber of some interbank business. In January 2015, the PBC issued the *Notice on Adjusting Statistical Caliber of Deposits and Loans of Financial Institutions*. According to the Notice, all the items that are deposited in deposit-taking financial institutions by non-deposit-taking financial institutions shall be included in the item of "all deposits", whereas all the items that are lent by deposit-taking financial institutions to non-deposit-taking financial institutions shall be included in the item of "all loans", so as to ensure the scientificity of the statistical standards and accurately reflect the aggregates of deposits and loans.

The above-mentioned regulation on financial institutions' interbank business operation and management will be conducive to standardizing the market order and effectively preventing and controlling financial risks. They will also help guide more funds to flow into the real economy, lower corporate financing costs, and escalate the financial system's ability to support the real economy. They will be conducive to accelerating the development of multi-layered capital market system, improving the proportion of direct financing, and enhancing the resilience of the economic and financial systems. They will also help implement credit policies and revitalize the stock, well utilize the increment, and boost economic restructuring and transformative upgrading.

II. Soundness Assessment

Credit conditions continued to deteriorate and provision levels stayed sufficient. Credit quality downturn in China's banking sector was likely to deepen, as economic growth decelerated, external demands shrank and operating conditions of certain enterprises turned to be worse. At end-2014, the total outstanding NPLs of banking institutions recorded RMB 1.43 trillion yuan; NPL ratio jumped to 1.6 percent. NPLs of commercial banks climbed up by RMB 250.6 billion yuan to RMB 842.6 billion yuan, which demonstrated an upward trend for 13 consecutive quarters. NPL ratio of commercial banks went up by 0.25 percentage point to 1.25 percent at end-2014. Special-mention loans of banking institutions increased by RMB 0.66 trillion yuan to RMB 3.57 trillion yuan. Special-mention loans ratio increased by 0.29 percentage point to 3.98 percent. Loan loss provision continued to stand at a high level. At end-2014, the provision coverage ratio of commercial banks dropped by 50.64 percentage points to 232.06 percent, while the loan loss provision adequacy ratio dropped by 40.02 percentage points to 281.19 percent. The provision to loan ratio recorded 2.9 percent, up by 0.07 percentage point from the previous year.

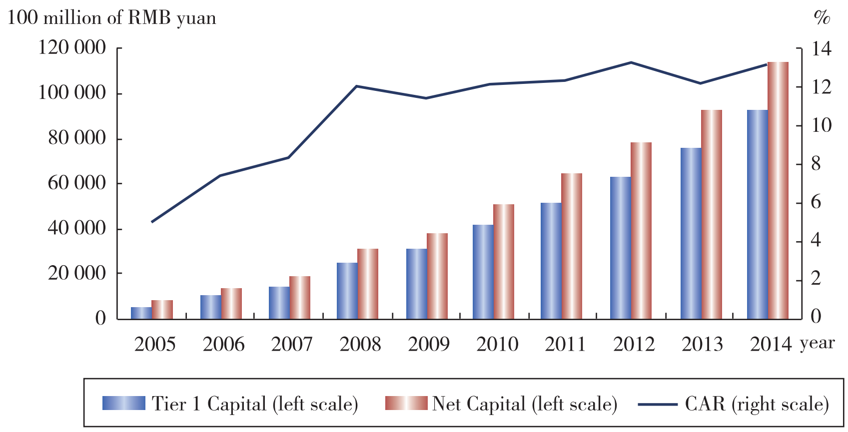
Figure 3.5 Changes of Special Mention Loans and NPLs



Source: The CBRC.

Progress was made to recapitalize the banking system, and banks' capital position was improved. In 2014, the banking institutions achieved additional capital replenishment of RMB 2.31 trillion yuan, composed of retained earnings of RMB 1.32 trillion yuan, equity financing of RMB 248.6 billion yuan, and hybrid bonds of RMB 215.8 billion yuan. In 2014, ICBC, ABC, BOC, SPDB and Industrial Bank issued preferred stocks of RMB 34.55 billion yuan, RMB 40 billion yuan, RMB 72 billion yuan, RMB 15 billion yuan and RMB 13 billion yuan respectively, either in domestic or oversea markets. Overall, internal financing of banks' capital replenishment accounted for 56.84 percent of the total capital increase, down by 23.15 percentage points from 2013. At end-2014, the CAR of commercial banks registered at 13.18 percent, with a y-o-y increase of 0.99 percentage point (Figure 3.6). The CET1 Ratio recorded 10.56 percent, up by 0.61 percentage point from the previous year. Total CET1 of commercial banks was RMB 9.07 trillion yuan or 80.1 percent of the total capital, which demonstrated a high capital quality.

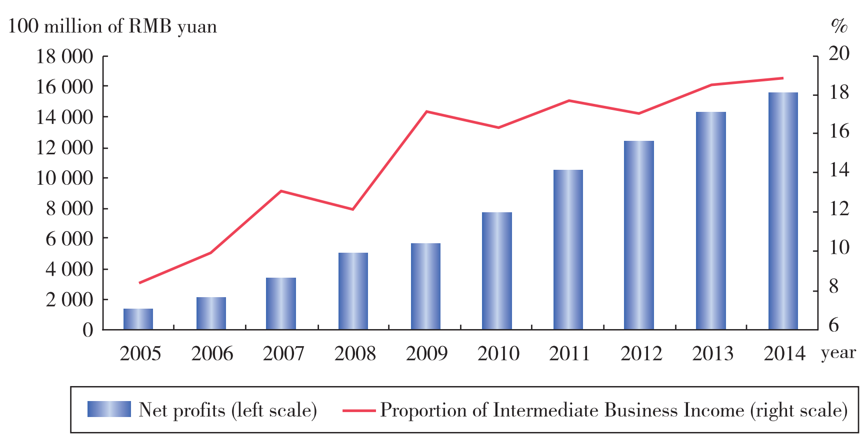
Figure 3.6 CAR and Capital Structure of Banking Institutions in Recent Years



Source: The CBRC.

Growth of profitability decelerated, while profit pattern should be improved. In 2014, the whole year net profit of the banking institutions was RMB 1.93 trillion yuan. The y-o-y growth was 10.5 percent, a decrease of 4.73 percentage points over the previous year. The ROA dropped by 0.03 percentage point to 1.19 percent, while ROE dropped 1.37 percentage points to 17.15 percent. The net interest margin of banking institutions climbed up by 0.02 percentage point to 2.71 percent. Intermediate businesses income accounted for 15.93 percent, up by 0.06 percentage point from the previous year (Figure 3.7). In line with the interest rate liberalization, the contraction in net interest margin could continue for some time due to the asymmetric adjustments of deposit rates and lending rates. For banking financial institutions, the proportion of net interest income in total net income registered 57.76 percent in 2014, up by 4.48 percentage points from the previous year.

Figure 3.7 Profitability and Proportion of Intermediate Business Income



Source: The CBRC.

The overall credit risk was manageable, while default risks spotlighted certain industries or areas. In 2014, credit conditions of the banking institutions deteriorated, but largely within control. From the industry perspective, the rebound of NPLs mainly flagged in segments of wholesale and retail, manufacturing and credit cards. New NPL recognition in these three segments accounted for 80% of the total NPL increase. Signs of corporate defaults mainly emerged in industries saddled with excessive capacity, such as steel, cement, electrolytic aluminum, shipping, PV, coal manufactures, etc. The prevalent reciprocal guarantees among enterprises fueled NPL recognition. Along with the accelerated correction in overcapacity sectors, NPL ratios in certain areas are expected to go up. As for the regional distribution, NPLs were concentrated in areas where overcapacity industries or resource-consuming industries dominated. Due to economic deterioration in certain regions and industries, as well as business distress in some enterprises, signs of credit risk have spread from industries with overcapacity to other industries, from eastern regions to central and western regions, from small and micro enterprises to large and medium-sized manufactures. A rebound of NPLs is expected in the banking sector.

Box 6 Analysis of Banking Risk Contagion

Financial risk contagion in the banking sector refers to the phenomenon that fluctuations or adverse changes in trading counterparties, connected institutions and financial markets cause direct or indirect negative impact on an individual banking institution or the entire banking system. In the event that there is a default risk exposure of a specific banking institution, its trading counterparts may suffer from direct losses and other banking institutions' balance sheets may be damaged due to a violent volatility of asset prices in the financial market. Meanwhile, risks might be transmitted to the entire banking system by market expectation channels or irrational psychological panics. We have learned from the financial network model commonly used in the international community and dynamically simulated infectious risks' pathways and influence between banks, based on the interbank business data.

I. Financial Network Model

Based on interbank data, we can set the financial network model as follows:

Network nodes are different banking institutions, and the lines connecting nodes are the interbank capital flows between banking institutions. Assume that there are n banking institutions and their capital flows will form an "n multiplies n" Matrix M, called interbank capital matrix. At a certain timing, Matrix M is shown like this:

$$M = \begin{bmatrix} M_{1,1} & \cdots & M_{1,j} & \cdots & M_{1,n} \\ \vdots & & & & \vdots \\ M_{i,1} & \cdots & M_{i,j} & \cdots & M_{i,n} \\ \vdots & & & & \vdots \\ M_{n,1} & \cdots & M_{n,j} & \cdots & M_{n,n} \end{bmatrix}$$

Among them, the element M_{ij} represents the interbank asset size formed at a certain timing when a banking institution i flowed out its capital to another banking institution j. Similarly, we can define the vector of overall asset size of the interbank market, $\bar{p} = (p_1, \dots, p_n)$, as follows: $p_i = \sum_{j=1}^{n} M_{ij}$, among which p_i represents the interbank asset size formed when the banking institution i flowed out its capital to all the banking institutions.

Assume that an interbank capital default happens to a banking institution h in the banking system, and that the assets and liabilities of another bank i having interbank transactions with it shall be shown as follow:

$$a_i + (p_i - \theta M_{ih}) = (k_i - \theta M_{ih}) + b_i$$

Among them, a_i, k_i, and b_i represent respectively other assets, net capital, and liabilities of the bank i, while θ represents loss given default (LGD). In the event that the capital of the bank i after offsetting losses is less than the minimum regulatory capital requirement, we can determine that the bank i has been infected and an interbank default will happen to it. If the bank h's default causes N banks to be infected in the banking system, we should consider next the contagion effect brought by N banks' simultaneous defaults, repeat the above steps until there are no defaults of new banks, and finally we would be able to calculate the contagious effect that the bank h's interbank default has on other banks in the banking system.

II. Analysis of China's Bank Network Stability

According to the above ideas, we chose the data concerning interbank assets and liabilities among 28 commercial banks with an asset size of above RMB 400 billion at the end of December 2014 to estimate two-way interbank risk exposures. These 28 commercial banks include 6 large commercial banks, 12 joint-stock commercial banks, 6 urban commercial banks and 4 rural commercial banks. We have set two different shock scenarios, namely the mild shock scenario, in which LGD (θ) is set as 50% and the severe shock scenario, in which LGD (θ) is set as 100%. In accordance with the *Measures for*

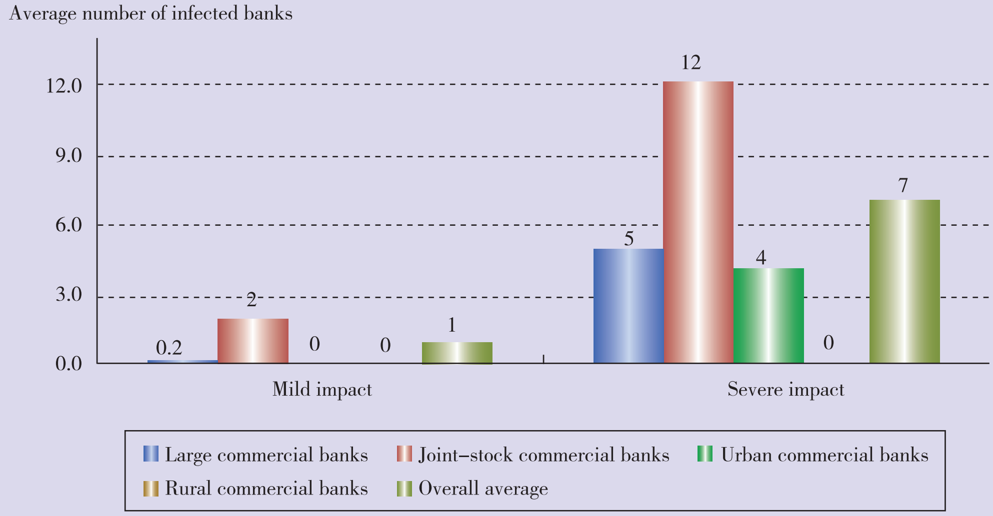
Capital Management of Commercial Banks (Trial), the minimum capital requirement for commercial banks is 8.9%. In the mild shock scenario, it is less likely to see the risk of these 28 commercial banks infected. In the severe shock scenario, the network stability situation of these 28 commercial banks is shown as follows:

Large commercial banks. When an interbank credit default shock occurs from a large commercial bank, on average five banks will be infected, two rounds of risk contagion will continue, and the proportion of consumed capital in the total capital of these 28 banks is about 9%. In terms of interbank market trading, large commercial banks are major capital exporters. Comparatively speaking, the size of interbank capital flowing into them is generally smaller. Therefore, risks brought by the interbank credit default impact are less infectious. However, in terms of being infected, the Postal Savings Bank of China (PSBC), one of the six large banks, is more vulnerable to the infection of other interbank credit default risks: interbank credit default shock from 20 institutions will be spread to the PSBC, mainly due to the large number and capital size of the interbank borrowing counterparties of the PSBC.

Joint-stock commercial banks. When an interbank credit default shock occurs from joint-stock commercial banks, on average 12 banks will be infected, the number of rounds of risk contagion will be increased to three, and the proportion of consumed capital in the total capital of these 28 banks is 24%. Overall, in terms of interbank market trading, joint-stock commercial banks are major capital borrowers. Once there is an interbank credit default, its contagion spectrum will be wide. In terms of capital flow direction, a joint-stock commercial bank mainly borrows interbank capital from large commercial banks and other joint-stock commercial banks, while it mainly lends interbank capital to other joint-stock commercial banks and urban commercial banks.

Urban commercial banks. When an interbank credit default shock occurs from an urban commercial bank, its impact and contagion spectrum are limited. When a single urban commercial bank produces an interbank credit default shock, it will infect four banks in the only one round of risk contagion and the proportion of consumed capital is about 7%. Analyzing the data of sample banks, we find that urban commercial banks are capital net importers in the interbank market, whereas their capital raised is mainly from large commercial banks and joint-stock commercial banks. Interbank lending counterparties of urban commercial banks are distributed in a dispersive fashion, so when an urban commercial bank brings an interbank default shock on its major interbank counterparties, the impact will not be too significant.

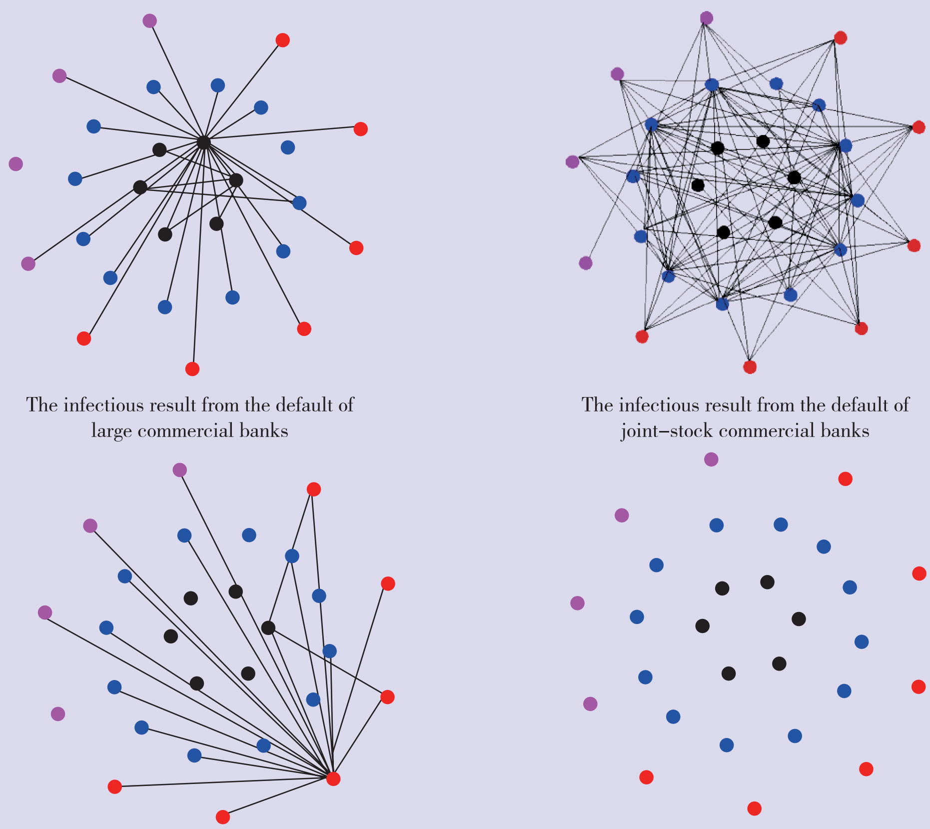
Figure 3.8 Infectious Risks of Commercial Banks by Bank Type



Rural commercial banks. Infectious risk of rural commercial banks is small. When any of them gives out an interbank credit default shock, it won't lead to contagion to other banks within the system.

Overall, after experiencing a standard development, the interbank business of banking institutions tends to grow in a decelerated way, thus reducing the possibility of interbank credit default risk contagion. Meanwhile, the majority of commercial banks have further increased registered capital either via issuing preferred stocks or via issuing secondary capital debts, therefore enhancing their ability to fend off infectious risks. By institution type, the vast majority of large commercial banks own a strong ability to withstand infectious risks, and joint-stock commercial banks' interbank credit default risk is rather infectious in the banking network, whereas urban and rural commercial banks' default risks are less infectious.

Figure 3.9 The infectious situation in the Bank Network——by bank type



The infectious result from the default of large commercial banks

The infectious result from the default of joint–stock commercial banks

The infectious result from the default of urban commercial banks

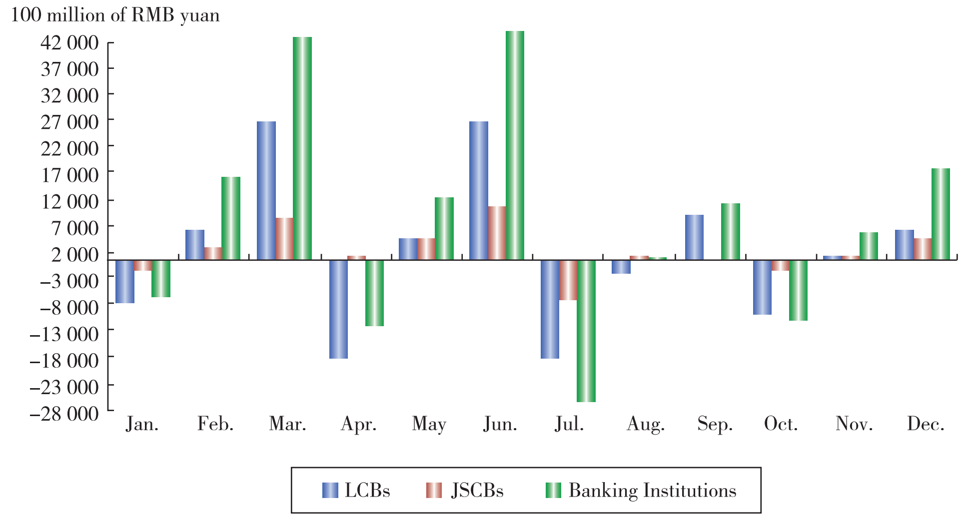
The infectious result from the default of rural commercial banks

Note: in the graphs, the dots refer to banks where black dots represent large commercial banks, blue dots joint-stock commercial banks, red dots urban commercial banks and pink dots rural commercial banks. The lines mean that connected banks are all infected.

The real estate market underwent certain correction, which induced higher potential risks. In some regions, the supply and demand relationship in the real estate market reversed, the inventory digestion process slowed, and housing price was increasingly expected to enter a downturn. In Dec. 2014, among the 70 large and medium-sized cities, 66 cities experienced downward newly-built house prices, while 60 cities experienced downward second-hand house prices. Some of the real estate developers were faced with squeezed funding sources. The pressure to turn to multi-channel financing with higher cost induced potential risks. At end-2014, the total outstanding real estate loans extended by banking institutions amounted to RMB 17.37 trillion yuan, 21.27 percent of the total outstanding loans. It is expected that the ongoing correction in the real estate market will exert an influence on the credit portfolio of the banking sector.

The overall liquidity was sufficient, while increasing instabilities loomed in the market. Firstly, at end-2014, the liquidity ratio of banking institutions was 46.44 percent, and deposit to loan ratio was 65.09 percent, which implied an overall sufficient liquidity situation. Secondly, the stress of wide fluctuation in banks' deposits remained unchanged, and the funding stability of banking institutions needed to be improved. In 2014, for banking institutions, the largest volatility in cross-quarter monthly deposits could be over RMB 7 trillion yuan (Figure 3.8). The deposit to liability ratio of commercial banks dropped from 87.20 percent in 2006 to 78.61 percent in 2014. Thirdly, banks' liability structure changed under the tress of staggered growth of deposits. In 2014, the deposit accumulation of banking institutions slowed to a single-digit growth, while interbank liabilities, as a relatively unstable funding source expanded rapidly. At end-2014, the outstanding claims on other banking institutions represented 15.13 percent of Chinese banks' aggregate liabilities, up by 1.54 percentage points from the previous year. The significant interbank exposure, with maturity mismatch between assets and liabilities inevitably stretched the liquidity management of some small and medium-sized banks.

Figure 3.10 Monthly Deposits of Banking Institutions in 2014



Source: The PBC, the CBRC.

The off-balance sheet business continued expansion, while the embedded risks remained. At end-2014, the outstanding balance of the off-balance sheet businesses of banking institutions (including entrust loans and entrust investments) registered RMB 70.44 trillion yuan, an increase of RMB 12.74 trillion yuan or a y-o-y growth of 22.07 percent. The outstanding balance accounted for 40.87 percent of Chinese banks' aggregated balance sheets, up by 2.75 percentage points from the previous year. Among this total, entrusted loans were RMB 10.69 trillion yuan, entrusted investments RMB 4.26 trillion yuan and bank acceptance RMB 9.83 trillion yuan. Great attention should be paid to the following embedded risks. Firstly, weak links in the management of off-balance sheet businesses might exaggerate operational risks. Secondly, off-balance sheet items could be used to circumvent and undermine financial regulations. Thirdly, by pushing non-performing assets off balance sheets, banks could whitewash potential credit risks.

Shadow banking continued serving the economic and social developments, while potential risks loomed in the system. In recent years, shadow banking has increased rapidly in China. While contributing to the real economic growth and broadening funding channels, shadow banking posed new types of risks to the financial system. Shadow banking activities might give rise to risk concerns including complicated intermediation chains, low transparency, blurry legal structures, poor management or inconsistent regulations. Firstly, some shadow banking entities pumped funding to local government financing vehicles (LGFVs), real estate sectors, and industries with high pollution, excessive energy consumption or overcapacity, which drove a wedge into macro economic control and economic restructuring. Secondly, shadow banking was interconnected with traditional financial system, and risks could be highly contagious without firewall in place. Thirdly, without comprehensive risk reminders, the unreasonably high yields of some shadow banking activities might mislead clients, undermine financial discipline and exacerbate unfair competitions.

Great attention should be paid to the combat against financial crimes, and risks embedded in illegal fundraising and private lending might erode the banking system. Due to poor risk management and weak internal control, some banking institutions claimed banking crimes, such as forgery deposit certificates, loan deceits, electronic banking fraudulence, cyber attacks, etc. As for the illegal fundraising cases, both the caseload and money involved increased and cross-provincal crimes appeared increasing. Some wealth management products, non-financing guarantee institutions, P2P lending and farmers' specialized cooperatives were also involved in illegal fundraising activities, and the associated contagion risks were eroding the banking system.

III. Outlook

Looking forward into 2015, banking institutions will continuously adhere to policies of reform, opening-up and development, respect the market's decisive role in allocating resources, encourage financial innovations, enhance the capacity to bolster real economy and manage financial risks, and strive for a sustainable development.

Ensure the implementation of prudent monetary policies, and support the stable economic growth and restructuring. Banking institutions should make efforts to promote economic restructuring, maintain a reasonable credit expansion, and pursue favorable credit policies to key segments, such as advanced manufacturing, strategically emerging industries, modern info-tech industries, info-consuming industries, labor-intensive industries and environmentally friendly industries, etc. Differentiated credit policies should be put into effect under the necessity of industries with overcapacity. Efforts should be made to address funding stress of small and micro enterprises, agriculture, rural areas, farmers and people's livelihood. On the premise of manageable risk-taking and sustainable business running, banking institutions will also support enterprises to implement the "going-out" strategy, optimize resource allocation on global market, and transfer excess capacity abroad.

Deepen reforms of banking sector, aiming to achieve a more sustainable growth. To implement the reform package for policy financial institutions, measures should be taken to cultivate a modern capital restraint mechanism, strengthen corporate governance and adhere to favorable fiscal and taxation polices. Remain committed to the reform agenda of large commercial banks, improve the modern enterprise system and speed up the restructuring process. Enlarge the scope of pilot reform of ABC's County Area Banking Division (CABD), and explore a more sustainable commercialized business model to support agriculture and rural areas. Continue the commercialization process of asset management companies. More support will be extended to eligible private capital to establish financial institutions, including small and medium-sized banks. Proper measures should be taken to secure the introduction of deposit insurance mechanism, and shore up the safeguard for financial stability.

Promote vigorous financial innovations, and stimulate the vitality of market players. Banking institutions should be motivated to accelerate financial innovations in line with new momentum as well as new business model in the financial sector. Trials of credit asset securitization will be expanded to unleash credit constrains. Capital replenishment mechanism should be improved by introducing innovative capital instruments, and qualified commercial banks are encouraged to issue contingent capital instruments. Bring new ways to enlarge debt financing, steer qualified banking institutions to invest in the interbank market, and elevate the size and market share of debt financing. Continue to explore the applicability of medium and large-sized agricultural machinery, contractual management rights of rural land and rural homeland as mortgages collaterals.

Strengthen risk monitoring and analysis, and mitigate existing risks in a timely way. Efforts should be made to take dynamic approach for risk identification, deliver comprehensive emergency plans and properly resolve risk events. Firstly, banking institutions should not squeeze credit to potentially high competitive enterprises, which are experiencing temporary financial difficulties. Non-viable zombie enterprises, whose products are barely competitive, should be shut down by means of bankruptcy or liquidation.

Unlawful acts including debt escape should be firmly resisted. Secondly, banking institutions should stay responsive to the correction in real estate market, persist implementing the differentiated housing credit policy and take feasible measures to prevent associated credit risks. Thirdly, introduce supporting policies to manage local government liabilities. Following up funding must be ensured for projects in construction, while effective measures are required to mitigate risks embedded in LGFVs. The pilot trail of Public-Private-Partnership (PPP) will be encouraged to finance urban infrastructure investments.

Extend supervisory capabilities, and improve robustness of the banking sector. Firstly, continuously streamline the differentiated supervisory process by drawing on the international experiences, refresh supervisory philosophy, enhance supervisory capabilities, and build up a domestic supervisory mechanism in line with international standards. Secondly, the international supervisory reforms should be timely promulgated in domestic market, and soundness standards of the banking sector should be intensified. Thirdly, take strict precautions against key areas, and define supervisory responsibilities for small lending companies, financing guarantee institutions and new types of rural cooperative financial institutions. Supervision should be intensified with regard to banking asset quality, wealth management businesses, off-balance sheet items and inter-bank businesses. It is a must to hold the bottom line of preventing systemic and regional risks from happening.

Chapter IV

Securities and Futures Sector

In 2014, the securities and futures sector kept the stable development momentum. The innovation capacity was enhanced, together with the institutional infrastructure. The regulatory transformation continued to press ahead, and the openness of the sector made positive progress. Going forward, in order to adapt to the new normal of economic development, the sector's risk management capacity needs to be strengthened, reforms of basic institutions should be deepened on all fronts, and the two-way openness should be further lifted.

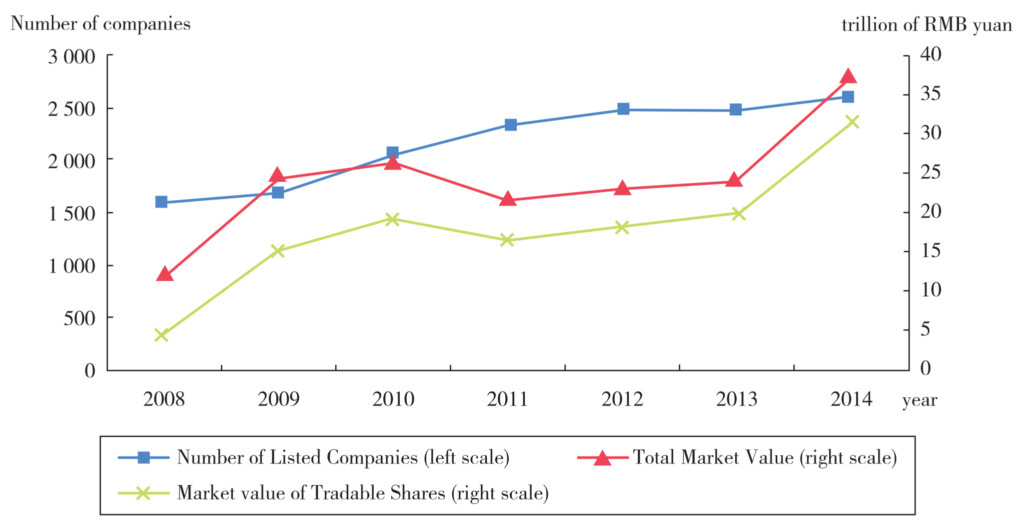
I. Recent Developments

1. The market entities developed stably

The capitalization of listed companies increased rapidly. By the end of 2014, there were 2613 listed companies on Shanghai Stock Exchange and Shenzhen Stock Exchange altogether, an increase of 124 from end-2013 y-o-y. In particular, there were 125 newly listed companies, and one company was delisted. The total market value and the market value of tradable shares reached RMB 37.25 and RMB 31.56 trillion yuan respectively, an increase of 55.83 percent and 58.14 percent y-o-y (Figure 4.1). The market value of tradable shares accounted for 84.72 percent of the total market value, up by 1.24 percentage points from the end of the previous year.

The number of companies listed on the "New Third Board" and their equity financing grew rapidly. As of end-2014, a total of 1572 companies were listed on the National Equities Exchange and Quotations System for Small and Medium Enterprises ("New Third Board"), an increase of 1216 from the end of 2013. The total shares and market capitalization reached 65.835 billion shares and RMB 459.142 billion yuan, up 5.78 and 7.3 times y-o-y, respectively.

Figure 4.1 Number and Market Value of Listed Companies, 2008-2014



Source: The CSRC.

The companies listed in 2014 realized equity financing of RMB 13.2 billion yuan, a y-o-y increase of 12 times, which showed that the financing function of the "New Third Board" was gradually strengthened.

The number of securities and futures companies increased steadily. By the end of 2014, there were 121 securities companies, up by 6 y-o-y, of which 22 firms were listed securities companies, up by 2 y-o-y. There were 153 futures companies, down by 3 y-o-y. The number of fund management companies was 95, up by 6 y-o-y (Figure 4.2).

The assets of securities and futures sector grew. By the end of 2014, the total assets of securities companies (excluding customers' assets) amounted to RMB 2.84 trillion yuan, up by RMB 1.32 trillion yuan and 86.57 percent y-o-y. The futures companies' assets (excluding customers' assets) totaled RMB 72.876 billion yuan, up RMB 9.887 billion yuan or 15.70 percent y-o-y. The total assets of fund management companies[①] (excluding customers' assets) posted RMB 82.701 billion yuan, up by RMB 15.346 billion yuan or 22.78 percent y-o-y. There were 1897 public equity funds managed by fund management companies, with 4.2 trillion units and a total net asset value of RMB 4.54 trillion yuan, up 34.74 percent and 51.05 percent[②] respectively y-o-y.

Figure 4.2 Number of Institutions Operating in the Securities and Futures Sector, 2004-2014

Source: The CSRC.

① Excluding other asset management institutions with public equity fund licenses.

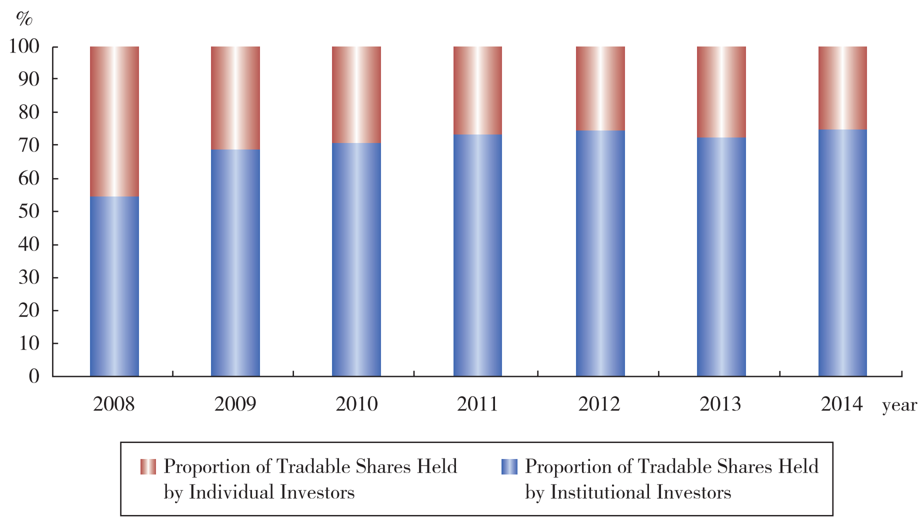
② Financial data of securities companies, futures companies and fund management companies in 2014 were not audited. The same applies in other chapters.

Product innovation by securities companies was pushed forward steadily. The *Opinions on Further Promoting the Innovation and Development of Securities Service Providers* was announced, which clarified how to promote innovation and development of securities institutions from three aspects including setting up modern investment banks, supporting innovation of businesses and products, and pushing ahead regulatory transformation. The innovation of financing-related businesses of securities companies made steady progress. The securities companies also conducted various pilot programs, such as trading and market making, commodities business, and credit risk mitigation products, and their channels for supplementing capital were also broaden. The *Opinions on Promoting the Innovation and Development of the Securities Investment Fund Industry* was announced, which clarified the general principles, major tasks and specific measures for innovation and development of fund management companies in the next stage. The reform of diversifying shareholders of fund management companies made steady progress, and professionals were allowed to hold shares in the companies. After the release of the *Measures for the Administration of the Operations of Publicly-raised Securities Investment Funds*, the business scope of public equity funds kept growing, and the innovation of products and services were strengthened. For example, close-ended funds that participated in the shareholding reforms of SOEs, funds that participated in the "Shanghai-Hong Kong Stock Connect" program, index-linked funds that were developed by using Internet-enabled big data and other innovative products were launched. The entities that were permitted to conduct asset securitization expanded from securities companies to include subsidiaries of fund management companies. The *Opinions on Further Promoting the Innovation and Development of Firms Engaged in Futures-related Businesses* was announced, which clarified how to promote innovation and development of futures companies through efforts on eight aspects such as improving the ability of supporting the real economy, enhancing the competitiveness of futures companies, and strengthening investors protection. Futures companies began to provide asset management products that manage assets in one account on behalf of more than one principal. Their business scope expanded, and natural persons were allowed to be shareholders.

Development of securities and futures companies was better regulated. The announcement of the *Norms for Overall Risk Management of Securities Companies* and the *Guidelines for the Management of Liquidity Risk of Securities Companies* helped securities companies to gradually set up and improve a comprehensive risk management system and liquidity risk management system. The release of the *Supplementary Notice on Further Regulatory Issues Related to Asset Management Business of Securities Companies* and the *Notice on Further Strengthening Risk Management of Specific Clients' Asset Management Business by Fund Management Companies and Their Subsidiaries* would help promote orderly and healthy development of asset management business of securities companies and fund management companies. *The Measures on for the Supervision and Administration of Futures Companies* was announced, which set out regulations on futures companies from nine aspects such as lowering market access requirements, improving business scope, and strengthening investors protection. This reflected the philosophy of functional supervision and moderate supervision, thus is conducive to promoting innovation and development of the futures industry, and improving the capability of futures companies to serve the real economy as well as enhancing their international competitiveness.

Institutional investors went from strength to strength. Securities companies and their asset management subsidiaries continued to actively participate in public equity fund business. The announcement of the *Notice of Improving Regulation over the Proportion of Usage of Insurance Capital* raised the upper limit of equity assets in which insurance companies can invest from 25 percent to 30 percent, which led to a growing proportion of capital that institutional investors could invest in the capital market. By the end of 2014, the market value for tradable shares held by institutional investors in Shanghai and Shenzhen Stock Markets represented 74.97 percent of the total A-share market value, marking an increase of 2.23 percentage points y-o-y and the 5th consecutive year above 70 percent (Figure 4.3).

Figure 4.3 Comparison of Proportion of Tradable Shares Held by Institutional and Individual Investors in Tradable A-Share Market, 2008-2014



Source: The CSRC.

2. Institutional infrastructure made steady progress

The reform of IPO system continued to deepen. Continued efforts were made to study the reform plan of IPO system, to set up a market-driven and well regulated IPO system with clarified responsibilities, well-defined expectations and focus on information disclosure. The approval process of IPO and refinancing was improved, regulation over issuance of new stocks was strengthened, and a regular inspection mechanism for issuing and underwriting was established. The amendment of the *Tentative Measures on Administration of Initial Public Offerings and Listings on the GEB* lowered the market access criteria of the GEB. At the same time, a refinancing system in line with the characteristics of the GEB and a mechanism for targeted issuance of additional stocks featuring small-value, rapidness, and flexibility forcefully supported the financing needs of companies listed on the GEB.

Environment for mergers and acquisitions (M&A) of listed companies was further improved. The announcement of the *Administrative Measures for the Material Asset Restructuring of Listed Companies* and the *Decision on Amending the* "*Administrative Measures on Acquisitions of Listed Companies*" reduced and simplified administrative approvals required for M&A, improved supporting arrangements through strengthening information disclosure, reinforcing in-process and *ex post* supervision, urging intermediaries to earnestly fulfill their responsibilities, and protecting investors' rights and interests. It also streamlined approval procedure, and further diversified payment tools for M&A. In 2014, listed companies conducted a total of 2920 deals of M&A, with the trading volume amounting to about RMB 1.45 trillion yuan.

The basic institutions for the private equity sector were set up. The regulatory mechanism and self-disciplinary management system for the private equity sector were set up in line with the principles of conducting self-discipline, bottom line supervision, and promoting development. The *Administrative Measures on Supervising and Regulating the Private Equity Sector* was released, and the standards for qualified private equity investors were erected. Statistics and information reporting system for the sector was improved, and the monitoring work using statistics data was launched. The OTC market for securities companies continued to develop, and the inter-institution private equity products quoting and service system continued to strengthen. As of end-2014, registered private equity fund managers totaled 4955, and private equity funds that had filed for records reached 7654, that managed RMB 2.12 trillion yuan of assets. A total of 42 securities companies were qualified for the OTC market pilot program, whereas 68 securities companies were interconnected with the private equity quoting system.

Innovation of securities, futures and derivatives market accelerated. The announcement of the *Administrative Measures* *on the Pilot Program of Preferred Stocks* allowed qualified listed and non-listed companies to issue preferred stocks, which was conducive to the shareholding reform, and could help diversify investible securities products. Throughout 2014, 5 listed companies raised RMB 103 billion yuan by issuing preferred stocks. The trading system for crude oil futures was continuously improved, and the preparatory work for the pilot program of SSE 50 ETF options and 10-year government bond futures kicked off. Six futures products including polypropylene, SPHC, late indica rice, ferrosilicon, manganese-silicon, and corn starch were introduced to the market. Continuous trading was expanded to cover another 17 products such as iron ore, deformed steel bar, and sugar. By the end of 2014, futures products increased to 46 covering basically all major areas of the national economy including agriculture, metals, energy, chemical engineering, and finance.

The investors' protection mechanism was continuously improved. The *Several Opinions on Reforming, Improving and Strictly Implementing the Delisting System of Listed Companies* was announced, which comprehensively specified scenarios of self-initiated delisting and forced delisting, and strengthened protection of the legitimate rights and interests of investors of the delisted companies. Cash dividend policies of listed companies were made more reasonable, stable and transparent, and so was the system linking cash dividends with refinancing. Listed companies continued to improve investors' voting system. In 2014, about 2208 and 1250 companies adopted internet voting and cumulative voting respectively, through which the right of small and medium-sized investors to participate in voting was further guaranteed. The hotline 12386 responsible for receiving investors' inquiries, advice and complaints completed over 100,000 cases of various kinds.

Box 7 The system of third-party custodian of clients' trading and settlement funds of securities firms further improved

Around 2002, large-scale and massive misappropriations of clients' trading and settlement funds by securities companies finally led up to a redemption crisis of the securities sector. The cumulation of years of risks severely damaged investors' interests, and the securities market faced with a severe crisis for survival and trust. In order to protect the rights and interests of investors, maintain financial and social stability, and help the securities sector to get rid of the difficulties, the government conducted comprehensive governance of the securities sector. In this process, the PBC worked with other government agencies to push for the establishment of the system of third-party custodian of clients' trading and settlement funds so as to eradicate misappropriation of clients' trading and settlement funds. As of end-

August 2007, the entire securities sector achieved third-party custodian.

1. The third-party custodian system effectively guaranteed the safety of clients' securities trading and settlement funds

Under the third-party custodian system, securities companies are only in charge of securities trading, shares management, and clearing and payment for their clients, whereas custodian banks are responsible for managing ledgers and summary accounts of clients' margin funds, providing margin deposit and withdrawal services, and supporting securities companies to handle fund settlements among legal persons such as custodian companies and OTC counterparties. The third-party custodian system follows the principle of "securities companies managing securities, and banks managing funds", achieves separation between securities companies' own funds and clients' margin funds, thus putting an end to the misappropriations of clients' trading and settlement funds. After the third-party custodian system was set up and put into operation eight years ago, a complete custodian system comprising of depository and settlement companies, securities companies, custodian banks, and the securities investor protection fund has taken shape in the A share market, with each institution fulfilling its own responsibilities. The system enables monitoring over the balance and changes of clients' funds through cross check and articulation of data, so as to effectively guarantee the safety of clients' securities trading and settlement funds.

2. The current third-party custodian system still has room for improvement

In practice, only the A-share clients' securities trading and settlement funds need to be put under third-party custodian system, and one customer can choose multiple custodian banks. In the context of diversifying financial instruments, the effectiveness of third-party custodian might be impaired. In addition, there are some other problems concerning the third-party custodian system. For example, the legal attribute of clients' trading and settlement funds needs to be clarified, not enough legal power is delegated to the securities investor protection fund that is in charge of monitoring third-party custodian institutions, the standards for compensating for clients' trading and settlement funds need to be improved, and the coordination between securities companies and custodian banks needs to be strengthened. In all, there is still room for improvement.

In general, the third-party custodian scheme for securities companies' clients trading and settlement funds has effectively mitigated the risks of misappropriating clients' funds by securities companies. Going forward, in line with the requirements of "gradually improve the custodian system for securities companies' clients trading and settlement funds on the premise of controlling risks" put forward in the *Several Opinions of the State Council on Further Promoting Healthy Development of the Capital Market*, and on the precondition of maintaining the basic framework of the third-party custodian scheme, efforts should be made to clarify the legal attribute of the funds under custodian, elevate the legal power delegated to the supervisory body, study in a coordinated manner the compensation standards, and strengthen communication and coordination between banks and securities companies, in order to improve the third-party custodian scheme on the basis of ensuring the safety of clients' trading and settlement funds.

3. The regulatory transformation was earnestly implemented

The reform of the administrative approval system was deepened. To carry out the *Several Opinions of the State Council on Further Promoting Healthy Development of the Capital Market*, progress was made in streamlining the administrative process and delegating power to lower levels. In 2014, the securities regulatory authority canceled administrative approval requirements for 13 items and partial approval requirements for 4 items, and eliminated the requirement for review of listed companies' acquisition reports and other far-reaching items. As a result, over 90 percent of the M&A transactions of listed companies would require no approval. Public equity fund products adopted the registration system. Basically, new products such as private equity funds were supposed to require no prior approval, and they would be subject to industrial associations' self-disciplined management. Meanwhile, non-administrative approval items were to be eradicated. Apart from one item that was intended to become administrative approval requirement, all the other nine items were planned to be eliminated.

The legal system was further improved. Legal institutions continued to be set up. The *Securities Law (Amendment Draft)* was submitted to NPC Standing Committee for the first read. The *Futures Law (Draft)* was improved. The *Regulatory Rules on Listed Companies* was being reviewed by the State Council. The administrative reconciliation pilot program in the securities and futures sector was approved by the State Council. The capital market credit information dataset was put into operation, and a platform for inquiring information on misconducts of the securities and futures sector was rolled out.

The law enforcement was strengthened. The law enforcement and ad hoc inspection was expanded to crack down on illicit behaviors in the securities and futures sector. In 2014, 678 reported clues were accepted, up 11 percent y-o-y; 205 new investigations were carried out, up 8 percent y-o-y; 74 cases were handed over to the public security system, up 76 percent y-o-y. While clamping down insider trading, significant cases involving listed companies' embezzling large amount of capital and serious financial account forging were targeted as priority cases, for which law enforcement was strengthened.

Supervisory cooperation among relevant authorities was improved. According to the MOU between the PBC and CSRC on *Strengthening Supervisory Cooperation in the Securities and Futures Sector and Jointly Safeguarding Financial Stability*, the two agencies shared information with each other, continued to steadily push ahead supervisory cooperation, and conducted cooperation in cracking down on illegal behaviors in the securities and futures sector, standardizing regional transaction platforms, monitoring financial risks, and protecting investors' rights and interests.

4. The openness of the sector made further progress

Two-way openness made groundbreaking progress. On November 17, 2014, the pilot program of Shanghai-Hong Kong Stock Connect was launched, marking the establishment of a new model for cross-border securities trading featuring convenience and controllable risks. By the end of 2014, the cumulative turnover of the Connect Program posted RMB 188.1 billion yuan, including northbound trading of RMB 167.5 billion yuan and southbound trading of RMB 20.6 billion yuan. The *Notice on Taxation Policies Governing the Pilot Program of Shanghai-Hong Kong Stock Connect Program* was announced simultaneously, which specified policies on income tax, business tax, and stamp tax on securities (stock) involving the Connect Program, thus facilitating smooth progressing of the Program.

Schemes of domestic enterprises going for overseas listing and qualified institutional investors were further improved. Domestic enterprises' applications for overseas IPO were exempted from financial examination. During 2014, a total of 49 such kind of applications were approved, up 113 percent y-o-y. The capital raised from overseas IPO reached USD 37 billion, up 112 percent y-o-y. B-share companies were still supported to pursue IPOs on the Hong Kong Stock Market by the way of introduction. By the end of 2014, the total quota for RMB Qualified Foreign Institutional Investors (RQFII) grew to RMB 820 billion yuan. The *Notice of Exempting Corporate Income Tax on Proceeds of Disposition of Stocks and Other Equity Assets under QFII and RQFII Schemes* was announced, which eliminated uncertainty of corporate income tax policies for Qualified Foreign Institutional Investors ("QFII") and RQFII, and further improved the opening environment.

Shanghai Free Trade Zone has become an important portal for opening up. In September 2014, the Shanghai Gold Exchange set up a precious metal market within the Shanghai Free Trade Zone open for both domestic and overseas investors, thus making a breakthrough in internationalization of membership, transaction funds, pricing, and delivery. The Shanghai Stock Exchange made preparations for the establishment of a financial asset trading platform within the Shanghai Free Trade Zone, which, building upon the Shanghai International Energy Trade Center, actively pushed ahead preparatory work for setting up a crude oil futures market in line with international norms. Securities and futures companies were allowed to set up various specialized subsidiaries and branches within the Shanghai Free Trade Zone.

Box 8 Successful launch of the Shanghai-Hong Kong Stock Connect Program

With the approval of the State Council, the Shanghai-Hong Kong Stock Connect program was officially launched on November 17, 2014. The program is one of the major reforms for implementing the decisions of the Third Plenary Session of the 18th CPC Central Committee and the *Several Opinions of the State Council on Further Promoting Healthy Development of the Capital Market*, and a remarkable breakthrough in terms of two-way opening-up between the Chinese mainland capital market and the Hong Kong capital market. The launch of the program helps expand the investment channels of Chinese mainland and Hong Kong investors, optimize the market structure, and strengthen the positions of Shanghai and Hong Kong as financial centers, while building a new platform for the capital market reform and the financial reform, and facilitating cross-border capital flows and convertibility of financial transactions.

The Shanghai-Hong Kong Stock Connect program refers to the program by which each of the Shanghai Stock Exchange ("SSE") and the Hong Kong Exchanges and Clearing Limited ("HKEx") allows investors in the Chinese mainland and Hong Kong to trade the stocks listed on the other exchange within a specified range through local securities companies (or brokers). System arrangements primarily consist that: First, the home market rules are applied, i.e., the program should follow local existing laws, regulations and rules on transaction and settlement in the two markets. A public company should comply with the regulatory requirements of the jurisdiction in which the company is listed, while a securities company or broker should comply with the regulatory requirements of the jurisdiction in which the securities company or the broker is located. Second, the direct connection model is adopted, i.e., each of the SSE and the HKEx establishes a securities trading service company at the other exchange to provide order routing services, receiving the orders from the investors having opened any account at the exchange for buying and/or selling the stocks listed on the other exchange. Third, the directly connected cross-border settlement model is employed, i.e., each of the clearing houses in the Chinese mainland and Hong Kong acts as the nominal holder of the stocks bought through the program by any local investor respectively, and serves as the clearing participant against the other clearing house. Fourth, the underlying stocks selected are restricted within certain range. Fifth, the program is only available when both Shanghai and Hong Kong are on a trading day and can satisfy settlement arrangements. Sixth, the overall quotas are controlled, while real-time monitoring is implemented. Among others, the aggregate quota of the Shanghai Stock Connect is set at RMB 300 billion yuan, with a quota of RMB 13 billion yuan per day, while the aggregate quota of the Hong Kong Stock Connect is fixed at RMB 250 billion yuan, with a quota of RMB 10.5 billion yuan per day. Seventh, the Hong Kong Stock Connect applies the investor suitability mechanisim.

Since its launch, the Shanghai–Hong Kong Stock Connect program has been operating steadily, while trading in both markets has been in good order and presented the following features:

First, the capital flow of the program exhibited a landscape of "hot northbound trading accompanied by sluggish southbound trading". As of end-2014, 576 out of the 596 underlying stocks (including the stocks that have been removed from the pool) under Shanghai Stock Connect were traded, with an aggregate turnover of RMB 167.512 billion yuan, accounting for 0.68 percent of the aggregate A-share turnover of all the underlying stocks under Shanghai Stock Connect. The quota for Shanghai Stock Connect actually used registered RMB 74.3 billion yuan in aggregate, making up 24.77 percent of the total quota for Shanghai Stock Connect. Meanwhile, 270 out of the 273 underlying stocks (including the stocks that have been removed from the pool) under Hong Kong Stock Connect were traded, with an aggregate turnover of RMB 20.563 billion yuan, representing 0.87 percent of the aggregate turnover of all the underlying stocks under Hong Kong Stock Connect. The quota for Hong Kong Stock Connect actually used posted RMB 10.4 billion yuan in aggregate, comprising 4.16 percent of the total quota for Hong Kong Stock Connect. In fact, the actual trading was more dynamic than what is reflected by quota-related data. As of end-2014, the daily average trading volume under Shanghai Stock Connect hit RMB 5.584 billion yuan, 2.2 times of the quota for Shanghai Stock Connect actually used per day (RMB 2.547 billion yuan); and the daily average trading volume under Hong Kong Stock Connect amounted to RMB 734 million yuan, 1.7 times of the quota for Hong Kong Stock Connect actually used per day (RMB 438 million yuan).

Second, capital under Shanghai Stock Connect was in favor of large-cap blue chips, while capital under Hong Kong Stock Connect was rather dispersed. According to trading statistics, as of end-2014, capital under Shanghai Stock Connect mainly flew into large-cap blue chips represented by the constituent stocks of the SSE 180 Index, with RMB 64.2 billion yuan and RMB 4.3 billion yuan flowing into the constituent stocks of the SSE 180 Index and the SSE 380 Index respectively. In terms of trading activity, the turnover of the constituent stocks of the SSE 180 Index traded by investors under Shanghai Stock Connect made up 94 percent of the total turnover under Shanghai Stock Connect, far higher than the proportion made up by the turnover of those of the SSE 380 Index (6 percent). As far as sectors are concerned, capital inflows under Shanghai Stock Connect rather focused on the financial, real estate, consumer discretionary and industrial sectors. As for Hong Kong Stock Connect, the overall trading volume was rather small; capital inflows were rather dispersed in respect of sectors and individual stocks; and the leaders in topping the capital inflow list were the financial and information technology sectors.

Third, account holders and trading under Hong Kong Stock Connect were dominated by individual investors. As of end-2014, the number of accounts of investors in the Chinese mainland that had obtained access to trading under Hong Kong Stock Connect had reached 448,000, including 446,000 individual investors, representing 99.55 percent, and 1,998 institutional investors, representing 0.45 percent. Among the accounts that had engaged in trading under Hong Kong Stock Connect, the aggregate turnover of the accounts held by natural persons had touched RMB 16.492 billion yuan, representing 80.20 percent. Among others, the most active traders were the natural persons boasting a rather big capital size and featuring a daily trading volume between RMB 1 million yuan and RMB 10 million yuan. The aggregate trading volume of these traders posted RMB 6.72 billion yuan, representing 32.68 percent of the total.

Fourth, clearing and settlement of the Shanghai–Hong Kong Stock Connect program operated steadily. Since its launch, clearing and settlement activities relating to the program have operated normally, while cross-border fund transfers and currency exchange-related operations have been completed within the required time frames. As of end-2014, China Securities Depository and Clearing Co., Ltd. ("CSDC") transferred RMB 11.517 billion yuan to Hong Kong and collected RMB 1,040 million yuan of risk control refunds from Hong Kong, completing currency exchange businesses in an amount of RMB 10.478 billion yuan. Regarding Shanghai Stock Connect, the operations of Hong Kong Securities Clearing Company

Limited ("HKSCC") under Shanghai Stock Connect were normal, and an aggregate amount of RMB 69.835 billion yuan of deals under Shanghai Stock Connect were settled. In respect of currency exchange under Hong Kong Stock Connect, CSDC organizes the branches of five currency exchange banks to make offers on a daily basis, and determines the settlement rate under Hong Kong Stock Connect, and the ratio of foreign exchange purchase versus sales settlements applicable to investors accordingly. In general, the exchange rate offers made by the five settlement banks for Hong Kong Stock Connect were good; the settlement rates offered to investors were significantly higher than the market exchange rates offered by the banks over the counter; and the offshore foreign exchange market did not experience any abnormal fluctuation resulting from Hong Kong Stock Connect.

II. Soundness Assessment

1. Some listed companies in certain sectors kept losing money, and attention should be given to the delisting risk of a few companies

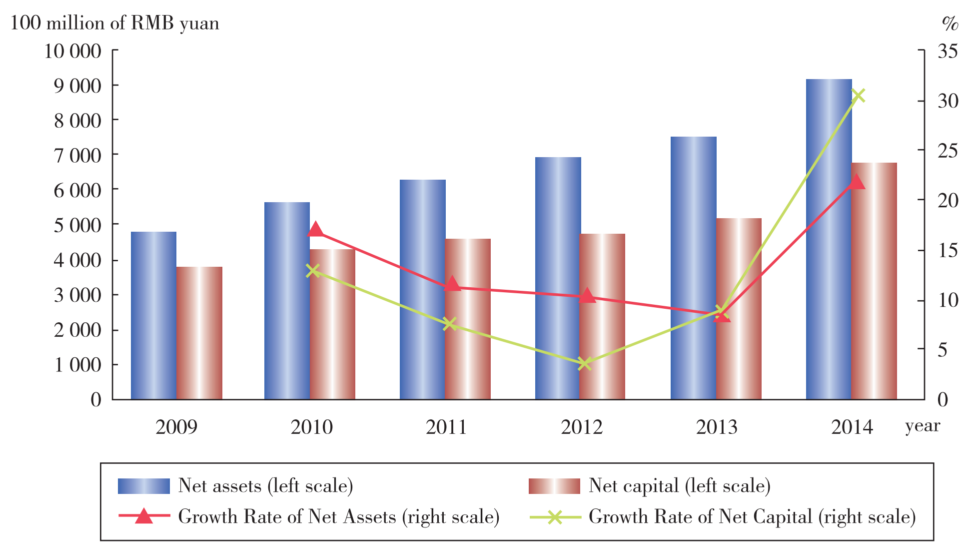
As of April 22, 2015, a total of 2,020 listed companies (those that just went public in 2015 were excluded) released their annual reports, accounting for 77.3 percent of all public companies. Among them, 147 listed companies suffered losses, representing 7.3 percent of the companies that had already released their annual reports. To be specific, 125 went into losses for the first time, while the remaining 22 reported continued losses. The loss-generating firms were mainly from the chemical raw material and chemical manufacturing industry, the computer, communication and other electronic equipment manufacturing industry, the electric machinery and equipment manufacturing industry and the real estate sector. The first two industries were also the ones in which many enterprises reported losses in 2013.

In 2014, affected by the overlapping of growth slowdown, structural adjustments, and the economy digesting legacy impact of the previous stimulus policies, the overall profitability of listed companies weakened to some extent, while operations in some sectors were under rather big pressure. As the structural adjustments of the Chinese economy gradually deepens, the performances of a few listed companies will likely further deteriorate. Therefore, attention should be paid to their delisting risk.

2. Securities companies operated soundly as a whole, whereas compliance risk management of some innovative businesses remained to be strengthened

As of end-2014, the total assets, total net assets and total net capital of securities companies touched RMB 4.09 trillion yuan, RMB 920.519 billion yuan and RMB 679.160 billion yuan, up 96.85 percent, 22.11 percent and 30.49 percent y-o-y respectively (Figure 4.4). After a slowdown for three consecutive years previously, the growth rate of this year picked up rather sharply. In terms of the industry average, the ratio of net capital of a securities company to its total risk-based capital provisions reached 637 percent, up 73 percentage points from end-2013, and the ratio of liabilities to net capital posted 303.04 percent, up 149.34 percentage points from end-2013. The overall risks of securities companies were under control, while their operations were sound in general.

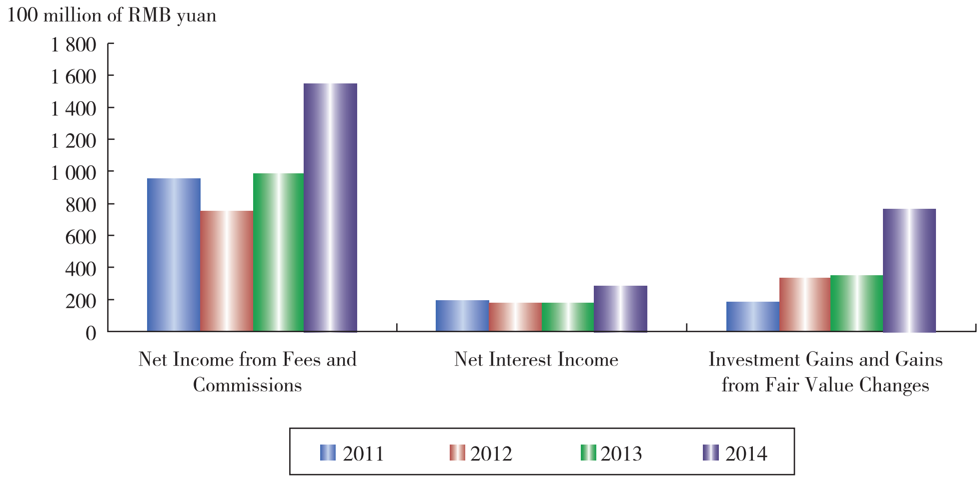
Figure 4.4 Changes of Net Assets and Net Capital of Securities Companies, 2009-2014



Source: The CSRC.

Regarding profitability data, the entire sector generated RMB 260.284 billion yuan of operating revenue in 2014, up 63.49 percent y-o-y. Among others, net income from fees and commissions, securities investment gains (including investment gains and gains from fair value changes) and net interest income posted RMB 154.428 billion yuan, RMB 76.379 billion yuan and RMB 28.372 billion yuan, up 46.05 percent, 119.80 percent and 56.35 percent respectively (Figure 4.5). The net profit of 2014 totaled RMB 96.554 billion yuan in aggregate, up 119.21 percent y-o-y. From the perspective of income composition, fees and commissions were still the major income source of securities companies, though its proportion contracted from 62.00 percent in 2013 to 59.33 percent of this year. As such, the profit structure of securities companies was improved to some extent.

Figure 4.5 Comparison of Securities Companies' Income Structures, 2011-2014



Source: The CSRC.

In 2014, innovative businesses of securities companies, as represented by margin financing and securities lending, grew quite fast, which played a positive role in optimizing the profit structure of securities companies and boosting their business transformation. However, the rapid development of such innovative businesses may also expose the securities sector to potential risks brought by illicit operations. Meanwhile, the capital sources and capital investment targets of some securities companies were imprinted with cross-sector, cross-institution and cross-market attributes. Once the capital market experiences any rather big fluctuation, the risk contagion from such companies to other sectors and markets should be watched out seriously.

Box 9 Rapid development of margin financing and securities lending of securities companies and its influence to the market

Margin financing and securities lending refer to investors' activities of providing collaterals for securities companies for the purposes of borrowing money to buy securities or borrowing securities to sell them. Since the beginning of 2014, margin financing and securities lending businesses explosively growed. As of end-2014, the balance of margin financing and securities lending broke through RMB 1 trillion yuan by standing at RMB 1,025.4 billion yuan, and 2.96 times from the end of 2013, in which the balance of margin financing and of securities lending amounted to RMB 1,017.2 billion yuan and RMB 8.18 billion yuan, up 196 percent and 169 percent y-o-y, respectively. The development of these businesses presented the following traits. First, the balance of margin financing became increasingly occupied by individual clients with high net value. By the end of 2014, the number of clients with a balance of margin financing approached one million, including 2,375 institutional clients, whose balance of margin financing only made up 7.3 percent of the total balance of margin financing. Meanwhile, the balance of margin financing of individual clients, the assets in whose credit accounts exceeded RMB 5 million yuan, surpassed RMB 600 billion yuan, comprising more than 60 percent of the total balance of margin financing. Second, collaterals were mainly large-cap blue chips. By the end of 2014, the total value of collaterals reached about RMB 2.7 trillion yuan, in which the stocks listed on the main boards of the Shanghai and Shenzhen stock exchanges accounted for 73.8 percent of the total value of collaterals. Third, the overall leverage of margin financing and securities lending was not high. By the end of December 2014, the securities companies' liability/asset ratio[①] stood at 69 percent, while their leverage was 3.26 times. At the same time, total assets and total liabilities in clients' credit accounts posted RMB 2.72 trillion yuan and RMB 1.03 trillion yuan respectively, presenting an overall liability/asset ratio of 38 percent.

Margin financing and securities lending businesses grew rapidly, bringing certain positive impact on the market. First, market liquidity was enhanced. In 2014, margin financing and securities lending brought more than RMB 700 billion yuan of incremental funds and more than RMB 5 billion yuan of securities to the securities market. In December, the margin purchase made up 19 percent of the A-share turnover. During the month, the margin purchases of 14 stocks outstripped 50 percent of their A share trading volume in a day, and those of 1,388 stocks exceeded 30 percent of their A share trading volume in a day. Second, margin financing and securities lending provided investors with hedging and risk management tools. The daily selling volume of securities lending reached RMB 4.4 billion yuan in 2014, up 60 percent y-o-y. In December, the selling volume of securities lending accounted for 3 percent of the A-share turnover. Among this total, the selling volume of ETF securities lending registered RMB 45.2 billion yuan, which was nearly equal to the buying volume of margin financing. Third, the profitability of securities companies was improved, beneficial to further optimizing their profit structure. In 2014, the interest income generated by securities companies from their margin financing and securities lending operations accounted for 17.1 percent of their operating income, up 5.5 percentage points y-o-y, representing one of the key income

① The assets and liabilities herein exclude transaction settlement funds.

sources of securities companies.

Despite their overall sound performance, margin financing and securities lending businesses also contained certain potential risks. According to on-site inspections made by the securities regulatory authority on the margin financing and securities lending operations of 45 securities companies in 2014, some companies had such problems as illegally extending mature margin financing and securities lending contracts, offering margin financing and securities lending businesses to ineligible clients, failing to promptly disposing clients' collaterals according to regulations, and illegally facilitating margin financing between different clients. For the next step, the infrastructure for avoiding and controlling the risks of margin financing and securities lending operations should be further improved to ensure the steady and healthy development of margin financing and securities lending businesses.

3. With slow growth of their net capital, futures companies' business was not properly diversified

As of end-2014, the total assets (excluding entrusted assets from clients), net assets and net capital of futures companies reached RMB 72.876 billion yuan, RMB 61.998 billion yuan and RMB 48.125 billion yuan, up 14.65 percent, 17.8 percent and 9.13 percent y-o-y, respectively. The total clients' margins totaled RMB 271.465 billion yuan, up 38.74 percent y-o-y. The ratio of their net capital to entrusted assets from clients hit 17.73 percent, down 4.8 percentage points from end-2013. During the year, futures companies generated RMB 19.020 billion yuan of operating revenue, up 3.91 percent y-oy, and RMB 4.152 billion yuan of net profits, up 16.86 percent y-o-y (Figure 4.6).

Figure 4.6 Changes of Major Indicators for Futures Companies, 2011-2014

Source: The CSRC.

The general strength of futures companies was weaker than that of other financial institutions in the securities sector. The main sources of operating revenue of futures companies were fee income and income from interests on clients' margins. In 2014, futures companies generated fee income and net interest income of RMB 10.355 billion yuan and RMB 6.941 billion yuan, making up 54.52 percent and 36.55 percent in their operating revenue respectively. As such, the business structure of futures companies needs to be futher diversified.

4. Whilst the entrusted assets in the fund sector expanded comparatively fast, risk incidents emerged in a few subsidiaries of fund management companies

As of end-2014, the net value of public equity funds posted RMB 4.54 trillion yuan, up 51.19 percent y-o-y. Among open-ended funds, stock market funds represented 28.96 percent, down 7.78 percentage points from end-2013; hybrid funds accounted for 13.28 percent, down 5.46 percentage points from end-2013; bond market funds made up 7.67 percent, down 3.35 percentage points from end-2013; and money market funds comprised 45.99 percent, up 21.07 percentage points from end-2013.

The specific clients' asset management products managed by subsidiaries of fund management companies developed rapidly and reached a total amount of RMB 3.74 trillion yuan as of end-2014, increasing by RMB 2.81 trillion yuan or 302 percent from end-2013. As some subsidiaries of fund management companies mainly conducted conduit business, some capital flew into the real estate sector and LGFVs, implying potential risks. In addition, since the internal control in such subsidiaries may not be strict enough, this kind of conduit business will also likely aggravate potential operational risks in the operation flow of such subsidiaries. In 2014, a few subsidiaries of fund management companies were already penalized by the regulatory authority resulting from non-compliance problems. Some of the subsidiaries were even involved in such risk incidents as misappropriations of the money invested in their products. For the next step, lessons should be learnt from risk incidents. Based on related regulations, such as the *Notice on Further Strengthening Risk Management of Specific Clients' Asset Management Business by Fund Management Companies and Their Subsidiaries*, infrastructure construction should be further ameliorated, and prevention of and control over the risks of the subsidiaries of fund management companies should be truly reinforced.

III. Outlook

In 2015, the securities and futures sector will thoroughly implement the *Several Opinions of the State Council on Further Promoting Healthy Development of the Capital Market*, closely center on serving real economy, and on the basis of a comprehensive in-depth regulatory transformation, accelerate reforms and opening-up, step up market-oriented development and legal system construction, and maintain steady and healthy development.

1. Actively and appropriately advancing the registration-based reform of IPO system, and continuously deepening the reform of the administrative approval system

Authorities should advance the registration-based reform of IPO system, improve the related regulatory system and investor protection system, set up and perfect arrangements on information disclosure, and urge market entities, such as issuers, agencies and investors, to play their expected roles and fulfill their due responsibilities. Besides, the securities regulatory authority should also study and set out a power list and a responsibility list for itself, and explore to work out a negative list. Furthermore, standardized management over administrative review and approval should be bolstered, while a new in-process and ex-post monitoring mechanism should be established through gradual explorations.

2. Increasing new types of products in the securities and futures market, and promoting the development and expansion of securities and futures companies

Efforts should be made to steadily launch an assortment of new products and instruments, including crude oil, SSE 50 ETF options, 10-year government bond futures, and SSE 50 and CSI 500 index futures, boost the development of OTC derivatives market, perfect the market price formation mechanism, and support the real economy's needs for risk management. Besides, focuses should be placed on actively developing the private equity market, bettering the private offering system, advancing the standardized development of private equity funds, motivating private investments, and helping connect capital to enterprising and innovative endeavors. Moreover, attention should be attached to steadily relaxing the entry threshold of the securities and futures sector, and supporting private capital and professionals to initiate, set up or hold shares of the securities and futures companies. Furthermore, it is expected to progressively facilitate cross-licensing among securities and futures companies, step up securities companies to apply for licenses for managing public equity funds and acting as custodians of funds, and endorse asset management institutions such as qualified insurance companies and private equity funds to apply for public equity fund licenses.

3. Further improving laws, rules and regulations of the securities and futures sector, and bettering the investor protection mechanism

Authorities should continue amending the *Securities Law* and enacting the *Futures Law*, drive forward the release of the *Regulatory Rules on Listed Companies* and the legal interpretations identifying behaviors of using information that are not publicly disclosed in trading and manipulating the market. Oriented by investors' needs, a multi-layered system of capital market information disclosure rules should be further improved. Efforts should be made to release measures to manage investor suitability of the securities and futures market, carry out administrative reconciliation pilot programs, and ameliorate the multi-layered investor compensation system consisting of compensations from the investor protection fund, the administrative reconciliation fund and the special compensation fund. Meanwhile, inspection and law enforcement should be comprehensively reinforced, and such illegal and criminal activities as fraudulent offerings and market manipulations should be definitely suppressed. Furthermore, the mechanism for addressing investors' complaints is expected to be improved, whilst the primary responsibility for handling the complaints made by market entities should be located. Moreover, endeavors should be directed to establishing a diversified dispute resolution mechanism, offering mediation and arbitration services in the securities and futures field, and creating the mechanism connecting mediation to arbitration and litigation. In addition, the pilot programs of exercising shareholders' rights should be started, to guide small and medium-sized investors to exercise their rights according to the law. Finally, authorities should also promote the construction of investor education bases, help develop and market influential educating products, and hence facilitate the integration of investor education into the national education system.

4. Further innovating the opening-up model and steadily lifting the two-way opening level

To start with, the authorities should fully recognize the new requirements set by the new normal of economic development to the two-way opening-up of China's capital market, and facilitate reforms with opening-up efforts. Thus, authorities should keep optimizing the Shanghai–Hong Kong Stock Connect mechanism and studing to launch the Shenzhen–Hong Kong Stock Connect Program. Also, efforts should be made to push forward the integration of A shares with international benchmark indices, and further accelerate the internationalization of A shares. What is more, focuses should be placed on facilitating domestic enterprises to be listed abroad, and enhancing the system of QFII and RQFII. Additionally, emphasis should be put on allowing fund products offered in the Chinese mainland and Hong Kong to be mutually recognized, encouraging Hong Kong and Macau to take the lead in experimenting on the opening-up model of "pre-establishment national treatment with a negative list", and releasing policies that support the opening of the capital market of the Shanghai Free Trade Zone.

Chapter V

Insurance Sector

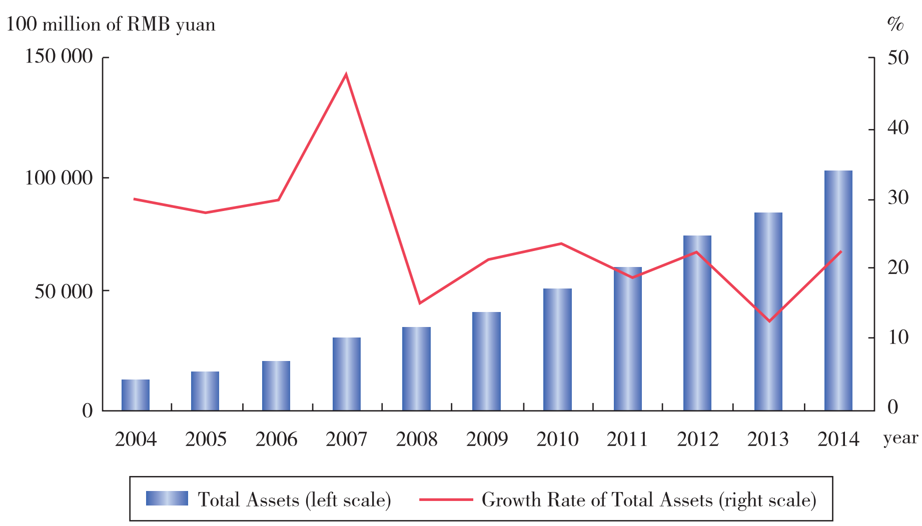
In 2014, China's insurance sector kept on its fast track of growth, with reforms pushed forward, business expanded further, profits enhanced significantly, and the capacity to serve the economy and society strengthened. Currently, the insurance sector reform is facing a critical period, and more attention should be paid to potential sector risks. Next, China's insurance sector will take initiative in adapting to the New Normal of the economy, continue to push for transformation and upgrading, accelerate reforms and innovation, and strive to realize sustainable growth.

I. Recent Developments

1. The number of insurance institutions increased, and the asset size registered dramatic growth

By the end of 2014, the number of insurance institutions in China has increased by 6 to 180. To be specific, there are 10 insurance groups and shareholding companies, 65 property insurance companies, 74 personal insurance companies, 9 reinsurance companies, 18 asset management companies, one export credit insurance company and three others. The total assets of the insurance sector registered 10.2 trillion yuan, up by 22.6 percent y-o-y (Figure 5.1). Specifically, total assets of property insurance companies, personal insurance companies, reinsurance companies and asset management companies had reached 1.4 trillion yuan, 8.2 trillion yuan, 351.4 billion yuan, and 24.1 billion yuan, up by 28.5 percent, 20.9 percent, 67 percent, and 26.1 percent y-o-y, respectively.

Figure 5.1 Total Assets and Growth Rate of the Insurance Sector



Source: The CIRC.

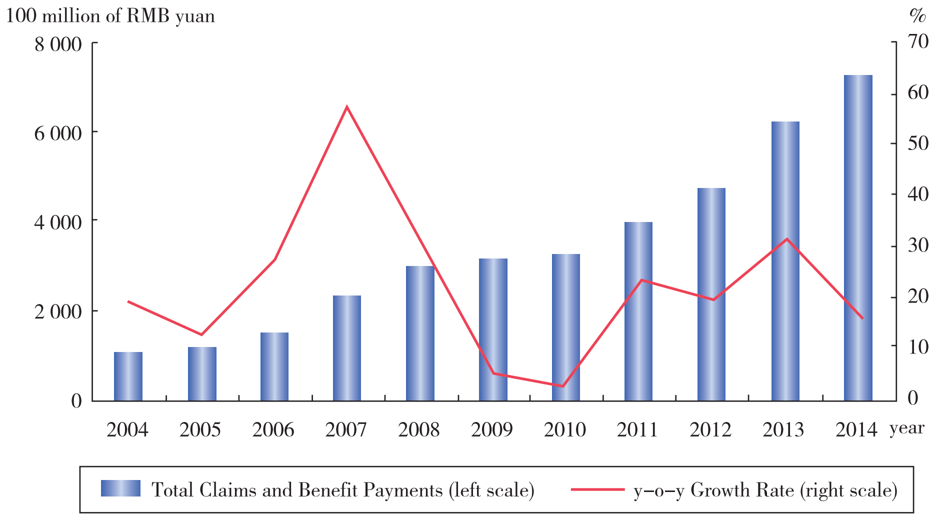
2. Premium income grew fast with further structural adjustment

In 2014, the premium income of China's insurance sector reached a total sum of 2.0 trillion yuan, up by 17.5 percent y-o-y. Among the total, premium income of property insurance, life insurance, health insurance, and accident insurance increased by 16 percent, 15.7 percent, 41.3 percent, and 17.6 percent y-o-y to 720.3 billion yuan, 1.1 trillion yuan, 158.7 billion yuan, and 54.3 billion yuan, respectively. Among property insurance, premium income of guarantee insurance, which has a close tie with the real economy, went up by 66 percent y-o-y, and that of credit insurance registered an increase of 29 percent y-o-y. Among life insurance, ordinary life insurance's proportion in premium income increased, while that of participating insurance declined; the premium income of annuity insurance, which is closely related to safeguarding people's livelihood, experienced a growth of 77 percent y-o-y.

3. Risk prevention function was strengthened, and the capability to serve the economy and society was significantly enhanced

In 2014, the insurance sector has provided the society with risk coverage worthy of 1114 trillion yuan, up by 25.5 percent y-o-y, with claims and benefit payments registering 721.6 billion yuan, up by 16.2 percent y-o-y (Figure 5-2). The premium income of agriculture insurance reached 32.6 billion yuan, up by 6.2 percent y-o-y, and the value of risk coverage reached 1.66 trillion yuan, 19.6 percent higher y-o-y. Payments to 35 million rural households affected by natural disasters totaled 21.5 billion yuan, up by 2.9 percent y-o-y. Major crop areas insured exceeded 1.5 billion acres, which accounted for 61.6 percent of all the crops planted nationwide, and the forest areas insured reached 2.47 billion acres, accounting for more than 85 percent of the total forest areas. 392 critical illness insurance pilot coordinating programs were launched across 27 provinces, covering 700 million people and the security level of the insured has risen by 10~15 percentage points generally. Trusted services for enterprise annuity covered 43 thousand enterprises and 8.77 million employees, with the amount of trusted assets and balances of investment management assets reaching 317.4 billion yuan and 375.4 billion yuan, respectively. The liability insurance sector received 25.3 billion yuan worth of premium income and offered a total risk coverage of 66.5 trillion yuan, and achieved new developments in the areas such as environment pollution prevention, medical treatment, and food security. The insurance sector has initiated 1.1 trillion yuan of infrastructure investment plans, up by 56.8 percent y-o-y, among which 107.3 billion yuan was invested directly to the shantytowns transformation and the construction of affordable housing.

Figure 5.2 Insurance Claims and Benefit Payments and Growth Rate



Source: The CIRC.

4. The guiding principle of the development of insurance sector was issued, and various reforms have been pushed forward in a steady way

In August 2014, the State Council issued "Several Opinions on Accelerating Development of a Modern Insurance Service Industry" ("Opinions" for short), which explicitly states overall requirements, major tasks and policies concerning the development of the insurance sector, setting a clear direction for the reforms and development of the insurance sector. In October, the State Council issued "Several Opinions on Accelerating the Development of Commercial Health Insurance", which made clear that China should has basically established a modern commercial health insurance service sector by 2020, which is characterized by sound market mechanism, diversified product lines and companies that are highly credible and perform in compliance with rules. Market access and exit mechanisms were improved continuously, "Management Rules on Mergers and Acquisitions of Insurance Companies" was issued, and four commercial insurance companies were encouraged to embark on short-term export credit insurance business pilot program. Market-based reform on the Utilization of insurance funds was deepened. Regulatory ratios were integrated and simplified, and a new multi-layered ratio regulatory system based on major asset classifications was established, steadily expanding the scope of insurance investment and gradually relaxing the limits on insurance funds in investing in growth enterprises market, preferred stocks, venture capital funds, and etc. The pilot program for insurance funds to establish private equity investment funds was launched, and registration-based reform concerning products such as infrastructure debt investment plans were further promoted. Insurance Asset Management Association of China was established. Catastrophe insurance mechanism was studied, and pilot programs were conducted in Shenzhen and Ningbo.

Box 10 *Several Opinions of the State Council on Accelerating the Development of the Modern Insurance Service Indurstry* was released

The "Opinions" aim to serve the modernization of national governance system and capability building, and consider the development of insurance sector as an integrated part of the overall picture of the economy and society. It requires the sector to be market-oriented and guided by policies, and also stresses reforms, innovation and opening-up. It sets the improvement of the economic compensation mechanism of insurance, the reinforcement of the core function of risk management, and the enhancement of insurance funds allocation efficiency as the sector's development direction, and strives to promote the development of a modern insurance service sector with competitiveness, innovation and vitality. It proposes the goal of raising the insurance penetration (premium income/GDP) to five percent and the insurance density (premiun income/total population) to 3500 yuan per person by 2020.

The main content of the "Opinions" includes the following: actively developing commercial endowment insurance and health insurance, and making commercial insurance an important pillar of the social security system; promoting innovation in public services through purchasing services from the insurance companies by the government; including insurance in the disaster and accident protection and aid system, and establishing catastrophe insurance mechanism; actively developing insurance products that serve agriculture, farmers, and rural areas; letting insurance funds fully play its role in making long-term investment and encouraging innovation in the use of funds to support key national projects and projects concerning people's livelihood, and providing financial support to the development of strategic and emerging industries; deepening the market-based reform of insurance premium rates, promoting reforms on market access and exit mechanisms, expanding market participants of the reinsurance market, and developing regional reinsurance centers; accelerating the construction of China Risk Oriented Solvency System (C-ROSS for short), and strengthening protection of the legal rights of insurance consumers.

The "Opinions" gives a comprehensive plan of the work concerning reforms, development and regulation of the insurance sector in the new era, and is important in ensuring that the insurance sector play an active role in strengthening modern financial system, promoting a development model with higher quality, higher efficiency and upgraded industries, innovating governance of society, and ensuring the stability of the society.

5. Regulatory mechanism and capacity have been continuously improved, and consumer rights are better protected

On-site inspection of corporate governance, special inspection of agriculture insurance, and inspection of the compliance of critical illness insurance were implemented, insurance intermediary market was screened and reorganized, and the risks of several problematic insurance companies were properly dealt with. Solvency capability supervision was strengthened, the study and framing of C-ROSS was completed, and capital classification system of insurance companies was established. Post-investment management of insurance funds was improved, and sales scale, expenditure limits and capital regulation of high cash-value products were clarified. The problems of difficulties in claims in auto insurance and misleading sales in life insurance were dealt with, and the average time from client report to completion of payments for auto insurance claims less than 10 thousand yuan was shortened from 90 days in 2012 to 21 days in 2014. Sales activities of commercial banks acting as agents for insurance business were regulated, regulations on qualifications and business standards for the sale of non-insurance financial products by insurance institutions and insurance sale agents were formulated, and life insurance companies were urged to strengthen accountability for misleading behaviors in sales. The building of the system to protect the rights of insurance consumers was pushed forward, the "Opinions on Strengthening the Protection of Rights and Interests of Insurance Consumer" was issued, and litigation and conciliation docking system for insurance conflicts was established in 139 cities with districts across the country.

II. Soundness Assessment

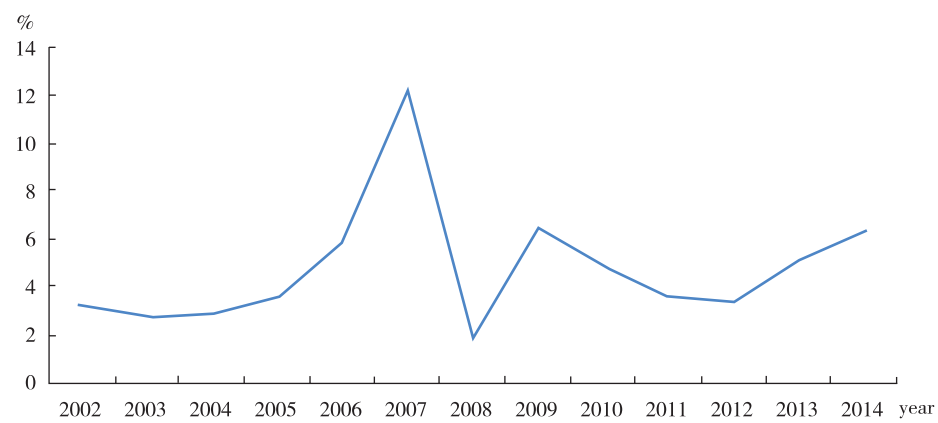
1. Return on investment was improved significantly, while investment risks warrant greater attention

In 2014, the growth of insurance sector's alternative investment① accelerated. As of the

① The insurance sector considers off-standard products such as infrastructure and property investment plans, equity investment plans, bank wealth management products, and assembled funds trust plans and other financial products, as alternative investment.

end of the year, the scale of other investment (mostly alternative investment) has increased significantly by 69.9 percent y-o-y to 2.2 trillion yuan, accounting for 23.7 percent of the total investment balances, up by 6.8 percentage points compared with the previous year. As the stock market prospered since the third quarter of the previous year, the insurance sector invested more funds in equity assets, with investment in stocks and securities investment funds reaching 1.03 trillion yuan, accounting for 11 percent of total investment balances, which was 0.8 percentage point higher than that of the previous year. Equity investment and alternative investment have lifted the return on investment of the insurance sector. In 2014, return on investment registered 535.9 billion yuan, up by 46.5 percent y-o-y, and the return on investment ratio reached 6.3 percent, up by 1.3 percentage points than the previous year, and set a record high for the past five years. However, the risk of insurance investment is also rising, as the real estate market is undergoing adjustment, the potential risks of low-grade credit bonds and some alternative investment projects increase, the potential risks of local government financing platforms are relatively high, and the fluctuations of the stock market are becoming evident.

Figure 5.3 Average ROI of Insurance Funds

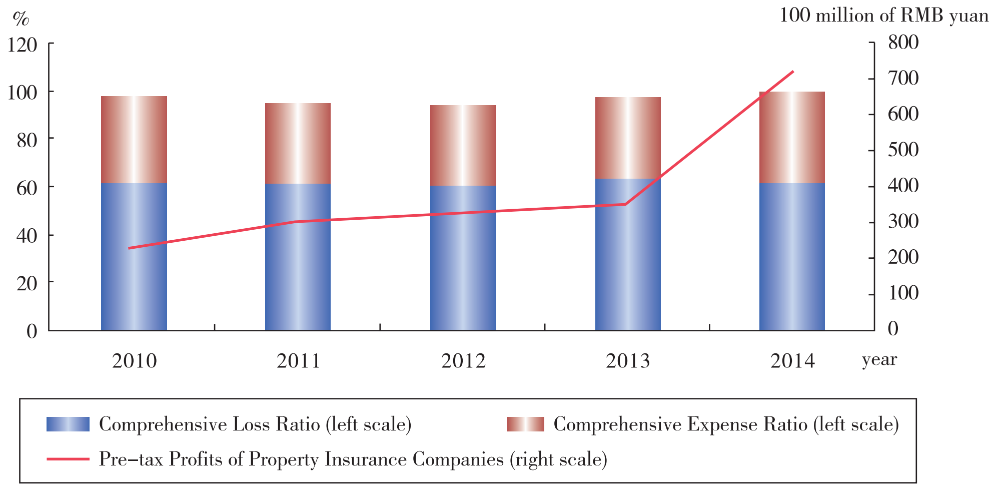


Source: The CIRC.

2. Premium income of property insurance companies experienced lower growth, but the profits went up substantially

In 2014, the premium income of property insurance companies amounted to 754.4 billion yuan, whose growth rate declined by 0.8 percentage point compared with the previous year due to factors such as greater downward pressure in the economy and structural adjustments. The premium income growth of auto insurance, enterprise property insurance and agriculture insurance declined by one percentage point, 2.8 percentage points and 21.2 percentage points than the previous year respectively, and the premium income of household property insurance and cargo insurance dropped by 11.1 percent and 7.3 percent y-o-y respectively. The combined ratio was 99.2 percent in 2014, which was 0.3 percentage point lower than the previous year. Due to substantially higher investment return, it is expected that the profits for all property companies in 2014 would reach 71.6 billion yuan, growing by 104.6 percent y-o-y.

Figure 5.4 The Combined Ratio of Property Insurance Sector and Pre-tax Profits in Recent Years

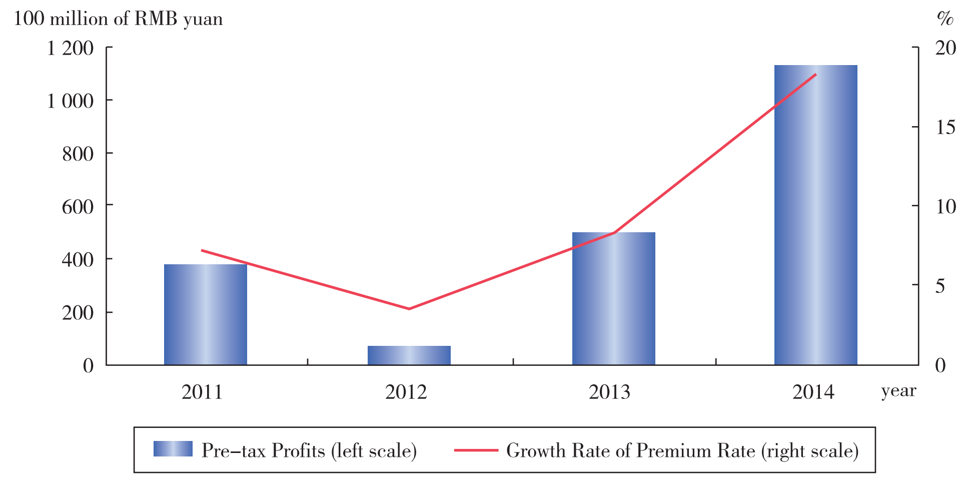


Source: The CIRC.

3. Premium income of personal insurance companies grew fast, and profits reached new record high in recent years

At the beginning of 2014, personal insurers promoted sales activities by focusing on ordinary life insurance that has a higher assumed interest rate. In the first quarter, total premium income of ordinary life insurance reached 514.4 billion yuan, up by 44.2 percent y-o-y, laying a firm foundation for the growth of premium income for the rest of the year. Through 2014, personal insurers received premium income of 1.3 trillion yuan, growing by 18.1 percent y-o-y and up by 10.2 percentage points than the previous year. Benefiting from the rise in stock market and bond market and the high yield debt investment plans, the return on investment of personal insurers was enhanced evidently. In 2014, the profits of personal insurers reached 112.5 billion yuan, up by 126 percent and reached a new record high in recent years.

Figure 5.5 Pre-tax Profits and Growth Rate of Premium Income of the Personal Insurance Companies



Source: The CIRC.

4. Payment upon maturity and surrender sped up for the personal insurance companies, causing some cash flow pressures

In 2014, the total payment upon maturity was close to 200 billion yuan for personal insurers, up by 25 percent y-o-y. Payment for surrender reached 333.1 billion yuan, increasing by 74.7 percent y-o-y, and the surrender rate registered 5.6 percent, up by 1.8 percentage points than the previous year. Main reasons include large amount of sales of high cash-value products by personal insurers in early days, and the tactical surrender behavior of policyholders. Due to predictability of insurance surrender, personal insurers could hedge through sales of new products, and the overall risk is under control. Nevertheless, the fast rising of the amount of payment upon maturity and surrender has caused a decline of net working cash inflow, and increased liquidity pressures of personal insurers.

5. The structure of life insurance products has changed, and the risks concerning high cash-value products need more attention

During 2014, premium rate reform of ordinary life insurance has achieved preliminary results, and the scale of ordinary life insurance dramatically increased. Premium income of ordinary life insurance reached 429.6 billion yuan, rising by 258 percent y-o-y and accounting for 39.4 percent of total premium income of life insurance, up by 26.7 percentage points than the previous year, and the long depressed ordinary life insurance business was revived. Meanwhile, the proportion of premium income of participating insurance in life insurance has dropped significantly from

86.3 percent to 59.7 percent. However, part of ordinary life insurance products is high cash-value products, which have the problems of short maturity, low safeguards, high promised income for consumers, low income for insurance companies, and high surrender rate, high reserve occupation and high capital input. As a result, the implied risks of these products need more attention.

6. Market concentration declined in general, and the market share of foreign-funded insurance institutions expanded

In 2014, the Herfindahl-Hirschman Index (HHI)[①] for property insurance and life insurance market were 0.171 and 0.114, decreasing by 0.003 and 0.027 compared with the previous year. The premium market shares of the largest property insurance company and personal insurance company were 33.4 percent and 26.1 percent, respectively, down by one percentage point and 4.3 percentage points than the previous year. The business of foreign-funded insurance companies expanded quickly. The premium income of foreign-funded property insurance companies and life insurance companies grew by 102.1 percent and 22.9 percent, and their market shares reached 2.2 percent and 5.8 percent, up by 0.9 percentage point and 0.2 percentage point compared with the previous year, respectively.

7. The amount of insurance complaints continued to grow, calling for further strengthening of consumer protection

In 2014, insurance regulators had received 27902 effective cases of complaints, up by 30.6 percent y-o-y. For every 100 million yuan of premium income, property insurance company received 1.68 cases of complaint, up by 0.28 than the previous year; and personal insurance company received 1.19 cases, 0.05 higher than the previous year. In property insurance complaints, conflicts over claims/payments accounted for 75.1 percent, much the same with the previous year; underwriting conflicts accounted for 19.4 percent, up by 6.9 percentage points than the previous year. Among life insurance complaints, non-compliance in sales accounted for 29.1 percent, down by 4.5 percentage points over the previous year, and cases of conflicts over surrender and underwriting accounted for 28.6 percent and 19.5 percent of the total, up by 2.5 percentage points and 4 percentage points than the previous year, respectively.

III. Outlook

As steady progress is being made in the development of new types of industrialization, applications of information technologies, urbanization, and agricultural modernization,

① HHI is the sum of squares of every institution’s market share in the sector. The higher the HHI goes, the more concentrated the market is.

and the establishment of national governance system and modern governance capacity is underway, the development of the insurance sector has great potential. Next, the guiding principles for the development of insurance sector shall be actively pursued, the development model of the sector shall be transformed, and the reforms shall be deepened, so as to satisfy increasing and diversified insurance demand of the society, balance the relationship between development and risk prevention, and promote the long-term sustainable and healthy development of the insurance sector.

1. The insurance sector should take initiative in adapting to the New Normal of the economy, and speed up transformation of its development model

The insurance sector should take initiative in adapting to the New Normal of the economy, accelerate the transformation from extensive growth pattern that focuses on scales and speed to intensive growth pattern that focuses on quality and efficiency, fully play its role in economic compensation and risk management, strengthen traditional business and expand new business, implement diversification strategy, actively cultivate new growth drivers of the sector, fully exploit potentialities of consumer demand, decrease low-level homogeneous competition, emphasize the function of long-term value and safeguard of insurance products, and use new technologies such as internet and big data to promote innovation in products, services, channels, management, and etc. At the same time, the insurance sector will use innovative approaches in investing insurance funds, support projects concerning people's livelihood and key national projects such as major infrastructure construction, shantytowns transformation and urbanization, invest in strategic emerging industries, promote internationalized allocation of insurance assets, and raise the efficiency of assets management.

2. Expand the coverage of insurance and support development of the real economy

The insurance sector will improve agriculture insurance mechanism, promote upgrading and quality improvement of agriculture insurance products, and strive to develop localized agriculture product insurance. It will also promote legislation in catastrophe insurance, study and establish catastrophe insurance fund, frame multilateral catastrophe risk sharing mechanism, implement residential housing earthquake insurance mechanism, and carry on catastrophe insurance pilot program. It will initiate individual tax-deferred commercial endowment insurance pilot program, and push for the launch of preferential tax policy for commercial health insurance as soon as possible. It will revise management mechanism on critical illness insurance, continuously expand the coverage of critical illness insurance to try to cover all provinces and cities. It will endeavor to expand enterprise annuity business, and orderly push forward pilot program of reverse mortgage endowment insurance. It will expand the scale of export credit insurance and provide insurance to all eligible complete sets of large equipments export financing. It will enhance development of credit guarantee insurance, and help solve the problem of a lack of access to financing and the high costs of financing of small and micro enterprises.

3. Market-based reforms will be steadily promoted by focusing on key areas

Market-based reform of life insurance premium rates will be deepened, and reforms on premium rates of universal life insurance and participating insurance will be initiated. Reform on commercial auto insurance premium rates will be steadily pushed forward by launching pilot programs in certain areas first and expanding to the whole nation when conditions are met. Reform on accident insurance pricing mechanism will be studied, and the establishment of compensation rate adjustment mechanism and pricing backtracking mechanism of accident insurance will be explored. Market-based reform on insurance funds utilization will be improved, and all-sector insurance asset trading platform and asset custody center will be established. Reforms on access and exit mechanism in the insurance market will be improved, exit practices from regional market will be accelerated, exit of problematic company branches will be implemented according to law, support to new market participants such as internet insurance, mutual insurance and captive insurers will be strengthened, and establishment of regional reinsurance center will be encouraged. The development of new sales models will be promoted, and pilot reform on individual agent stores exclusive to communities will be explored. Approvals concerning operation qualifications of agriculture insurance and compulsory traffic accident liability insurance for motor vehicles will be gradually phased out, and electronic management system of insurance products will be established.

4. Regulate the market and protect the rights of consumers

Regulation on insurance products and inspection and punishment of violations will be strengthened, monitoring of hot issues and key issues in the market and businesses such as liability insurance will be enhanced, sales misleading behaviors will be corrected, personal insurance product hesitant period mechanism will be standardized, and rectification of insurance intermediary market will be pushed forward continuously. The service quality of settlement of claims for property insurance will be monitored, channels to file complaints will be expanded, accountability will be enhanced, and severe punishment such as market exit will be forced upon companies that seriously disturb market orders. Information disclosure will be strengthened, the establishment of black list mechanism will be explored, and complaints against insurance companies, results of evaluation on degrees of satisfaction, and typical cases where insurance companies harm legal rights of consumers will be regularly published. Compliant processing mechanism and dispute settlement mechanism will be improved, disputes over consumption will be properly dealt with, coordinated supervision of related departments, news media and society will be enhanced to protect insurance consumer rights in a practicable way.

5. Enhance regulation and safeguard the bottom line of not allowing the emergence of either systemic risks or regional risks

The implementation of the C-ROSS will be promoted, and shifting from the old system to the new one will be officially started according to the performance of the new system during the transition period and the preparation of the sector. Regulation on corporate governance will be enhanced, evaluation method of corporate governance structure of insurance companies will be issued, independent director mechanism will be improved, proportion supervision of related party transactions will be strengthened, and consolidated regulation of insurance groups will be enhanced. Risks of payment upon maturity and surrender will be protected against, window guidance will be used in time for companies with relatively high risk of surrender, surrender risk emergency plan will be improved, and potential mass disturbances will be properly dealt with. Fund utilization risks will be prevented, screening and monitoring of cash flow risks of key companies will be implemented, and due attention will be paid to asset and liability matching management of high cash-value business and investment risks of insurance funds in areas such as trusts and real estates. Passing-through of external risks to insurance sector will be prevented, inspection system on major risks and major cases will be established, screening of risks such as illegal fund raising by insurance institutions will be urged, and internal control of insurance companies will be strengthened. Cyber risk and information security risk will be prevented, internet security plan of the insurance sector will be initiated. Insurance sector risk resolution mechanism will be studied and explored, risk resolution instruments will be enriched, emergency plans will be improved, and the bottom line of allowing neither systemic risks nor regional risks to emerge will be safeguarded.

Box 11 The insurance sector has established China Risk Oriented Solvency System

China's first-generation solvency regulation system (solvency I for short) since 2003 has played an important role in setting up the idea of capital constraints and preventing sector risk. As the insurance sector develops, the risks it faces become more diversified and complicated, and solvency I has exposed the shortcomings such as incomplete risk coverage, excessive conservation in asset and liability assessment, and insensibility to risks, which made solvency I impossible to satisfy the requirement of the development and market-based reforms of the sector. In March 2012, the CIRC initiated the work on establishing the C-ROSS, and successively issued "Plans for the Construction of China's Second-generation Solvency Supervision System" and "Overall Frameworks of China's Second-generation Solvency Supervision System", on which basis the CIRC drafted regulatory rules and conducted several rounds of technical standard tests. In February 2015, the CIRC officially issued the pivotal technical standards of the C-ROSS consisting of 17 regulatory rules, which signaled the establishment of a risk-oriented new solvency supervision system in China's insurance sector. At the same time, the insurance sector has entered the transition period of the C-ROSS. During the transition period, insurance companies are required to file reports on the old and new system and obey the rules of the old system. The CIRC will ensure stable transitioning from the old to the new system according to the performance of the new system during transition period and in a flexible and practical manner.

Based on the model of risk stratification of China's insurance sector, the C-ROSS has been structured with a framework of three pillars. The first pillar is quantitative regulatory requirements, and is used to prevent three categories of quantifiable risks, which consist of insurance risk, market risk and credit risk. By identifying and quantifying the above risks scientifically, the first pillar requires insurance companies to hold adequate capital that is in line with its risk exposure. Specific regulatory instruments include minimum capital requirement, valuation standards of available capital, capital classification, stress test and regulatory measures. The second pillar is qualitative supervisory requirements, and is used to prevent operational risk, strategic risk, reputation risk and liquidity risk that are hardly quantifiable. Specific regulatory instruments include integrated risk rating, risk management requirements and assessment, liquidity risk regulation, supervisory inspection and analysis and regulatory measures. The third pillar is market discipline mechanism, which relies on methods such as public information disclosure and higher transparency so that the market can play the role of monitoring and constraining, and prevent risks that cannot be dealt with normal regulatory instruments. Specific instruments include strengthening information disclosure of insurance company solvency, establishing continuous and two-way communication mechanism between regulators and the market, and regulating and guiding credit rating agencies. Compared with solvency I, the C-ROSS has a more complete coverage and more scientific measurement of risks, and is more sensitive to risks. Testing results using June 2014 as the base time have revealed that the overall solvency adequacy ratio of the insurance sector was stable under the C-ROSS. To be specific, the solvency adequacy ratio of personal insurers rose from 215 percent to 219 percent, and that of property insurers decline from 251 percent to 242 percent. Meanwhile, a diversified pattern was witnessed among different insurance companies. Those companies with stable operation and good risk control have seen the level of solvency going up, while those with ambitious strategies and weaker risk control were left with lower the level of solvency.

The C-ROSS uses risk management capacity of insurance company as an input to determine the capital requirement of that company, which establishes economic incentive mechanism for risk management, and will encourage insurance companies to balance risks and capital costs while pursuing development targets such as scales, speed and income. This is helpful in promoting transforming and upgrading of the sector and higher quality and efficiency, guiding insurance companies to continuously enhance risk management capacity, and promoting the healthy development of the sector.

Chapter VI

Financial Market

In 2014, financial market in China operated soundly with steady progress made in various financial market reform and development initiatives, robust transactions, deeper product innovation, and improvement in institutional arrangement on the market, enabling the financial market to play its role in serving the real economy.

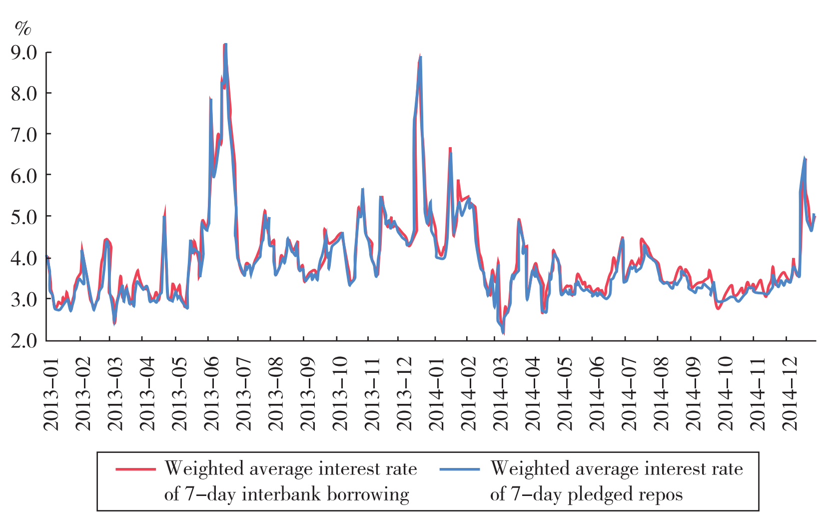
I. Market Overview

1. Money market

Turnover on the money market increased substantially from the previous year, and most of the transactions were of short maturities. In 2014, turnover on the money market totaled RMB 262.1 trillion yuan, gaining 35.3 percent y-o-y. Broken down, turnover of inter-bank borrowing registered RMB 37.7 trillion yuan, growing by 6.0 percent y-o-y, and the turnover of bond repo went up by 41.9 percent y-o-y to RMB 224.4 trillion yuan. In particular, turnover of inter-bank borrowing with maturities of less than 7 days posted RMB 35.6 trillion yuan, accounting for 94 percent of the total, which was flat with the previous year; turnover of pledged repo with maturities within 7 days stood at RMB 196.9 trillion yuan, accounting for 93 percent of the total, which was 1 percentage point more than 2013.

Key interest rates declined significantly with subdued fluctuations. In December 2014, the weighted average interest rate of pledged repo registered 3.49 percent, declining by 79 basis points y-o-y; the weighted average interest rate of interbank borrowing stood at 3.49 percent, falling by 67 basis points y-o-y. There were two major fluctuations on the money market in 2014. On January 20, the weighted average interest rate of 7-day pledged repos surged to the year's high of 6.59 percent; on December 22, the weighted average interest rate of 7-day pledged repos rose to 6.38 percent, reaching the peak of the second half of 2014. In comparison with 2013, money market rates fluctuated within a much narrower range (Figure 6.1).

Figure 6.1 Money market rates in 2014



Source: National Interbank Funding Center.

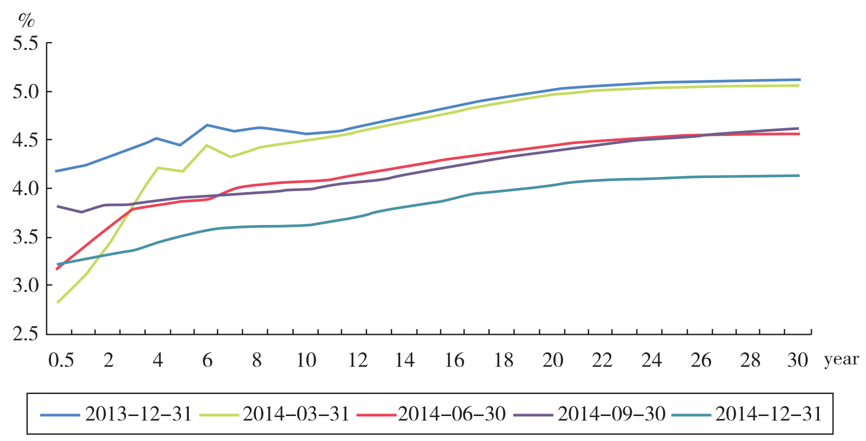
2. The foreign exchange market traded briskly

In 2014, the foreign exchange market in China traded briskly, with trading volume of derivatives exceeding that of spot transactions for the first time. Total trading volume on the inter-bank foreign exchange market totaled USD 8.9 trillion, rising 16.7 percent y-o-y, among which turnover on the RMB foreign exchange market gained 16.9 percent to USD 8.8 trillion, while trading volume of foreign currency pair transactions dropped 5.7 percent y-o-y to USD 60.56 billion. Broken down by products, the turnover of foreign exchange derivatives exceeded that of spot transactions for the first time, with trading volume of spot foreign exchange transactions increasing by 1.4 percent y-o-y to USD 4.2 trillion, and turnover of foreign exchange derivatives rising 7.1 percent y-o-y to USD 4.7 trillion. Broken down by currencies, direct RMB trading against the New Zealand dollar, British pound, euro and Singapore dollar were launched in 2014, further improving the currency structure of the market.

3. Bond market

Turnover of spot bonds edged down compared with 2013, and the yield curve moved downward by a large margin. In 2014, turnover of spot bonds on the inter-bank market stood at RMB 40.4 trillion yuan, representing a y-o-y decline of 3.0 percent. Total trading volume of all bonds on the exchange market rose by 65.03 percent to RMB 2.82 trillion yuan. The inter-bank bond index increased form 143.93 at the beginning of 2014 to 158.69 at the year-end, gaining 10.25 percent or 14.76 points. The government bond index on the exchange market rose by 6.16 points or 4.42 percent from 139.52 at the beginning of the year to 145.68 at end-2014. Government bond yield curve on the inter-bank market shifted downward substantially (Figure 6.2), with yields of 1-year, 3-year, 5-ear,7-year and 10-year government bonds dropping by 96, 105, 95, 98 and 93 points respectively at end-December 2014.

Figure 6.2 Government bond yield curve on the inter-bank bond market in 2014



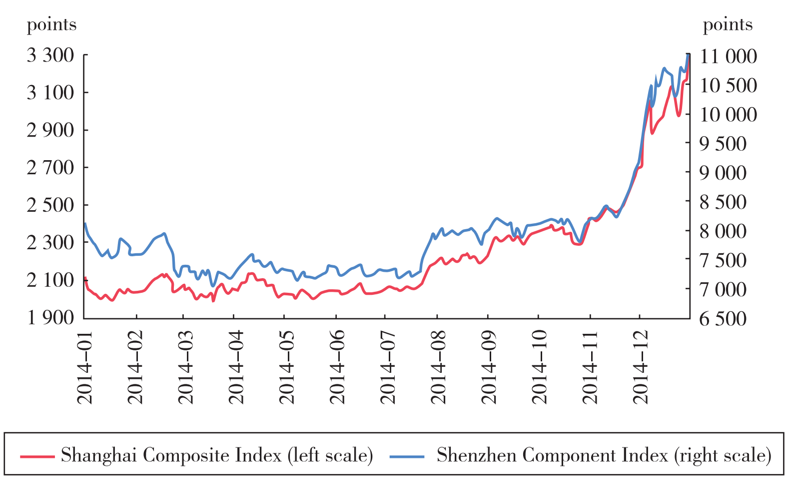
Source：China Central Depository & Clearing Co. Ltd. (CCDC).

The investors continued to increase and diversify. By end-2014, there were altogether 6462 participants on the inter-bank market, increasing by 1579 or 32.34 percent. Among this total, locally-incorporated institutions grossed 1848, while domestic non-legal person institutions totaled 4434. Broken down, four categories of non-legal person institutional investors that met prudential requirements for qualified institutional investors were approved to open accounts, including rural financial institutions and trust products, asset management schemes of securities firms, special client asset management schemes of asset management companies and their subsidiaries, and asset management products of insurance asset management companies. By end-2014, a total number of 211 foreign institutions, including foreign central banks or monetary authorities, international financial institutions, sovereign wealth funds, RMB clearing banks, participating banks in RMB settlement of cross-border trade transactions, foreign insurance institutions, RQFII and QFII, were allowed to enter the inter-bank bond market, 73 more than that at end-2013, and among which 180 were already trading on the market.

4. Stock market

Stock indices went up among fluctuations. In 2014, stock indices on the Shanghai and Shenzhen exchanges increased after hovering within a certain band (Figure 6.3). The Shanghai Composite Index fluctuated within 2000 to 2100 points from January through July, and went up slightly from end-July to November. Since the later part of November, the index rose sharply to peak 3234.68 by the end of the year, an increase of 1118.7 points or 52.9 percent. The Shenzhen Component Index gained 2892.83 points or 35.6 percent to close at 11014.62 points at end-2014. Capitalization of the two stock exchanges totaled RMB 37.3 trillion yuan, among which the capitalization of tradable shares reached RMB 31.6 trillion yuan, increasing by 55.8 percent and 58.1 percent respectively compared with end-2013.

Figure 6.3 Shanghai Composite Index and Shenzhen Component Index in 2014



Source: Wind data.

The stock market traded more briskly. In 2014, total turnover on the two stock exchanges registered RMB 303.64 billion yuan, increasing by RMB 106.69 billion yuan or 54.2 percent y-o-y. The turnover rate on the Shanghai and Shenzhen stock exchanges increased by 50.2 and 88.8 percentage points respectively compared with those in 2013, indicating more active trading than the previous year.

5. Futures market

Turnover on the futures market increased. By end-2014, there were altogether 46 types of futures products in domestic futures market, among which 44 were commodity futures and 2 were financial futures. Total trading volume in domestic market rose by 21.5 percent y-o-y to 2.51 billion, and total turnover gained 9.2 percent to RMB 292.0 trillion yuan. Among this total, trading volume and turnover of commodity futures registered 2.29 billion and RMB 128.0 trillion yuan, while those of financial futures posted 220 million and RMB 164.0 trillion yuan. Compared with the previous year, the trading volume of iron ore, egg, plywood, lead, fiberboard, cotton, aluminum, zinc, methanol, Treasury bond and soybean No. 1 futures contracts rose more significantly.

The price of commodity futures declined in general, with an exception for financial futures. In 2014, the price of commodity futures dropped in general among heightened downward economic pressure and lower demand for commodities. By end-2014, the commodity futures index in China fell 16.4 percent compared with end-2013 to 71.35 points, among which the index of agricultural product futures decreased by 10.0 percent y-o-y to close at 868.9 points, and the index of industrial product futures went down by 15.9 percent compared with end-2013 to 744.05 points. Due to optimistic expectation of reform prospects, successful launch of the Shanghai-Hong Kong Stock Connect and downward movement of interest rates, stock index futures and government bond futures both strengthened. Major contracts of Shanghai Shenzhen 300 stock index futures went up along with the spot stock market in the fourth quarter, which closed at 3593.2 points at end-2014, 1248.2 points more than that at end-2013. Major contracts of Treasury bond futures closed at RMB 96.772 yuan at the year end, which was RMB 4.970 yuan more than that at end-2013.

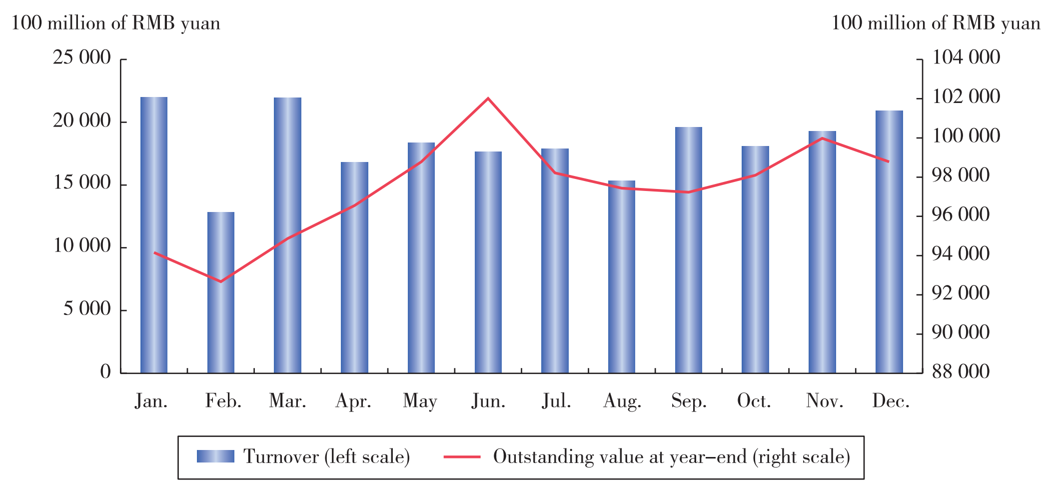
The government bond futures market operated soundly after the relaunch. On September 6 2013, the trading of Treasury bond futures was launched again after 18 years. From then on to end-2014, price of government bond futures remained stable, with the daily fluctuation of major contracts averaging at 0.15 percent, the largest daily fluctuation of 0.82 percent and the average closing basis of futures standing at RMB 0.18 yuan. Market participants diversified, including natural persons, securities firms, private equities, securities investment funds and futures companies' asset management products, with a total number of 19340 investors trading on the market and 62 percent of the position held by legal person investors by end-2014. A total of

5 deliveries were carried out, registering 451, 277, 77, 320 and 305 respectively. Investors were more professional in choosing futures types for delivery, and such deliveries have played a role in reinvigorating the stock of Treasury bond futures. Generally speaking, the relaunch of government bond futures has played a positive role in enhancing the efficiency of government bond market operation, enabling risk management and promote connection between bond markets.

6. The bill market traded actively

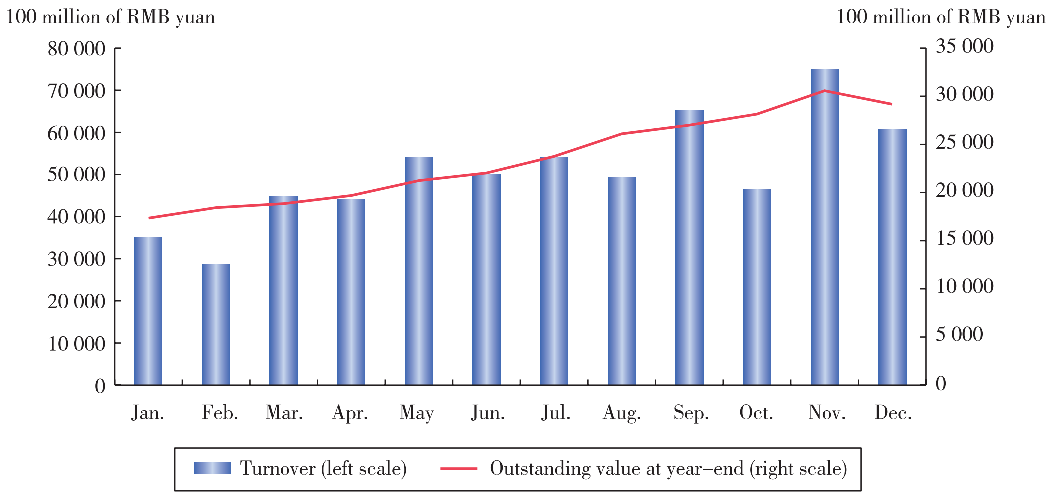
In 2014, bill acceptance in China rose slightly, with accumulated issuance of commercial bills gaining 8.9 percent to RMB 22.1 trillion yuan, representing an acceleration of 4.4 percentage points y-o-y (Figure 6.4). At end-2014, the outstanding value of commercial bills went up by 9.3 percent to RMB 9.9 trillion yuan, which was 1.0 percentage point more y-o-y. Outstanding value of bill financing registered rapid growth, with cumulative value of commercial bills discounted by financial institutions rising by 33.0 percent y-o-y to RMB 60.7 trillion yuan (Figure 6.5). The outstanding value of discounted bills stood at RMB 2.9 trillion yuan, growing by 48.9 percent y-o-y.

Figure 6.4 Issuance of commercial bills in 2014



Source: The PBC.

Figure 6.5 Discounted commercial bills in 2014



Source: The PBC.

7. RMB interest rate derivatives market

Trading on the RMB interest rate derivatives market was significantly more active. In 2014, a total of 43019 RMB interest rate swap transactions were completed, with total value of nominal principal standing at RMB 4.0 trillion yuan, increasing by 47.9 percent y-o-y. Broken down by maturities, trading of swaps with maturities of 1 year or less was the most active, with the value of nominal principal totaling RMB 3.2 trillion yuan, accounting for 78.9 percent of the total. In terms of the reference interest rates, the fixing rate of 7-day repo and Shibor were major reference interest rates for the floating end of the RMB interest rate swaps, with total value of nominal principal of interest rate swaps linked with the two rates accounting for 81.1 percent and 18.2 percent of the total respectively.

Standardized interest rate derivatives got off the ground. Since its launch in November 2014, standardized interest rate derivatives were traded in 212 transactions, with nominal principal totaling RMB 41.35 billion yuan. Among the four types of products, turnover of 1-month Shibor O/N standard overnight index swap and 3-month FR007 standard 7-day repo interest rate swap posted RMB 30.75 billion yuan and RMB 9.5 billion yuan respectively, accounting for 74.4 percent and 22.9 percent of the total, while the turnover of 3-month standard Shibor 1W interest rate swap and 3-month standard Shibor 3M forward interest rate agreements stood at RMB 300 million yuan and RMB 800 million yuan respectively.

Box 12 Setting up the Central Clearing Mechanism of OTC Financial Derivatives

In the aftermath of the 2008 international financial crisis, the FSB and its members have been actively engaged in setting up a central clearing mechanism for OTC derivatives. Compared with bilateral clearing mechanism, central clearing could allow greater room for credit extension and promote trading via contract substitution, and enhance the efficiency of clearing and the use of funds via multilateral netting.

Though a latecomer, China's OTC derivatives market is developing with a good momentum. The growth of RMB interest rate swaps was most rapid, making it the most important OTC derivatives in China. In 2014, total turnover of RMB interest rate swaps registered RMB 4 trillion yuan, accounting for 99 percent of gross turnover of all RMB interest rate derivatives. To further promote the reform and development of the OTC financial derivatives market in China, the PBC has guided the Shanghai Clearing House to launch central clearing of OTC derivatives based on international experience on regulatory reform of OTC derivatives and market players' opinions and suggestions since its establishment in 2009. In December 2013, the Shanghai Clearing House launched central clearing of RMB interest rate swaps, where market participants send their transactions to Shanghai Clearing House for central clearing, and where the Shanghai Clearing House bears claims and liabilities of both counterparties as the central counterparty, derives net interests of market participants on the same settlement day via multilateral netting, and sets up risk control mechanism to ensure that the contracts be honored and interests be netted.

In January 2014, the PBC released the *Notice on the Establishment of an OTC Financial Derivatives Central Clearing Mechanism and Issues Related to the Central Clearing of RMB Interest Rate Swaps*, stipulating mandatory central clearing of RMB interest rate swaps since July 1, 2014, and requiring financial market infrastructure including the Shanghai Clearing House to improve risk management. The Notice marks the establishment of the central clearing mechanism of OTC financial derivatives in China, playing an important role in promoting safe and efficient operation and healthy development of OTC financial derivatives market in China.

The central clearing of RMB interest rate swaps operated soundly after its launch, which was well-received by the market. By end-2014, a total of 72 institutions participated in central clearing of RMB interest rate swaps, with a cumulative settlement value of RMB 2.31 trillion yuan. Among this total, the cumulative settlement value in the second half of 2014 reached RMB 2.28 trillion yuan after the mandatory central clearing requirements took effect, which was 93 times as much as that of the first half.

8. Gold price fluctuated

In 2014, movement of domestic gold price was consistent with international gold price, with a narrowing price gap. The London Gold Price PM Fix declined by USD 2.25 per ounce or 0.2 percent y-o-y to close at USD 1199.25 per ounce at end-2014, with a yearly high of USD1385 per ounce and low of USD 1142 per ounce. The price of AU9999 at Shanghai Gold Exchange reached the year's peak and bottom of RMB 273.6 yuan per gram and RMB 223.00 yuan per gram respectively, and closed at RMB 240.59 yuan per gram at end-2014, which was RMB 4.13 yuan per gram or 1.8 percent higher than end-2013. Trading volume at the Shanghai Gold Exchange rose 59.2 percent y-o-y to 19000 tons, while the turnover went up by 42.8 percent y-o-y to RMB 4.6 trillion yuan.

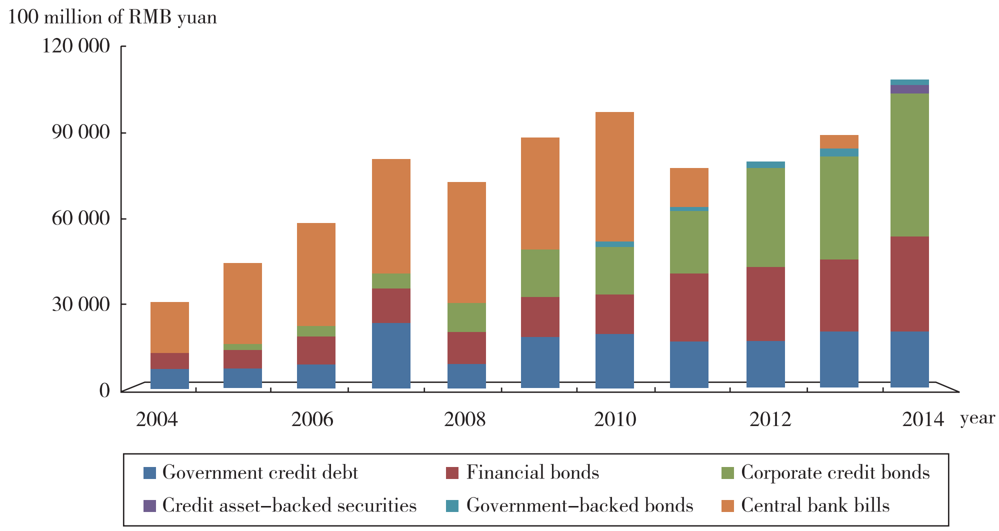
II. Overview of Market Financing

Issuance and depository trust on the bond market continued to increase. In 2014, RMB-denominated bond issuance increased by 22.3 percent y-o-y to RMB 11 trillion yuan. Among this total, a total of RMB 10.7 trillion yuan of RMB-denominated bonds was issued on the inter-bank bond market, which was 24.0 percent more than the previous year. By end-2014, depository trust on the bond market reached RMB 35 trillion yuan, which was 18 percent higher than the previous year. In particular, depository trust of bonds on the inter-bank bond market registered RMB 32.4 trillion yuan, rising by 16.9 percent y-o-y. Currently, the issuer structure, products and credit structure on the inter-bank bond market further diversified, with issuers including the Ministry of Finance, China Development Bank, policy banks, China Railway, commercial banks, non-bank financial institutions, international development institutions and non-financial enterprises (Figure 6.6).

Issuance of corporate credit bonds grew more rapidly. In 2014, issuance of corporate credit bonds totaled RMB 5.2 trillion yuan, which was 38.9 percent more than the previous year, representing an acceleration of 34.9 percentage points. Among this total, issuance of debt financing instruments of non-financial enterprises[①], enterprise bonds and corporate bonds reached RMB 4.1 trillion yuan, RMB 695.2 billion yuan and RMB 348.4 billion yuan in 2014, rising by 45.4 percent, 46.3 percent and -14.6 percent respectively y-o-y (Table 6.1).

① Debt financing instruments of non-financial enterprises include short-term commercial papers, ultra short-term commercial papers, medium-term notes, collective notes issued by SMEs, private placement notes and asset backed securities.

Figure 6.6 The issuance of major bonds on the inter-bank bond market in recent years



Note: 1. Government credit debt includes Treasury bonds and local government bonds.

2. Financial bonds include bonds issued by China Development Bank and other policy banks, short-term financing bills of security firms and other financial bonds.

3. Corporate credit bonds include short-term commercial papers, ultra short-term commercial papers, medium-term notes, collective notes issued by SMEs, private placement notes, asset-backed securities, corporate bonds and enterprise bonds.

Source: China Central Depository & Clearing Co. Ltd., Shanghai Clearing House.

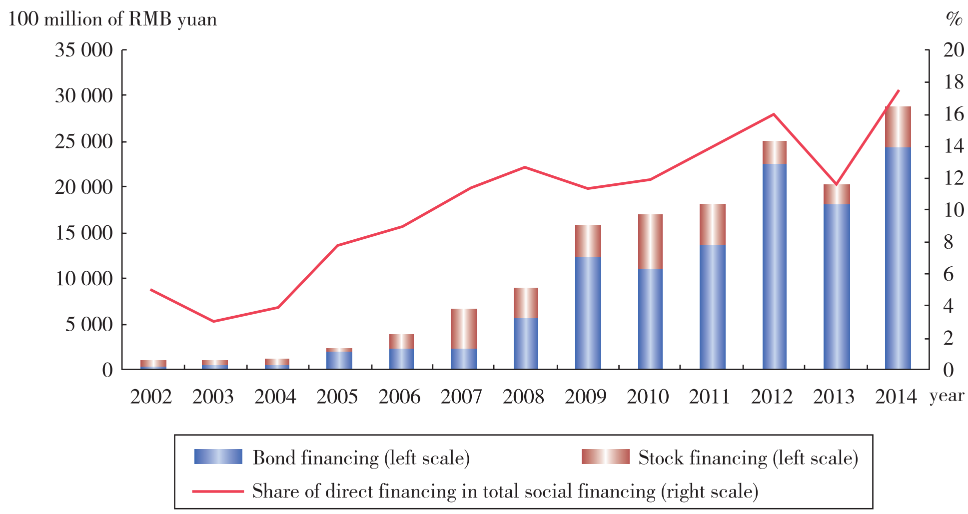
Table 6.1 Issuance of Major Bonds in 2014

Bond types	Issuances (100 million of RMB yuan)	y-o-y increase
Treasury bonds	17 047.3	0.60%
Local Government bonds	4 000.0	14.29%
Bonds issued by China Development Bank and other policy banks	20 760.3	10.31%
Short-term financing bills issued by securities firms	4 246.9	41.76%
Other financial bonds	5 459.5	313.29%
Corporate credit bonds	51 653.4	38.89%
Among which： short-term commercial papers	10 521.5	26.39%
Ultra short-term commercial papers	10 996.0	45.93%
Medium-term notes	9 368.4	39.49%
Collective notes issued by SMEs	4.3	-92.94%
Private placement notes	10 230.2	80.49%
Asset-backed securities	89.2	85.83%
Enterprise bonds	6 952.0	46.29%
Corporate bonds	3 483.8	-14.64%

Source: China Central Depository & Clearing Co. Ltd., Shanghai Clearing House.

Stock financing increased. In 2014, IPO on the A-share market was relaunched, and stock financing soared by 72.5 percent or RMB 203.13 billion yuan to RMB 483.4 billion yuan in 2014. Broken down, funds raised by IPO totaled RMB 66.89 billion yuan; funds raied by secondary offering rose by RMB 170.02 billion yuan or 73.1 percent to RMB 402.72 billion yuan; funds raised by allotment plunged by RMB 33.78 billion yuan or 71.0 percent to RMB 13.8 billion yuan.

Figure 6.7 The direct financing by non-financial enterprises and its proportion in the total social financing in 2002-2014



Source: The PBC.

III. Infrastructure building

Product innovation made headway. In order to stabilize growth and promote restructuring, product innovation was promoted to better facilitate the bond market to play its role in supporting the real economy. In 2014, a series of new products were innovated to meet diversified financing demands of the corporate sector, including project revenue bills, M&A bills, carbon-emission bonds, supply chain bonds and etc. To facilitate overseas use of RMB and further opening up of the financial sector to the foreign investors, further efforts were made to promote domestic financial institutions to issue RMB-denominated bonds overseas, and to support issuance of panda bonds by foreign non-financial institutions. The first policy financial bond was issued by China Development Bank on the exchange market as a pilot program, and efforts were also made to promote the pilot program of corporate exchangeable bond issuance by shareholders of listed companies and short-term corporate bonds and M&A bonds issued by securities firms.

Financing channels of consumer financing

companies were widened, and threshold for bond issuance by financial leasing firms and auto financing companies lowered. On May 8, 2015, the PBC and CBRC issued an announcement, which introduced consumer financing companies as financial bond issuers on the inter-bank bond market for the first time, lowered the threshold for financial bond issuance application by financial leasing firms and auto financing companies, and encouraged qualified financial leasing firms, auto financing companies and consumer financing companies to issue financial bonds.

The securitization of credit assets was accelerated. It was decided on the State Council executive meeting in August 2013 that the PBC should lead the efforts of expanding the pilot program of credit asset securitization. Since then, a good momentum has been developed with an institutional framework already in place, sound market operation and expanding size of issuance. Securitization's effect in reinvigorating stock assets and optimizing allocation of financial resources starts to show. From August 2013 to end-2014, financial institutions issued 71 credit asset-backed securities with a total value of RMB 294.2 billion yuan. Among this total, 66 credit asset-backed securities worth RMB 282 billion yuan were issued in 2014.

Qualified non-financial institutional investors were allowed to access the inter-bank bond market. On November 3 2014, the *Notice on Access by Qualified Non-financial Institutional Investors to the Inter-bank Bond Market* was released, providing for the scope of investors allowed access to the inter-bank bond market and market makers, defining roles and responsibilities of regulators, self-regulatory institutions and market platforms, and making detailed requirements about fundamental settlement procedure, consecutive quotation by lead underwriters and conditional bond exchange. Qualified non-financial institutional investors were allowed to invest in and trade bonds via a specific trading platform, which is beneficial to improving the multi-tiered bond market system, further consolidating the investor base on the inter-bank bond market, and better supporting the real economy.

Price discovery on the bond market improved. On December 18, 2014, the *Administrative Measures on When-Issued Trading of Bonds on the Inter-bank Bond Market* was released, launching bond when-issued trading on the inter-bank market, providing for the scope of bonds and ways of trading and settlement for when-issued trading, and also setting out risk management measures. The launch of when-issued trading would facilitate better transparency and competition in bond issuance pricing, improvement in bond yield curve and more active transactions on the secondary market.

Regulation was made on tender issue of bonds. On April 9, 2014, the *Notice on Tender Issue of Bonds on the Inter-bank Bond Market* was released, regulating tender issue of non-financial enterprise bonds, loosening requirements on credit rating of issuers, threshold value of issuance and number of tenders, and making detailed requirements on information disclosure and reporting by issuers and intermediaries after the conclusion of the tender. Threshold requirements for non-financial enterprises to issue bonds via the tender system were adjusted, providing institutional support to encourage non-financial enterprises' tender issue of bonds.

Trial market making was regulated and improved. Featured by active market participation by a large number and diversified types of institutions and increasing size of market making, trial market making played a positive role in selecting market makers, and became an important part of the market making system. On June 12, 2014, the *Trial Market Making Procedures on the Inter-bank Bond Market* was released, further improving the market making system on the inter-bank bond market, which would enable the market makers to play a more positive role and enhance market liquidity.

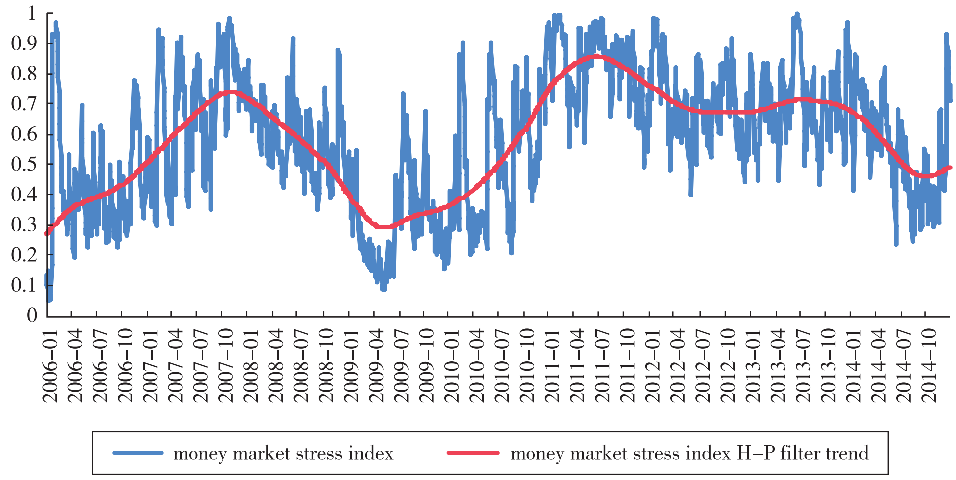
Building of the New Third Board made steady progress. The pilot program of National Equities Exchange and Quotations system (NEEQ, or the New Third Board) was expanded nationwide, where all enterprises, regardless of their size, business scope, and location, are eligible to file an application to be listed. The *Administrative Provisions (Provisional) on Market Making of National Equities Exchange and Quotations System* was released on June 5, 2014 and implemented on August 25, which would diversify ways of trading, improve market efficiency and enhance value for investment on the New Third Board. After the implementation of market making, there were altogether 61 market makers providing market making for 122 listed companies by end-2014, and market liquidity substantially improved with cumulative trading volume and turnover of stocks traded via market making totaling 250 million and RMB 2.12 billion yuan.

IV. Soundness Assessment

In 2014, the financial market operated soundly in general, and market stress was lower than the previous year.

Money market rates declined in general while market stress lessened. Except for the rate fluctuations caused by fund shortage during the Spring Festival, upon quarter-ends and year-ends and during huge IPOs, money market rates shifted downward in general in year 2014. By end-2014, weighted average interest rates of overnight credit borrowing and 7-day pledged repos stood at 2.71 percent and 3.62 percent respectively, declining by 30 basis points and 70 basis points y-o-y. Shibor rates of all maturities declined except for overnight Shibor. In particular, overnight Shibor rose 38 basis points to 3.53 percent, 7-day Shibor fell 61 basis points to 4.64 percent and 3-month Shibor dropped 42 basis points to 5.14 percent. Upon the end of the year, the special timing and intense IPOs contributed to a significant rise in rates. On December 31, weighted average rates of 1-day and 7-day pledged repos and 3-month Shibor stood at 3.76 percent, 5.07 percent and 5.14 percent respectively, which were 97, 144 and 17 basis points higher than the year's average. Generally speaking, stress on the money market declined in 2014 compared with that in 2013, as the market stress fell off almost immediately after the sharp increase upon year-end and it kept moderate along the year in general.

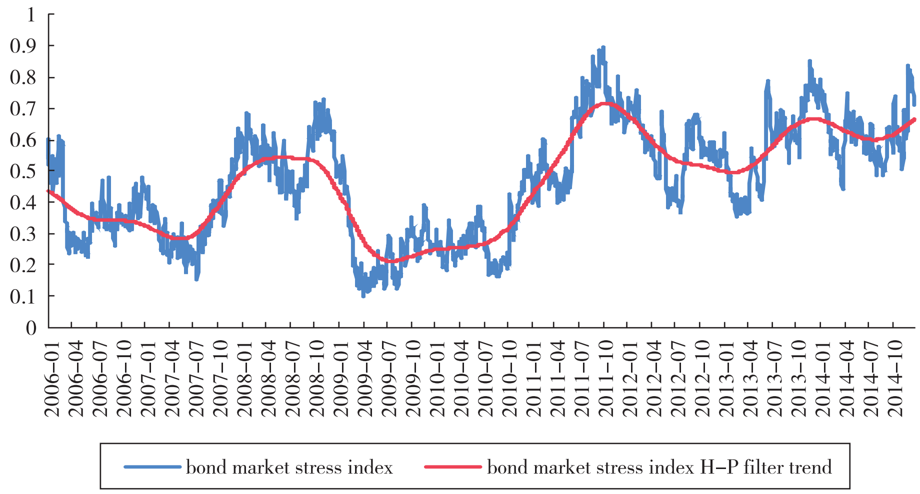
Figure 6.8 Money Market Stress Index, 2006-2014



Source: Author's calculation based on Wind and CEIC data.

Yield on the bond market shifted downward and market stress was moderate while tilted to the higher end. Among the three components of bond market stress index, though interest rate risk declined, credit risk went up and term premium narrowed, resulting in a stress level in 2014 almost flat with that in 2013, which was moderate though tilted to the higher end. Specifically speaking, except for some minor adjustments of Treasury yields of key maturities in April and July, fluctuation declined significantly compared with 2013, and interest rate risk has declined as indicated by yield to maturity of T-bonds. By end-2014, yield to maturity of 1-year, 5-year and 10-year T-bonds fell by 96, 95 and 93 basis points respectively; in 2014, the fluctuation rates of yields to maturity of 1-year, 5-year and 10-year T-bonds dropped by 27 percent, 27 percent and 31 percent respectively, which was 23, 18 and 7 percentage points lower than the previous year. The spread between AA-rated medium-term notes and T-bonds of the same maturities widened significantly, indicating heightened credit risk. In 2014, the daily average spread between AA-rated medium-term notes and T-bonds of same maturities stood at 209 and 259 basis points, rising by 16 and 28 basis points respectively over the previous year. T-bond yield to maturity curve flattened, and term premium between 1-year and 10-year T-bonds increased from 46 basis points at the beginning of the year to the peak of 139 basis points in April, and narrowed thereafter, to 36 basis points at end-2014.

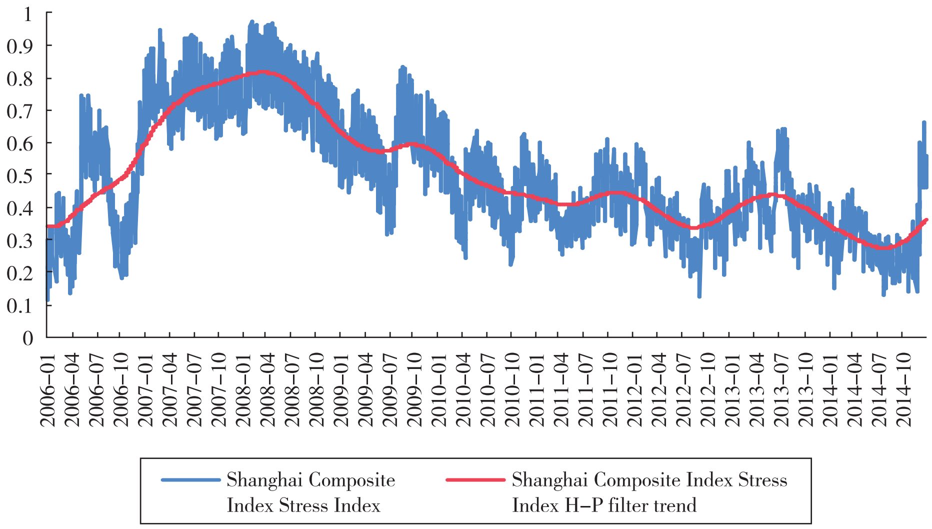
Figure 6.9　Bond Market Stress Index, 2006-2014



Source: Author's calculation based on Wind and CEIC data.

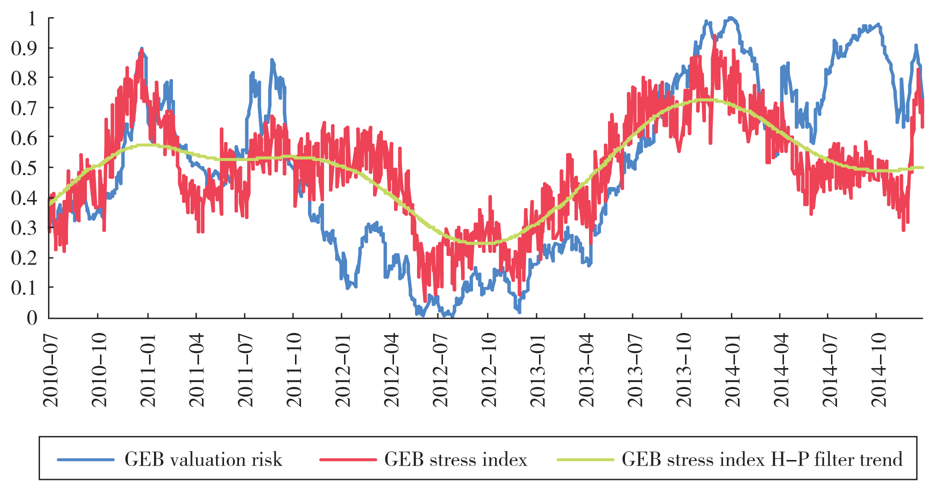
Stress on the stock market was heightened upon the year end, and risks in rapid growth of leveraged transactions need special attention. In 2014, the A-share market surged, while valuation of large-cap and blue-chip stocks were still hovering low, and diverged significantly from the SME board and GEB). By end-2014, rolling price-to-earnings ratios of all AB shares, Shanghai-Shenzhen 300, SME board and GEB rose 39.3 percent, 46.5 percent, 17.0 percent and 6.6 percent y-o-y to 19.5 times, 14.0 times, 43.0 times and 64.3 times respectively; and their respective price-to-book ratios gained 39.7 percent, 49.3 percent, 20.3 percent and 26.6 percent y-o-y to 2.6 times, 2.2 times, 4.0 times and 5.8 times. Entering the second half of 2014, buying on margin increased rapidly on the A-share market, and through the whole year, turnover of buying on margin increased by 5.9 percentage points y-o-y to 12.9 percent; at end-2014, outstanding financing value on the A-share market stood at RMB 1017.21 billion yuan, increasing by 196.1 percent y-o-y; in the second half of 2014, volatility on the A-share market rose sharply, with the 20-day rolling volatility of Shanghai Composite Stock Index rising 21.5 percentage points y-o-y to 36.1 percent at December 31, and that of Shenzhen Component Stock Index gaining 16.2 percentage points to 35.1 percent. The stock market stress index was at a subdued level from January through November in 2014, but it rose rapidly to a heightened level at year-end; stress index on GEB declined at the beginning of the year, peaked during the middle of the year and fell down upon the year end. The pilot of Shanghai-Hong Kong Stock Connect was launched on November 17, 2014, and the stock market stress index was stable after its launch.

Figure 6.10 Shanghai Composite Index market stress index, 2006-2014



Source: Author's calculation based on Wind and CEIC data.

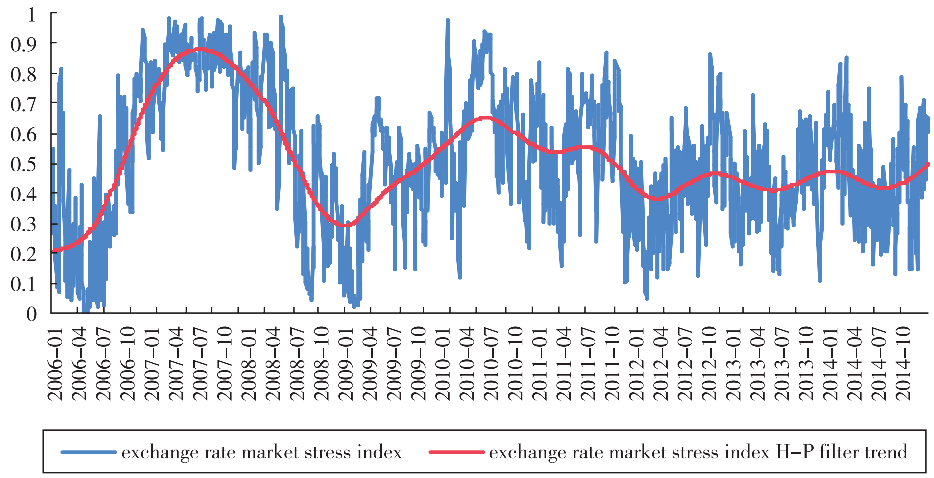
Figure 6.11 GEB Stress Index, 2010-2014



Source: Author's calculation based on Wind and CEIC data.

RMB depreciated slightly against the U.S. dollar, and stress on the exchange rate market was moderate. At end-2014, the bidding price of USD against RMB was RMB 6.2040 per dollar in on-shore market, depreciating by 1501 basis points or 2.4 percent compared with end-2013; the price was RMB 6.2185 per dollar in Hong Kong market, depreciating by 1623 basis points or 2.6 percent compared with end-2013. Since the expansion of RMB exchange rate against the USD to 2 percent on the inter-bank spot foreign exchange market on March 17, 2014, the exchange rate of RMB against the USD exhibited higher two-way flexibility. As indicated by exchange rate market stress index, stress on the market in 2014 was generally moderate and basically flat with that of the previous year.

Figure 6.12 Exchange rate market stress index, 2006-2014



Source: Author's calculation based on Wind and CEIC data.

V. Outlook

In the next stage, efforts will be made to further invigorate the market and add momentum to innovation, and let financial markets play a more positive role in economic growth, structural adjustment, transformation and upgrading, and risk prevention.

Bond market infrastructure will be further improved. Market innovation will be further strengthened to diversify bond products and facilitate the development of a multi-tiered bond market, so as to better meet the needs of investors. Efforts will be made to improve the market making mechanism in order to enhance liquidity in the bond market and lay a solid foundation for fostering an effective yield curve. Diversified development will be promoted in terms of the market participants including investors and intermediaries and financial products by introducing more qualified domestic and foreign institutional investors to invest on the bond market and bolstering market discipline and risk sharing mechanism.

Sound and healthy development of the stock market will be promoted. Efforts will be made to further develop the main board and SME board, foster a multi-tiered exchange market, launch the Board for Strategically Emerging Industries in Shanghai Stock Exchange, and press ahead with reform of the GEB, so as to better support the real economy. Endeavors will also be made to foster a multi-tiered New Third Board, diversify ways of financing by listed companies and improve trading mechanism. Regional equity markets for small and micro enterprises will be developed in a well-regulated manner, as well as private equity product quotation and service system between the OTC market of securities firms and institutions. Possibilities of establishing a mechanism for transfer between boards will be explored.

Further efforts will be made to promote the development of foreign exchange and gold markets. Development of the foreign exchange market will be accelerated by further optimizing the RMB exchange rate regime, improving institutional arrangements and market infrastructure, and promoting innovation of exchange rate risk management instruments. An open, efficient and multi-tiered gold market will be established gradually by improving institutional arrangements, accelerating product innovation, diversifying market participants, optimizing market infrastructure and steadily promoting further opening-up.

The futures and derivatives markets will be further developed. Commodity futures market will be further developed to better discover price, and meet hedging and risk management needs. Government bond futures market will be strengthened by diversifying products and engaging more financial institutions. Efforts will be made to set up a foreign exchange futures market by introducing foreign exchange futures products denominated in non-major currencies, diversifying risk management instruments and lowering foreign exchange risk management cost.

Endeavors will be made to steadily expand the pilot program of credit asset securitization. The market-based interest rate reform will be furthered and management mechanism improved to provide a facilitating environment for securitization of credit assets. Market-based disciplinary mechanism such as information disclosure and credit rating will be bolstered to enhance the in-process and ex post management and product transparency. Responsibilities of participants in credit asset securitization will be further defined so that they can better fulfill their roles. The procedures will be streamlined to improve transparency of issuance management. Efforts will also be made to promote product innovation, provide more standardized and well-regulated products and increase product liquidity. Investor base will be further fostered to diversify investor structure.

Box 13 Three Balances to Strike when Furthering the Securitization of Credit Assets

The credit asset-backed security is a kind of bond product with complicated structure and certain features of derivatives. Constrained by unfinished market-based interest rate reform and other macroeconomic factors, development of credit asset backed securities in China is still fledgling, and the product design is not yet mature or finalized. During the development of credit asset securitization, efforts should be made to strike a balance in the following aspects.

1. The balance between securitization of credit assets and interest rate liberalization. Credit asset securitization connects the credit market with the bond market. The yields of underlying assets and securitized products correspond with lending rates and bond market rates respectively. Therefore, the development of credit asset securitization will be constrained by and at the same time promote the still ongoing market-based interest rate reform. As indicated by the expanded pilot program, before March 2014, yield of the underlying assets dropped away from that of bond market rates, and was therefore not well received by financial institutions, with only 10 tickets of issuance totaling RMB 35.7 billion yuan; after March 2014, amidst lowering bond market rates, issuance applications filed by financial institutions surged, and 61 tickets were issued totaling RMB 258.5 billion yuan. As shown by international experiences, securitization of credit assets plays an important role in facilitating interest rate liberalization. As commercial banks become increasingly engaged in credit asset securitization, they will take into account whether the loans can be packaged and sold when pricing lending rates, which will have a reversed transmission on market-based pricing of loans by commercial banks, enhance their pricing capability and help develop a transmission mechanism from bond rates to loan rates.

2. The balance between securitization of credit assets and macroeconomic management. Credit asset securitization in China is structured as a trust with trust companies as trustees and the pool of securitized assets is a true sale and bankruptcy remote. By securitizing part of their stock credit assets, commercial banks could take such assets off the balance sheets, and therefore extend more credit, lessen capital consumed, lower credit concentration and better support the real economy. Securitization in China is still a pilot program, with a small size and limited influence, though commercial banks were able to extend more credit and increase effective credit extension, and its impact on macroeconomic management is still limited. Along with its further development, the size of the market will expand to such an extent that it could exert substantial impact on the aggregate money and credit, implementation of monetary policies and macro-prudential management. Therefore, when promoting regular development of securitization, efforts should be made to well handle its relationship with macroeconomic management. While promoting the market-based development of credit asset securitization, the coordination mechanism of financial regulation should play a positive role in regulating its size, direction of development and pace of product issuance, by closely monitoring and analyzing its impact on macroeconomic management, and improving macro-prudential management mechanism and measures, so as to create a stable monetary and financial environment for the development of the real economy.

3. The balance between securitization of credit assets and risk management. Experience of subprime crisis in the U.S. indicated that, as a financial product, asset securitization is neutral, which can play a positive role in diversifying risks, enhancing liquidity, invigorating stock credit resources, lowering financing cost and facilitating interest rate liberalization, but could also be abused by the market, evolve into instruments for speculation and arbitrage, and trigger systemic risks. Appropriate regulation and risk management are key for asset securitization to play a positive role. After the financial crisis, reforms targeted to solve problems exposed in the regulation of asset securitization have been carried out in many countries, including the mandatory requirement of risk retention, enhanced requirement of information disclosure and regulatory reform of credit rating. Since the launch of the pilot program, relevant legislature also made headway. A management framework which facilitated risk management was set up and improved. Drawing upon international experiences, the framework features simple and well-designed trading structure, where risk retention and double rating requirements were established, so as to strengthen risk prevention and control. As its market size and participants increase, a balance should be stricken between development of the securitization market and risk prevention, by coordinating innovation and regulation, following the investor suitability principle, improving management system and strengthening regulatory coordination, so as to strengthen regulation of all links in asset securitization and eliminate various hidden risks in a timely manner.

Chapter VII

Financial Infrastructure

In 2014, the building of financial infrastructure in China continued to make headway, with improved payment system, gradually upgraded financial laws and regulations, further optimized accounting rules and standards, well-regulated development of credit information system and progress made in anti-money laundering, which contributed to better financial service and management and sound operation of the financial system.

I. Payment, clearing and settlement system

1. Institutional building made headway

The institutional set-up made new progress. First, the *Regulations on RMB Bank Account Management* and its implementation rules were drafted; the *Notice on Strengthening the Management of RMB Inter-bank Settlement Accounts of Banking Financial Institutions* was released, which effectively regulated inter-bank business; more studies were carried out to make rules on promoting the free trade account business. Second, management of bankcard business and bill printing was enhanced by formulating the *Notice on Strengthening the Management of Bankcard Businesses and the Notice on Strengthening the Management of Bank Bill Printing*. Third, the *Administrative Measures on Online Payment by Payment Institutions, Guidance on Mobile Payment* and *Measures on Settlement of Domestic Letter of Credit (revised)* were drafted. Fourth, the *Decision on Managing the Market Entry of Bankcard Clearing Institutions* was reviewed and approved at the meeting of the State Council standing committee, making substantial progress in bankcard clearing market access. Fifth, the *Measures on Supervising Payment System Participants of the People's Bank of China* was formulated, enhancing regulation and management over participants in the payment system and maintaining safe and stable operation of the payment system.

Financial infrastructure further improved. In 2014, progress was made in building financial market infrastructure including the payment system, the securities settlement system, central counterparty and trade repository, with continued expansion of businesses processed. First, progress has been made in improving payment infrastructure. The Accounting Data Centralized System (ACS) was applied nationwide, realizing the centralization of central bank accounting data, which played a positive role in facilitating monetary policy transmission and fund management by financial institutions. Application of the second generation of the payment system was pressed ahead steadily, and 302 legal entities had transitioned to the new system, and the "single point clearing" will be carried out over time. The phase I construction of Cross-border Inter-bank Payment System (CIPS) made significant progress. Demand analysis and confirmation of CIPS business and the selection of participating institutions were completed. Second, payment systems of various kinds operated soundly, with rapid development in transactions processed. In 2014, a total of 30.535 billion transactions with a value of

RMB 3388.85 trillion yuan were processed by various payment systems in China, increasing by 29.51 percent and 15.29 percent y-o-y respectively. The number and value of transactions processed by payment systems of the PBC stood at RMB 4.184 billion and RMB 2455.79 trillion yuan, rising by 50.24percent and 13.49 percent y-o-y respectively, in which a total of 1.639 billion transactions with a worth of RMB 17.79 trillion yuan were processed by the online payment cross-bank clearing system, surging by 128.27percent and 87.88 percent respectively. Businesses of clearing institutions including China Union Pay, Clearing Center for City Commercial Banks and Rural Credit Banks Funds Clearing Center continued to expand. In particular, the cross-border trading and clearing system of China Union Pay processed 18.674 transactions worth RMB 41.11 trillion yuan, increasing by 23.34 percent and 27.29 percent y-o-y respectively. Third, the value of securities depository trust and clearing of China Central Depository & Clearing Co., Ltd. the Inter-bank Market Clearing House Co., Ltd, and the China Securities Depository and Clearing Co., Ltd (China Clear) continued to increase. The value of securities depository trust rose by 20.9 percent y-o-y to RMB 35.64 trillion yuan. A total of RMB 352.55 trillion yuan of spot and repo transactions were cleared, increasing by 30.03 percent y-o-y. Moreover, China Clear took on the responsibilities of central securities depository trust on the bond market, securities clearing system and central counterparty, which launched unified securities accounts, and connected with the clearing system in Hong Kong. The depository trust and clearing value of China Clear registered RMB 40.57 trillion and RMB 541.36 trillion yuan respectively, rising by 54.82 percent and 52.37 percent y-o-y respectively. Fourth, central counterparty business of the Inter-bank Market Clearing House Co., Ltd. expanded to cover spot bonds, spot foreign exchange, RMB interest rate swaps and derivatives of commodities, with a total processing size of RMB 19.59 trillion yuan. As central counterparties in the commodity and financial futures markets, the Zhengzhou Commodities Exchange, Shanghai Futures Exchange, Dalian Commodities Exchange and China Financial Futures Exchange played an important role. Fifth, trade repository of the Foreign Exchange Trading Center had collected and published data of foreign exchange, money, spot bonds and derivatives, which covered information of almost a full range of local and foreign-currency markets.

Steady progress was made in developing non-cash payment. Innovation was achieved in retail payment, enhancing the efficiency of payment and settlement, lowering transaction cost and changing the way of financial service. In 2014, a total of 62.752 billion non-cash payment transactions were processed worth RMB 1817.38 trillion yuan, rising by 25.11 percent and 13.05 percent respectively y-o-y, while the growth of value decelerated by 11.92 percentage points. By the end of 2014, a total of 4.936 billion bankcards were issued nationwide, increasing by 17.13 percent y-o-y, in which 1.226 billion were financial IC cards. Bankcard acceptance environment continued to improve, with a bankcard penetration rate of 47.7 percent for the whole year. Size of credit cards grew moderately, with a credit line of RMB 5.6 trillion yuan, and debt payable totaled RMB 2.34 trillion yuan at period end, increasing by 26.75 percent y-o-y. Growth of e-payment kept its momentum, and mobile payment rose rapidly. Banking institutions processed a total of 28.574 billion online payment transactions worth RMB 1376.02 trillion yuan, up by 20.7 percent and 29.72 percent y-o-y. Online payment transactions processed by payment institutions numbered 21.816 billion, worth RMB 16.21 trillion yuan, increasing by 41.63 percent and 75.5 percent y-o-y respectively. A total of 154.66 mobile payment transactions were processed with a value of RMB 8.41 trillion yuan, soaring by 299.53 percent and 655.51 percent respectively y-o-y.

Regulation and management were further strengthened. First, efforts were made to promote the development of the mechanism to verify the provisioning information of payment institution clients, set on the construction of client provisioning regulatory system, implement and improve classified regulation, territorial regulation, annual regulatory reporting and the reporting mechanism of major issues. Second, management over bankcard businesses of commercial banks was strengthened by regulating the issuance of entity settlement card and commercial bank pre-paid cards and cooperation between commercial banks and payment institutions. Efforts were also made to regulate the development of new payment businesses including suspending off-line two dimensional code payment and virtual credit card businesses. Third, resolution of risk events in the pre-paid card industry was conducted in close cooperation with local governments. Information of risk events caused by bankcard pre-authorization was officially disseminated, and the involved payment institutions were punished. The PBC and the Ministry of Public Security jointly established a major payment and settlement risk event reporting and coordinated investigation mechanism, and regularly disclosed major cases and risk warning. Fourth, studies were carried out to set up a payment system risk evaluation indicator system, in order to promote risk evaluation in the payment system. Fifth, efforts were made to summarize progress made in authentication of stock personal bank accounts, improve inquiry function of the RMB bank settlement account management system, and research on remote account opening. Sixth, endeavors were made to promote the reform of Clearing Center for City Commercial Banks and capital increase and share expansion of Rural Credit Banks Funds Clearing Center.

The Principles for Financial Market Infrastructures (PFMI) was implemented. In order to improve coordination, the PBC and CSRC jointly set up the leading group and office of financial market infrastructure, which were responsible for defining guiding principles and objectives for the development of financial market infrastructure in China and promote the implementation of PFMI. Efforts were made to carry out self-assessment of domestic financial market infrastructure, facilitate the implementation of international standards, enhance risk management and continue to improve financial market infrastructure in China. According to results of the external assessment conducted by the Committee on Payments and Market Infrastructure (CPMI) and International Organization of Securities Commissions (IOSCO) on the implementation of PFMI in China, the PBC and CSRC are legally authorized and have the responsibilities and capability to promote domestic implementation of PFMI.

Payment service environment in rural areas continued to improve. Efforts were made to incorporate the establishment of rural payment service environment into the State Council's arrangement on financial support for the development of agriculture, rural areas and rural residents, to release the *Guidance on Further Deepening Payment Service Environment in Rural Areas*, and to promote comprehensive and in-depth development of payment services that benefit rural residents and agriculture. By end-2014, there were 2.745 billion bank accounts opened by financial institutions and individuals in rural areas, with a total number of 1.737 billion bankcards and 1.95 cards held per person. There were altogether 112,600 outlets of banking institutions, among which 85,300 had access to the cross-bank payment system of the PBC, with a coverage ratio of 75.82 percent, and 107,100 had access to intra-bank (cooperative) systems, with a coverage ratio of 95.17 percent. There were 920,000 agro-supporting bankcard withdrawal outlets, covering approximately 500,000 administrative villages, with a coverage ratio of 85 percent. In 2014, 4.509 billion cases of non-cash disbursements of agro-related fiscal subsidies were carried out with a total value of RMB 327.169 billion yuan. A total of 157 million agro-supporting withdrawals were conducted with a value of RMB 49.4 billion yuan, increasing by 69.3 percent and 73.9 percent y-o-y.

International exchange and cooperation on payment system were deepened. Leveraging on international platforms such as CPMI, Executives' Meeting of East Asia-Pacific Central Banks (EMEAP), South East Asian Central Banks (SEACEN), and Association of Southeast Asian Nations plus China, Japan and South Korea (ASEAN+3), the PBC has maintained sound communication with other member institutions and enhanced our voice in the payment, clearing and settlement area. First, the *MOU on Joint Supervision of SWIFT on the SWIFT Supervision Forum between the National Bank of Belgium and the People's Bank of China* was signed. Second, the PBC fulfilled its responsibilities as chair of EMEAP payment and settlement working group for two terms and four years, and finished the Report on *Financial Inclusion in the EMEAP Region*. Third, efforts were made to improve bilateral dialogue mechanism in work related to payment, to convene bilateral meetings with the European Central Bank on payment and settlement, and to facilitate the signing of the *MOU on Cooperative Supervision of Non-financial Institution Payment Business* by Mainland and Hong Kong authorities.

2. Outlook

In the next stage, efforts will be made

to formulate the *Guiding Opinion on the Development of Payment System in China (2016-2020)*, so as to coordinate the development of payment, clearing and settlement systems, and enhance the safety and efficiency of financial market infrastructure and retail payment service market. Priorities on the agenda include: improving the legal system concerning payment businesses, maintaining sound operation of financial market infrastructure, encouraging innovation of payment instruments and services while strengthening regulation over the payment service market, regulating the behaviors of participants on the payment service market, accelerating the implementation of PFMI by completing regulators' assessment on domestic financial market infrastructure and releasing the list of qualified financial market infrastructure, guiding and promoting the development of inclusive payment services, and further deepening international communication and cooperation on payment system.

II. Legal Environment

1.The legal system governing the financial sector further improved

New laws and regulations were made. The *Budget Law of the People's Republic of China* was amended and approved, which would strengthen budget management by law and further improve the comprehensive, open and transparent budget system already put in place; work were also done in regulating the receipt and expenditure of the government, enhancing budget regulation, improving budget control, and setting up a multi-year budget balance mechanism; management over local government debt was put under regulation, which helped mitigate fiscal and financial risks. The *Administrative Litigation Law of the People's Republic of China* was revised, which made stricter requirements for administration by law on part of financial regulators. A legal decision was made on the application of administrative approval system on the establishment, alteration and operation of enterprises stipulated in the *Law on Foreign-funded Enterprises in People's Republic of China* in free trade zones in Guangdong, Tianjin, Fujian and Shanghai, which facilitated reform experiments in the free trade zones in order to gain more experience for further financial reform. The *Administrative Regulations on Foreign-funded Banks in People's Republic of China* was amended and approved, lowering the threshold for market access and operation of RMB businesses by foreign-funded banks, which enabled the foreign-funded banks to play a more positive role and enhance the efficiency of financial resource allocation. The *Provisional Regulations on Registration of Immovable Properties* was approved, which set up a unified immovable property registration platform, facilitating information sharing between the financial sector and other immovable property registration authorities.

More judicial interpretations were released. The Supreme People's Court published *Several Provisions on the Enforcement of Property-related Criminal Judgment,* stipulating property closure, forfeiture and freeze by different judicial authorities in one case, and the transition of successive closure, forfeiture and freeze of properties, which facilitated the financial institutions in fulfilling enforcement assistance responsibilities. The *Interpretation on Applicable Laws on Hearing Financial Leasing Contract Dispute Cases* was released, stipulating that the nature of financial leasing contracts should be defined based on legal structure in reality, and setting strict conditions for the dissolution of contracts, which played a positive role in facilitating healthy development of the financial leasing market and guiding financial capital to better support the real economy.

New rules and measures were made. The PBC issued regulations on banks' engagement in foreign exchange settlement and sales, and required that financial institutions and certain non-financial institutions should better fulfill their responsibilities in freezing assets related to terrorist activities. Rules were also made on strengthening the management of bankcard business, central clearing of OTC financial derivatives, credit asset securitization, financial market infrastructure, RMB settlement of cross-border trade transactions, the building of credit system and anti-money laundering. In order to regulate and promote the development of relevant industries, regulators made a series of regulations and regulatory documents, bolstering regulation and management of financial leasing companies, private equity funds, factoring business of futures firms and commercial banks, liquidity risk of commercial banks, pilot program on preferred shares, merger and acquisition of listed companies, use of insurance funds and etc. Administrative licensing was put under regulation; the CBRC made regulations of administrative licensing concerning foreign-funded banks, and rural small and medium-sized financial institutions; the CIRC also published implementation measures on administrative licensing. Such developments would facilitate the transition of regulators' functions and the development of the financial market.

2. Outlook

In 2015, endeavors will be made to promote ruling by law as deployed by the CPC Central Committee, press ahead with financial reforms, improve legal system in the financial sector, accelerate the revision of *Law on the People's Bank of China, Securities Law, Insurance Law, Provisional Regulations on Cash Management,* and *Regulations on Foreign Exchange Administration*, and actively promote the formulation and launch of futures law, regulations on non-deposit taking lending organizations, administrative regulations on RMB bank accounts, regulations on financial statistics, administrative regulations on financial guarantee companies, and administrative regulations on the supervision of listed companies.

Box 14 The Formulation of *Regulations on Non-deposit Taking Lending Organizations*

Credit market in China can be divided into three categories, based on whether an institution takes deposits or not and on the nature of lending: the deposit-taking lender, non-deposit-taking lender and private lender. Regulations have already been made to govern the lending of commercial banks, automobile financing companies and consumer financing companies. However, laws and regulations governing most non-deposit-taking lenders such as micro-credit companies are still absent. Therefore, administrative regulations, namely the *Regulations on Non-deposit Taking Lending Organizations* (*hereafter* "*Regulations*") should be formulated to regulate such non-deposit taking lenders, and regulatory responsibilities of local governments should also be defined.

In 2013 and 2014, the formulation of the *Regulations* was put on the legislation agenda of the State Council. According to the overall work plan of the State Council, the PBC set up a legislation working group, and took the lead in organizing relevant researches and discussion on development and regulation of non-deposit taking lending organizations, which were joined by other competent authorities. During such efforts, the PBC communicated and discussed on key issues in the formulation of the *Regulations* with practitioners, experts, small and micro enterprises and local governments, soliciting opinions and taking suggestions from a wide range of sources.

The *Regulations* would stipulate the establishment, termination and business operation of non-deposit taking lending organizations, and define regulatory and resolution responsibilities of local governments, and also legal liabilities for conducts that violate the *Regulations*. Non-deposit taking lenders will operate in accordance with the *Regulations* after its enaction, which would fill the legal gap and facilitate healthy and orderly development of the non-deposit lending market.

III. Accounting Standards

1. Significant progress has been made in developing accounting standards

In 2014, the formulation and revision of accounting standards made headway. First, the corporate accounting standard system was further improved, with the release of corporate accounting rules such as *Fair Value Accounting, Joint Arrangements and Disclosure of Interests in Other Entities*; efforts were made to further converge with international accounting standards by revising *Presentation of Financial Statements, Employee Compensation, Consolidated Financial Statements, Long-term Equity Investment* and *Presentation of Financial Instruments*. Second, the PBC studied the accounting standard system of the government, and the State Council approved and published the *Plan on the Reform of Comprehensive Accounting System of the Government on Accrual Basis*. Third, efforts were made to promote and implement the *Accounting Standards of Administrative Units* and provide training to relevant staff. Fourth, the general classification standard of corporate accounting standards was revised, and continued efforts were made to promote its implementation, and organize studies on its application in internal management of enterprises. *The 2015 Version of Corporate Accounting Standard General Classification Standard Elements List, Accounting Software Data Interface Standard Elements List* and drafts of other standards on accounting informatization were published, so as to enhance the level of accounting informatization standard.

2. Outlook

Efforts will be made to promote the convergence of corporate accounting standards in China with International Financial Reporting Standards (IFRS), especially the already published IFRS 9 Financial Instruments and IFRS 15 Revenue from Contracts with Customers, and the standard on leasing which was about to be released, so as to accelerate the reform and development of accounting standards of enterprises in the financial sector. Endeavors will be made to promote reform of government accounting, by revising fiscal budget accounting system, issuing basic standards of government accounting, and formulating government financial accounting standard, government financial statement formulation measures and operational guidance. Wider application of Extensible Business Reporting Language (XBRL) will be promoted, and standard of accounting software data interface using XBRL will be made. Continued efforts will be made to implement the general classification standard in various types of enterprises, and standardize account and transaction-level accounting data. The PBC will actively engage in the formulation and revision of international accounting standards and enhance international communication and cooperation.

IV. Credit Environment

1. The credit information industry and social credit system developed in a well-regulated manner

The plan for building the social credit system was launched. *Outline for Building the Social Credit System (2014-2020)* was enacted, which defined guiding principles and objectives of the initiative, and outlined a comprehensive framework for the credit system, which would play an important role in promoting the improvement of the credit system and building an honorable and credible social environment.

Box 15 Enaction of the *Outline for Building the Social Credit System* (2014-2020)

Accelerating the development of a credit system is an important means for improving socialist market economy, as well as enhancing and innovating social governance, which is of great significance for enhancing the general public's awareness of credibility, fostering a virtuous credit environment and strengthening national competitiveness. On June 14, 2014, the *Outline for Building the Social Credit System (2014-2020)* was released, the first country-level special plan in this area.

The *Outline* defined the principles and objectives for building the social credit system. Relevant work will be promoted in the principle of "government-driven, widely-participated; comprehensive and lawful, well-regulated development; well-planed and well-paced implementation; focusing on key areas, and wide application". Efforts will be made to accomplish the objective of establishing a comprehensive legal framework, building a nationwide credit information system based on information sharing, putting in place a comprehensive regulatory system, building a mature credit service market, and putting in place an effective incentive mechanism by the year of 2020.

The *Outline* listed 34 detailed objectives closely related to people's livelihood and to healthy social and economic development, which can be divided into four key areas, including government credibility, business credibility, social credibility and judicial credibility. The *Outline* proposed 3 basic measures: first, efforts will be made to enhance education and foster a social environment valuing credibility and integrity by setting good examples, conducting outreach programs, penalizing incredible deeds and conducts in key industries, so that the general public will deem credibility an honor while incredibility a shame; second, building and application of the credit information system will be sped up, by setting up a unified social credit code system for natural persons, legal persons and other organizations, promoting inter-industry and cross-regional sharing of credit information, and having in place a credit information exchange and sharing mechanism; third, the social credit system based on a well-designed incentive mechanism will be improved, by streamlining procedures or providing green pass for credible players, while posing regulatory, market-based, industrial or social punishment on incredible ones, having in place a comprehensive legal system and standard system, fostering and regulating credit service market, protecting rights and interests of information owners, and strengthening management of the security of credit information.

In order to promote the development of the social credit system and ensure timely completion of various objectives, the *Outline* focused on supporting arrangements in the following 5 aspects: first, strengthening responsibility fulfillment; second, enhancing policy support; third, carrying out government information transparency initiative, rural credit system building initiative and small and micro enterprise credit system building initiative; fourth, promoting local credit building comprehensive demonstration, regional credit building cooperation demonstration, key area and industry credit information application demonstration; fifth, improving organizational support, and improving organization and coordination mechanism.

In the next stage, the *Outline* will be carried out by building the legal framework and standards system, promoting the collection and sharing of credit information, establishing a credit-based incentive system, protecting rights and interests of credit information owners, and safeguarding credit information security, so as to accelerate the building of social credit system.

Standardization of the credit information industry made further progress. The *Standard on Management of Financial Credit Information Basic Database* and the *Credit Information Institution Information Security Standard* were enacted, making detailed standards on behavior of users of financial credit information database and information security of credit information agencies, which would prevent leakage of credit information, protect legal rights and interests of information owners, and promote healthy and rapid development of the credit information industry.

Supervision of credit information agencies was strengthened according to relevant laws and regulations. Abiding by the *Regulations on Administration of the Credit Reference Industry* and the *Administrative Measures for Credit Reference Agencies*, licensing of individual credit information agencies and registration of corporate credit information agencies were carried out in an orderly manner. In October 2014, branch offices of the PBC started to publish the list of corporate credit information agencies already registered within their respective jurisdictions and enhanced management over such agencies. By end-2014, a total of 46 corporate credit information institutions in 13 provinces and municipalities completed the registration procedures, whose list was displayed online.

Management over credit information business of financial institutions was strengthened. A long-term on-site examination mechanism of financial institutions' credit information business was established, and regular, dynamic off-site examination was improved. As a result, the examination had a comprehensive coverage over financial institutions' credit information business within a certain period. The special examination on the implementation of the *Regulations on Administration of the Credit Reference Industry* was accomplished, covering 20 financial institutions with nationwide networks, 5 foreign-funded banks, and 405 financial institutions with regional networks, with a total number of 2791 outlets, disclosing and penalizing misconducts and irregularities including misuse of credit information, inappropriate dispute settlement and failure to report indecent information.

Credit rating management was further improved. Continued efforts were made to improve the way of credit rating on the credit market, further define the registration management procedure and measures, and strengthen the in-process and ex-post monitoring of credit rating. By end-2014, there were 97 legal-person credit rating agencies and 74 non-legal person credit rating agencies registered at the PBC. A total of 3,819 and 37,281 credit rating transactions were completed on the bond market and credit market respectively. The pilot program of micro-credit companies and financing guarantee companies expanded to cover 16 provinces (municipalities and autonomous regions) as opposed to 6 provinces (municipalities and autonomous regions) at the beginning, accomplishing credit rating for 969 micro-credit companies and 1,367 financing guarantee companies.

The credit information market continued to expand. Information collection of the Financial Credit Information Basic Database became more comprehensive. Information collection on entrusted loans and trust loans by financial institutions was launched, and micro-credit companies and financing guarantee companies got internet access to the credit information system. By end-2014, the Financial Credit Information Basic Database collected credit information of 857 million natural persons and 19.69 million enterprises and other organizations, with total information inquiries of 405 million times and 100 million times respectively. The PBC's accounts receivable financing platform and movables financing registration platform developed steadily. A total of 32,000 institutions registered at PBC's accounts receivable financing platform, with total financing of more than RMB 92 billion yuan; a total of 9,427 users registered at the unified movables financing registration platform, with an accumulated number of 1.57 million registration transactions and 2.77 million inquiries.

Establishment of small and micro enterprise and rural credit system made steady progress. The *Opinions on Accelerating the Establishment of Small and Micro Enterprise and Rural Credit System* was issued, defining the working mechanism and launching pilot programs in 63 prefecture-level cities and counties. With priorities given to the establishment and operation of pilot programs, the host cities or counties accelerated the development of the credit system, so as to facilitate financing of credible small and micro enterprises and rural households. By end-2014, credit information of 2.506 million small and micro enterprises was supplemented accumulatively, and 405,000 small and micro enterprises acquired bank loans, with an outstanding value of RMB 8.9 trillion yuan. Credit information files were established for 160 million rural households, among which the credit of 100 million were rated, and 90.12 million acquired credit support, with an outstanding value of RMB 2.2 trillion yuan.

Education on credit information was deepened. An outreach program themed "Accelerating building the social credit system, promoting healthy development of credit information market" was carried out nationwide. It was estimated that a total of more than 46,000 relevant activities were conducted, which were participated by more than 300,000 staff of more than 150 credit information and credit rating agencies at around 150,000 outlets of financial institutions, with a total audience of approximately 23 million.

2. Outlook

Looking forward, continued efforts will be made to strengthen the management of credit information, promote well-regulated development of the credit information market, and protect lawful rights and interests of credit information owners. The PBC will enhance in-process and *ex-post* administration of the credit rating industry, foster and regulate the credit rating market, and expand the credit rating pilot of micro-credit companies and financing guarantee companies nationwide. The *Outline* will be implemented so as to promote building of the social credit system in an orderly manner. Further efforts will be made to build the small and micro enterprise and rural credit system, in order to facilitate their financing. More outreach and education programs on credit information will be conducted to raise credit awareness of the general public.

V. Anti-money laundering

1. Reform and innovation were further promoted

In 2014, reform on anti-money laundering work was pressed ahead by accelerating the institutionalization and wider application of pilot programs, and strengthening regulation and supervision on key areas and key risks, so as to enhance efficiency of anti-money laundering in China.

Evaluation of money laundering risk in China has started. As required by the Financial Action Task Force (FTAF), the PBC started establishing national money laundering evaluation system by drafting the overall plan on money laundering and terrorist financing risk evaluation framework and by launching pilot programs of money laundering risk assessment and data collection.

Institutional arrangements on anti-money laundering and counter terrorist financing were improved. In January 2014, the PBC published the *Administrative Measures on Freezing Terrorist Activity-related Assets*, providing legal support for handling involved assets by financial institutions. The *Administrative Measures on Anti-money Laundering Regulation of Financial Institutions* was formulated, strengthening anti-money laundering regulation and administration of financial institutions from the perspective of legal person governance, which enhanced awareness of financial institutions in terms of voluntary fulfillment of anti-money laundering obligations. The PBC revised and improved the Administrative *Measures on Reporting of Large-value and Suspicious Transactions*, requiring financial institutions to set up a reporting system based on reasonable suspicion.

Anti-money laundering regulation on high-risk industries and businesses was enhanced. Targeting emerging anti-money laundering risks, the PBC bolstered regulation of funds, trusts and payment institutions by organizing on-site evaluations, so as to conduct better-targeted and more efficient anti-money laundering. Risk warning on criminal conducts was launched including cases of passport forgery by foreigners for the purpose of fraud, money laundering through large-value dividend payment in the insurance sector and telecommunication fraud, requiring relevant participants to enhance internal control and take active measures to prevent money-laundering risks.

Monitoring and analysis on terrorist financing transactions were strengthened as a priority. Based on analysis of relevant cases in the past years, a model on monitoring terrorist activity-related financing was developed, which was used to warn relevant risks to financial institutions, guide financial institutions to further improve monitoring and identification of relevant transactions utilizing the model, and assist the competent authorities in case investigation.

International cooperation on anti-money laundering entered a new stage. The PBC signed a MOU on anti-money laundering with the central bank of Argentina, reached preliminary consensus on bilateral anti-money laundering cooperation with financial regulators in the U.S., France, Russia, Singapore, as well as Hong Kong and Macao, and set up AML communication mechanism between mainland, Hong Kong and Macao.

2. Outlook

In the next step, the PBC will actively engage in a new round of international peer review under the FATF framework, accomplish money laundering risk evaluation as soon as possible, screen weak links in the AML system, bolster weak points in the institutional arrangements, follow the principle of risk-based and legal person regulation, let the financial institutions to fulfill their due responsibilities, optimize AML resource allocation of financial institutions, enhance regulation in key areas such as innovative financial products and cross-border capital flows, so as to enhance the efficiency of anti-money laundering and counter-terrorist financing in China.

Chapter Ⅷ

Macro-prudential Regulation

In 2014, the international community continuously improved macro-prudential policies and promoted the implementation of macro-prudential management framework. China continued to enhance macro-prudential regulation, further improved the financial regulatory coordination mechanism, carried out effectively counter-cyclical macro-adjustment measures, strengthened the assessment and monitoring of systemic risks, reinforced the regulation of systemically important financial institutions, and effectively guaranteed the sound performance of financial system.

I. International Developments on Macro-prudential Regulation

1. Building more resilient financial institutions

Improving the policy framework. The Basel Ⅲ package of reforms made by Basel Committee on Banking Supervision (BCBS) is the centerpiece of the international community's work to build more resilient banking institutions. BCBS has largely completed the design of Basel Ⅲ policy framework. Firstly, leverage ratio, liquidity coverage ratio (LCR), net stable funding ratio (NSFR), and large exposure framework were published. Secondly, standardized approach of credit risk, capital requirement on operational risk, and requirement of capital floor were being revised. Thirdly, a plan to address excessive variability in risk-weighted asset (RWA) calculations had been set out. International Association of Insurance Supervisors (IAIS) published consultative documents on global insurance capital standard (ICS) in December 2014, and the ICS will be included in the IAIS' comprehensive framework for the supervision of Internationally Active Insurance Groups (ComFrame).

Promoting the implementation of Basel III. To promote the full, timely and consistent implementation of Basel Ⅲ, BCBS carried out a comprehensive assessment on the implementation of member jurisdictions. The assessment outcomes showed that member jurisdictions have made considerable progress in the implementation of Basel Ⅲ. In terms of timely adoption, all member jurisdictions had put into force the final set of Basel III-based capital regulations, most jurisdiction had issued regulatory framework on LCR, leverage ratio and the requirements that apply to systemically important banks. In terms of the consistency of implementation, 9 member jurisdictions including China were deemed consistent with Basel III standards among the 11 jurisdictions that took part in the consistency assessment.

Strengthening risk management. Risk management is a critical first line of defence in the resilience of financial institutions. The Financial Stability Board (FSB) had been working to strengthen risk management practices through increased regulatory and supervisory focus as well as guidance on firms' risk culture and governance practices. In 2014, the FSB issued a series of guidelines, such as *Principles for An Effective Risk Appetite Framework, Sound Management of Risks Related to Money Laundering and Financing of Terrorism,* and *Identification and Assessment Methodologies for Securities Regulators.*

Enhancing compensation practices. G20 Summit called on FSB member jurisdictions to implement the *Principles for Sound Compensation Practices and their Implementation Standards* (P&S). The monitoring report of the FSB showed that all the member jurisdictions had implemented P&S. Almost all authorities assessed the level of implementation by significant banks in their jurisdictions as being medium or high. There remain significant differences among jurisdictions in the approach to identify material risk takers. All authorities reported that notable improvements by significant financial institutions were observed in terms of ex ante risk adjustment. As regards ex post performance adjustment, progress is more evident on the use of malus than clawbacks.

2. Promoting effective resolution regime

Promoting effective resolution regime for global systemically important financial institutions (G-SIFIs). The FSB required that home and host authorities of G-SIFIs should establish cross-border crisis management groups (CMGs), draw up recovery and resolution plans (RRPs) and launch resolvability assessment programs (RAPs). In 2014, the CMGs of global systemically important banks (G-SIBs) continuously improved RRPs, and began to develop cross-boarder cooperation agreements (COAGs). Initial results from the RAPs launched by 10 G-SIBs showed that the main factors affecting the resolvability of G-SIBs were incomplete legal and regulatory framework, the banks' over-complicated financial, legal and operational structure, and the insufficiency of effective cross-border cooperation and coordination. Since the FSB published the list of the first 9 global systemically important insurers (G-SIIs) in July 2013, authorities of member jurisdictions had sped up the construction of effective resolution regime of G-SIIs. CMGs had been established for most G-SIIs, and the design of RRP was underway. The FSB established the Insurance Cross-border Crisis Management Group (iCBCM) in January 2014, and published the consultative document of *Recovery and Resolution Planning for Systemically Important Insurers: Guidance on Identification of Critical Functions and Critical Shared Services* in October 2014. The guidance identified critical functions and critical shared services of G-SIIs through impact assessment, substitutability analysis and *firm-specific test*, which assisted home and host authorities in developing RRPs and conducting RAPs. In addition, iCBCM had already started to develop the *Guidance on Effective Resolution Strategies for Insurers*.

Developing Total Loss Absorbency Capacity (TLAC) requirements. G20 summit asked the FSB and BCBS to develop TLAC requirements for G-SIBs. TLAC requirements raised loss-absorbing capacity while kept the Basel III capital floor and capital buffer requirements and avoided the cost to taxpayers in resolving a failed G-SIB. TLAC requirement complemented with the Basel III going-concern capital requirement framework and constituted loss-absorbing capacity of G-SIBs. In November 2014, the FSB published the consultative document for *Adequacy of Loss-*

absorbing Capacity of Global Systemically Important Banks in Resolution. The FSB, with assistance from the BCBS and the Bank for International Settlement (BIS), also carried out microeconomic and macroeconomic impact study, market survey, review of loss histories, and shortfall analysis in order to determine the final calibration of TLAC requirement.

Box 16 Total Loss Absorbency Capacity Requirement for G-SIBs

For the purpose of "Ending Too Big To Fail" of G-SIBs, the FSB brought forward TLAC requirement. TLAC consists of common equity and specific form of debt instruments, which can avoid cost to taxpayers in resolution, maintain key functions of G-SIBs and safeguard financial stability. TLAC means an additional capital requirement while keeping the Basel III pillar 1 capital requirement and capital buffer stable, which indicates that TLAC is different with regulatory capital.

In September 2013, the G20 St. Petersburg summit called on the FSB to collaborate with related standard setting bodies to develop concrete proposals on TLAC by the end of 2014, including the amount and eligible instruments of TLAC, allocation of TLAC within groups and so on. In November 2014, the FSB published the consultative document for *Adequacy of Loss-absorbing Capacity of Global Systemically Important Banks in Resolution*, and proposed minimum TLAC requirement to be set within the range of 16%~20% of RWAs. TLAC requirement incorporates existing Basel III minimum capital requirements and excludes Basel III capital buffers (conservation capital, G-SIB surcharge and counter-cyclical capital). A G-SIB should maintain overall TLAC of at least 19.5%~25% of RWAs, including conservation capital requirement of 2.5% and a 1%-2.5% G-SIB surcharge. At the mean time, the consultative document also proposes that leverage ratio of G-SIBs should be at least twice the quantum of capital required to meet the Basel III Tier 1 leverage ratio requirement. It can be predicted that G-SIBs will be confronted with critical financing pressures after the implementation of TLAC. In consideration of the underdeveloped financial markets, deposit-oriented financial structures and the less international activeness of G-SIBs in emerging markets, the consultative document states clearly that the G-SIBs that are headquartered in emerging markets will not, initially, be subject to the Common Pillar 1 Minimum TLAC requirement.

Currently, the FSB and related international standard setting bodies including BCBS are calibrating the TLAC requirement to finalize the TLAC standard. The final standard of the TLAC requirement is expected to be published in 2015 and the G-SIBs may be required to conform with the requirement no later than 2019.

Promoting the implementation of Key Attributes. In 2014, progress continued to be made in the implementation of the *Key Attributes for Effective Resolution Regimes* ("Key Attributes") in banking sector. Several jurisdictions had already introduced legislative reforms in line with the Key Attributes. France designated the ACPR as the resolution authority for banks and provided ACPR with crisis management and resolution powers. Germany entered in force the *Act on Ring-fencing and Recovery and Resolution Planning for Credit Institutions and Financial Groups* in January 2014 to ensure orderly resolution of financial institutions. Japan amended the *Deposit Insurance Act*, which further clarified the measures to be taken for improving the resolvability of financial institutions. The *Bank Recovery and Resolution Directive* (BRRD) of EU was implemented in April 2014. EU member jurisdictions should adopt relative national legislative adjustment by the end of 2014 and formally put the adjustment into force from 1 January 2015. Implementation of the Key Attributes in the non-bank financial sectors was less advanced. In October 2014, the FSB published sector-specific implementation guidance that complemented the Key Attributes covering financial market infrastructures (FMIs), insurers and financial institutions holding client assets, which assisted jurisdictions in implementing Key Attributes. In addition, the FSB, with the assistance from Committee on Payments and Market Infrastructures (CPMI), International Association of Deposit Insurers (IADI), International Organization of Securities Commissions (IOSCO), the IMF and the World Bank, had revised the assessment methodology of the Key Attributes according to the first pilot assessment. The assessment methodology was planned to be used in assessments in 2016 as part of Financial Sector Assessment Programs (FSAP) and the Standards & Codes initiative.

Publishing revised version of *Core Principles for Effective Deposit Insurance Systems*. In November 2014, IADI published the revised version of *Core Principles for Effective Deposit Insurance Systems*. The revision reflected the strengthened idea of market-based financing, improved the rule on the uses of deposit insurance funds, highlighted the important role of deposit insurers in crisis response and management, stated clearly that the deposit insurers should have in place effective contingency planning and crisis management policies to ensure effectively response to the risk of bank insolvency and other events.

3. Strengthening supervision on SIFIs

Updating the list of G-SIBs. In November 2014, the FSB updated the list of G-SIBs based on the end-2013 data. One bank has been added to the list of G-SIBs that were identified in 2013, increasing the overall number from 29 to 30 (Table 8.1). Agricultural Bank of China was included in the list of G-SIBs for the first time, which together with BOC and ICBC was allocated in the Bucket 1 of lowest systemic importance. The corresponding loss absorbency requirement is 1%. The G-SIBs in the updated list will apply higher loss absorbency requirement from 1 January 2016, and also be subject to higher supervisory expectations for internal controls, risk management functions, data aggregation capacities, and establishment of effective RRP. According to the disclosure requirements, the FSB also published the sample totals[①] of global systemically important assessment indicators, bucket thresholds and cut-off point for G-SIB designation.

Table 8.1 Updated List of G-SIBs

Bucket (Higher Loss Absorbency Requirement)	G-SIBs in alphabetical order within each bucket
5 (3.5%)	(Empty)
4 (2.5%)	HSBC JP Morgan Chase
3 (2.0%)	Barclays BNP Paribas Citigroup Deutsche Bank
2 (1.5%)	Bank of America Credit Suisse Goldman Sachs Mitsubishi UFJ FG Morgan Stanley Royal Bank of Scotland
1 (1.0%)	Agricultural Bank of China Bank of China Bank of New York Mellon BBVA Groupe BPCE Group Crédit Agricole Industrial and Commercial Bank of China Limited ING Bank Mizuho FG Nordea Santander Société Générale Standard Chartered State Street Sumitomo Mitsui FG UBS Unicredit Group Wells Fargo

Source: *2014 Update of Group of Global Systemically Important Banks* by the FSB, Nov. 2014.

① Systemically important indicators include 12 indicators with different weights across five categories, namely cross-jurisdictional activity, size, interconnectedness, substitutability and complexity. To calculate the score for a given indicator, the bank's reported value for that indicator is divided by the corresponding sample total, and the resulting value is then expressed in basis points. Averaging all the indicators with different weights produces the final score.

Table 8.2 Bucket Thresholds and Cut-off Point for G-SIB Designation①

Bucket and HLA requirement	Score range
5(+3.5%)	530~629
4（+2.5%）	430~529
3（+2.0%）	330~429
2（+1.5%）	230~329
1（+1.0%）	130~229

Source: *2014 Update of Group of Global Systemically Important Banks* by the FSB, Nov. 2014.

Developing Basic Capital Requirements (BCR) for G-SIIs. In October 2014, IAIS issued the *Basic Capital Requirements for Global Systemically Important Insurers*, which captured capital status of G-SIIs by calculating BCR ratio (Total Qualifying Capital Resources for BCR / Required Capital for BCR). BCR Required Capital is the amount of capital required to satisfy the BCR calculated based on the risks, which captured 5 main categories of insurance activity, namely traditional life insurance, traditional non-life insurance, non-traditional insurance, assets and non-insurance. BCR Qualifying Capital Resources is the amount of qualifying capital resources owned by insurers, which consists of core capital and additional capital. The core capital is comprised of qualifying financial instruments and capital elements contributing to insurers' financial strength and absorbing losses on a going-concern and gone-concern basis. The additional capital is comprised of qualifying financial instruments and capital elements other than core capital that protect policyholders in winding-up. The development of the BCR is the first step of the project to develop group-wide global capital standards by IAIS. IAIS will continue to develop and promote implementation of higher loss absorbency requirements and insurance capital standard.

Publishing assessment methodologies to identify non-bank non-insurer (NBNI) G-SIFIs. The FSB, jointly with IOSCO, published a consultative document on the assessment methodologies to identify NBNI G-SIFIs in 2014. The methodologies comprised a high-level framework for identifying NBNI G-SIFIs and detailed NBNI sector-specific methodologies for finance companies, market intermediaries, and investment funds, while maintaining broad consistency with the assessment methodologies for G-SIBs and G-SIIs. In order to overcome limitations in data availability, the assessment methodologies

① The cut-off score used for the G-SIB designation was 130 basis points and the bucket sizes were 100 basis points.

to identify NBNI G-SIFIs also allowed a greater role for supervisory judgement. The methodologies will be finalized by the end of 2015. Once the assessment methodologies have been finalized, the FSB, in cooperation with IOSCO and other SSBs where relevant, will begin work to develop the policy measures on NBNI G-SIFIs.

4. Strengthening supervision on shadow banking system

Continuously monitoring. In November 2014, the FSB published the *Global Shadow Banking Monitoring Report 2014* using end-2013 data from 25 jurisdictions. The report estimated the size and growing trend of global shadow banking system by using both broad and narrow measures[①]. According to the broad estimate, global shadow banking system grew by USD 5 trillion in 2013 to reach USD 75 trillion, accounting for 25 percent of global financial assets, roughly half of banking system assets, and 120 percent of GDP in sample jurisdictions, approaching the peak of 124 percent of GDP in 2007. Advanced economies represented the main part of shadow banking system, with the proportion of United States dropping, Euro area and United Kingdom slightly increasing. Emerging economies saw a rapid growth in shadow banking, with 9 of them increasing by over 10 percent. Among the shadow banking system, sub-sectors that grew most rapidly are Trust Companies and Other Investment Funds. The narrow measure reported the size of shadow banking for the 23 jurisdictions reducing from USD 62 trillion to USD 35 trillion, and the growth rate reducing from 6.6 percent to 2.4percent.

Strengthening supervision. The FSB contributed to the development and implementation of policy measures for shadow banking system in five areas. (i) Mitigating risks in banks' interactions with shadow banking entities. To ensure that the spill-over of risks from the shadow banking system to the banking system was addressed, the BCBS had finalized risk-sensitive capital requirements for banks' investments in the equity of funds, and the supervisory framework for measuring and controlling banks' large exposures. The BCBS also continued to work on reviewing the scope of consolidation to ensure that all banks' activities interacted with shadow banking system were captured in prudential regimes. (ii) Reforming the money market funds (MMFs). Since 15 policy recommendations to reform MMFs were issued by IOSCO in October 2012, national authorities had made

① The broad measure covers total financial assets held by Other Financial Intermediaries (OFIs), which include all non-bank financial intermediaries with the exception of insurance companies, pension funds and public financial institutions. The narrow measure filters out of financial assets of non-bank financial entities not involved in bank-like credit intermediation, financial assets related to those non-bank financial entities that are prudentially consolidated into a banking group, and financial entities whose activities do not exhibit risks associated with shadow banking activities.

dramatic progress in reforming their regulatory frameworks for MMFs. The preliminary findings of a peer review launched by IOSCO in 2014 indicated that most FSB jurisdictions had measures in force. In the US, the Securities and Exchange Commission (SEC) adopted new rules requiring a floating net asset value (NAV) for institutional prime MMFs so that the daily share prices of these funds fluctuate along with changes in the market-based value of fund assets. (iii) Improving incentive mechanisms in securitization. IOSCO issued policy recommendations in November 2012 related to transparency, standardization and risk retention requirements. The preliminary findings of the peer review launched by IOSCO in 2014 indicated that there had been good progress in implementing the recommendations. BCBS and IOSCO also published the consultative document of *Criteria for Identifying Simple, Transparent and Comparable Securitizations* in December 2014. (iv) Dampening pro-cyclicality and other financial stability risks in securities financing transactions (SFTs). The FSB published in October 2014 the regulatory framework for haircuts on non-centrally cleared securities financing transactions, which includes numerical haircut floors for transactions in which financing against collateral other than government securities is provided to entities other than banks. The Framework aimed to limit the build-up of excessive leverage outside the banking system and to help reduce the pro-cyclicality of that leverage. The FSB had also conducted researches on the application of numerical haircut floors for non-bank-to-non-bank transactions to ensure shadow banking activities were fully covered, to reduce the risk of regulatory arbitrage and to maintain a level playing field. (v) Assessing and mitigating systemic risks posed by other shadow banking entities and activities. Recognizing that shadow banking entities and activities take a variety of forms and evolve over time, the FSB had developed a forward-looking high-level policy framework to detect and address financial stability risks from shadow banking. The framework comprised an assessment of non-bank financial entity types based on five economic functions, the adoption of policy tools to mitigate financial stability risks where necessary, and information sharing by FSB member authorities.

Box 17 Peer Review of China Accomplished Successfully

Country peer review is an important task of the FSB, which focuses on the implementation and effectiveness of international financial standards and policies agreed within the FSB, and mainly examines the adoption and steps taken to address Financial Sector Assessment Program (FSAP) recommendations by reviewed member jurisdictions. According to the commitment to G20 and the FSB, China will undergo an assessment under the IMF-World Bank FSAP every five years, and the FSB country peer review 2~3 years after FSAP.

The peer review of China formally started in early 2014. The review team consisted of experts from treasury ministries and central banks of United Kingdom, United States, Netherlands, Switzerland, and European Union. The PBC, collaborated with Ministry of Finance, China Banking Regulatory Commission (CBRC), China Securities Regulatory Commission (CSRC) and China Insurance Regulatory Commission (CIRC), established formal joint ministerial leadership team and working group on China peer review. The topic of FSB peer review consisted of "macro-prudential framework" and "non-bank credit intermediation", which assessed the progress China had made since initial FSAP and the remaining gap on macro-prudential framework and non-bank credit intermediation.

Based on the response to the questionnaire and the on-site assessment, peer review team drew up the *Peer Review of China*. The report pointed out that China had made a good progress in adopting FSAP recommendations on macro-prudential management and non-bank credit intermediation, while there was additional work to be done. On the macro-prudential side, the authorities need to further clarify the roles of different bodies in the macro-prudential framework, strengthen the coordination, promote the further development of the framework on integrated systemic risk assessments, review the sharing of information for financial stability purpose, and enhance communication on macro-prudential policy issues. On the non-bank credit intermediation side, authorities need to continue to enhance data collection efforts, strengthen risk assessment capabilities within and across sectors, and develop a more activity-based regulatory approach. The authorities should also continue to promote a more diversified and flexible financial system by increasing reliance on market-based pricing mechanisms via the removal of implicit guarantees, and encouraging the development of the capital market.

In general, the peer review report highly appreciated the progress China had made on macro-prudential management and non-bank credit intermediation since initial FSAP from the international regulators' perspective, deeply analyzed the remaining problems and brought forward applicable recommendations that is valuable for improving financial regulation in China.

5. Promoting reforms of OTC derivatives markets

Progress continued to be made in reforming global OTC derivatives markets in 2014. In terms of implementation of international standards, over half of FSB member jurisdictions had adopted legislation to ensure the reform to be implemented. Over three-quarters of FSB member jurisdictions had some trade reporting requirements already in effect. 90 percent of the member jurisdictions had the relevant requirements fully or partially in effect in implementation of Basel III capital standards for derivatives exposures. In aspect of cross-border resolution, the FSB published a report in September 2014, noting that most jurisdictions, in order to resolve the cross-border regulatory issues of OTC derivatives markets, had established or were establishing frameworks on deferring to other jurisdictions' OTC derivatives regulatory regime. As to global aggregation of trade repository (TR) data, while a majority of jurisdictions had introduced trade-reporting obligations, data quality was still limited. The FSB published in September 2014 a study of the feasibility of various options for a mechanism to produce and share globally aggregated TR data, proposing to develop a global guidance on harmonization of data elements and to establish a data aggregation mechanism.

6. Improving accounting and auditing standards

In July 2014, the International Accounting Standards Board (IASB) published the final version of its revised standard of IFRS 9 Financial Instruments, changing the current accounting model of financial instruments in 3 phases of classification and measurement, impairment and hedge accounting. IFRS 9 will replace the International Accounting Standard 39 (IAS 39) in the future. The most important revision of IFRS 9 was the requirement for entities to account for impairment by using Expected Credit Loss (ECL), which requires entities to account for a portion of expected credit losses when financial instruments were first recognized and to recognize full lifetime expected credit losses on a timely basis. The FASB had developed an expected credit loss model which requires an entity to recognize at each reporting date the total expected credit losses over the life of the financial assets. The FSB encouraged the IASB and FASB to monitor the consistent implementation of their respective standards and to continue to seek opportunities for further convergence.

The FSB encouraged International Forum of Independent Audit Regulators (IFIAR) to conduct a survey on external audits of G-SIBs[①], and extend the survey to G-SIIs to realize the consistency of auditing quality. The BCBS in March 2014 published its revised *Guidance on External Audits of Banks* with the expectation to improve the quality of bank audits and enhance the effectiveness of prudential supervision.

① IFIAR published its first research report in 2014 on auditing quality of G-SIBs' annual auditing reports. The research report involved issues on internal control of banks, assets in fair value and auditing on loan loss reserves.

7. Others

Reforming the financial benchmark-setting mechanism. In order to address manipulation concerns of financial benchmarks in recent years, the FSB conducted a research on the formation of key interest rate benchmarks and key FX rate benchmarks and proposed policy recommendations. The FSB undertook a fundamental review of the governance and determining mechanism of major interest rate benchmarks (LIBOR, EURIBOR, and TIBOR) according to IOSCO's *Principles for Financial Benchmarks*. The findings indicated that all three administrators had made significant progress in implementing the majority of the principles, while reforms were still needed on benchmark design, data sufficiency and transparency of benchmark determinations. The FSB proposed at least two benchmarks for financial markets, one of which should be a risk-free or nearly risk-free rate, another of which should include bank credit risk. This multiple-rate approach was recommended to improve the design of benchmarks. Based on the FSB research, the key factor affecting the fairness of exchange market was the imperfect trading mechanism. The FSB then proposed to reform the calculation methodology of the foreign exchange benchmark rates, such as widening the fixing window in determining the middle rate, publication of reference rates by central banks, and strengthening supervision on the behavior of market traders.

Building the global legal entity identifier (LEI) system. The global LEI system was effectively functioning and actively used in uniquely identifying participants in financial markets and enhancing effectiveness of financial regulation. The Regulatory Oversight Committee (ROC) took the responsibility of monitoring and maintenance of the Global LEI System, which consisted of members and observers from more than 70 authorities. As of end-September 2014, over 300,000 legal entities from 189 countries had obtained LEIs from 18 local operating units (LOUs). The Global LEI Foundation (GLEIF) was established in 2014, which will support the maintenance of a logically centralized database of identifiers to ensure the application of uniform global operational standards and protocols.

Box 18 LOU of Global LEI System Started Operation in China

The Global LEI System was proposed by the FSB in July 2011, and was also endorsed by G20 with the purpose of establishing international uniform financial regulatory framework and enhancing the global systematic financial risk recognition. LEI system allocated a unique 20-digit, alpha-numeric code to each legal entity, and then linked the information of legal entities with the LEI in the form of reference data to identify the participants of international financial transactions and promote effective financial regulation. In order to provide uniform LEI coding principles, International Organization for Standardization (ISO) issued *Financial services—Legal Entity Identifier* in 2012, which specified the components of LEI code and reference data.

LEI system comprised 3 hierarchies. The first hierarchy was the Regulatory Oversight Committee (ROC) made up by global regulatory authorities, that oversaw the Global LEI System in the public interest. The second hierarchy was the central operating unit (COU), which took responsibility for global data collecting and processing. The third hierarchy was the local operating units (LOU) established in each local jurisdiction, which took the responsibility of LEI registration and local data maintenance.

LOU of LEI System started operation in China, and achieved independent LEI code issuing. China Financial Standardization Technical Committee (CFSTC), under the instructions ofPBC, established LOU of LEI in China and had formally offered LEI code service since August 18, 2014. The main function of LOU in China included LEI registration, data verifying, annual examination, questioning and responding, data inquiry and downloading. LOU in China had allocated LEI code to 41 legal entities including the China Foreign Exchange Trade System by the end of 2014.

LOU in China was globally recognized and the international service was further enhanced. In 2014, the LEI ROC endorsed the international recognition request of China, which means LOU in China and its LEI code achieved international recognition. At the same time, CFSTC, complying with general LEI ROC principles, continuously updated LOU website and established an English version, enhanced international service, offered LEI code immigration service to local legal entities that registered abroad, and strengthened local information safety management.

System construction insistently improved and the operating environment of LOU continuously ameliorated. LOU in China insisted on standardized operation, and highlighted the service and data quality complying with international standards. At present, the regulations of LOU in China consisted of internal rules and international rules. International rules defined the LEI registration and usage, including Legal Entity Identifier System User Service Provision Agreements. Internal rules defined the internal responsibilities, task and procedure, including the Legal Entity Identifier System Registration Management Rule and Legal Entity Identifier System operational procedure.

Reducing reliance on credit rating agencies (CRAs). The FSB issued in 2010 *Principles for Reducing Reliance on CRA Ratings* and encouraged the financial institutions to develop their own capacity for credit risk assessment. The peer review in 2014 found that progress toward the action plan on removal of reliance on CRA ratings had been uneven across the financial sectors. Authorities from member jurisdictions had made action plans on promotion of developing internal ratings-based approaches by financial institutions, but most action plans did not include concrete suggestions for establishing alternative standards of creditworthiness, and the design of the approach by financial institutions was still in the exploration. The FSB then recommended authorities to take comprehensive actions to reduce over-reliance on the CRA ratings, engage in dialogue with market participants, encourage market participants to actively promote alternative approaches that are reflective of their business and regional difference, and reduce reliance on CRA ratings of provisions within private contracts. At the same time, simply substituting CRA ratings with one or several approaches may also lead to risk.

II. Major jurisdictions' progress in Macro-prudential Policy

1. United States

Raising financial regulatory standards. Firstly, relevant authorities implemented Basel III requirements and established a rigid liquidity regulatory framework. The Federal Reserve Board (FRB), Federal Deposit Insurance Corporation (FDIC) and Office of the Comptroller of the Currency (OCC) jointly issued the final rule on Liquidity Coverage Ratio (LCR) applied to banking organizations with total consolidated assets of above USD 250 billion or total consolidated on-balance-sheet foreign exposure of above USD 10 billion, setting the minimum requirement of LCR. The LCR requirement will take into effect from 1 January 2017. Secondly, the supplementary leverage ratio requirements was issued, with leverage ratio of bank holding companies with more than USD 700 billion in consolidated total assets or more than USD 10 trillion in assets under custody raised at least to 5%, and their insured depository subsidiaries maintaining at least 6%. The effective date of supplementary leverage ratio requirements is January 1, 2018. Thirdly, the FRB issued a final rule strengthening supervision and regulation of large foreign banking organizations conducting business within the U.S., which applied to foreign bank holding companies with total assets of more than USD 10 billion. The final rule set different regulatory requirements according to the consolidated assets and assets of branches operating in United States, and will take into effect from 1 July 2016. Fourthly, SEC published a new regulatory rule on MMFs, requiring the application of floatingNAV by institutional prime MMFs that comprise 1/3 of total money market funds, and permitting liquidity fees and redemption gates for investors.

Reviewing living wills of SIFIs. In order to fulfill the requirements of *Dodd-Frank Wall Street Reform and Consumer Protection Act* and ensure the smoothly implementation of resolution plans, the Fed and FDIC jointly announced the completion of reviews of resolution plans submitted by 11 large and complex banking institutions in 2013. The two agencies noted some improvements on the resolution plans. However, the living wills still need to be improved, such as improving organizational structure and business lines to reduce the firm's complexity, ensuring the continuity of shared services that support critical operations and core business lines throughout the resolution process, and promoting operational capabilities for resolution preparedness and reliable information accessibility.

Identifying and preventing systemic risk. In 2014, Financial Stability Oversight Council (FSOC) performed its mandates of identifying and preventing systemic risk and published its annual report. The report analyzed macroeconomic environments and financial market condition in the U.S., clarified the regulatory improvements and potential financial risks of the U.S., and proposed recommendations on further reform measures.

2. United Kingdom

Introducing macro-prudential policies. In 2014, the Financial Policy Committee (FPC) continuously perfumed its mandate and introduced a series of macro-prudential policies. Firstly, raised requirements on mortgage loans by developing solvency capacity tests on obligors under the stress scenario that the interest rates go up for 3 percentage points in the future five years when issuing new mortgage loans. Secondly, applied loan to income (LTI) ratio limits by requiring mortgage lenders to limit the number of mortgage loans at LTI of above 4.5 times to no more than 15% of their total number of new mortgage loans. The recommendation applies to lenders with residential mortgage lending in excess of GBP 100 million per annum. Thirdly, FPC obtained?a power of instruction to?real estate market. FPC, under the designation of HM Treasury, could made instructions to Prudential Regulation Authority (PRA) and Financial Conduct Authority (FCA) about mortgage loan extension restrictions, and the main policy instruments included loan-to-value (LTV) ratio and debt-to-income (DTI) ratio. Fourthly, HM Treasury designated FPC to make recommendations to PRA about leverage ratio and buffer requirements for banks, building societies and investment firms.

Imposing structural reform in banking sector. In October 2014, PRA published a consultation paper of *The implementation of ring-fencing: consultation on legal structure, governance and the continuity of services and facilities*, which set out recommendations as follows. First, ring-fenced bodies (RFBs) were prohibited from being owned by or owning entities carrying out excluded or prohibited activities to keep core activity unaffected from the high-risk activities. At the same time, RFBs and other entities of the banking groups should adopt a 'sibling structure', which means RFBs and entities are expected to be structured as separate clusters of subsidiaries beneath one UK holding company. Second, RFBs should be able to make decisions independently of other members of the group and take all reasonable steps to identify and manage conflicts of interest with other group members to avoid being disrupted by other entities. Third, an RFB may receive shared services and facilities only from other group entities where such entities are part of the RFB's subgroup or are dedicated intra-group services entities, which could ensure the provision of services and facilities from other group entities and third parties to an RFB not be capable of being disrupted through the acts, omissions, or insolvency of other group entities.

Improving resolution regime. Alongside implementation of the European Union's *Bank Recovery and Resolution Directive*, the Bank of England's approach to resolution was published in October 2014, which improved the resolution regime of banks, building societies and certain investment firms. Firstly, the roles of authorities were clearly defined. The Bank of England, with the responsibility for the resolution of a failing bank, was responsible for deciding which tools to use, conducting the resolution, and consulting PRA and FCA to assess whether a firm should be put into resolution. HM Treasury was responsible for deciding whether to put a firm into temporary public ownership or make a public equity injection. The Financial Services Compensation Scheme (FSCS) paid out or funded the transfer of deposits protected by the deposit guarantee scheme. Secondly, resolution procedure was further clarified. There are three key phases to any resolution, i.e. stabilization, restructuring and exit from resolution. When the failure of the firm would injure public interests, resolution authorities can bring forward stabilization measures either through transfer to a solvent third party or through bail-in to recapitalize the failed firm. Once the firm has been stabilized, the restructuring stage would be entered to restore viability and consistent funding capacity from the financial market. The resolution authorities should exit when a restructured firm could operate without official liquidity support or cease to exist.

3. European Union

Improving macro-prudential policy. In 2014, the European Systemic Risk Board (ESRB) instructed macro-prudential authorities of member jurisdictions to fulfill their macro-prudential mandate by improving macro-prudential regulatory tools and systemic risk monitoring indicators, and expanded the monitoring scope to insurance sector, shadow banking system and financial infrastructures from banking sector. Firstly, instructed member jurisdictions to use macro-prudential tools. In March 2014, the ESRB published the *Flagship Report on Macro-prudential Policy in the Banking Sector* and *the ESRB Handbook on Operationalizing Macro-prudential Policy in the Banking Sector*, which set four steps to conduct macro-prudential management including risk identification and assessment, instrument selection and calibration, policy implementation and policy evaluation. The ESRB also reviewed the macro-prudential mandate and use of tools of authorities of member jurisdictions. Secondly, continued to improve macro-prudential tool kit and expand the application scope. To prevent liquidity risk, the ESRB encouraged member jurisdictions to gradually introduce LCR and NSFR which could influence the financing cost of banking institutions in addition to the Loan-to-Deposit (LTD), LTV, LTI and DTI ratios.

Promoting the establishment of the Banking Union. European parliament approved three acts to establish the Banking Union on 15 April 2014, namely the *Bank Recovery and Resolution Directive* (BRRD), Single Resolution Mechanism regulation and revised Directive on Deposit Guarantee Schemes . According to the Single Resolution Mechanism regulation, a resolution fund of EUR 55 billion will be established in the future 8 years. European Central Bank (ECB), European Commission and national resolution authorities will constitute the Single Resolution Board (SRB), which will be in charge of the restructuring and closing of banks in Euro area, and deciding the resolution tools and the way to use resolution fund. The SRB has the power to carry out resolution of a failed bank directly if national resolution authorities fail to comply with resolution decision made by SRB. The Deposit Guarantee Schemes asked 28 member jurisdictions to set up a deposit guarantee fund by levying tax against banks to offer protection to depositors with deposits under EUR 100000, and avoid rescuing a failed bank with public fund.

Strengthening capital regulation framework of banking sector. European Union started to implement the *Capital Requirements Directives* (CRD) in banking sector from 1 January 2014, thus the capital requirement was further strengthened. Firstly, banks should keep liquidity assets accounting for at least 25 percent of cash outflows in addition to LCR and NSFR requirements and the minimum capital requirements under Basel III. Secondly, counter-cyclical capital buffer should be established to address pro-cyclicality of the banking system. Additional capital buffer[①] requirement was also introduced for G-SIIs and other systemically important institutions to prevent systemic risk and inter-connectedness risk. At the same time, member jurisdictions were also asked to build systemic risk buffer[②] to lower down the long-term structural systemic risk, such as high leverage ratio. Thirdly, specific instruments were permitted by national authorities, which included raising credit risk weight of real-estate sector, strengthening minimum equity capital requirement, and reducing threshold of large exposure. Fourthly, banks were asked to

① The mandatory capital buffer surcharge will be between 1% and 3.5% of RWAs for the global systemically important institutions, and the ceiling of the buffer for other systemically important institutions will be 2% of RWAs.

② The systemic risk buffer could be imposed exclusively from G-SIIs and O-SIIs capital buffer. Generally the higher of the two buffers should be applied.

disclose risk indicators like leverage ratio and so on to enhance transparency.

4. Germany

Germany, based on its national financial market condition, further enhanced macro-prudential management to build a resilient financial system under EU framework. Firstly, Financial Stability Committee (FSC), with instructions from ESRB, was responsible for macro-prudential management and provided early warning of potential risks and recommendations to the federal government, Federal Financial Supervisory Authority (BaFin) and other authorities. Secondly, Bundesbank was responsible for submitting consultative documents and preliminary policy recommendations, evaluating results of macro-prudential policy, and preparing and submitting FSC report to parliament annually, which means the Bundesbank continuously played an important role in macro-prudential management. At the same time, the financial stability mandate of Bundesbank was further enhanced by establishing a specific financial stability department to continuously identify and assess financial risk, develop macro-prudential analysis tools, set up systemic risk monitoring indicator system, and identify the evolving risk profile of credit institutions and insurance institutions, especially the systemically important institutions. Thirdly, Federal Agency for Financial Market Stabilization (FMSA) supported financial institutions through Financial Market Stabilization Fund (SoFFin). As of April 2014, SoFFin had offer EUR 168 billion guarantee to 9 banks, and EUR 30 billion recapitalization to 4 banks. At the same time, FMSA also supervised the newly set up asset management companies (AMC) to spin off bad assets of banks, relieve the pressure on banks' balance sheets, ensure banks' credit service to real economy, and avoid social cost caused by failed banks. FMSA is expected to update to a specialized supervisory authority on restructuring financial institutions in 2016.

III. China's Practice in Macro-prudential Regulation

1. Constantly promoting the Joint Ministerial Conference on Financial Regulatory Coordination Mechanism

The Joint Ministerial Conference on Financial Regulatory Coordination (Joint Conference in short) consistently improved its working mechanism in 2014, developed research on the important and emerging issues in the financial sector, and coordinated the regulatory policy development and implementation. In 2014, five meetings were held, 26 issues were discussed and a series of policy arrangements were brought forward.

Box 19 The Joint Ministerial Conference on Financial Regulatory Coordination Operated Soundly

In August 2013, the State Council approved the establishment of a joint ministerial conference on financial regulatory coordination, to be led by the PBC and participated by the CBRC, CSRC, CIRC and State Administration of Foreign Exchange, and the financial regulatory coordination had operated in an institutionalized, standardized and normalized way. There had been 8 meetings since the joint conference was established, 35 issues had been discussed and a series of policy arrangements had been made, with the effectiveness of macro-adjustment and financial regulation constantly improving, financial reforms taking good progress, financial sector providing better service to real economy, and the bottom line for systemic and regional financial risk at well control.

Promoting the implementation of financial reforming policies. First, implementation of financial reforming measures and resilient standards were promoted, and the coordinated macro-prudential and micro-prudential financial regulatory framework was being established. Second, regulatory information sharing and financial comprehensive statistical construction were energetically enhanced. Third, regulatory and resolution responsibilities between central and local authorities were further clarified, and coordination mechanism between central and local authorities were actively explored. Fourth, internal and external opening-up of financial sector was deepened, the principle of pre-establishment national treatment and negative list management mode to promote financial sector opening-up was clarified, and it achieved consensus what measures and action plans should be applied for the financial opening-up and innovation pilot program of China (Shanghai) Pilot Free Trade Zone.

Enhancing coordination between macro-adjustment and financial regulation, and promoting the financial sector to serve the real economy. Firstly, complemented policy arrangements to recover and enhance funding function of the stock market were brought forward. Secondly, policy measures to normalize inter-financial institutions business were launched. Thirdly, research on several measures to reasonably bring down social funding cost had been developed and consensus was achieved, with a series of policy measures brought forward accordingly. Fourthly, research on policy measures to expand securitization pilot and reinvigorate stock assets to promote economic re-structuring was under way. Fifthly, measures to strengthen capital market construction and optimize social financing structure were being developed. Sixthly, Rules on Initial Public Offerings (IPO) were under improvement to relieve the cyclical pressure to money market by massive IPOs.

Preventing financial risks arising from the key areas to maintain financial stability. First, work was done on the prevention and mitigation of key potential risks in financial sector. Second, measures to relieve debt risk of local governments were considered. Third, steps to defuse NPLs in banking sector were under consideration. Fourth, resolution on financial risk events in certain local areas was speeded. Fifth, arrangements of prevention from default of credit debt instruments and trust products were being discussed. Sixth, steps to normalize private finance were under consideration. Seventh, efforts were made to formalize financial products trading in local exchange markets and banks' activities in exchange markets.

Clarifying regulatory principles on cross-market and cross-sector financial innovation in time, and promoting normative development of emerging financial business. In the context of accelerating financial market innovation and internet finance, the joint conference discussed and developed uniform regulatory rules, clarified responsibility boundary, and strengthened risk monitoring and regulatory coordination. Firstly, clarified general requirement, principles, and categorized regulatory requirements to promote sound development of internet finance, and brought forward regulatory measures. Secondly, enhanced the management on money market funds and investment-linked insurance products that were sold through the internet channel. Thirdly, discussed on the sound development of the asset management industry. Fourthly, coordinated policies on the crude oil futures settlements, treasury bond futures, and hedge of agricultural companies futures. Fifthly, promoted urban commercial banks and rural commercial banks to be listed on the National Equities Exchange and Quotations.

2. Implementing the counter-cyclical macro-adjustment policies

The PBC continuously used dynamic adjustment framework on differentiated reserve ratio to enhance macro-prudential management. The PBC calibrated some parameters of the dynamic adjustment system on differentiated reserve ratio, guided financial institutions to fulfill the sound monetary policy, namely to maintain the sound operation, to extend credit supply in an appropriate and reasonable way, and to optimize the credit structure. In accordance with the downside risk and low inflation, the PBC, in order to ensure reasonable credit expansion, had made adjustments to parameters of the dynamic adjustment system on differentiated reserve ratio for four times, lowered down the macro-economic parameter, enhanced adjustments of parameters on credit policy implementation involving small and micro enterprises and agriculturalloans, made more targeted encouragment and instructions towards financial institutions to raise credit line to small and micro enterprises, the rural areas, farmers, agricultures as well as the underdeveloped regions like middle and western China. At the same time, inter-bank business was also included in the parameter to prevent from the risk arising from speedy expansion of inter-bank business.

3. Strengthening monitoring and assessment of systemic risk

The PBC, in collaboration with regulatory authorities, strengthened financial risk monitoring, assessment and early warning, guarding against the systemic and regional financial risk. Firstly, enhanced information collection and analysis on banking, securities and futures, insurance sectors, non-financial institutions with financing function, and private finance. Established monitoring and analyzing system that comprised all non-bank credit intermediaries, and further promoted reporting mechanism of important matters and contingency management on financial institutions. Secondly, promoted risk monitoring and investigation of key sectors, keeping an eye on the potential risk from local government debts, the real-estate industry, over-capacity industries, and cross-sector, cross-industry and cross-market business. Thirdly, conducted on-site assessment on soundness of financial institutions, raising width and depth of the assessment. Stress-testing was also used to highlight forward-looking and scientific assessment. Fourthly, enhanced early warning system of systemic risk, searching potential risk in both non-financial sector and financial sector. Special attention was paid on solvency of non-financial sector and early-warning indicators like resilience of financial system and liquidity, building inter-connected early-warning analyzing framework of systemic financial risk.

4. Enhancing regulation on SIFIs

Crisis Management Group (CMG) of Bank of China (BOC) had approved its annual update of RRP. ICBC CMG was established in September 2014, which was composed of Ministry of Finance, the PBC, CBRC, Hong Kong Monetary Authority, and Monetary Authority of Macao. The ICBC CMG approved the RRP of ICBC. In May 2014, CMG of Ping An Insurance (Group) Company of China was established, consisting of CIRC, CBRC, and China Insurance Security Fund Co., Ltd. The RRP of Ping An Insurance (Group) Company of China had been completed.

Special Topic Ⅰ

Deposit Insurance System Established in China

As the fundamental institutional arrangement for depositor protection, the deposit insurance system is an important component of the financial safety net. The decision of the 3rd Plenary meeting of the 18th CPC Central Committee requires establishing the deposit insurance system and improving the market-based exit regime for financial institutions. The 2014 Report on the Work of Government also underlined the importance of establishing the deposit insurance system. To implement the above requirements, the PBC worked together with other relevant departments, reviewing the design of deposit insurance system, seeking comments and advices from various parties, developing the implementation plan, as well as pushing forward the deposit insurance legislation. In 2014, the Implementation Plan of Deposit Insurance System proposed by the PBC was approved by the executive meeting of the State Council. Premier LI Keqiang signed the No. 660 Decree of the State Council on February 17, 2015, releasing the Deposit Insurance Regulations of the People's Republic of China, which took effect since May 1.

The policy objectives of establishing the deposit insurance system were protecting the legal rights and interests of depositors, promoting the prudent and sound operation of financial institutions, preventing and dealing with financial risks timely and fostering the long-term financial stability mechanism. As one of the three pillars, the deposit insurance system will help to strengthen the financial safety net, together with the central bank's role as the lender of last resort and the prudential supervision. As far as the timing was concerned, the establishment of deposit insurance system will further help delineate the boundaries between government and market, push forward the reform, openness and evolution of financial sector, promote the diversified ownership, efficient service, equitable competition and continuous growth of financial institutions, improve corporate governance and risk management, and enhance the financial sector's capacity to serve real economy and compete globally.

I. The Basic Concept and Functions of Deposit Insurance

Deposit insurance, which also refers to the deposit guarantee, is the institutional arrangement of deposit protection offered by the government to its public through explicit legislation, where a specific deposit insurance fund was established and when the insured deposit-taking institutions were on the verge of failing, such fund may be used to protect depositors with necessary measures taken to safeguard the fund. Currently, the deposit insurance system has been adopted by more than 110 jurisdictions. The international practices demonstrate that the deposit insurance system play an effective role in protecting depositors' rights and interests, preventing and dealing with financial risks, and maintaining financial stability, and is an essential component of the financial safety net.

1. The deposit insurance system could better protect the depositors' rights and interests

As its starting point and operational footing, the core function of deposit insurance system lies in its capacity to protect depositors. Specifically speaking, the deposit insurance system will help to protect depositors from the following three aspects.

Firstly, the deposit insurance system is established through legislation, which offers explicit and sufficient protection to the public's deposits, requires the accumulation of deposit insurance funds to ensure reliable funding in case any individual insured financial institution fails and the compensation to depositors would be warranted according to the legislation.

Secondly, the deposit insurance system will help to strengthen the market discipline for financial institutions, improve the risk identification and verification by authorities, and promote the prudential and sound operation of financial institutions by imposing more early risk warning and prompt corrective measures. As a result, the financial system will become sounder to guarantee the safety of deposits.

Thirdly, the establishment of deposit insurance system will help to improve the financial safety net. The explicit guarantee for deposits will help to lift the confidence of market and depositors, enhance the financial safety net's operational effectiveness, and ensure the long-term stable and healthy development of the banking system as a whole.

2. The deposit insurance system will be conducive to forming the market-based risk prevention and resolution regime, and improving the long-run financial stability mechanism

The risk-based deposit insurance premium system, under which the financial institutions with different risk profiles will be charged differently, will help to strengthen the incentives and discipline for financial institutions through market-based means, and promoting their prudential operation and healthy development. As the major loss absorbing party in the bank failure, the deposit insurer has the inner incentive to strengthen risk identification and take necessary risk prevention measures, so as to prevent accumulation of financial risks. When the insured financial institution become troubled, the deposit insurer, in its largetst capacity, is mandated to take market-based resolution actions, generally by purchase and assumption transactions, to deal with financial failures, which was not only useful for protecting depositors' legitimate rights and interests and containing risk contagion but also for resolving the risks in a timely manner, reducing resolution costs and maintaining financial stability.

Box 1 The Evolution of the Deposit Insurance System and Its Role in Maintaining Financial Stability

The first deposit insurance system was established in the United States in 1933, through legislation by the government dealing with a large number of bank failures during the Great Depression. Since its establishment, the deposit insurance system in the United States had been proved to be very successful in enhancing the public confidence and effective in dealing with banking crisis. During the more than 80 years after its establishment, the deposit insurance system had been regarded as the important institutional foundation to enhance public confidence in the banking sector. While the U.S. deposit insurance system kept operating successfully and improving over time, the system was adopted by more and more jurisdictions around the world.

The experiences by major economies in withstanding the 2008 global financial crisis demonstrated again the important role of the deposit insurance system in protecting depositors, dealing with financial crisis and maintaining financial stability. During the crisis, the banking system in the United States was seriously hit. A total number of more than 510 banks failed during 2008-2014. To deal with the crisis, the deposit insurance system in the United States managed the different size bank failures efficiently through various flexible resolution methods such as purchase and assumption transactions, playing a critical role in containing risk contagion, maintaining financial stability and enhancing public confidence. In comparison, the deposit insurance systems in some European countries were proved to be insufficient in dealing with the crisis and protecting depositors. The deposit insurers in these countries lacked the capacities of early intervention and timely resolution and can only compensate depositors after the banks were declared to fail, which was proved to be insufficient in responding to the crisis and maintaining market confidence. As a result, the governments of these countries had to bail-out, restructure and exercise the temporary public ownership for troubled banks. Such responses not only put taxpayers' money at risk, but also complicated the policy exit to such an extent that they even further exacerbated the sovereign crisis in these countries.

In June 2009, the *Core Principles for the Effective Deposit Insurance System* was released jointly by the Basel Banking Supervision Committee (BCBS) and the International Association of Deposit Insurers (IADI), reflecting the experiences and lessons drawn from the international practices, especially from the recent global financial crisis. The Core Principles pointed out that: the deposit insurance system should be established during the time the financial system was stable; in order to contain moral hazard, the design of the system should follow the principles of compulsory membership, adequate coverage to protect most depositors, necessary mandates, and timely compensation. The deposit insurance system should be part of the policy framework for risk monitoring, mitigation and resolution of problem banks as well as maintaining financial stability. The G20 London Summit has declared its endorsement, through its Leaders' Statement, for implementing the key international financial standards that included *the Core Principles*. Currently, the *Core Principles* has been recognized as one of the major international financial standards.

II. The Policy Background for Establishing the Deposit Insurance System

1. The establishment of deposit insurance system will lay a solid basis for the development of small and medium-sized banks and private banks

On the one hand, the deposit insurance system will in fact enhance the credit worthiness and competitiveness of private banks and small and medium-sized banks. Through explicit legislation, the legal protection for deposits was put in place for the depositors, which could create an equitable environment for competition among different types of banks. On the other hand, the establishment of the deposit insurance system will help to achieve a stable and orderly financial market environment for private banks and small and medium-sized banks through the strengthened depositor protection, stable expectations of the public and enhanced market confidence. In case any individual financial institution becomes troubled, the deposit insurance authority may adopt various resolution measures to deal with potential financial failure, cutting off the risk contagion chains and improving the resilience and soundness of the banking system as a whole.

Based on the relevant experiences of other countries, the establishment of the deposit insurance system provided the solid institutional basis for the development of small and medium-sized banks and private banks. In the United States, the health development of community banks benefited much from its deposit insurance system, which helped to create the institutional basis for fair competition between small banks and big banks. The healthy development of community banks played an important role in maintaining the diversity of financial system, and meeting the financial service needs of small enterprises, communities and farmers. The establishment of deposit insurance system and the market-based institutional arrangement for financial failures in China will also lay a solid institutional basis for the healthy development of small and medium-sized banks and private banks. Generally speaking, the risk-based deposit insurance premium system, under which the financial institutions with different risk profiles will be priced differently, and the prompt corrective measures taken against troubled institutions will help to foster a robust small bank system with effective competition, sustainable growth and business models focusing on the financing needs of farmers and small and micro enterprises. Such a small bank system will further help optimize the structure of the financial system and enhance the financial sector's capacity to serve the real economy.

Box 2 Deposit Insurance System and the Development of Community Banks in the Untied States

The experiences of United States and other countries showed that the small banks and community banks benefited, advocated and pushed forward the development of the deposit insurance system. As the institutional basis to promote fair competition in the banking sector, the deposit insurance system creates the equitable operating environment for big banks and small banks, which help maintaining the diversity of financial institutions and better meeting financial service needs of small businesses, communities and agriculture.

In the United States, the community banks play the unique role that can not be replaced by big banks. There are 7000 community banks, which mainly focused on the financing needs of small business and agriculture. According to the statistics of the Federal Deposit Insurance Corporation, the assets of community banks only accounted for 14% in the banking industry, but was responsible for 46% loans of the banking sector offered to small business and agriculture. For over 20% counties the financial services can only be accessed in community banks.

The Deposit insurance system plays an important role in fostering the development of community banks. Without the deposit insurance system, the depositors prefer the big banks, making community banks difficult to survive. The deposit insurance system greatly boost the depositors' confidence on community banks, promote the equitable environment that supports competition, helping to foster the healthy development of community banks and maintain the diversity of financial institution system.

2. The establishment of the deposit insurance system will lay the institutional support for further liberalizing the interest rates

With the interest rates liberalized progressively, the market entities will enjoy more autonomy in pricing and therefore need to further strengthen their corporate governance and hard budget constraints. As the supportive institutional arrangement, the deposit insurance system with the risk-based premium arrangements will help to improve the early identification and correction for financial risks, deal with troubled banks in a timely manner, strengthen the favorable incentives and market discipline for financial institutions and therefore consolidate the financial institution basis for the interest rate liberalization reform. In addition, the establishment of the deposit insurance system will help to strengthen depositor protection and the resolution regime, which will further remove the barriers for the interest rate liberalization reform.

From the viewpoint of increasing the openness of the financial sector, given that the deposit insurance system has been adopted by a number of jurisdictions, its establishment in China will be conducive to facilitating the cross-border policy coordination in the area of depositor protection and risk resolution, so as to enhance the global competitiveness of China's financial sector.

III. Major Characteristics and Policy Considerations for China's Deposit Insurance System

The design of China's deposit insurance system took into account the country specific circumstances, especially the current development stage, drawing upon experiences and lessons from the global practices, with major characteristics reflecting core elements of best practices and general principles of an effective deposit insurance system agreed internationally.

1. Covered Financial Institutions and Deposits

The major policy objective of establishing the deposit insurance system is to protect depositors' rights and interests. In order to fully protect depositors, ensure the fairness and reasonableness of the system, as well as to promote equitable competition of the banking sector, the deposit insurance system covers all the deposit-taking financial institutions. According to the *Deposit Insurance Regulations*, all the commercial banks, rural cooperative banks and rural credit cooperatives that take deposits within the territory of the People's Republic of China (hereinafter referred to as insured financial institutions) shall participate in the deposit insurance system. In the meanwhile, in line with international practices, the foreign branches of insured financial institutions and the domestic branches of foreign banks will not be covered by the deposit insurance system unless there is any agreement between China and other countries.

As far as the covered deposits are concerned, both the RMB and foreign currency deposits are covered by the deposit insurance system, including the principal and interests of deposits of individuals, enterprises and other entities. The deposits not covered are deposits from other financial institutions, senior management of the insured financial institutions, and deposits that the Deposit Insurance Fund Management Authority determined not to be covered. In line with international practices, exclusion of certain deposits from the coverage of deposit insurance aims to enhance market discipline and promote the sound performance of the banking sector.

2. The Compensation Limit

The determination of the compensation limit of deposit insurance system should help to fully protect depositors' interests and contain moral hazard. It is suggested by other countries' experiences that such a limit should achieve full protection for 90% depositors, or be set as 2~5 times per capita GDP, to ensure the sufficient protection for depositors and stable operation of the banking sector. For example, the compensation limit of United States, United Kingdom, Korea and India were 5.3, 3, 2 and 1.3 times per capita GDP respectively. Considering the circumstances that the Chinese saving inclination is relatively high, the deposits assume the function of social security and they compose the major funding resources for banks, the compensation limit was determined to be RMB 500,000 Yuan after repeated calculation. Being equivalent to 10.7 times per capita GDP of the year 2014 and higher than most other countries, the limit will help to protect depositors, promote the sound operation of the banking sector and maintain financial stability. The statistics indicated that the compensation limit can provide full protection for 99.63% depositors.

The limited compensation arrangement does not mean the deposits above the limit were not safe. The banking sector operated soundly in recent years, with sound performance in major financial and supervisory indicators such as the capital adequacy ratio. Meanwhile, with the strengthened banking supervision, the banking sector's overall risk management capacity has been lifted. The establishment of the deposit insurance system will further help to improve the financial safety net and provide the solid institutional basis for the healthy development of banking sector. It has been demonstrated by the international practice that even if an individual financial institution fails, its deposits will be transferred to sound banks to safeguard depositors' interests. According to the *Deposit Insurance Regulations*, if the Deposit Insurance Fund Management Authority decides to use the deposit insurance fund to protect depositors, besides the methods of direct pay-out within the compensation limit, it can provide financial support to other qualified insured financial institutions to facilitate its purchase or assumption of the business, assets and liabilities of the financial institution that has been taken over by the authorities, or the charter of which has been canceled, or that has been filed for bankruptcy so that depositors will be protected as full as possible.

3. Deposit insurance fund and the premium system

The deposit insurance fund should be composed mainly of premiums charged on the insured financial institutions to strengthen the market discipline. To ensure the safety of the fund, its use and investment were strictly limited by the *Deposit Insurance Regulations*, where to achieve the liquidity, safety and value restoring purposes. The fund can only be placed with the PBC, be invested in government bonds, central bank notes, financial debentures with high credit ratings, other non-financial debentures with high credit ratings and be used in other ways approved by the State Council.

The deposit insurance premium system will be the combination of the basic premium rate and risk differentiated premium rate. The premium rate standards will be determined and adjusted by the Deposit Insurance Fund Management Authority, taking into account the factors of economic and financial conditions, deposit structure and the accumulative level of deposit insurance funds, and will be applied after approved by the State Council. The applicable premium rate for each insured financial institution will be determined by the Deposit Insurance Fund Management Authority based on its risk profile. The combination of basic premium rate and risk differentiated premium rate will help to promote the fair competition and appropriate incentives, strengthen market discipline, and encourage prudential and sound operation of financial institutions. Considering the international experiences, the financial burden of financial institutions and resolution requirements, the initial premium rates for insured financial institutions will be much lower than the level currently adopted in most other countries and the level adopted when they started the deposit insurance system.

4. Mandates

Drawing on the successful practices of other countries, the Deposit Insurance Fund Management Authority is mandated to take corrective and resolution measures according to the *Deposit Insurance Regulations*. Such arrangements help to foster the appropriate division of labor and different focuses of the deposit insurer and banking supervisor under the precondition of not changing the current banking supervisory system, and improve the efficiency of risk identification and prevention. To fulfill its mandates, the Deposit Insurance Fund Management Authority will have the following powers: verifying information related to premium computation, including the information and materials submitted by insured financial institutions; participating in the financial regulatory coordination regime and the information-sharing system, and if necessary, requiring insured financial institutions to submit materials for the purposes of safeguarding the deposit insurance fund, compensating depositors in a timely manner and determining deposit insurance premium rates; issuing risk warning to insured financial institutions if they are found to operate in the way that threatens the safety of depositors and the deposit insurance fund, such as failing to meet regulatory capital requirements; taking necessary corrective measures against insured financial institutions with apparently declining capital levels and being considered as the threat to the exposure of the deposit insurance fund.

In addition, in order to reduce the losses of deposit insurance fund and achieve the seamless integration with the current legal framework, according to the *Deposit Insurance Regulations*, when the Deposit Insurance Fund Management Authority uses the deposit insurance fund to deal with problem insured financial institutions, it can not only make direct pay-out, but also chose flexible methods, such as agency repayment or giving financial support to facilitate the purchase and assumption transactions. Such arrangements will help to better protect depositors, achieve the least-cost use of deposit insurance fund, foster an fast and effective resolution regime, ensure continuity of business and service in the resolution process, and maintain financial stability.

Box 3 The U.S. Savings and Loan Crisis and the Prompt Corrective Actions of the Deposit Insurance System

In 1980s, the United States went through a large-scale crisis in the savings and loan associations. During the period, the interest rates were deregulated and many savings and loan associations attracted deposits with exhibitive interest rates to fund their high-risk business. Nearly 3000 banks and savings and loan associations failed during 1980-1994, making a total loss of USD 924 billion. The Federal Savings and Loan Insurance Corporation (FSLIC), which was responsible for the deposit insurance system for the industry, went into bankruptcy. One of the major lessons from the crisis lies in that the deposit insurer need mechanisms to contain moral hazard, including the authority to examine banks, enhance market discipline, and take resolution measures against problem insured financial institutions to reduce the losses of depositors and deposit insurance funds.

In 1991, in response to the savings and loan crisis, the *Federal Deposit Insurance Corporation Improvement Act* was passed by the Congress to reform the deposit insurance system. The core elements of the act include: implementing the risk-based premium system, under which the insured financial institutions will be rated and the riskier banks will be charged more compared to sound banks to contain moral hazard; implementing the prompt corrective actions, under which structured corrective measures would be adopted obligatorily when the insured financial institutions became troubled and could threaten the safety of the deposit insurance funds; strengthening the resolution regime for problem banks, where if any insured institution's capital level fell below 2%, the FDIC shall be appointed as the receiver and start the resolution process. The reform had the far-reaching yielding for the evolution of the FDIC, empowering it with more mandates in preventing and dealing with the potential risks through strengthened early risk identification, intervention and resolution, and making it better positioned to achieve the objectives of a "risk-minimizer" deposit insurer.

According to the guidance paper issued by the IADI in March 2013, the deposit insurance system should be part of the policy framework of risk early identification and correction, because it could be the potential major party that will bear the losses in bank failures. This arrangement will help to ensure the efficacy and efficiency of the deposit insurance system and overall effectiveness of the financial safety net.

Special Topic II

Reform of International Financial Regulatory System —Practice and the Way Forward

The international financial regulatory system has gone through major reforms since the 20th century, driven by multiple factors including economic and financial crises. After the Great Depression in the 1930s, government regulation has replaced free development to be the dominant force in the financial sector, and separate operation and separate regulation have been enhanced. With the rise of financial deregulation in the 1980s, authorities started to ease their regulation. The frequent occurrence of regional financial crisis in the 1990s led to the situation where separate regulation started to be replaced by unified regulation, institutional regulation replaced by functional regulation. The international financial crisis in 2008 has once again triggered overall rethinking and extensive discussion of the regulatory system, embarking a new round of reform with the core idea of strengthening macro-prudential regulation, enhancing the regulatory role of central banks and safeguarding the overall stability of the financial system. It is important for us to improve China's financial regulatory system and adapt to financial reform and innovation by conducting a comprehensive review of the international practice and basic themes of financial regulatory reforms and by having an in-depth analysis of experiences so as to identify correct reform directions.

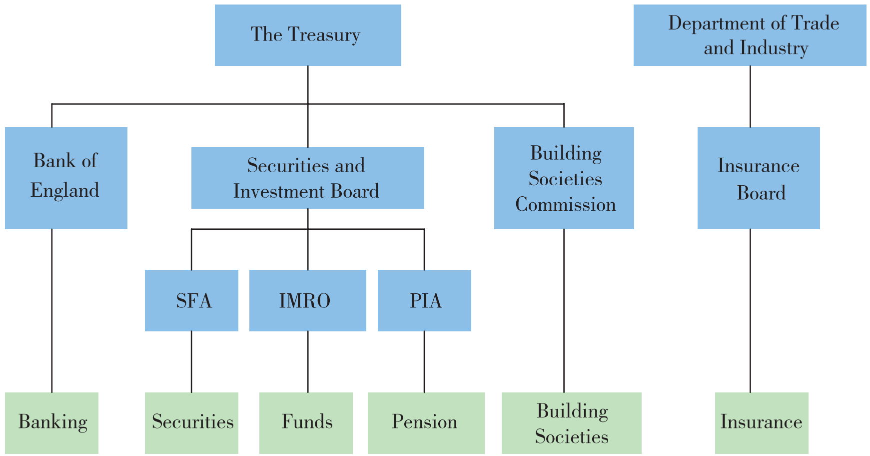
I. International Practice of Financial Regulatory Reform

1. The United Kingdom (UK)

The UK has long been adhered to liberalism in its financial sector policies. The *Bank of England Act 1946* stipulated that the Bank of England, with the approval from the Treasury, could guide banks in their operation activities, but this was never put into action. As the economy improved in the 1950s and 1960s, the financial market grew quickly and financial institutions started to take in large amount of wholesale deposits, leading to rapid balance sheet expansion. It was not until 1973 when the first liquidity crisis hit the securities firms and a number of small-and-medium-sized banks the UK authority started to realize the importance of financial regulation. The *Banking Act 1979* officially entrusted the Bank of England with the right to regulate financial sector, and in the same year, the Deposit Protect Scheme was put into place. After that, financial regulation in the UK began to be on the right track, and a separate regulation regime was established (Figure 1).

To add incentives to the privatization of British state-owned companies, the Thacher government launched the "Big Bang" reform of the financial sector in 1986 when British commercial banks began to acquire securities dealers, which resulted in the emergence of a large number of financial groups, making separate regulation increasingly incompatible with integrated operation. A series of incidents, including the bankruptcy of the Bank of Credit and Commerce International in 1991 and Barings Bank in 1995, further triggered the public challenge to the regulatory effectiveness. In 1997, the Labor Party took power and was ready for immediate reform. The revised *Bank of England Act 1998* gave the Bank of

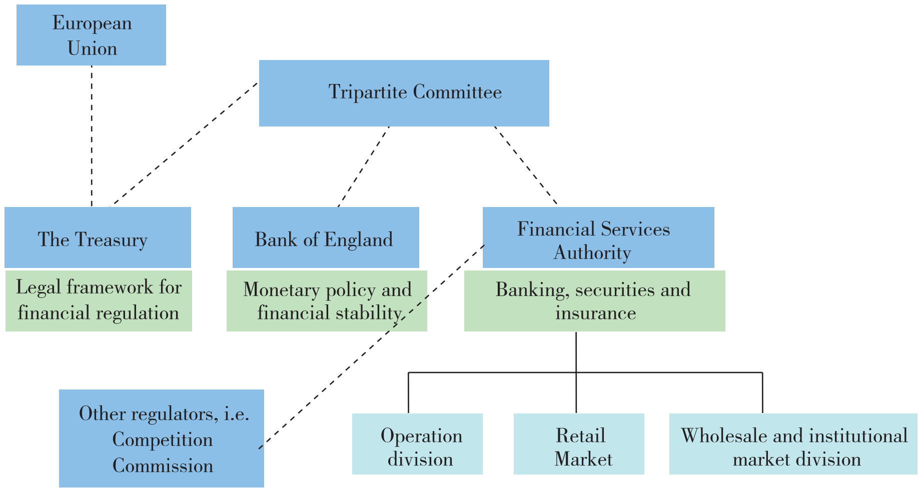
Figure 1 Separate regulation framework of UK



Note: SFA (Securities and Futures Authority), IMRO (Investment Management Regulatory Organization) and PIA (Personal Investment Authority) are self-regulatory organizations under the Securities and Investment Board.

England independence on monetary policy, and put the regulatory responsibility over depository institutions under the Securities and Investment Board, but retained its role in financial stability. Then, the *Financial Services and Markets Act 2000* was implemented. In 2001, the Financial Service Authority (FSA) was established as a unified regulatory agency exercising prudential regulation over financial institutions in the banking, securities and insurance sectors. As a result, a unified regulatory regime was established (Figure 2). To enhance regulatory cooperation, the Treasury, the Bank of England and the FSA signed a Memorandum of Understanding to launch the Tripartite Committee with the Chancellor as the Chair. The Treasury was responsible for the arrangement of the financial regulatory system and relevant legislation as well as negotiations and coordination with the European Union.

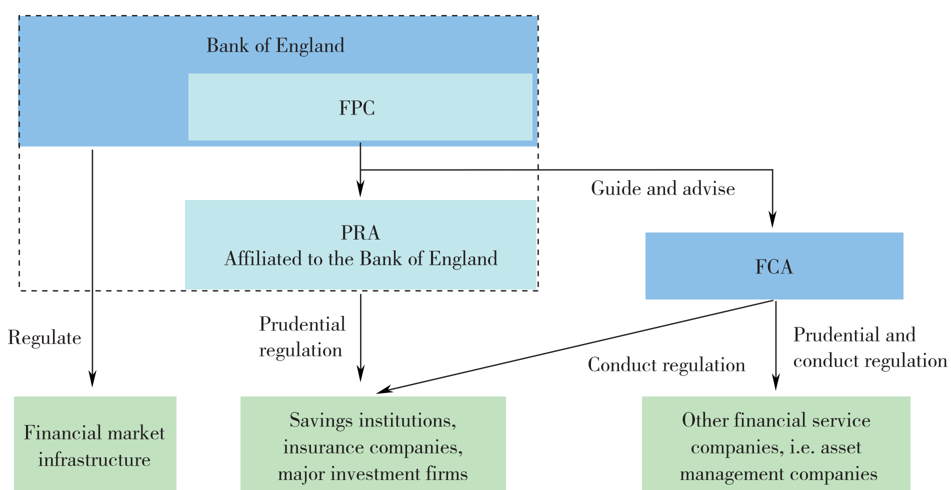
Figure 2 Unified regulatory framework of UK before the 2008 crisis



Note: Dotted lines indicate a cooperative relationship.

The 2008 international financial crisis brought heavy losses to the UK financial sector. In particular, the liquidity crisis of the Northern Rock triggered the first bank run in Britain since 1866, leading to public reflection on UK's financial regulatory system. After the crisis, the UK has focused on building a strong central bank by adjusting the regulatory agencies—establishing the Financial Policy Committee (FPC) under the Bank of England to handle macro-prudential regulation; removing FSA and setting up the Prudential Regulation Authority (PRA) under the Bank of England to be responsible for micro-prudential regulation together with the Financial Conduct Authority (FCA), an independently established body; confirming the Bank of England as the resolution authority for banks and giving it extensive power on resolution; establishing a multi-tiered regulatory coordination mechanism and clarifying the responsibilities of the Bank of England and the Treasury in crisis response. On April 1st 2013, *the Financial Services Act 2012* came into force, marking the operation of the new financial regulatory framework (Figure 3).

Figure 3 Current financial regulatory framework of UK

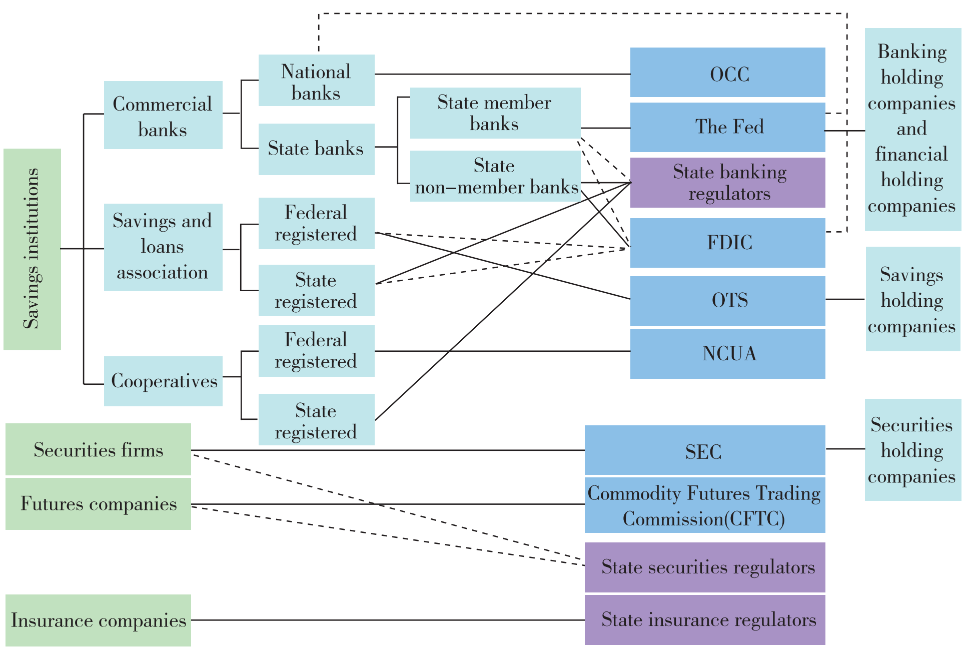


2. The United States (US)

The year 1791 witnessed severe economic recession and debt crisis in the United States, a country that had just ended the War of Independence. The US, inspired by their UK counterpart, established the First Bank of the United States which acted as the central bank, only to be closed 20 years later when its charter expired due to lack of political support. The Second Bank of the United States, established in 1817, was also suspended when its charter expired. In the next 30 years, the banking sector entered in an era of free competition, and the state governments acted in their own way. With the growing number of banks in each state, the internal competition worsening and the frequent bank runs and bankruptcy, the US federal government even could not allocate funds effectively during the Civil War, which highlighted the importance of a government-sponsored single currency and banking regulation. The *National Bank Act* of 1864 established the Office of Comptroller of Currency (OCC) whose responsibility was to regulate national banks registered at the federal government, marking the formulation of a two-tiered regulatory system consisting of the federal government and the state governments.

In the early 20th century, the US suffered from frequent financial crisis. In particular, the Banker's Panic in 1907 led to the near paralysis of the credit payment system. The Federal Reserve Board (or "the Fed") was established with the adoption of the *Federal Reserve Act* in 1913, in order to ensure financial stability. The Fed was responsible for monetary policy, banking regulation, building of a national payment and settlement system and acting as the lender of last resort. In its early time, the Fed did not play any critical role in banking regulation because most state banks refused to become its members. After the Great Depression, the *Glass-Steagall Act* was enacted in 1933, stipulating the clear separation of investment banking from commercial banking business. The provisions established a separate operation system, resulting in a separate regulation system (Figure 4). The *Bank Holding Company Act* of 1956 clearly provided that all bank holding companies should be subject to the Fed's regulation, and that banking regulators at the federal level included the OCC, the Federal Deposit Insurance Corporation (FDIC), the Office of Thrift Supervision (OTS) and the National Credit Union Administration (NCUA). The securities sector was first regulated by each state, but the launch of the Securities and Exchange Commission (SEC) in 1934 led to the establishment of a national securities and exchange regulation system. The insurance sector was regulated by each state.

Figure 4 Financial regulatory framework before 2008 crisis of US

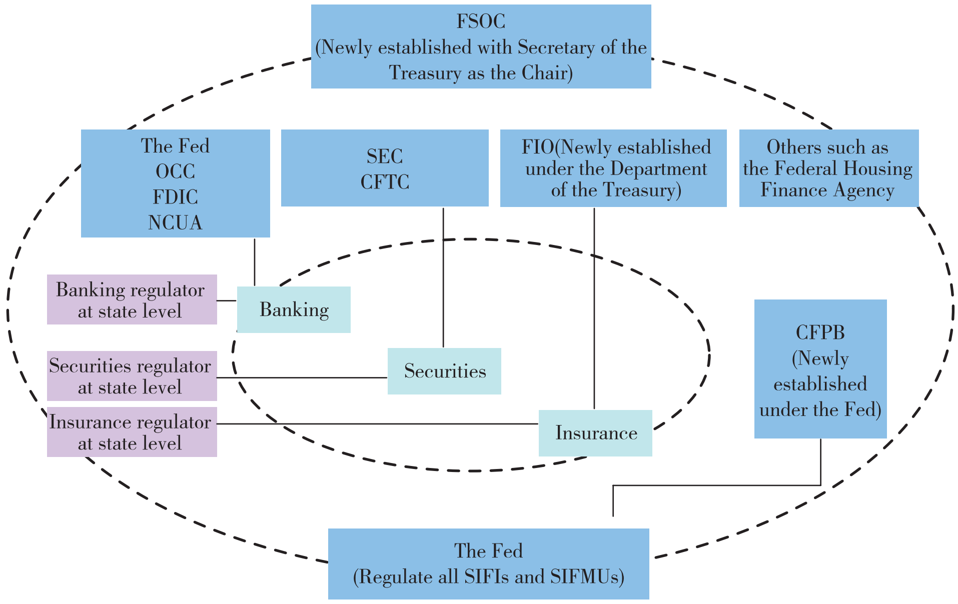


Note: The solid black lines mean major regulatory institutions and dotted blue lines mean supportive regulatory institutions.

When economic globalization and financial deregulation started to gain momentum in the 1980s, countries like the UK, Germany and Japan began easing their restrictions upon integrated operation of financial institutions. Faced with huge competition, the US financial sector started the business expansion of commercial banks. In 1996, the Fed gave green light to bank holding companies, allowing them to set up securities-related companies, and moved up the ceiling of the proportion of securities income to 25%. This meant that the *Glass-Steagall Act* was practically no longer in force anymore. The *Financial Services Modernization Act* of 1999 allowed well-managed bank holding companies with healthy capital conditions to be elected to be financial holding companies that could conduct banking, securities and insurance businesses. This marked the establishment of the integrated operation system of the financial sector. Correspondingly, an umbrella regulation model was formulated where the Fed was responsible for the overall regulation of financial holding companies and each regulatory body supervised subsidiaries based on business types.

After the financial crisis in 2008, the *Dodd-Frank Wall Street Reform and Consumer Protection Act* was enacted in July 2010 with the purpose of reshaping and enhancing the regulatory role of the Fed in an attempt to strengthen the financial stability framework (Figure 5)—the Financial Stability Oversight Council (FSOC) was established to identify and prevent systemic risks and to enhance regulatory coordination; the Fed took the responsibility of regulating all kinds of systemically important financial institutions (SIFIs) including banks, securities firms, insurance companies, financial holding companies as well as systemically important financial market utilities (SIFMUs) and led the efforts to formulate more restrictive regulations; within the Fed, a relatively independent Consumer Financial Protection Bureau (CFPB) was established to take on the role of consumer protection; the Fed, together with the FDIC, was in charge of the resolution of systemic risks. Meanwhile, OTC derivatives, hedge funds and private funds were brought under regulation, and a Federal Insurance Office (FIO) was built under the Department of the Treasury. In addition, the OTS was removed and most of its responsibilities were redirected to the OCC.

Figure 5 Current financial regulatory framework of US



Note: Words in red refer to institutions that are newly established or have had responsibility adjustment.

3. The European Union (EU)

In 1967, the European Communities were born thanks to the efforts of the European countries to build closer economic and financial ties after the Second World War. In 1991, members of the European Communities adopted the *Maastricht Treaty* which gave birth to the EU, and started to build an economic and monetary union in the Europe by the following efforts: first, gradually repealing all capital control among members; second, setting up the European Central Bank (ECB) in 1998 to formulate uniform monetary policy; third, adopting the euro by member states in January 1999 as the single currency and making it the only legal tender in the euro zone in July 2002. The financial regulation power was retained by each EU member because of the absence of a united financial market and the demands for separating monetary policy from financial regulation.

With the development of European economic and monetary union, it became increasingly important to have uniform financial regulatory standards and to enhance regulatory coordination. In 1985, the *White Paper on the Internal Market* was adopted by the European Communities, demanding the application of the principles of “mutual recognition” and “minimum harmonization” in financial regulation. In 1989, the council of the European Communities published the *Second Banking Directive*, promoting the principles of the single banking license and home country control in banking regulation. In 1999, the European Commission published the *Financial Services Action Plan* which covered various aspects including banking, insurance, securities, integrated operation, payment and settlement, accounting standards and consumer protection. The Plan laid the foundation for the abolition of restrictions in cross-border financial services and the establishment of a unified financial regulatory system. In 2001, the European Commission adopted the advice of the then ECB President—Alexandre Lamfalussy—that differences among member states in terms of legislative principles and technical rules should be fully respected, and proposed a four-tiered financial regulatory framework (Table 1). This framework became the primary basis for regulation coordination in the EU.

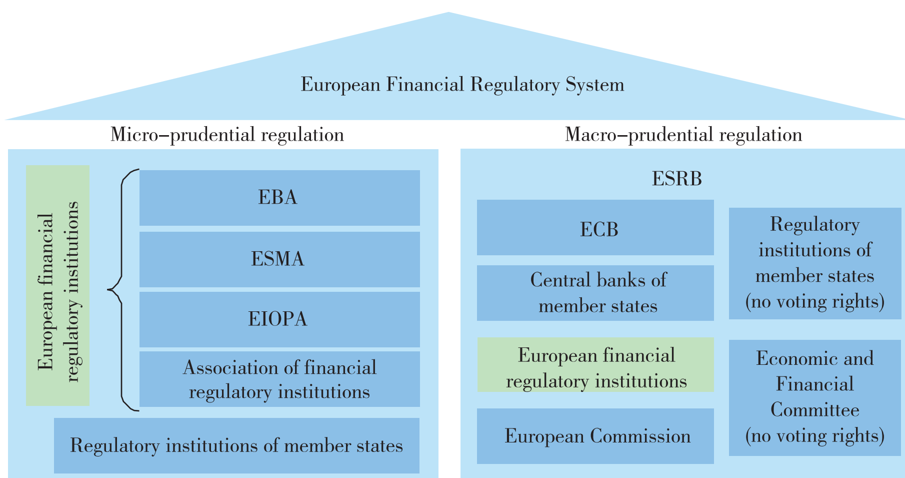
Table 1 EU financial regulatory system under the Alexandre Lamfalussy framework

	Institution	Responsibility
Level 1	Council of the European Union, European Commission, European Parliament	Formulating financial regulatory directives and rules at EU level in accordance with legislative procedure
Level 2	Administrative committees: European Banking Committee (EBC), European Securities Committee (ESC), Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS) and Financial Conglomerates Committee (FCC)	Formulating technical rules in line with market regulation in accordance with the level 1 legislations
Level 3	Regulatory committees：Committee of European Banking Supervisors (CEBS), Committee of European Securities Regulators (CESR) and Committee of European Insurance and Occupational Pensions Supervisors (CEIOPS)	Promoting cooperation among regulators of EU countries on the basis of level 1 and level 2 legislations
Level 4	Executive committee	Cooperating with member states and enhancing law enforcement

The financial crisis in 2008 heavily hit the European market and triggered sovereign debt crisis in Europe. In 2010, the EU adopted the bill to reform the pan-European financial regulatory framework, which initiated a comprehensive reform of the regulatory framework (Figure 6), and began to build, in 2012, the Banking Union featuring Single Supervisory Mechanism, Single Resolution Mechanism and Deposit Guarantee Schemes. The role of the ECB started to extend from monetary policy to financial stability, as illustrated by the following measures. First, under the ECB the European Systemic Risk Board (ESRB) was set up to take responsibility for macro-prudential administration as well as the identification and assessment of potential risks. The ESRB should also give warnings or suggestions to three newly established micro-prudential regulatory authorities—the European Banking Authority (EBA), the European Securities and Markets Authority (ESMA) and the European Insurance and Occupational Pensions Authority (EIOPA)—

together with the member states and their regulatory authorities. A dedicated task force was set up by the ESRB to examine how well the suggestions were adopted. Second, it was made clear that the banking sector would apply the Single Supervisory Mechanism where the ECB would directly supervise 120 significant banks whose assets value exceeded Euro 30 billion or whose assets exceeded 20% of the GDP of the member state in which it was located. The ECB would have the authority to take over direct supervision of any small and medium-sized bank and take intervention measures when necessary. Third, it was proposed by the Single Resolution Mechanism of the Banking Union that the ECB, the European Commission and member states jointly establish the Single Resolution Board, which was responsible for the closing and restructuring of banks in the Euro zone and for analyzing and deciding on the types of bailout measures as well as the operation model of the European Resolution Fund.

Figure 6 Financial regulatory framework of EU



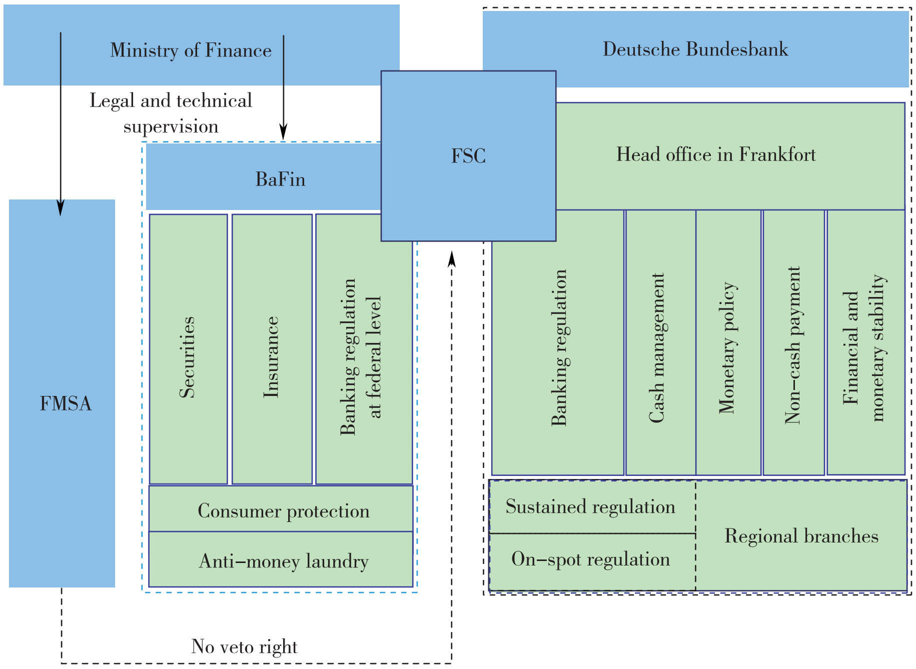
4. Germany

Germany, as a major economic powerhouse in the Europe, has witnessed the transformation of its financial regulatory system from separate regulation to unified regulation. Since the 1950s, Germany has started to adopt the universal banking system with limited regulation in the early stage. The banking crisis in 1931 gave rise to the birth of the first *Bank Act* in 1934, introducing government regulation for the first time. After the Second World War, the West Germany, following their US counterpart, adopted separate operation for the financial business, and as a result, three universal banks—the Deutsche Bank, the Dresdner Bank, and the Commerzbank—were split into more than 30 smaller banks. But with the rapid recovery of the national economy, demand for capital by the real economy boomed significantly, and by the end of 1950s, each of the three major banks was re-unified and began to involve in multiple business sectors. In 1957, the West Germany published the *Deutsche Bundesbank Act*, giving Deutsche Bundesbank—the central bank of Germany—the responsibility for monetary policy and banking regulation. The *Banking Act* adopted in 1961 established the Federal Banking Supervisory Office under the Ministry of Finance. Later, the Ministry of Finance set up the Federal Insurance Supervisory Office and the Federal Securities Supervisory Office, marking the formation of a separate regulation system.

After the unification of Germany in 1990, competition and the Universal Banking System were introduced to East Germany. To meet the needs of the universal banks for development, Germany adopted the *Financial Services and Integration Act* in 2002 and established the Federal Financial Supervisory Authority (BaFin) which would exercise unified regulation over financial institutions in the banking, securities and insurance sectors. Meanwhile, Deutsche Bundesbank participated in financial regulation in an extensive way including: conducting financial information statistics independently, implying that BaFin had no right to collect information from financial institutions on their own; taking advantage of its multiple branches and offices to participate in the daily supervision of financial institutions, to share information and to conduct joint stress tests and spot inspections with BaFin; sending representatives to BaFin's Administrative Council and supervising its management team; deciding on BaFin's budget and giving suggestions on its special regulatory tasks. It was stipulated that BaFin had to consult with Deutsche Bundesbank before issuing any regulations and that consensus should be reached when deciding on matters related to monetary policy.

Germany did not protect itself from the shocks of the 2008 financial crisis and Europe's sovereign debt crisis during which, many issues received lots of attention such as the concentration of decision-making power in the financial regulatory system, loose internal control, regulation overlaps and high cost of coordination. Inspired by the reform of the European supervisory framework, Germany further improved its network of regulatory institutions (Figure 7) by the following measures: establishing the Financial Market Stabilization Agency (FMSA) to take over the Special Financial Market Stabilization Funds (SoFFin) which was set up in the wake of the financial crisis and to supervise two newly-established asset management companies that handled non-performing assets; elevating the FMSA as regulatory authority by 2016 to be specialized in the restructuring of financial institution; adopting the *Financial Stability Act* in 2013 which gave the responsibility of macro-prudential administration to a separate institution—the Financial Stability Committee (FSC) which consisted of the Ministry of Finance, the Deutsche Bundesbank, BaFin and the FMSA, etc., and the Deutsche Bundesbank would be responsible for supervising financial stability risks continuously and evaluating the implementation of macro-prudential policies. The Deutsche Bundesbank should also submit risk evaluation reports and policy advice to the FSC, and prepare FSC's annual report to the German parliament.

Figure 7 Financial regulatory framework of Germany

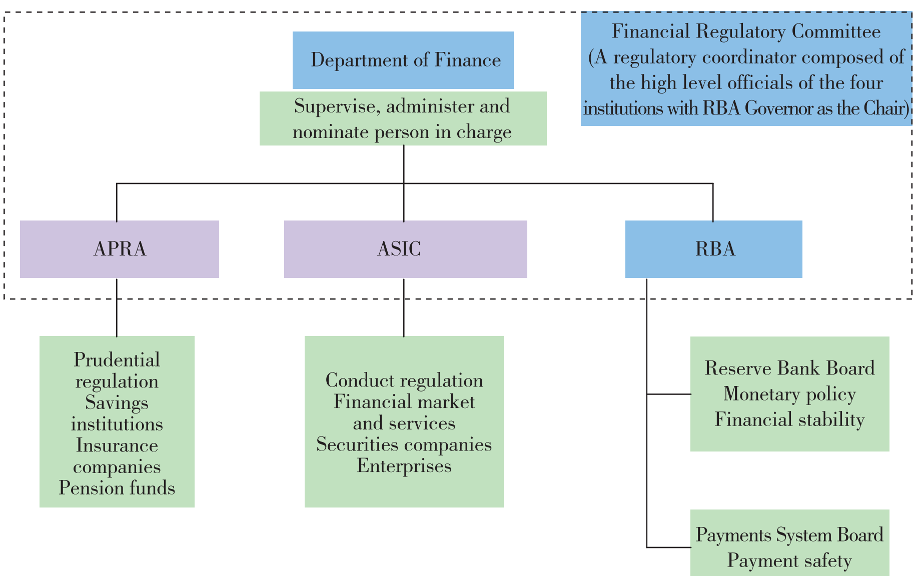


5. Australia

Australia exercised strict financial regulation before the 1980s. In the early 1980s, in order to improve the effectiveness of financial services and the competitiveness of financial institutions, Australia started to promote financial de-regulation, eased market entrance requirements for banks, abolished direct control over banking operation, eliminated foreign exchange control and opened up the financial market. The financial regulatory system was composed of two tiers—the federal level and the state level. At the federal level, there were four regulators under the Department of Finance, namely the Reserve Bank of Australia (RBA), the Australian Securities?Commission (ASC), the Insurance and Superannuation Commission (ISC) and the Australian Competition and Consumer Commission (ACCC). At the state level, the Australian Financial Institutions Commission and the regulatory authorities of each state established a regulatory system for financial institutions to supervise credit co-operatives and the architecture association.

In the late 1980s, the adverse impact of financial de-regulation began to reveal itself, illustrated by intense fluctuation in the stock market, continuous deficit in the balance of payment and a sharp increase of non-performing loans in numerous financial institutions in the 1990s. Meanwhile, integrated operation started to gain momentum, and problems brought by institutional regulation became increasingly acute including regulatory vacuum and inconsistent standards. In March 1997, the Campbell Committee, after taking into account factors including cost, efficiency and feasibility, came up with a reform proposal for financial regulatory system. The Australian Prudential Regulation Authority (APRA) and the Australian Securities and Investments Commission (ASIC) were set up, on the basis of splitting and integrating the existing regulatory agencies at the federal and state levels, forming a "twin peaks" regulatory model which combined oversight of financial institutions and market conduct (Figure 8). The first peak was the APRA that exercised prudential regulation of financial institutions with the purpose of risk prevention and financial stability. The other peak, namely the ASIC, supervised the market conduct of financial institutions to protect consumer interests. The Department of Finance was responsible for regulatory coordination and the nomination of RBA Governor and Board of Directors of APRA and ASIC. As the central bank, the RBA had established under itself the Reserve Bank Board and the Payments System Board, responsible for monetary policy and payment system respectively, so as to ensure financial stability.

Figure 8 Financial regulatory framework of Australia

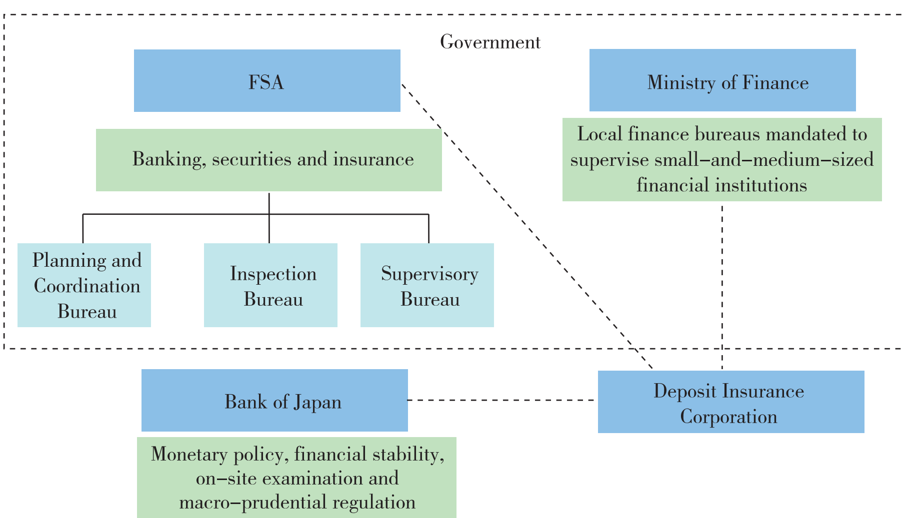


After the 2008 financial crisis, Australia reviewed its financial system, and came to the conclusion that the "twin peaks" model needed improvements in the following aspects: enhancing regulators accountability by establishing the Financial Regulator Assessment Board (FRAB) to annually review and evaluate the performance of regulatory authorities; enriching regulatory tools of ASIC, entrusting it with the right of early intervention of financial products and giving it necessary responsibility in market entrance; regularly analyzing and evaluating how financial regulation has impacted the competition of the financial sector and easing market access for domestic and overseas institutions when necessary; enhancing regulatory capability and adopting a three-year budget system to provide stable and sufficient funds to regulators and attract high-quality staff with appealing remuneration.

6. Japan

After the Second World War, Japan continued to carry out the government-led financial regulatory system that had existed long before the War. The Ministry of Finance was responsible for administrative management of the financial system and could give business orders to Bank of Japan (BOJ). In the late 1970s, Japan began the financial de-regulation reforms featuring interest rate liberalization and loose control. After the burst of economic bubbles in the early 1990s, Japan initiated a comprehensive financial reform in 1996, also known as the "Japanese Big Bang", but was soon hit by the Asian financial crisis, which led to the bankruptcy of numbers of banks. After that, the reform began to focus on the structure of financial regulatory authorities. The?revision of the *Bank of Japan Act* in 1997 gave BOJ more independence, mitigated the control of Ministry of Finance over the financial sector and set up the Financial Services Agency (FSA) to carry out unified financial regulation. The major responsibilities of the BOJ were to ensure price stability and financial system stability, and the BOJ could sign with BOJ account holders an Examination Contract which allowed it to conduct on-site examination and enhance risk management. By 2001, a unified regulatory system was formed where the FSA, the independent BOJ and the deposit insurance authority played major roles and administrative agencies such as the local finance bureaus assumed supportive roles (Figure 9).

Figure 9 Financial regulatory framework of Japan



Note: Dotted lines indicate a cooperative relationship.

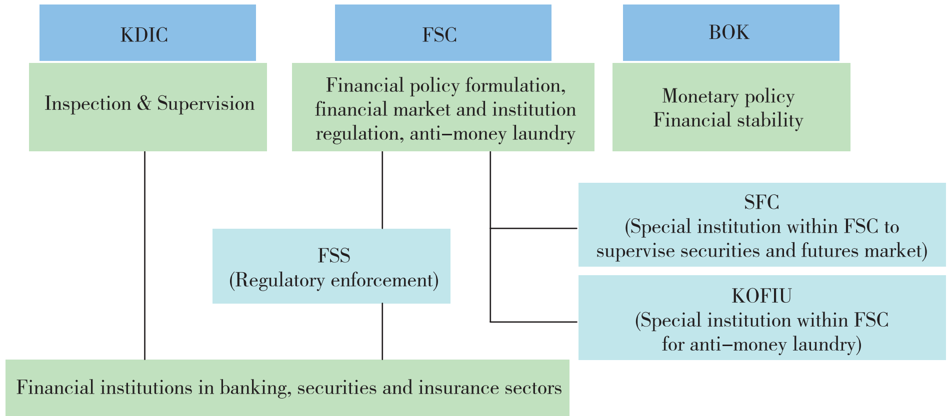
After the financial crisis in 2008, BOJ's role in macro-prudential regulation was enhanced. Its Initiatives on the Macro-prudential Front formulated in 2011 put forward the following measures: integrating macro-prudential administration with on-site examination and off-site monitoring, and deciding the examination frequency and scope of a financial institution with reference to its impact on the financial system; publishing Financial System Report on a regular basis and identifying the interaction between the financial sector and the real economy and between the non-banking sector and the banking sector; providing financial institutions with necessary liquidity in a timely manner by means such as issuing unsecured loans and enhancing BOJ's role as the lender of last resort to ensure financial stability; improving the effectiveness of monetary policy in macro-prudential regulation, enhancing the projection of economy and price level and identifying and evaluating risk factors related to the implementation of monetary policy.

7. Korea

In 1961, the Korean government began to directly control financial sector in order to support the five-year-plan for economic development. Regulatory functions were performed by multiple authorities including the Ministry of Finance and Economy(MOFE), the Bank of Korea(BOK), the Office of Bank Supervision, the Securities Supervisory Board and the Insurance Supervisory Board. In the late 1980s, the government reduced administrative intervention to the financial market, which led to rapid growth of integrated operation, and loopholes of the separate regulation system became increasingly obvious. After the Asian financial crisis in 1997, Korea, inspired by the UK, established a unified regulation system and enhanced the independence of the BOK. The financial regulatory functions were concentrated on the newly established Financial Services Commission (FSC) which was affiliated to the State Council, but the responsibility of financial policy formulation was retained to the MOFE. Under the FSC, the Financial Supervisory Service (FSS) and the Securities and Futures Commission (SFC) were set up to supervise financial institutions and the capital market respectively. The BOK focused on monetary policy and retained limited indirect regulatory functions, such as asking the FSS to conduct joint investigation of financial institutions. Meanwhile, the Korea Deposit Insurance Corporation (KDIC) was set up to examine and monitor all financial institutions.

After the international financial crisis, the Korean government adjusted the financial regulatory framework again. In 2008, the FSC and the Financial Policy Bureau of MOFE were integrated into the Financial Services Commission (FSC), an institution responsible for financial regulation and financial policy formulation. The Korea Financial Intelligence Unit (KoFIU) was also consolidated into the FSC to carry out anti-money laundering and counter-terrorist financing missions. Given that the BOK was critical to the sound operation of financial market and crisis response, the *Bank of Korea Act* was revised to designate the BOK with clear function of ensuring financial stability, to expand its regulatory power and to enrich its policy instruments, including extension of the collection scope of information from national commercial banks to all financial institutions, making financial institutions without eligible collaterals covered by Emergency Liquidity Assistance and incorporating inter-bank lending of securities into open market operation.

Figure 10 Financial regulatory framework of Korea



II. Regulatory shortcomings revealed by the international financial crisis

A review of the financial regulatory reforms of the developed economies has shown that financial crisis has always been the direct driving force of reforms. The financial crisis in 2008 has again cast a spotlight on the shortcomings of the existing financial regulatory framework and operation model, which has triggered extensive and profound reflection and discussion in the international community.

New systemic risks created by highly lax regulatory environment. Around the world, there has always existed in the financial sector a cycle of "crisis—more regulation—financial innovation—less regulation—new crisis". Since the 1980s, the financial deregulation has significantly expanded the financial business covered by weak or zero regulation, and non-traditional financial products and businesses have developed rapidly including all types of complicated OTC structured products, hedge funds, special purpose vehicles and other private fund pools. These have become an important source of systemic risks due to insufficient disclosure, difficulties in identifying their high risks, their intertwined relationship with the traditional financial system and lax regulation or even regulatory vacuum. Therefore, to prevent another crisis, it is important to strike a balance between improving competitiveness of financial institutions and guarding against financial risks.

Micro-prudential regulation alone cannot ensure overall financial stability. Theories of micro-prudential regulation, which had prevailed before the crisis, argued that the stability of the macro-financial system could be guaranteed as long as every single financial institution was regulated properly and its sound operation was ensured, thus there was no need for central banks to engage in micro-regulation. However the crisis has shown that with financial risk externalities, individual rationalities can lead to collective irrationalities. Therefore, it is necessary to pay attention to the close connections among different financial sectors and between the financial market and the macro economy, to prevent systemic risks across both institutions and time, and to establish a counter-cyclical macro-prudential administration system. Central banks should play an important role in this because of their macro perspectives, administration experience, advantages in resources, functions in payment and settlement and their role as the lender of last resort.

Separation of monetary policy from financial regulation is uncondusive to financial stability. Before the crisis, it was a common belief of the academic community that the primary goal of the central bank was to ensure price stability and that monetary policy should be independent, which led to the argument that role conflict would occur if the central bank engaged in both monetary policy and financial regulation. The financial crisis has shown that a stable currency does not necessarily mean financial stability. It is not enough for central banks to solely focus on monetary policy, meaning that financial stability is, by its nature, also a part of central banks' responsibility. It is not possible for central banks to achieve the dual goals of price stability and financial stability by solely relying on interest rate policy instruments. The close inner connection between conventional macro-economic policy and prudential-regulation tools mean that fine coordination should be maintained in order to achieve financial stability.

Power dispersion in the financial regulatory system affects crisis response in a negative way. Identification of systemic risks and effective response to crisis require complete and true data and information. Under a regulatory system with dispersed power, data of different sectors is segmented, information is not fully shared and fine coordination is not achieved, leading to higher costs for central banks to communicate with regulatory agencies. This makes it difficult for central banks to timely obtain information that is accurate and complete, which in turn affects its role as lender of last resort and finally impairs its capability of accurately judging the situation of the crisis and putting forward bailout measures timely. In the US, there is not a single regulatory authority, even with Fed included, that has access to full and complete information of the financial system, which makes it hard to assess the interconnection and mutual impact within the financial system. In the UK, the absence of a clear division of responsibility among the Treasury, the Bank of England and the Financial Services Authority, added by inefficiency in information sharing and coordination, has led to the incapability of the regulators to roll out effective measures to handle Northern Rock bank-run in a timely manner.

III. Directions of regulatory reform after the international financial crisis

Financial regulatory reform after the financial crisis has focused on setting up a macro-prudential regulation system with the purpose of preventing and dissolving systemic risks while at the same time, improving the micro-prudential regulation system that combines prudential regulation and market conduct regulation, and promoting the coordination between the two.

Establishing macro-prudential regulation system and enhancing the role of central banks in financial stability and administration. Countries such as the UK that split the power of financial regulation out of their central banks have given the power back and also expanded it. Before the crisis, 90% of the central banks shouldered the major responsibility of financial stability and regulation, but only 2/3 countries made it clear by legislation. Since 2009, the ratio has risen up to 4/5 after more than 60 countries and regions have made it clear that the central banks are responsible for financial stability when revising the central banks acts. Meanwhile, more than 30 cross-departmental macro-prudential policy committees have been established across the globe where central banks participate as members and play important roles. During this process, the responsibilities of central banks in terms of financial stability and macro-prudential regulation have been made clearer. For instance, it is now generally believed that the Fed and the FSOC share the same goal, i.e. identifying and responding to possible risks that may jeopardize the stability of US financial system.

Formulating more strict prudential regulation standards and improving financial infrastructure. Guided by the G20, major standard-setting bodies of financial regulation such as the Basel Committee on Banking Supervision(BCBS) have made full use of the Financial Stability Board(FSB) as a platform to improve financial regulatory standards by highlighting the importance of single financial institution to overall financial stability and by ensuring the sound operation of single institution through raising regulatory standards in terms of capital, liquidity and corporate governance. Structural banking reforms have also been promoted focusing on "business separation" and highly risky businesses are restricted, which have made the structure of banks more clear and transparent in order to ensure risk control. Regulation over shadow banking and financial derivatives has been strengthened. Construction of financial infrastructure has been enhanced. Accounting standards have been optimized and reforms of rating agencies have been promoted.

Establishing financial consumer protection agencies and focusing more on regulation of market conduct. The "twin peaks" model has gained more recognition after the crisis.

The UK set up an independent FCA, which made institutional arrangement to separate financial consumer protection from prudential regulation. The US also established the CFPB within the Fed. The primary reason for separating prudential regulation from conduct regulation is that they have different goals and regulatory tools—prudential regulation aims to ensure sound operation of financial institutions by means of supervision and examination, while conduct regulation aims at consumer protection and relies mainly on rulemaking and compliance. The merit of such separation is that the protection of financial institutions and consumers becomes more transparent. Because prudential regulation focuses on risk monitoring and management while conduct regulation highlights the disclosure of marketing conduct, the two approaches can complete and promote each other. Applying uniform conduct regulation to the products and services of different financial sectors is also conducive to regulatory efficiency and helps to prevent regulatory arbitrage.

The current regulatory system of China is operating soundly and is in line with the characteristics and demands of economic and financial development at current stage. However, as financial reform and innovation accelerate, issues such as regulatory vacuum, regulatory arbitrage and regulatory impediments have started to show up. To adapt to the new international trend of financial regulatory reform and the new normal economy, it is necessary to further improve financial regulatory system. An important starting point would be to properly handle the relationship among monetary policy, financial regulation and financial stability. With the goal of preventing and dissolving systemic risks, we will accelerate the establishment of a macro-prudential regulatory framework, improve the role and tools of the central bank in financial stability, let the Joint Ministerial Conference on Financial Regulatory Coordination play a bigger role, make innovation in counter-cyclical control mechanism such as dynamic adjustment of differentiated reserve ratio, raise the regulatory standards for SIFIs and establish a uniform framework for crisis management and risk resolution. We should properly define the relationships between regulation and market, between regulation and macro-control, and between regulation and financial institutions. We should also draw a line between regulatory responsibility and the role of promoting industrial development, so as to focus more on the core regulatory goals. We will promote the integration of institutional regulation and functional regulation; identify regulators for new business, new product and new market in a timely manner; clearly define regulatory rules to prevent regulatory vacuum and arbitrage. At the same time, we will enhance coordination and cooperation with international organizations and relevant regulatory policies of other countries; actively participate in studies on and formulation of international financial regulatory standards and rules to strengthen our influence and voice, and promote domestic application of the standards so as to build our sound image in the implementation of international standards.

Special Topic III

The Banking Sector Stress Tests

I. The Snapshot of the Stress Tests

At the end of 2014, the PBC organized 28 commercial banks whose assets are above RMB 400 billion yuan to conduct Financial Stability Stress Tests of 2015. The tests were composed of credit risk stress test, market risk stress test and liquidity risk stress test. The tests, based on the end of 2014 balance sheets data of 28 commercial banks, were to assess the soundness of the commercial banks amid negative shocks.

Scope. The tests covered 28 banks including the large commercial banks (LCBs), the medium commercial banks(MCBs) and the small commercial banks (SCBs). The LCBs that participated in the test are ICBC, ABC, BOC, CCB, BOCOM and PSBC, which assets are above RMB 6 trillion yuan. The MCBs that participated in the test are China Merchants Bank, Shanghai Pudong Development Bank, Industrial Bank, China CITIC Bank, China Minsheng Banking Corporation, Everbright Bank, Huaxia Bank, Guangdong Development Bank, Pingan Bank, Bank of Beijing, Bank of Shanghai and Bank of Jiangsu, which assets are between RMB 1 trillion yuan and RMB 6 trillion yuan. And the SCBs that participated in the test are China Zheshang Bank, Bohai Bank, Evergrowing bank, Bank of Ningbo, Bank of Nanjing, Bank of Tianjin, Chongqing rural commercial bank, Beijing rural commercial bank, Chengdu rural commercial bank and Shanghai rural commercial bank, which assets are below RMB 1 trillion yuan.

Approach. The tests followed both top-down approach and bottom-up approach. In top-down approach, the PBC collected data in given format from the 28 commercial banks and conducted tests. The bottom-up tests aimed to assess the risk profile of individual banks or various groups of commercial banks, which were carried out by banks themselves. The PBC was in charge of collecting and analyzing the bottom-up tests results.

Methodology. The credit risk stress test consisted of sensitivity stress test and scenario stress test. The sensitivity stress test directly assessed the impact of credit risk exposures deterioration in key areas; the scenario stress test focused on the changes of overall NPL ratio and CAR in banking system under the condition of macroeconomic downturn. The market risk stress test mainly estimated the changes of CAR of the commercial banks stemming from both fluctuation in interest rate and exchange rate. The liquidity risk stress test measured how the policy factors and macroeconomic factors affected liquidity ratio of the commercial banks.

Stress Scenarios[①]**.** The scenario test of

① The stress scenarios were developed based on a hypothetical scenario which using the feedback of questionnaires from external economic experts, and should not be assumed to represent PBC`s judgements on macroeconomic condition.

credit risk chose GDP growth rate, M_2 growth rate, real estate price drop and CPI annual rise as the stress indicators to characterize the macroeconomic downturn scenario. The sensitivity stress test of credit risk selected aggregate credit assets and NPL rate, default or losses in 7 key areas as the stress indicators. Stress test on interest rate risk of banking book selected the shift of deposit and loan interest rates in parallel as well as narrowing interest margin as the stress indicators; stress test on the interest rate risk of trading book used the RMB-bond yields ratio as the stress indicator. The stress indicator of exchange rate risk stress test was RMB/USD exchange rate. The liquidity stress test selected bond price, NPL ratio, deposit scale and interbank deposit (borrowing) scale as indicators.

Table 1 Scenarios for the Financial Stability Stress Test

Types of Risk	Types of Test	Stress Target	Stress Scenarios
Credit Risk	Scenario Stress Test	Aggregate credit assets	➢ Mild: GDP growth rate down to 6.5% ➢ Medium: GDP growth rate down to 5.5% ➢ Severe: GDP growth rate down to 4% （M_2 growth rate, real estate price drop and annual CPI rise were developed based on experts' opinions）
	Sensitivity Stress Test	Aggregate credit assets	➢ Mild: NPL ratio[1] up 100% ➢ Medium: NPL ratio up 250% ➢ Severe: NPL ratio up 400%
		Loans to LGFPs	➢ Mild: NPL ratio up 5 percentage points[2] ➢ Medium: NPL ratio up 10 percentage points ➢ Severe: NPL ratio up 15 percentage points
		Loans to 'high pollution, high energy consumption and overcapacity' industries	➢ Mild: NPL ratio up 10 percentage points ➢ Medium: NPL ratio up 15 percentage points ➢ Severe: NPL ratio up 20 percentage points
		Real estate loans	➢ Mild: NPL ratios of real estate developing loans (including land reserve loans) and residential mortgage loans up 5 percentage points respectively Medium: NPL ratios of real estate developing loans (including land reserve loans) and residential mortgage loans up 10 and 7 percentage points respectively ➢ Severe: NPL ratios of real estate developing loans (including land reserve loans) and residential mortgage loans up 15 and 10 percentage points respectively

① Assuming that the initial NPL ratio is X %, up n percent means the NPL ratio becomes X %(1+n percent).

② Assuming that the initial NPL ratio is X %, up n percentage points means the NPL ratio becomes (X+n) percent .

(concluded)

<table>
<tr><th>Types of Risk</th><th>Types of Test</th><th>Stress Target</th><th>Stress Scenarios</th></tr>
<tr><td rowspan="4">Credit Risk</td><td rowspan="4">Sensitivity Stress Test</td><td>Loans to Yangtze river delta region</td><td>➢ Mild: NPL ratio up 150%
➢ Medium: NPL ratio up 300%
➢ Severe: NPL ratio up 450%</td></tr>
<tr><td>Customer concentration</td><td>➢ Mild: the top 1 largest group(legal entity) customer default
➢ Medium: the top 2 largest groups(legal entities) customer default
➢ Severe: the top 3 largest groups(legal entities) customer default</td></tr>
<tr><td>Exposures to off-balance sheet activities</td><td>➢ Mild: 5% loss to exposure balance of off-banlance sheet activities occuring advances
➢ Medium: 10% loss to exposure balance of off-banlance sheet activities occuring advances
➢ Severe: 15% loss to exposure balance of off-banlance sheet activities occuring advances</td></tr>
<tr><td>Exposures to on-and-off-balance sheet wealth management products[①]</td><td>➢ Mild: 10% loss of on-and-off-balance sheet wealth management products
➢ Medium: 20% loss of on-and-off-balance sheet wealth management products
➢ Severe: 30% loss of on-and-off-balance sheet wealth management products</td></tr>
<tr><td rowspan="2">Market Risk</td><td rowspan="2">Interest rate risk stress test</td><td>Banking book</td><td>Interest rate parallel shifting risk:
➢ Mild: both deposit rate and loan rate up 25 bps
➢ Medium: both deposit rate and loan rate up 75 bps
➢ Severe: both deposit rate and loan rate up 150 bps
Benchmark interest rate risk：
➢ Mild: deposit rate up 25 bps, while loan rate down 25 bps
➢ Medium: deposit rate up 75 bps, while loan rate down 50 bps
➢ Severe：deposit rate up 150 bps, while loan rate down 100 bps</td></tr>
<tr><td>Trading book</td><td>➢ Mild: bond yield curve up 100 bps
➢ Medium: bond yield curve up 250 bps
➢ Severe: bond yield curve up 350 bps</td></tr>
</table>

① In terms of the investment orientations of wealth management products, the exposures tested in this stress test were credit wealth management products, exclusive of products invested in bonds and deposits, capital market trust or overseas wealth management products, etc.

(concluded)

Types of Risk	Types of Test	Stress Target	Stress Scenarios
Market Risk	Exchange rate risk stress test[①]	Banking book and trading book	➢ Mild：RMB appreciating/depreciating 10% against USD ➢ Medium：RMB appreciating/depreciating 20% against USD ➢ Severe：RMB appreciating/depreciating 30% against USD
Liquidity risk	Scenarios stress test	Banking book and trading book	➢ Mild: 4% of loans due within 30 days turn to NPLs, securities' price down 4%, deposits down 6% , interbank deposits and borrowing down 10% ➢ Medium: 7% of loans due within 30 days turn to NPLs, securities' price down 7%, a deposits down 8%, interbank deposit and borrowings down 30% ➢ Severe: 10% of loans due within 30 days turn to NPLs, securities' price down 10%, deposits down 10%, interbank deposits and borrowings down 50%

II. Overview of the Stress Tests

1. Credit risk

The banking sector illustrates strong resilience to credit shocks. The results of the Sensitivity Test and the Scenarios Test of aggregate credit risk reflect banks' stable asset quality and solid capital position. The banking sector, represented by the 28 commercial banks, remains resilient under macro-economic shocks and performed soundly.

The result of the Sensitivity Test indicates that, under the severe shock that the overall NPL ratio rise by 400%, the CAR of the banking sector would fall from 13.02% to 11.31% (Figure1), among which the CAR of LCBs would decrease by 1.88 percentage points, the CAR of MCBs would decrease by 1.46 percentage points, and the CAR of SCBs would decrease by 0.97 percentage point (Figure2). Under the mild, medium and severe shocks to the credit exposures of the 7 key areas, the CAR of banking sector remains high. Even under the severe shock, the CAR would be more than 10.5%.

① The shock in the exchange rate risk stress test refers to changes of exchange rate of the RMB against the USD, while assuming that exchange rates of the USD against other currencies remain stable.

Figure 1 The Sensitivity Stress Test for Aggregate Credit Assets: Overall

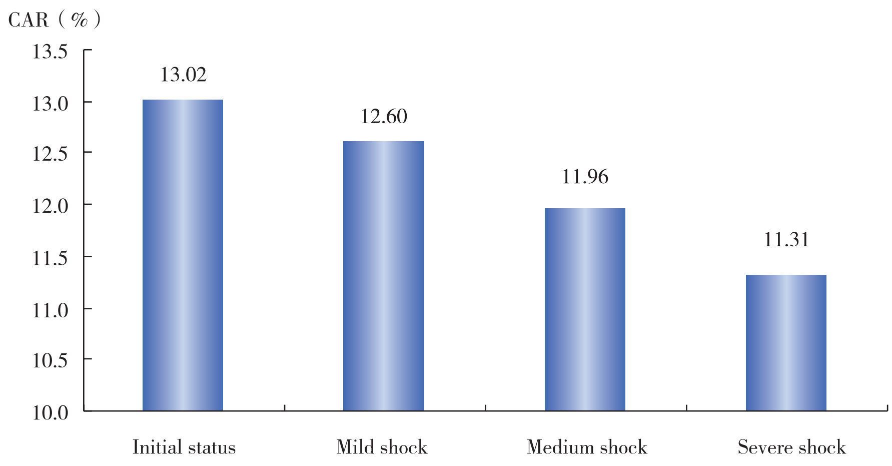
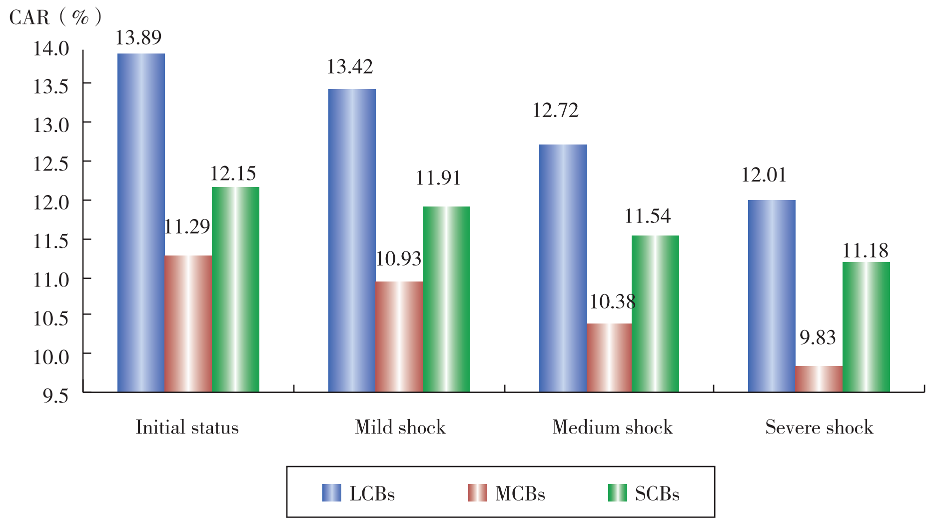
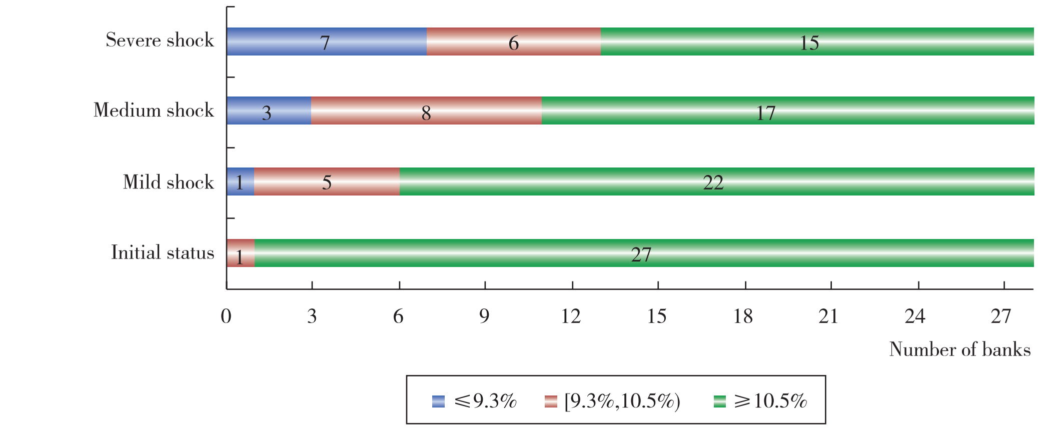


Figure 2 The Sensitivity Stress Test for Aggregate Credit Assets: by group



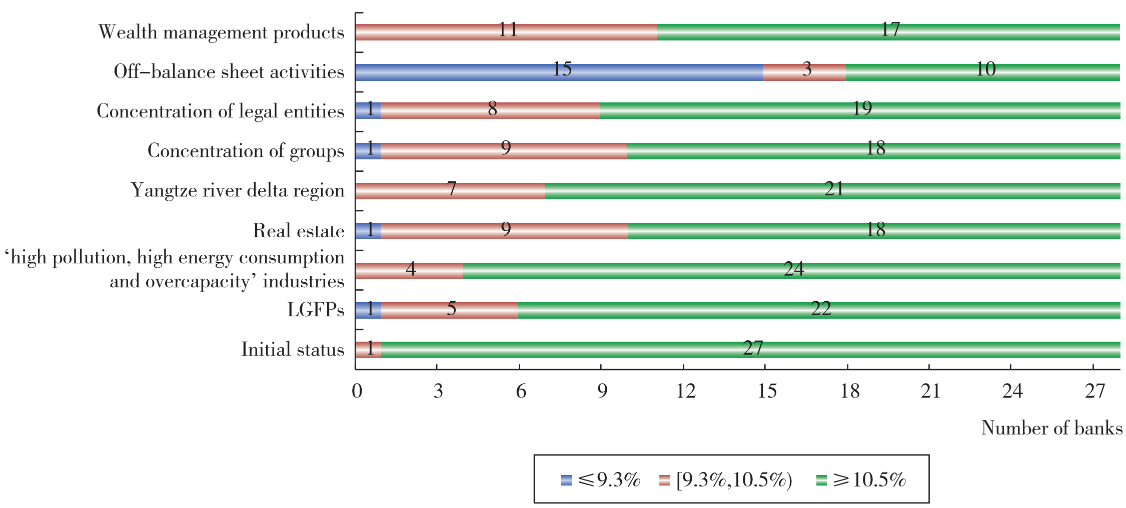
The Scenarios Stress Test of credit risk suggests that, under mild, medium and severe shocks, the overall CAR of banking sector would decrease to 12.64, 12.14 and 10.97 percent respectively. Although the severe shocks would have significant impact on the banking sector, the high CAR under such shocks shows that China's banking sector is resilient to macroeconomic shocks and performs soundly. Under the initial status, the CARs of 27 commercial banks are higher than 10.5%, while under the mild, medium and severe shocks, the number would decrease to 22, 17 and 15 respectively(Figure 3).

Figure 3 Distribution of Bank's CAR: the Scenarios Stress Test



The focus of attention is on credit risks in several key areas. According to the results of Sensitivity Test of credit exposures in 7 key areas, risks in off-balance sheet activities, real estate, on- and off-balance sheet wealth management products, as well as customer concentration should be paid attention to (Figure 4). In terms of the types of institutions, due to the differences in capital adequacies, risk exposures and asset qualities, the resilience of banks is different.

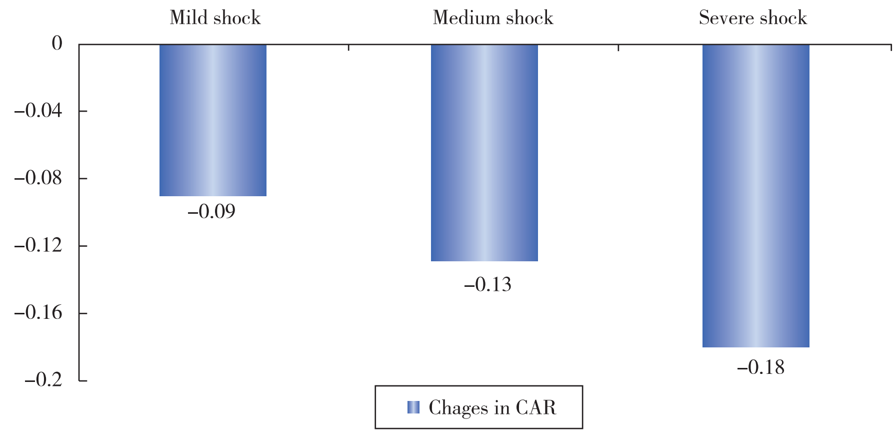
Figure 4 Distribution of Bank's CAR: the Sensitivity Stress Test (Severe Shock)



2. Market risk

The interest rate parallel shifting risk has little influence on banking book. The result indicates that, under severe shock, namely both deposit and loan interest rate increase by 150 bps, the CAR of banking sector merely falls by 0.18 percentage point (Figure 5).

Figure 5 Interest rate parallel shifting risk of banking book



The benchmark interest rate risk of banking book is under control. Under mild, medium and severe shocks, while deposit rate up and loan rate down, the overall CAR of banking sector should decrease by 0.53, 1.26 and 2.38 percentage point respectively (Figure 6).Under the same shocks, the CARs of all types of banks approximately fall the same, while the net interest margin of MCBs declines more than that of LCBs and SCBs.(Figure 7 and Figure 8)

Figure 6 Benchmark interest rate risk of banking book

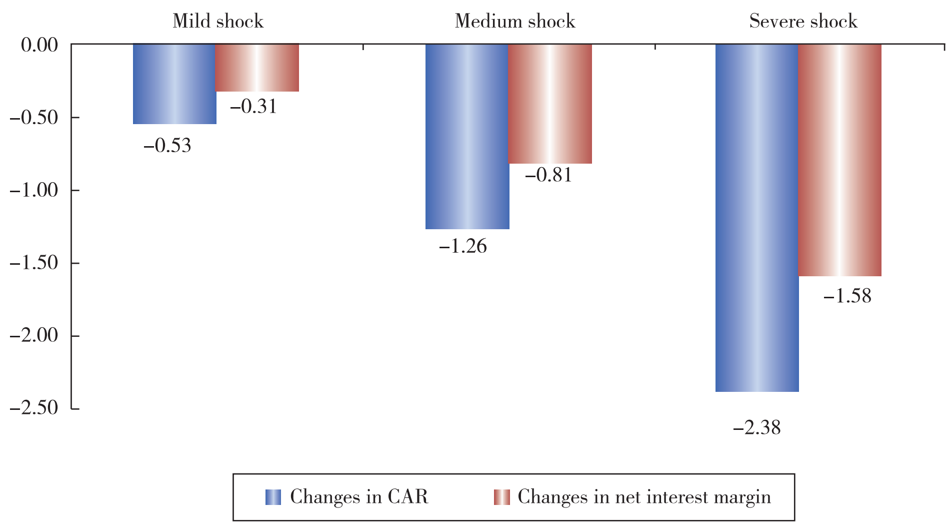


Figure 7　Benchmark interest rate risk of banking book: by group (CAR)

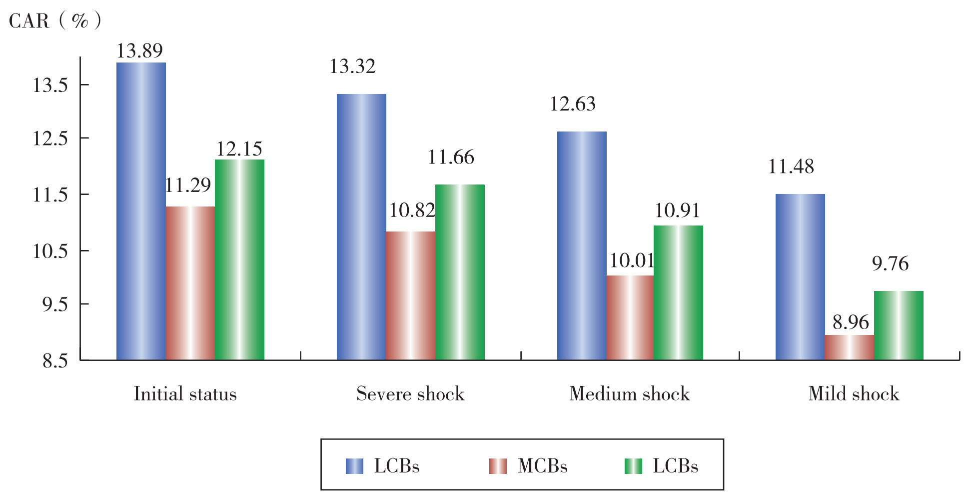
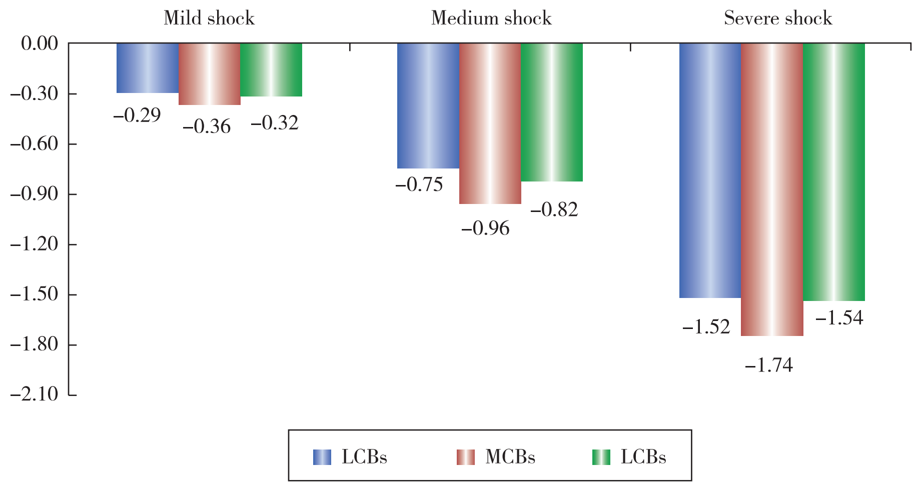


Figure 8　Benchmark interest rate risk of banking book: by group (net interest margin)



The interest rate risk has insignificant impact on trading book. The result of trading book interest rate stress test indicates that, under severe shock, even though the various bonds yield curve up 350 bps, the CAR of 28 banks would drop slightly, and the CAR of banking sector only decreases by 0.039 percentage point (Figure 9). Thereinto, the CAR of SCBs declines more than that of LCBs and MCBs, indicating SCBs are more sensitive to upswing of bond yield curve (Figure 10).

Figure 9 Interest rate risk of the trading book

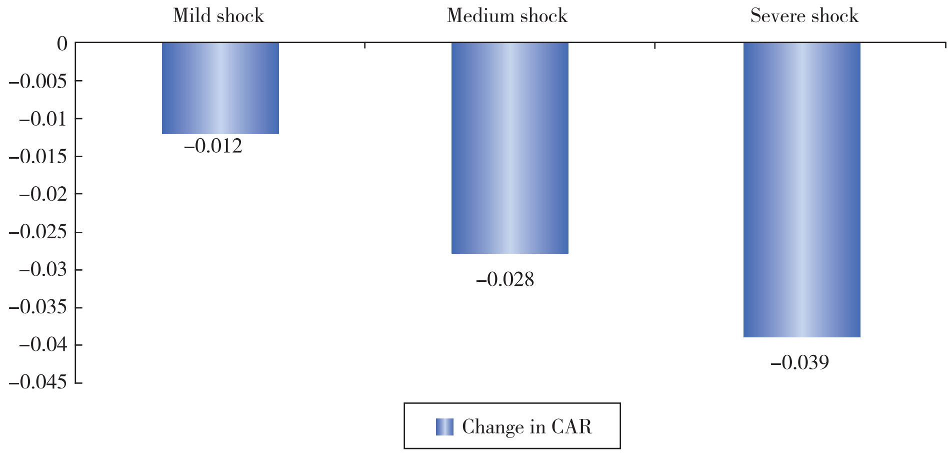
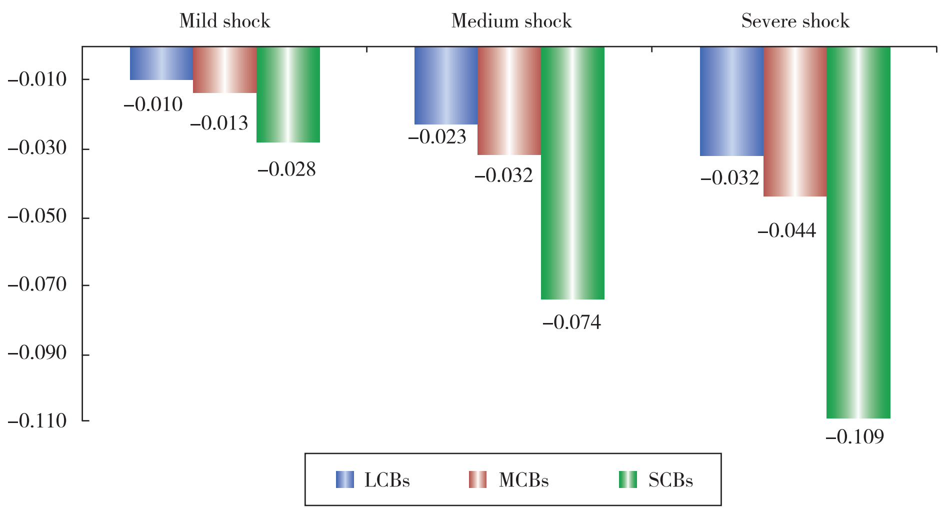


Figure 10 Changes of CAR caused by interest rate risk of the trading book: by group



The direct impact of the change of exchange rate on banking sector is limited. The stress test results show, even under the severe shock, the CAR of banking sector decreases by merely 0.05 percentage point (Figure 11). Thereinto, under the same shocks, the CAR of MCBs has the biggest drop, while the CAR of LCBs is mainly unchanged (Figure 12).

Figure 11 Direct Exchange Rate Risk

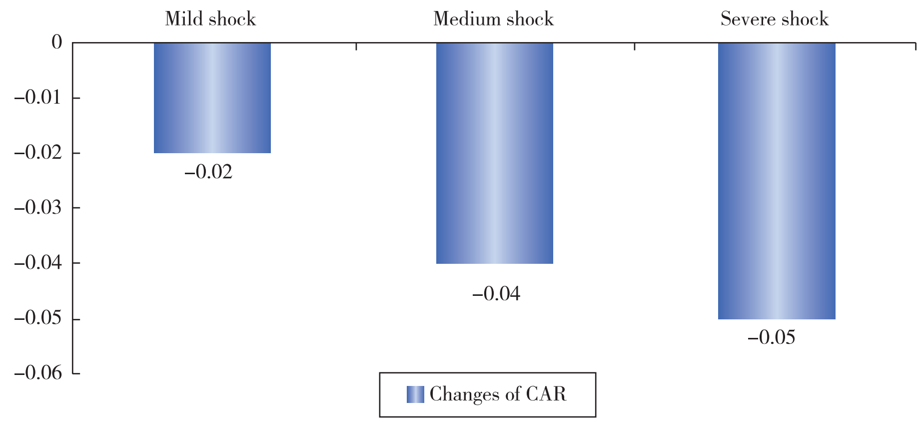
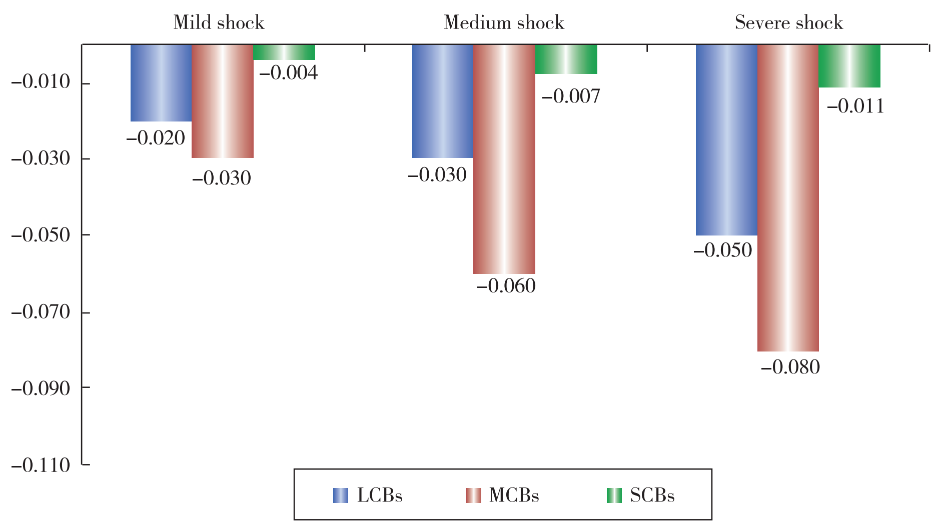


Figure 12 Changes in CARs Caused by Direct Exchange Rate Risk: by group

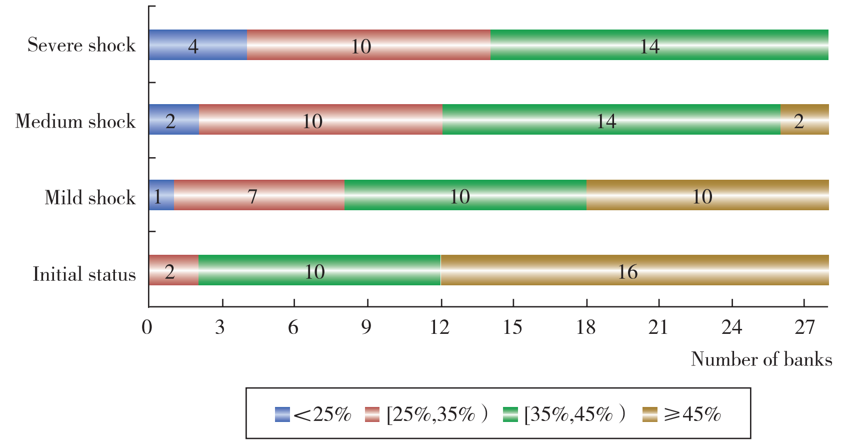


3. Liquidity risk

The Liquidity Risk Stress Test was carried out by the banks themselves. The results show that the liquidity ratio of the commercial banks should incoordinately decrease under different shocks. Under mild, medium and severe shocks, there are 1, 2 and 4 banks' liquidity ratio falling below the regulatory requirement[①](Figure 13).

① The *core indicators of commercial banks (for trial implementation)* issued by CBRC requires the liquidity ratio of a commercial bank should be above 25%.

Figure 13 Distribution of banks' liquidity radio: liquidity risk



Special Topic IV

The Securities Sector Stress Tests

I. The Snapshot of the Stress Tests

In order to enhance the assessment and mitigation of systemic risks in the securities sector, the Securities Association of China conducted comprehensive stress tests under the unified scenarios with the instructions from PBC and CSRC in 2015. The stress tests were designed to address the main risk factors and to assess the risk profile and resilience of the securities sector taking into account the business model of each company respectively.

Scope. The tests involved 10 typical securities companies whose total assets accounted for nearly 50 percent of the whole securities sector by the end of 2014.

Model. The organizers provided the unified scenarios of the stress tests. The business risk, market risk, credit risk, operational risk and compliance risk of tested securities companies were revealed through the selection and valuation of typical risk factors under mild, medium and severe shocks. Based on their own conditions, the tested securities companies reported requested data which mainly included: companies' balance sheet data and the real value of risk control indicators in 2014; key indicators on business operation which could help to simulate the transfer channel from stress tests scenarios to ultimate tests outcomes, such as the commission rate of brokerage and business scale of investment banking, etc.

Stress Scenarios. The stress scenarios mainly involved macro scenarios and stress indicators, where macro scenarios included macro variables impacting the operation of securities companies significantly, such as GDP growth rate, decreasing rate of housing prices and M_2 growth rate, etc. The valuation of selected macro variables stayed the same as that from the banking sector stress tests (Table 1).

Table 1 Macro Scenarios for the Securities Sector Stress Tests

Stress Scenarios	GDP Growth Rate	Decreasing Rate of Housing Prices	M_2 Growth Rate	CPI Growth Rate	Changes of Benchmark Interest Rates
Mild	6.5%	10.0%	Developed based on expert opinions		
Medium	5.5%	20.0%			
Severe	4.0%	30.0%			

Stress indicators included mesoscale industrial parameters impacting the operation of securities companies directly (Table 2). Both macro scenarios and stress indicators were developed based on the assessment of external experts, and should not be assumed to represent test organizers' judgement on macroeconomic conditions.

Table 2 Stress Indicators for the Securities Sector Stress Tests

Types of Risk	Risk Factors	Mild	Medium	Severe
Business Risk	Change of daily average of stock turnover	-8.00%	-18.00%	-28.00%
	Change of commission rate of brokerage	-10.00%	-17.00%	-25.00%
	Change of stock lead underwriting amount	-8.00%	-16.00%	-28.00%
	Change of bond lead underwriting amount	-8.00%	-17.00%	-27.00%
	Change of daily average balance of margin financing and securities lending	-6.00%	-12.00%	-18.00%
	Change of income from asset management	-6.00%	-12.00%	-21.00%
Market Risk	Change of SSE composite index	-10.00%	-19.00%	-29.00%
	Increase of benchmark interest rates and rates of interest rate bonds	0.25%	0.50%	0.75%
	Increase of credit spread (Debenture bonds rated AAA)	0.30%	0.65%	1.10%
	Increase of credit spread (Debenture bonds rated below AAA and above BBB(included))	0.55%	0.90%	1.55%
	Increase of credit spread (Debenture bonds rated below BBB)	0.90%	1.50%	2.50%
Credit Risk	LGD for client financing	0.60%	1.20%	2.00%
	LGD for OTC trading	0.60%	1.30%	2.10%
	LGD for quasi credit investments (real estate)	2.60%	5.00%	10.00%
	LGD for quasi credit investments (non real estate)	1.30%	2.50%	6.00%
	LGD for distribution of financing products (real estate)	0.30%	0.70%	1.30%
	LGD for distribution of financing products (non real estate)	0.20%	0.40%	1.00%
Operational Risk	Loss rate of operational risk	2.00%	3.00%	5.00%
Compliance Risk	Category Rating	Downgraded by 1 notch	Downgraded by 2 notches	Downgraded by 3 notches

II. Overall Results of the Stress Tests

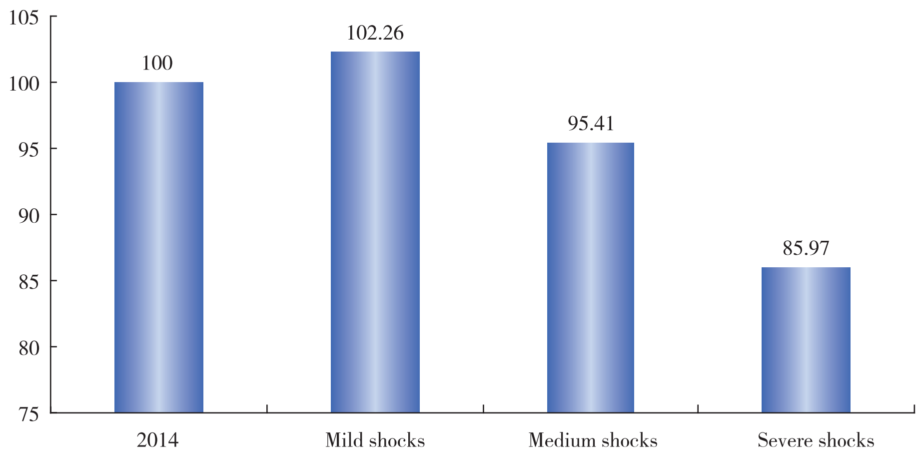
1. Regulatory Indicators

Tested securities companies meet all regulatory requirements under the three scenarios. The stress tests assess tested companies' regulatory indicators under mild, medium and severe shocks. It turns out that all of the 10 tested companies meet the regulatory requirements of the *Management Measures of*

Securities Companies' Risk Control Indicators, which means the securities sector, represented by the 10 tested companies, remains resilient and performs soundly.

Tested securities companies hold adequcote net capital. The net capital of 10 tested securities companies increased by 2.26[①] percent, decreased by 4.59 percent and decreased by 14.03 percent respectively compared with that of 2014 under mild, medium and severe shocks. The level of net capital and ratios of net capital to sum of all the risk capital reserves exceed far from alert and regulatory standards, which indicates that tested securities companies hold adequate net capital.

Figure 1 Net capital of tested securities companies（2014 as base year=100）



Regulatory indicators of some tested securities companies touch the alert level, but still satisfy the regulatory requirements. Ten tested securities companies satisfy all regulatory requirements under mild, medium and severe shocks, yet the ratio of net capital to net assets, ratio of net assets to liabilities and ratio of proprietary equity securities and securities derivatives to net capital of some tested companies might reach the alert level[②].

① Since all tested securities companies can make positive net profits under mild shocks, net assets will increase due to the capitalization of undistributed profits, which increases the net capital compared with that of 2014 under mild shocks.

② The alert and regulatory standards in these tests are set based on the *Management Measures of Securities Companies' Risk Control Indicators* (CSRC Decree No. 55).

Table 3 Performance of Tested Securities Companies' Regulatory Indicators

Regulatory Indicator	Performance under Shocks
Net Capital/Sum of All the Risk Capital Reserves	All the companies meet the alert and regulatory standards
Net Capital/Net Assets	One company touches the alert level under mild, medium and severe shocks; One company touches the alert level under severe shocks; All the companies meet the regulatory standards
Net Capital/Liabilities	All the companies meet the alert and regulatory standards
Net Assets/Liabilities	Two companies touch the alert level under severe shocks; All the companies meet the regulatory standards
Proprietary Equity Securities and Securities Derivatives/Net Capital	One company touches the alert level under mild, medium and severe shocks; All the companies meet the regulatory standards
Proprietary Fixed-income Securities/Net Capital	All the companies meet the alert and regulatory standards

2. Financial Indicators

Part of the securities companies suffer from losses under shocks. Tests show that all the 10 securities companies remain profitable under mild shocks, while 9 of which show losses under medium and severe shocks. The losses can mainly be attributed to two reasons that investment income of proprietary trading fluctuates significantly with market risk and turns negative when SSE composite index drops sharply together with an increase in benchmark interest rates and credit spread, and that non-operating expenses rise substantially due to the wide exposure of the securities companies' credit risks.

It is important to note that the stress tests aim to assess the potential risk origin of securities companies and **the outcomes should not and couldn't be regarded as the prediction of the profitability of the securities sector.** Firstly, part of the scenarios in the tests is categorized as tail risks with relatively low probabilities to happen; Secondly, the positions of proprietary trading are set static to guarantee the certainty of the test results. But in real circumstances securities companies usually adjust their positions to avoid some market risks; Finally, severe default events have not arisen so far from the securities companies' business of margin financing, securities lending, agreed repo and stock pledge, which indicates that the LGDs under the *Credit Risk Item* mainly illustrate the subjective judgement of external experts and cannot be interpreted as that the real losses will get to those levels in real circumstances.

3. Risks Deserving Attention

Securities companies should pay attention to market downside risks due to the high volatility of their income from proprietary

trading. Proprietary trading of securities companies has developed rapidly recent years. Based on the data from the Securities Association of China, during the period from 2012 to 2014, incomes from securities investment (profits and losses arising from fair value changes included) of the securities companies nationwide are RMB 29.017 billion yuan, RMB 30.552 billion yuan and RMB 71.028 billion yuan, accounting for 22.4 percent, 19.2 percent and 27.3 percent of total income respectively. The active development of proprietary trading has important significance to the diversification of securities companies' business models. However, proprietary trading is very sensitive to market risk and highly volatile, which indicates that the profitability of securities companies may face severe shocks under scenarios like a sharp drop in stock and bond market. It is especially important to apply stricter requirement to market risk management because income from proprietary trading of some securities companies accounts for much more shares of total revenue since 2014 due to the significant rise of the stock market.

It deserves to pay more attention to the potential credit risk from margin financing, securities lending, agreed repo and stock pledge, etc. Nowadays most securities companies conduct client financing business such as margin financing, securities lending, stock repo and stock pledge, OTC business such as investment return swap and interest rate swap, and other quasi credit investment and distribution of financing products. So far the real LGDs of above business are nearly zero, which might benefit from the mechanism of margin or stock pledge requirements. This mechanism can control the credit risk effectively, yet the possibility that credit risk does not truly expose still exists. As far as securities companies transit from conventional *light-asset* channel business to *heavy-asset* capital intermediary business, their risk profile will substantially change, where securities companies' performance will be more sensitive to credit risk. Securities companies should prudentially assess and manage credit risk, and avoid underestimating potential risk due to excessive reliance on history data in the application of internal risk control model.

III. Reverse Stress Tests

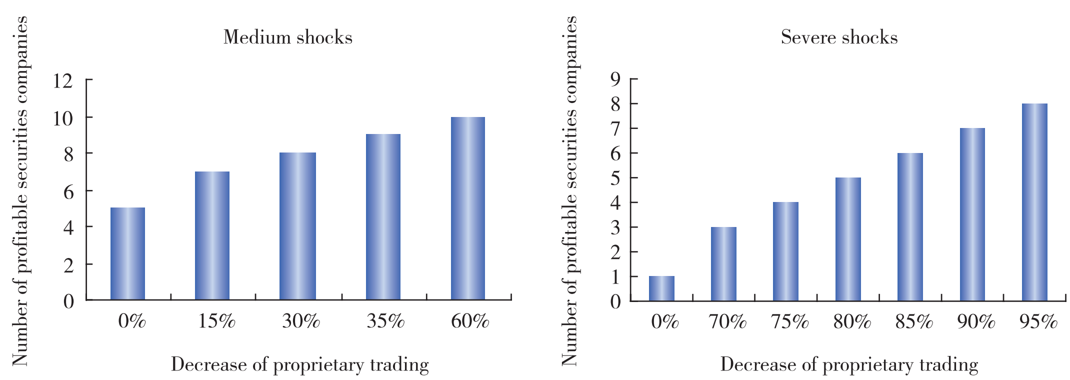
We carried out reverse stress tests on market risk and credit risk, which, as we found in the above stress tests, are very influential to the performance of securities companies. The reverse stress tests assessed the largest LGDs for credit risk securities companies can bear given the specific level of market risk, and the proprietary business positions securities companies need to adjust in order to keep profitable given the specific level of credit risk.

1. Reverse stress tests on market risk

Approach. To control risks and mitigate losses, securities companies usually adjust their positions dynamically based on the market circumstance in real operation. We simulated this process by the approach of reverse stress tests. Since credit risk can influence the test result significantly, we first fix credit risk (stress indicators under *credit risk item* are all set to zero), and then decreased securities companies' positions of proprietary trading until they turn to profitable under medium and severe shocks. The positions of proprietary equity securities and proprietary bonds were decreased by the same proportion, ie the reverse stress tests do not consider the case that the positions of proprietary equity securities and proprietary bonds are adjusted asymmetrically.

Result. The test result indicates that securities companies differ in sensitivity to market risk due to their different business models. Five securities companies remain profitable without cutting the scale of proprietary trading under medium shocks due to the relative low proportion of proprietary income. One securities company remains profitable without cutting the scale of proprietary trading under severe shocks. Eight securities companies remain profitable through cutting the scale of proprietary trading by 95 percent under severe shocks. Two securities companies cannot remain profitable by cutting the scale of proprietary trading since the losses are mainly resulted from other business.

Figure 2　Reverse stress tests on market risk



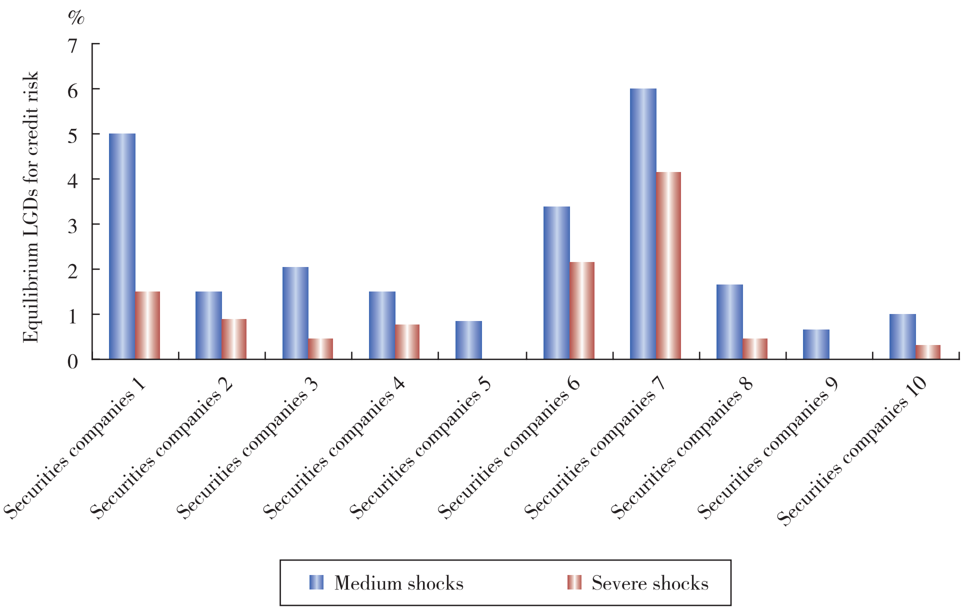
2. Reverse stress tests on credit risk

Approach. So far we mainly assessed securities companies' tolerance of LGDs for credit risk due to the lack of accurate estimation of securities companies' credit risk indicators. Since test result is sensitive to market risk, we first set all stress indicators under *market risk item* to zero, and then increased the LGDs under *credit risk item* until securities companies experience losses under medium and severe shocks. To keep the simplicity of the result, we gave all LGDs under *credit risk item* the same value instead of discriminating different LGDs for different businesses.

Result. Under medium shocks, it is indicated that all securities companies remain profitable when LGDs for credit risk are less than 0.65 percent, and part of securities companies still remain profitable when LGDs reach 6 percent due to the relative small scale of their margin financing and securities lending businesses which are involved in credit risk. The average equilibrium of LGDs that all securities companies just remain profitable is

2.36 percent. Under severe shocks, 8 securities companies remain profitable when LGDs are less than 0.30 percent, while part of securities companies still remain profitable with LGDs reaching 4.15 percent. The average equilibrium of LGDs that all securities companies just remain profitable is 1.33 percent. 2 securities companies experience losses given zero LGDs since the losses mainly result from other business.

Figure 3 Reverse stress tests on credit risk



Appendix

Statistics

Table 1 Selected Economic Indicators

(Year-end Balance)

Items	2010	2011	2012	2013	2014
Gross Domestic Product (RMB 100 million yuan)	401 513	473 104	519 470	568 845	636 463
Industrial Value Added	160 722	188 470	199 671	210 689	227 991
Fixed Asset Investment (RMB 100 million yuan)	278 122	311 485	374 695	447 074	512 761
Retail Sales of Consumer Goods (RMB 100 million yuan)	156 998	183 919	210 307	237 810	262 394
Export & Import (USD 100 million)	29 740	36 419	38 671	41 600	264 334
Export	15 778	18 984	20 487	22 096	143 912
Import	13 962	17 435	18 184	19 504	120 423
Balance	1 816	1 549	2 303	2 592	23 489
Foreign Direct Investment (USD 100 million)	1 057	1 160	1 117	1 176	1 196
Foreign Exchange Reserve (USD 100 million)	28 473.4	31 811.0	33 116.0	38 213.0	38 430.0
Consumer Price Index (previous year = 100)	103.3	105.4	102.6	102.6	102
Fiscal Revenue (RMB 100 million yuan)	83 101.51	103 874.43	117 253.52	129 143	140 350
Fiscal Expenditure (RMB 100 million yuan)	89 874.16	109 247.79	125 952.97	139 744	151 662
Per Capita Urban Residents Dispensable Income (RMB)	19 109	21 810	24 565	26 955	28 844
Per Capita Rural Residents Net Income (RMB)	5 919	6 977	7 917	8 896	9 892
Number of Employed Persons in Urban Area (million)	—	359.1	371.0	382.4	393.1
Registered Unemployment Rate in Urban Area (%)	4.1	4.1	4.1	4.05	4.09
Total Population (million)	1 339.7	1 347.4	1 354.0	1 360.7	1 367.8

Note：1.GDP from 2010 to 2013 is verified and final, and GDP in 2014 is preliminary.

2.Since 2011，the cut-off size of fixed assets investment projects rose from a total planned investment above RMB 500 thousand yuan to RMB 5 million yuan.

Source: Calculated on the basis of data from *China Statistical Year Book* and *Statistical Communique of The People's Republic of China on the National Economic and Social Development.*

Table 2 Selected Financial Indicators (1)

(Year-end Balance)

(100 million of RMB yuan)

Items	2010	2011	2012	2013	2014
Money & Quasi-money (M_2)	725 851.8	851 590.9	974 148.8	1 106 525.0	1 228 374.8
Money (M_1)	266 621.5	289 847.7	308 673.0	337 291.1	348 056.4
Currency in Circulation (M_0)	44 628.2	50 748.5	54 659.8	58 574.4	60 259.5
Total Deposits with Financial Institutions	718 237.9	809 368.3	917 368.1	1 043 846.9	1 138 644.6
Household Deposits	303 302.5	343 635.9	399 546.9	447 601.6	485 261.3
Non-financial Enterprise Deposits	244 495.6	303 504.3	327 444.9	361 555.2	378 333.8
Total Lending by Financial Institutions	479 195.6	547 946.7	629 906.6	718 961.5	816 770.0

Note: Urban & Rural Household Deposits and Enterprise Deposits have been replaced by Household Deposits and Non-financial Enterprise Deposits since 2011.

Source: The PBC.

Table 3 Selected Financial Indicators (2)

(Growth Rates)

(percent)

Items	2010	2011	2012	2013	2014
Money & Quasi-money (M_2)	19.73	13.61	13.80	13.59	11.01
Money (M_1)	21.19	7.85	6.49	9.27	3.19
Currency in Circulation (M_0)	16.69	13.76	7.71	7.16	2.88
Total Deposits with Financial Institutions	20.16	13.54	13.34	13.76	9.08
Household Deposits	16.31	13.78	16.27	12.03	8.41
Non-financial Enterprise Deposits	12.61	9.23	7.89	10.43	4.64
Total Lending by Financial Institutions	19.89	15.83	14.96	14.14	13.60

Note: Growth rate has been adjusted to reflect recent changes in statistical coverage.

Source: The PBC.

Table 4 International Liquidity

(USD million)

Items	2010	2011	2012	2013	2014
Total Reserves (minus gold)	2 862 276	3 197 107	3 325 440	3 833 291	3 853 760
Special Drawing Rights (SDRs)	12 345	11 855	11 366	11 184	10 456
Reserve Positions in IMF	2 593	4 104	2 485	792	286
Foreign Exchange	2 847 338	3 181 148	3 311 589	3 821 315	3 843 018
Gold (1 million ounces)	33.89	33.89	33.89	33.89	33.89
Gold (national valuation)	9 815	9 815	9 815	9 815	9 815
Foreign Liabilities of Other Depository Companies	108 406	123 250	157 509	294 789	409 995

Source: The PBC.

Table 5 Gold and Foreign Exchange Reserves

Year	Gold Reserves (10 thousand ounces)	Foreign Exchange Reserves (USD 100 million)	Change in Foreign Exchange Reserves (percent)
1996	1 267	1 050.3	42.7
1997	1 267	1 398.9	33.2
1998	1 267	1 449.6	3.6
1999	1 267	1 546.8	6.7
2000	1 267	1 655.7	7.0
2001	1 608	2 121.7	28.1
2002	1 929	2 864.1	35.0
2003	1 929	4 032.5	40.8
2004	1 929	6 099.3	51.3
2005	1 929	8 188.7	34.3
2006	1 929	10 663.4	30.2
2007	1 929	15 282.5	43.3
2008	1 929	19 460.3	27.3
2009	3 389	23 991.5	23.3
2010	3 389	28 473.4	18.7
2011	3 389	31 811.5	10.7
2012	3 389	33 115.9	4.1
2013	3 389	38 213.2	15.4
2014	3 389	38 430.2	0.6

Note: The PBC made adjustments to statistical coverage of gold reserves in December 2001, December 2002 and April 2009.
Source: The PBC.

Table 6 Assets of China's Financial Sector

(December 31, 2014)

(trillion of RMB yuan)

Type of Financial Institutions	Assets
Financial Sector	219.18
Central Bank	33.82
Banking Financial Institutions	172.34
Securities Financial Institutions (Assets of clients excluded)	2.86
Insurance Financial Institutions	10.16

Note: Securities financial institutions only include securities companies.
Source: Calculated by the Financial Stability Analysis Group of PBC.

Table 7 Depository Corporations Survey in 2014

(Quarter-end Balance)

(100 million of RMB yuan)

Items	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Net Foreign Assets	284 032.5	289 009.2	288 865.7	288 390.4
Domestic Credit	972 329.3	1 016 864.2	1 032 886.4	1 076 962.2
Claims on Governments(net)	48 407.0	46 665.6	47 087.1	55 047.0
Claims on Non-financial Sectors	831 077.7	858 227.8	878 406.8	902 512.9
Claims on other Financial Sectors	92 844.7	111 970.8	107 392.5	119 402.3
Money & Quasi-money	1 160 687.0	1 209 587.2	1 202 051.4	1 228 374.8
Money	327 683.7	341 487.4	327 220.2	348 056.4
Currency in Circulation	58 329.3	56 951.1	58 845.0	60 259.5
Demand Deposits	269 354.4	284 536.4	268 375.2	287 796.9
Quasi-money	833 003.6	868 099.8	874 831.2	880 318.4
Time Deposits	250 779.0	265 644.2	272 197.0	264 055.7
Savings Deposits	500 399.2	508 024.9	504 261.9	508 878.1
Other Deposits	81 825.4	94 430.6	98 372.3	107 384.6
Deposits not Included in Broad Money	28 640.3	32 791.6	33 008.2	31 135.8
Bonds	108 253.9	113 378.4	118 474.4	123 119.4
Paid-in Capital	33 107.3	33 666.0	34 121.0	36 630.2
Other Items(net)	-74 327.2	-83 549.9	-65 903.0	-53 907.7

Source: The PBC.

Table 8 Balance Sheet of the Monetary Authority in 2014

(Quarter-end Balance)

(100 million of RMB yuan)

Items	Quarter 1	Quarter 2	Quarter 2	Quarter 4
Foreign Assets	280 177.7	280 169.5	280 121.2	278 622.9
Foreign Exchange	272 149.1	272 131.0	272 017.9	270 681.3
Money Gold	669.8	669.8	669.8	669.8
Other Foreign Asstes	7 358.7	7 368.6	7 433.4	7 271.7
Claims on Goverments	15 312.7	15 312.7	15 312.7	15 312.7
Of Which: Central Government	15 312.7	15 312.7	15 312.7	15 312.7
Claims on Other Depository Corporations	12 384.0	14 556.6	21 015.3	24 985.3
Claims on Other Financial Corporations	8 818.0	8 809.2	8 731.6	7 848.8
Claims on Non-financial Corporations	25.0	25.0	25.3	11.6
Other Assets	9 929.8	10 825.6	11 055.4	11 467.5
Total Assets	**326 647.2**	**329 698.6**	**336 261.6**	**338 248.8**
Reserve Money	274 741.1	279 898.7	285 299.2	294 093.0
Currency Issuance	64 815.8	63 260.5	65 544.7	67 151.3
Deposits of Other Depository Corporations	209 925.3	216 638.2	219 754.4	226 941.7
Deposits of Financial Corporations not included in Reserve Money	1 365.6	1 516.6	1 661.7	1 558.4
Bond Issuance	7 762.0	7 132.0	6 922.0	6 522.0
Foreign Liabilities	1 998.8	1 477.3	1 964.0	1 833.8
Deposits of Government	28 962.8	33 283.0	36 787.5	31 275.3
Own Capital	219.8	219.8	219.8	219.8
Other Liabilities	11 597.2	6 171.3	3 407.5	2 746.5
Total Liabilities	**326 647.2**	**329 698.6**	**336 261.6**	**338 248.8**

Source: The PBC.

Table 9 Balance Sheet of Other Depository Corporations in 2014

(Quarter-end Balance)

(100 million of RMB yuan)

Items	Quarter 1	Quarter 2	Quarter 3	Quarter 4
Foreign Assets	29 878.6	35 152.0	35 940.3	36 689.0
Reserve Assets	216 345.3	223 025.1	226 343.4	233 488.7
Deposits with Central Bank	209 858.8	216 715.7	219 643.7	226 597.0
Cash in Vault	6 486.4	6 309.4	6 699.7	6 891.7
Claims on Governments	62 057.0	64 635.9	68 561.8	71 009.6
Of Which: Central Government	62 057.0	64 635.9	68 561.8	71 009.6
Claims on Central Bank	15 966.3	10 314.4	7 579.2	6 564.0
Claims on Other Depository Corporations	279 594.9	293 407.5	278 523.3	280 389.3
Claims on Other Financial Corporations	84 026.7	103 161.6	98 660.8	111 553.5
Claims on Non-financial Corporations	625 036.8	642 770.5	655 324.1	673 285.7
Claims on Other Resident Sectors	206 015.9	215 432.3	223 057.4	229 215.6
Other Assets	84 969.8	85 778.0	88 931.2	79 834.6
Total Assets	**1 603 891.2**	**1 673 677.2**	**1 682 921.5**	**1 722 029.9**
Liabilities to Non-financial Institutions and Households	1 056 770.7	1 097 645.6	1 086 315.7	1 102 202.6
Deposits Included in Broad Money	1 020 532.6	1 058 205.5	1 044 834.2	1 060 730.7
Enterprise Demand Deposits	269 354.4	284 536.4	268 375.2	287 796.9
Enterprise Time Deposits	250 779.0	265 644.2	272 197.0	264 055.7
Household Savings Deposits	500 399.2	508 024.9	504 261.9	508 878.1
Deposits not Included in Broad Money	28 640.3	32 791.6	33 008.2	31 135.8
Transferable Deposits	7 252.9	7 927.9	7 814.6	8 156.7
Other Deposits	21 387.4	24 863.7	25 193.6	22 979.1
Other Liabilities	7 597.8	6 648.4	8 473.3	10 336.0
Liabilities to Central Bank	11 690.8	15 284.6	21 889.6	26 616.7
Liabilities to Other Depository Corporations	112 139.8	114 185.6	107 682.3	111 117.9
Liabilities to Other Financial Corporations	86 323.3	98 502.4	103 207.2	112 400.8
Of Which: Deposits Included in Broad Money	81 825.4	94 430.6	98 372.3	107 384.6
Foreign Liabilities	24 025.0	24 835.0	25 231.9	25 087.6
Bond Issuance	108 253.9	113 378.4	118 474.4	123 119.4
Paid-in Capital	32 887.6	33 446.2	33 901.3	36 410.4
Other Liabilities	171 800.1	176 399.4	186 219.2	185 074.5
Total Liabilities	**1 603 891.2**	**1 673 677.2**	**1 682 921.5**	**1 722 029.9**

Source: The PBC.

Table 10 Balance Sheet of Chinese-funded Large Banks in 2014

(Quarter-end Balance)

(100 million of RMB yuan)

Items	Quarter1	Quarter2	Quarter3	Quarter4
Foreign Assets	20 058.06	23 243.74	22 989.55	23 268.14
Reserve Assets	122 260.28	123 488.29	125 882.27	122 514.77
Deposits with Central Bank	118 655.76	120 044.02	122 056.79	118 637.65
Cash in Vault	3 604.52	3 444.27	3 825.48	3 877.12
Claims on Governments	40 641.57	41 467.79	42 802.08	43 798.59
Of Which: Central Government	40 641.57	41 467.79	42 802.08	43 798.59
Claims on Central Bank	13 724.67	9 585.07	7 073.01	6 230.14
Claims on Other Depository Corporations	117 007.73	124 524.51	118 423.73	119 071.79
Claims on Other Financial Corporations	24 781.98	36 374.55	33 304.49	36 983.54
Claims on Non-financial Corporations	339 685.31	347 254.01	353 217.66	359 189.15
Claims on Other Resident Sectors	110 341.06	114 987.47	118 820.49	121 801.01
Other Assets	61 507.72	60 473.38	62 408.50	53 022.53
Total Assets	**850 008.36**	**881 398.81**	**884 921.79**	**885 879.65**
Liabilities to Non-financial Institutions and Households	584 019.79	597 191.84	588 746.57	588 822.72
Deposits Included in Broad Money	564 109.19	576 592.56	567 164.60	567 167.06
Enterprise Demand Deposits	146 816.40	152 656.38	144 757.25	149 263.31
Enterprise Time Deposits	105 646.69	111 297.17	112 862.91	107 492.19
Household Savings Deposits	311 646.09	312 639.00	309 544.43	310 411.56
Deposits not Included in Broad Money	14 590.34	16 277.16	15 608.58	14 089.23
Transferable Deposits	3 566.71	3 600.61	3 534.19	3 732.03
Other Deposits	11 023.63	12 676.56	12 074.38	10 357.21
Other Liabilities	5 320.26	4 322.12	5 973.40	7 566.43
Liabilities to Central Bank	3 540.79	6 308.79	12 161.71	12 629.72
Liabilities to Other Depository Corporations	18 427.52	20 902.96	20 267.59	21 852.31
Liabilities to Other Financial Corporations	40 012.79	49 911.77	50 215.78	53 509.47
Of Which: Deposits Included in Broad Money	38 905.22	48 914.19	49 330.79	52 782.91
Foreign Liabilities	12 608.97	12 661.94	12 483.20	11 929.91
Bond Issuance	67 592.86	69 944.53	70 672.23	71 222.15
Paid-in Capital	16 081.85	16 082.17	16 084.84	17 643.65
Other Liabilities	107 723.79	108 394.80	114 289.86	108 269.72
Total Liabilities	**850 008.36**	**881 398.81**	**884 921.79**	**885 879.65**

Source: The PBC.

Table 11 Balance Sheet of Chinese-funded Medium-sized Banks in 2014

(Quarter-end Balance)

(100 million of RMB yuan)

Items	Quarter1	Quarter2	Quarter3	Quarter4
Foreign Assets	8 211.63	10 120.24	11 004.41	10 802.31
Reserve Assets	38 531.59	41 366.73	41 364.41	44 166.20
Deposits with Central Bank	37 887.00	40 709.52	40 744.65	43 479.73
Cash in Vault	644.59	657.21	619.76	686.47
Claims on Governments	10 972.99	11 933.52	13 640.97	14 513.02
Of Which: Central Government	10 972.99	11 933.52	13 640.97	14 513.02
Claims on Central Bank	1 404.60	259.80	196.47	126.87
Claims on Other Depository Corporations	66 831.06	72 688.32	66 941.26	64 679.14
Claims on Other Financial Corporations	30 945.62	36 033.99	33 204.96	40 458.04
Claims on Non-financial Corporations	145 599.64	149 668.47	152 155.95	157 577.08
Claims on Other Resident Sectors	40 320.83	42 122.33	43 800.31	46 053.91
Other Assets	8 845.94	10 196.61	10 554.41	10 964.34
Total Assets	**351 663.89**	**374 390.01**	**372 863.15**	**389 340.91**
Liabilities to Non-financial Institutions and Households	189 559.37	205 343.60	198 745.48	201 771.50
Deposits Included in Broad Money	178 219.18	191 734.94	184 335.82	188 105.41
Enterprise Demand Deposits	54 843.35	59 831.72	53 463.37	60 317.38
Enterprise Time Deposits	79 308.05	84 581.75	86 282.00	83 300.40
Household Savings Deposits	44 067.79	47 321.47	44 590.45	44 487.63
Deposits not Included in Broad Money	10 246.00	12 464.54	13 135.26	12 437.25
Transferable Deposits	2 044.32	2 606.08	2 598.47	2 496.58
Other Deposits	8 201.68	9 858.46	10 536.78	9 940.67
Other Liabilities	1 094.18	1 144.12	1 274.40	1 228.84
Liabilities to Central Bank	5 899.96	6 127.07	6 257.56	10 249.30
Liabilities to Other Depository Corporations	40 904.31	40 833.57	37 926.87	38 070.40
Liabilities to Other Financial Corporations	38 407.56	39 579.23	42 118.76	46 270.70
Of Which: Deposits Included in Broad Money	35 811.05	37 185.31	39 036.00	43 431.21
Foreign Liabilities	4 678.47	5 666.74	5 991.50	6 338.84
Bond Issuance	38 523.02	41 031.28	44 456.32	46 615.30
Paid-in Capital	2 656.28	2 737.82	2 749.54	3 029.66
Other Liabilities	31 034.93	33 070.69	34 617.12	36 995.21
Total Liabilities	**351 663.89**	**374 390.01**	**372 863.15**	**389 340.91**

Source: The PBC.

Table 12　Balance Sheet of Chinese-funded Small Banks in 2014

(Quarter-end Balance)

(100 million of RMB yuan)

Items	Quarter1	Quarter2	Quarter3	Quarter4
Foreign Assets	371.66	351.79	400.80	575.03
Reserve Assets	37 824.35	39 676.19	40 432.58	45 602.52
Deposits with Central Bank	36 557.53	38 418.23	39 111.59	44 154.91
Cash in Vault	1 266.82	1 257.96	1 320.99	1 447.61
Claims on Governments	8 352.82	8 704.99	9 328.35	9 804.64
Of Which: Central Government	8 352.82	8 704.99	9 328.35	9 804.64
Claims on Central Bank	105.92	98.65	100.08	83.14
Claims on Other Depository Corporations	59 195.09	60 120.47	56 431.99	59 783.65
Claims on Other Financial Corporations	23 839.92	25 744.81	27 083.85	28 641.30
Claims on Non-financial Corporations	94 935.11	99 965.92	103 794.07	109 410.57
Claims on Other Resident Sectors	31 233.67	33 496.46	35 658.43	37 481.78
Other Assets	8 962.47	9 588.22	10 187.59	10 458.29
Total Assets	**264 821.02**	**277 747.50**	**283 417.75**	**301 840.91**
Liabilities to Non-financial Institutions and Households	181 577.18	191 978.53	195 250.52	205 272.33
Deposits Included in Broad Money	179 867.45	190 105.78	193 139.16	202 802.50
Enterprise Demand Deposits	45 952.84	48 975.67	46 872.40	51 314.56
Enterprise Time Deposits	46 137.61	49 678.69	51 748.86	52 304.46
Household Savings Deposits	87 777.00	91 451.42	94 517.90	99 183.48
Deposits not Included in Broad Money	1 067.68	1 159.42	1 424.12	1 535.82
Transferable Deposits	292.13	304.98	313.99	356.77
Other Deposits	775.55	854.43	1 110.13	1 179.04
Other Liabilities	642.05	713.34	687.23	934.01
Liabilities to Central Bank	999.29	1 376.42	1 837.42	2 187.61
Liabilities to Other Depository Corporations	43 771.29	42 525.17	39 526.36	42 095.89
Liabilities to Other Financial Corporations	6 839.39	8 024.80	9 838.50	11 287.83
Of Which: Deposits Included in Broad Money	6 472.24	7 766.42	9 439.13	10 546.90
Foreign Liabilities	714.29	702.87	785.64	753.43
Bond Issuance	1 896.63	2 158.73	3 150.17	4 977.04
Paid-in Capital	7 459.08	7 785.87	8 128.33	8 558.96
Other Liabilities	21 563.88	23 195.10	24 900.81	26 707.84
Total Liabilities	**264 821.02**	**277 747.50**	**283 417.75**	**301 840.91**

Source: The PBC.

Table 13 Balance Sheet of Foreign-funded Banks in 2014

(Quarter-end Balance)

(100 million of RMB yuan)

Items	Quarter1	Quarter2	Quarter3	Quarter4
Foreign Assets	1 109.61	1 294.78	1 443.41	1 888.69
Reserve Assets	2 951.42	3 018.86	2 898.58	3 205.40
Deposits with Central Bank	2 939.79	3 007.53	2 886.84	3 194.46
Cash in Vault	11.63	11.33	11.74	10.93
Claims on Governments	1 342.80	1 799.12	2 055.36	2 184.62
Of Which: Central Government	1 342.80	1 799.12	2 055.36	2 184.62
Claims on Central Bank	658.99	301.81	134.12	39.63
Claims on Other Depository Corporations	6 742.82	6 471.25	5 989.28	5 774.89
Claims on Other Financial Corporations	1 490.64	1 578.42	1 684.16	2 124.82
Claims on Non-financial Corporations	10 874.64	10 891.65	11 034.54	11 077.28
Claims on Other Resident Sectors	842.61	891.11	933.08	970.37
Other Assets	1 056.73	934.27	1 063.84	877.40
Total Assets	**27 070.26**	**27 181.28**	**27 236.37**	**28 143.09**
Liabilities to Non-financial Institutions and Households	15 015.76	15 123.90	15 006.82	15 730.67
Deposits Included in Broad Money	12 168.56	12 219.82	12 087.19	12 685.11
Enterprise Demand Deposits	2 471.33	2 597.29	2 325.64	3 314.92
Enterprise Time Deposits	7 634.71	7 573.70	7 760.51	7 440.21
Household Savings Deposits	2 062.53	2 048.83	2 001.04	1 929.99
Deposits not Included in Broad Money	2 435.83	2 556.30	2 509.25	2 621.09
Transferable Deposits	1 121.81	1 189.36	1 171.01	1 249.23
Other Deposits	1 314.02	1 366.94	1 338.24	1 371.86
Other Liabilities	411.37	347.78	410.38	424.47
Liabilities to Central Bank	1.82	0.67	1.77	1.85
Liabilities to Other Depository Corporations	1 563.57	1 873.92	1 624.04	1 784.86
Liabilities to Other Financial Corporations	647.11	596.59	637.79	708.67
Of Which: Deposits Included in Broad Money	519.66	452.11	460.23	512.50
Foreign Liabilities	6 023.24	5 803.41	5 971.08	6 056.96
Bond Issuance	80.30	80.62	85.71	114.50
Paid-in Capital	1 618.00	1 634.85	1 660.95	1 654.05
Other Liabilities	2 120.46	2 067.32	2 248.22	2 091.54
Total Liabilities	**27 070.26**	**27 181.28**	**27 236.37**	**28 143.09**

Source: The PBC.

Table 14 Balance Sheet of Rural Credit Cooperatives in 2014

(Quarter-end Balance)

(100 million of RMB yuan)

Items	Quarter1	Quarter2	Quarter3	Quarter4
Foreign Assets	3.57	4.22	3.87	2.61
Reserve Assets	12 112.86	12 664.47	12 798.26	14 985.24
Deposits with Central Bank	11 154.03	11 725.89	11 876.94	14 115.69
Cash in Vault	958.83	938.58	921.32	869.55
Claims on Governments	690.39	675.24	683.66	653.55
Of Which: Central Government	690.39	675.24	683.66	653.55
Claims on Central Bank	71.58	69.07	75.48	84.21
Claims on Other Depository Corporations	22 298.80	21 577.18	21 179.65	18 939.23
Claims on Other Financial Corporations	2 276.74	2 487.34	2 356.48	2 377.99
Claims on Non-financial Corporations	22 353.85	22 912.05	22 877.69	22 917.85
Claims on Other Resident Sectors	22 891.07	23 526.34	23 415.09	22 443.07
Other Assets	4 374.87	4 369.16	4 498.55	4 272.88
Total Assets	**87 073.74**	**88 285.07**	**87 888.74**	**86 676.63**
Liabilities to Non-financial Institutions and Households	68 767.61	68 973.22	67 660.87	66 661.92
Deposits Included in Broad Money	68 640.19	68 854.23	67 531.55	66 484.37
Enterprise Demand Deposits	11 211.95	11 406.00	11 044.12	10 847.51
Enterprise Time Deposits	2 588.68	2 889.80	2 884.47	2 775.93
Household Savings Deposits	54 839.56	54 558.43	53 602.96	52 860.94
Deposits not Included in Broad Money	5.20	5.51	9.35	6.09
Transferable Deposits	0.44	0.54	0.62	0.43
Other Deposits	4.75	4.96	8.72	5.66
Other Liabilities	122.22	113.48	119.98	171.46
Liabilities to Central Bank	1 137.52	1 359.55	1 524.68	1 435.21
Liabilities to Other Depository Corporations	6 914.72	7 415.30	7 828.51	6 697.71
Liabilities to Other Financial Corporations	345.06	333.55	355.90	560.50
Of Which: Deposits Included in Broad Money	59.85	62.00	71.17	75.16
Foreign Liabilities	0.05	0.05	0.07	0.13
Bond Issuance	0.00	0.00	0.00	1.00
Paid-in Capital	2 523.65	2 549.72	2 523.55	2 646.50
Other Liabilities	7 385.13	7 653.67	7 995.17	8 673.65
Total Liabilities	**87 073.74**	**88 285.07**	**87 888.74**	**86 676.63**

Source: The PBC.

Table 15 Statistics of Securities Market

Year	2009	2010	2011	2012	2013	2014
Number of Domestic Listed Companies (A share, B share)	1 718	2 063	2 342	2 494	2 489	2 613
Number of Domestic Listed Foreign Companies (B share)	108	108	108	107	106	104
Number of Overseas Listed Companies (H share)	159	165	171	179	182	205
Number of Shares Issued (100 million shares)	26 162.85	33 184.35	36 095.52	38 395.00	40 569.08	43 610.13
Of Which: Negotiable Shares (100 million shares)	19 759.53	25 642.03	28 850.26	31 339.60	36 744.16	39 104.28
Total Market Value of Shares (RMB 100 million yuan)	243 939.12	265 422.59	214 758.10	230 357.62	239 077.19	372 546.96
Of Which:Negotiable Shares (RMB 100 million yuan)	151 258.65	193 110.41	164 921.30	181 658.26	199 579.54	315 624.31
Trade Volume of Shares (100 million shares)	51 106.99	42 151.99	33 957.55	32 881.06	48 372.67	73 754.61
Turnover of Shares(RMB 100 million yuan)	535 986.74	545 633.54	421 646.74	314 667.41	468 728.60	743 912.98
Shanghai Composite Index (close)	3 277.14	2 808.08	2 199.42	2 269.13	2 115.98	3 234.68
Shenzhen Composite Index (close)	1 201.34	1 290.87	866.65	881.17	1 057.67	1 415.19
Number of Investor Accounts (10 thousand)	12 037.69	13 391.04	14 050.37	17 064.46	17 517.63	14 214.68
Average P/E						
Shanghai	28.73	21.61	13.40	12.30	10.99	15.99
Shenzhen	46.01	44.69	23.11	22.01	27.76	34.05
Average Turnover Rate (%)						
Shanghai	499.41	197.61	124.80	101.59	123.59	439.50
Shenzhen	793.27	557.46	340.49	297.85	389.11	635.81
Treasury Bonds Issuance (RMB 100 million yuan)	17 927.24	19 778.30	17 100.10	16 154.20	20 230.00	21 747.00
Corporate Bonds Issuance (RMB 100 million yuan)	16 599.30	16 094.45	21 395.32	37 365.46	36 699.00	51 516.00
Trade Volume of Bonds (10 thousand units)						
Turnover of Bonds (RMB 100 million yuan)						
Turnover of Outright Treasury Bonds Purchase (RMB 100 million yuan)	42 291.52	78 391.44	87 629.52	92 221.85	56 498.86	58 552.15
Turnover of Treasury Bonds Repo (RMB 100 million yuan)	35 475.87	65 877.79	199 581.50	443 655.31	583 253.84	814 741.84
Number of Securities Investment Funds	557.00	704.00	914.00	1 173.00	1 552.00	1 897.00
Total Net Asset Value of Securities Investment Funds (RMB 100 million yuan)	26 767.05	24 228.35	26 510.37	28 661.81	30 025.77	45 353.61
Turnover of Securities Investment Funds (RMB 100 million yuan)	10 249.58	8 996.43	6 365.80	8 667.36	1 024.87	13 247.01
Trading Volume of Futures (10 thousand lots)	215 751.76	156 684.42	105 413.75	145 052.57	206 182.30	250 585.57
Turnover of Futures (RMB 100 million yuan)	1 305 142.92	1 540 296.21	1 375 162.44	1 711 269.35	2 674 662.02	2 919 882.26

Source: The CSRC, China Government Securities Depository Trust &.Clearing Co..

Table 16 Ratio of Stock Market Capitalization to GDP

(100 million of RMB yuan unless otherwise noted)

Year	GDP	Market Capitalization	Ratio of market captialization to GDP (percent)	GDP	Negotiable Market Capitalization	Ratio of negotiable market captialization to GDP (percent)
1997	78 973	17 529	22	78 973	5 204	6.59
1998	84 402	19 506	23	84 402	5 746	6.81
1999	89 677	26 471	30	89 677	8 214	9.16
2000	99 215	48 091	48	99 215	16 088	16.21
2001	109 655	43 522	40	109 655	14 463	13.19
2002	120 333	38 329	32	120 333	12 485	10.38
2003	135 823	42 458	31	135 823	13 179	9.70
2004	159 878	37 056	23	159 878	11 689	7.31
2005	183 868	32 430	18	183 868	10 631	5.78
2006	211 923	89 404	42	211 923	25 004	11.80
2007	249 530	327 141	131	249 530	93 064	37.30
2008	300 670	121 366	40	300 670	45 214	15.04
2009	335 353	243 939	73	335 353	151 259	45.10
2010	397 983	265 422	67	397 983	193 110	48.52
2011	471 564	214 758	46	471 564	164 921	34.97
2012	519 322	230 358	44	519 322	181 658	34.98
2013	568 845	239 077	42	568 845	199 580	35.09
2014	636 463	372 547	59	636 463	315 624	49.59

Source: The CSRC.

Table 17 Ratio of Domestic Stock Financing to Bank Loan Increment

(100 million of RMB yuan unless otherwise noted)

Year	Domestic Stock Financing	Loan Increment	Ratio of deomestic stock financing to loan increment (percent)
1997	933.82	10 712.47	8.72
1998	803.57	11 490.94	6.99
1999	897.39	10 846.36	8.27
2000	1 541.02	13 346.61	11.55
2001	1 182.13	12 439.41	9.50
2002	779.75	18 979.20	4.11
2003	823.10	27 702.30	2.97
2004	862.67	19 201.60	4.49
2005	338.13	16 492.60	2.05
2006	2 463.70	30 594.89	8.05
2007	7 722.99	36 405.60	21.21
2008	2 619.71	41 703.76	6.28
2009	3 894.53	96 290.18	4.04
2010	8 954.99	79 510.73	11.26
2011	5 073.07	68 751.14	7.38
2012	3 127.54	81 962.95	3.82
2013	3 457.52	93 326.01	3.70
2014	4 834.04	101 548.47	4.76

Note: Since 2008, the Statistics of stock refinancing were divided into two items: asset injection and cash injection, and the former was not included in "Domestic Stock Financing".

Source: Calculated on the basis of data from the CSRC and the PBC.

Table 18 Statistics of Stock Market

Year		2008	2009	2010	2011	2012	2013	2014
Number of Domestic Listed Companies (A share, B share)		1 625	1 718	2 063	2 342	2 494	2 489	2 613
Of Which: ST Companies		140	142	153	137	96	57	43
Medium/ Small-sized Companies		273	327	531	646	701	701	732
Growth Enterprises Board			36	153	281	355	355	406
Number of Domestic Listed Foreign Companies (B share)		109	108	108	108	107	106	104
Of Which: ST Companies		20				12		4
Number of Shares Issued (100 million shares)		24 522.85	26 162.85	33 184.35	36 095.52	38 395.00	40 569.08	43 610.13
Of Which: Medium/ Small-sized Companies		591.60	794.13	1 366.74	1 943.50	2 410.25	2 818.48	3 470.59
Growth Enterprises Board			34.60	175.06	399.53	600.89	761.56	1 077.26
Total Market Capitalization of Shares (RMB 100 million yuan)		121 366.44	243 939.12	265 422.59	214 758.10	230 357.62	239 077.19	372 546.96
Of Which: Medium/ Small-sized Companies		6 269.68	16 872.55	35 364.61	27 429.32	28 804.03	37 163.74	51 058.20
Growth Enterprises Board			1 610.08	7 365.22	7 433.79	8 731.20	15 091.98	21 850.95
Market Capitalization of Negotiable Shares (RMB 100 million yuan)		45 213.90	151 258.65	193 110.41	164 921.30	181 658.26	199 579.54	315 624.31
Of Which: Medium/ Small-sized Companies		2 672.68	7 503.57	16 150.32	14 343.52	16 244.15	25 543.70	36 017.99
Growth Enterprises Board			298.97	2 005.64	2 504.08	3 335.29	8 218.83	13 072.90
Volume (100 million shares)	Total	24 131.38	51 106.99	42 151.99	33 957.55	32 881.06	48 372.67	73 754.61
	Daily Average	98.10	209.45	174.18	139.17	135.31	203.25	301.04
	Medium/ Small-sized	1 189.26	3 283.65	4 055.35	3 729.74	5 075.85	8 245.92	11 313.54
	Growth Enterprises Board	—	38.55	400.53	761.69	1 478.14	3 035.83	4 035.31

(concluded)

Year		2008	2009	2010	2011	2012	2013	2014
Turnover (RMB 100 million yuan)	Total	267 112.64	535 986.74	545 633.54	421 649.72	314 667.41	468 728.60	743 912.98
	Daily Average	1 085.82	2 196.67	2 254.68	1 728.07	1 294.93	1 969.45	3 036.38
	Medium/ Small-sized	16 637.28	48 273.52	85 832.42	69 026.48	61 891.45	100 224.00	152 166.56
	Growth Enterprises Board	—	1 828.11	15 717.88	18 879.15	23 304.64	51 182.00	78 041.35
Average Turnover Rate (%)	Shanghai	392.52	499.41	197.61	124.80	101.59	123.59	439.50
	Shenzhen	469.11	793.27	557.46	340.49	297.85	389.11	635.81
Average P/E	Shanghai	14.86	28.73	21.61	13.40	12.30	10.99	15.99
	Shenzhen	17.13	46.01	44.69	23.11	22.01	27.76	34.05
	Medium/ Small-sized	24.96	51.01	56.93	28.26	25.42	34.07	41.06
	Growth Enterprises Board		105.38	78.53	37.62	32.01	55.21	64.51
Shanghai Composite Index	Open	5 265.00	1 849.02	3 289.75	2 825.33	2 212.00	2 289.51	2 112.13
	Highest	5 522.78	3 478.01	3 306.75	3 067.46	2 478.37	2 444.80	3 234.68
	Date	2008/1/14	2009/8/4	2010/1/11	2011/4/18	2012/2/27	2013/2/18	2014/12/31
	Lowest	1 664.92	1 844.09	2 319.74	2 134.02	1 949.46	1 849.65	1 991.25
	Date	2008/10/28	2009/1/5	2010/7/2	2011/12/28	2012/12/4	2013/6/25	2014/1/20
	Close	1 820.81	3 277.14	2 808.08	2 199.42	2 269.13	2 115.98	3 234.68
Shenzhen Composite Index	Open	1 450.33	560.10	1 207.33	1 298.60	871.93	887.36	1 055.88
	Highest	1 584.40	1 240.64	1 414.64	1 316.19	1 020.29	1 106.27	1 504.48
	Date	2008/1/15	2009/12/4	2010/11/11	2011/1/6	2012/3/14	2013/10/22	2014/12/16
	Lowest	452.33	557.69	890.24	828.83	724.97	815.89	1 004.93
	Date	2008/11/4	2009/1/5	2010/7/2	2011/12/28	2012/12/4	2013-06.25	2014/4/29
	Close	553.30	1 201.34	1 290.87	866.65	881.17	1 057.67	1 415.19

Sources: The CBRC, Shanghai Stock Exchange and Shenzhen Stock Exchange.

Table 19 Summary of China's Bond Issuance

(100 million of RMB yuan)

Year	Treasury Bonds			Financial Bonds			Corporate Credit Bonds		
	Issuance	Redemption	Outstanding Balance	Issuance	Redemption	Outstanding Balance	Issuance	Redemption	Outstanding Balance
1995	1 510.86	496.96	3 300.30				300.80	336.30	646.61
1996	1 847.77	786.64	4 361.43				268.92	317.80	597.73
1997	2 411.79	1 264.29	5 508.93				255.23	219.81	521.02
1998	3 808.77	2 060.86	7 765.70				147.89	105.25	676.93
1999	4 015.00	1 238.70	10 542.00				158.20	56.50	778.63
2000	4 657.00	2 179.00	13 020.00				83.00		861.63
2001	4 884.00	2 286.00	15 618.00				147.00		
2002	5 934.30	2 216.20	19 336.10				325.00		
2003	6 280.10	2 755.80	22 603.60				358.00		
2004	6 923.90	3 749.90	25 777.60				327.00		
2005	7 042.00	4 045.50	28 774.00				2 046.50	37.00	
2006	8 883.30	6 208.61	31 448.69				3 938.30	1 672.40	
2007	23 139.10	5 846.80	48 741.00				5 181.00	2 880.90	7 683.30
2008	8 558.20	7 531.40	49 767.80				8 723.40	3 277.84	13 250.62
2009	17 927.24	9 745.06	57 949.98				16 599.30	4 309.12	25 540.80
2010	19 778.30	10 043.38	67 684.90				16 094.45	5 099.23	36 318.15
2011	17 100.00	10 959.00	75 832.00	23 491.00	7 683.00	75 748.00	23 548.00	10 326.00	49 095.00
2012	16 154	9 464	82 522	26 202	8 588	93 362	37 365	8 750	77 710
2013	20 230	8 996	95 471	26 310	13 306	105 772	36 784	18 673	93 242
2014	21 747	10 365	107 275	36 552	19 345	125 489	51 516	27 388	116 214

Notes:①"Financial Bonds" are bonds issued by financial insitutions, including financial bonds issued by CDB, policy financial bonds, common bonds, subordinated bonds and hybrid bonds issued by commercial banks, asset-backed securities, bonds and short-term financing bills issued by securities companies, and financial bonds issued by asset management companies.

②Due to statistical method adjustment, since 2012, the item "Enterprise bonds" is replaced by "Corporate credit bonds", including Debt Financing Instruments of Non-financial Enterprises, Enterprise Bonds, Corporate Bonds, Convertible Bonds, Bonds with Detachable Warrants, and SME Private-funded Bonds.

Source: The PBC.

Table 20 Statistics of China's Insurance Sector

(100 million of RMB yuan unless otherwise noted)

Items	2008	Growth (y-o-y) (percent)	2009	Growth (y-o-y) (percent)	2010	Growth (y-o-y) (percent)	2011	Growth (y-o-y) (percent)	2012	Growth (y-o-y) (percent)	2013	Growth (y-o-y) (percent)	2014	Growth (y-o-y) (percent)
Premium Income	9 784.10	39.06	11 137.30	13.83	14 527.97	30.44	14 339.25	—	15 487.93	8.01	17 222.24	11.20	20 234.81	17.49
1.Property Insurance	2 336.71	16.97	2 875.83	23.07	3 895.64	35.46	4 617.82	18.54	5 330.93	15.44	6 212.26	16.53	7 203.38	15.95
2.Personal Accident Insurance	203.56	7.08	230.05	13.02	275.35	19.69	334.12	—	386.18	15.58	461.34	19.46	542.57	17.61
3.Health Insurance	585.46	52.40	573.98	-1.96	677.47	18.03	691.72	—	862.76	24.73	1 123.50	30.22	1 587.18	41.27
4.Life Insurance	6 658.37	49.17	7 457.44	12.00	9 679.51	29.80	8 695.59	—	8 908.06	2.44	9 425.14	5.80	10 901.69	15.67
Claim Payment	2 971.17	31.16	3 125.48	5.19	3 200.43	2.40	3 929.37	22.78	4 716.32	20.03	6 212.90	31.73	7 216.21	16.15
1.Property Insurance	1 418.33	38.99	1 575.78	11.10	1 756.03	11.44	2 186.93	24.54	2 816.33	28.78	3 439.14	22.11	3 788.21	10.15
2.Personal Accident Insurance	62.57	-1.35	63.92	2.15	71.39	11.69	81.84	14.64	96.80	18.28	109.51	13.12	128.42	17.27
3.Health Insurance	175.28	49.99	217.03	23.82	264.02	21.65	359.67	36.23	298.17	-17.10	411.13	37.88	571.16	38.92
4.Life Insurance	1 314.98	23.54	1 268.74	-3.52	1 108.99	-12.59	1 300.93	17.31	1 505.01	15.69	2 253.13	49.71	2 728.43	21.09
Operating Expenses	1 079.52	13.92	1 234.06	14.32	1 538.35	24.66	1 882.38	22.36	2 171.46	15.36	2 459.59	13.27	2 795.79	13.67
Bank Deposits	8 087.55	24.11	10 519.68	30.07	13 909.97	32.23	17 737.17	27.51	23 446.00	32.19	22 640.98	-3.43	25 233.44	11.45
Investment	22 465.22	11.18	26 897.43	19.73	32 136.65	19.48	37 736.67	17.43	45 096.58	19.50	54 232.43	20.26	66 997.41	23.54
Of Which: Treasury Bonds	4 208.26	6.24	4 053.82	-3.67	4 815.78	18.80	4 742.40	-1.52	4 795.02	1.11	4 776.73	-0.38	5 009.88	4.88
Securities Investment Funds	1 646.46	-34.93	2 758.78	67.56	2 620.73	-5.00	2 915.86	11.26	3 625.58	24.34	3 575.52	-1.38	4 714.28	31.85
Total Assets	33 418.44	15.22	40 634.75	21.59	50 481.61	24.23	60 138.10	19.13	73 545.73	22.29	82 886.95	12.70	101 591.47	22.57

Notes: ①Since 2011, the calculation of premium income has been adjusted according to Accounting Standards for Enterprises No.2 circulated by the Ministry of Finance. As a result, data of premium income since 2011 is incomparable with those in previous years.

②Data of premium income, claim payment and operating expenses are data for the year.

③Data of bank deposits, investment and total assets are data of year-end balance.

Source: Calculated based on data from CIRC Website.

Table 21 The Structure of Non-life Insurance Premium Income

(100 million of RMB yuan unless otherwise noted)

Insurance Lines	2010	proportion (percent)	2011	proportion (percent)	2012	proportion (percent)	2013	proportion (percent)	2014	proportion (percent)
Automobile Insurance	3 004.15	74.60	3 504.56	73.33	4 005.17	72.43	4 720.79	72.84	5 515.93	73.11
Enterprise Property Insurance	271.61	6.74	329.81	6.90	360.36	6.52	378.80	5.84	387.35	5.13
Cargo Transportation Insurance	78.74	1.96	97.83	2.05	101.71	1.84	102.94	1.59	95.44	1.27
Accident Insurance	85.53	2.12	105.12	2.20	126.54	2.29	150.93	2.33	171.93	2.28
Liability Insurance	115.88	2.88	148.01	3.10	183.77	3.32	216.63	3.34	253.30	3.36
Others	470.98	11.70	593.73	12.42	752.33	13.60	911.07	14.06	1 120.45	14.85
Total	4 026.89	100.00	4 779.06	100.00	5 529.88	100.00	6 481.16	100.00	7 544.40	100.00

Source: The CIRC.

Table 22 The Structure of Life Insurance Premium Income

(100 million of RMB yuan unless otherwise noted)

Insurance Lines	2010	proportion (percent)	2011	proportion (percent)	2012	proportion (percent)	2013	proportion (percent)	2014	proportion (percent)
Life Insurance	9 679.31	92.18	8 695.40	90.96	8 907.90	89.46	9 424.99	87.75	10 901.57	85.90
Of Which: Common Life Insurance	948.17	9.03	951.20	9.95	969.65	9.74	1 200.27	11.17	4 296.49	33.86
Participating Insurance	7 454.77	70.99	7 662.54	80.15	7 854.29	78.88	8 132.81	75.72	6 508.75	51.29
Unit-linked Insurance	152.82	1.46	4.55	0.05	4.35	0.04	4.42	0.04	4.42	0.03
Accident Insurance	189.83	1.81	229.00	2.40	259.64	2.61	310.41	2.89	370.63	2.92
Health Insurance	631.74	6.02	635.61	6.65	790.35	7.94	1 005.52	9.36	1 418.09	11.17
Total	10 500.88	100.00	9 560.00	100.00	9 957.89	100.00	10 740.93	100.00	12 690.28	100.00

Source: The CIRC.

Table 23 Insurance Premium Income of China's Different Regions in 2014

(100 million of RMB yuan)

Regions	Insurance Premium Income	Property Insurance	Life Insurance	Accident Insurance	Health Insurance
Total	20 234.81	7 203.38	10 901.69	542.57	1 587.18
Jiangsu	1 792.97	590.00	1 014.18	48.90	139.90
Guangdong	1 683.76	606.29	916.72	48.47	112.27
Shandong	1 251.79	426.51	680.45	28.34	116.49
Beijing	1 207.24	314.76	708.69	34.64	149.16
Zhejiang	1 060.63	371.76	583.61	29.77	75.49
Henan	1 051.08	472.91	482.53	29.92	65.73
Sichuan	1 036.08	278.38	659.88	18.77	79.05
Hebei	986.75	320.36	545.60	38.33	82.46
Shanghai	931.94	356.72	493.59	19.64	61.99
Hubei	700.23	204.55	421.51	18.52	55.64
Hunan	587.73	211.27	317.00	15.96	43.50
Anhui	572.29	241.45	274.42	11.21	45.21
Shenzhen	557.70	187.42	319.08	11.05	40.15
Fujian	554.61	182.19	303.39	16.12	52.91
Liaoning	548.66	206.95	282.91	17.32	41.49
Shanxi	507.09	122.03	346.79	8.68	29.59
Shanxi	476.75	160.00	266.48	11.75	38.51
Heilongjiang	465.37	156.03	271.92	8.72	28.70
Chongqing	407.26	138.87	222.94	15.82	29.64
Yunnan	400.37	138.75	222.60	9.48	29.54
Jiangxi	375.99	177.26	147.66	14.21	36.86
Tianjin	330.00	107.66	191.89	5.26	25.18
Guangxi	317.75	108.87	174.51	6.58	27.79
Inner Mongolia	317.41	131.63	141.23	12.24	32.32
Xinjiang	313.97	138.26	144.44	7.10	24.17
Jilin	313.30	130.62	143.79	12.99	25.90
Ningbo	213.06	112.43	78.89	8.56	13.18
Guizhou	208.44	80.00	106.44	6.34	15.66
Gansu	206.98	111.57	81.45	5.52	8.45
Qingdao	203.14	88.12	95.04	4.88	15.10
Dalian	199.27	71.86	107.14	4.45	15.82
Xiamen	131.21	57.08	60.54	4.08	9.51
Ningxia	85.15	37.83	40.55	2.35	4.42
Hainan	83.92	36.37	36.05	2.41	9.09
Qinghai	46.09	22.99	16.57	1.55	4.97
Tibet	12.76	9.01	1.09	1.47	1.18
Group and Head Office Level	96.07	94.62	0.13	1.17	0.16

Note: Data of "Group and Head Office Level" refers to the premium income earned by the group and head office, which is not reflected in any regions' data.

Source: The CIRC.

Table 24 Transactions of Payment Systems

(10 thousand transactions/RMB 100 million yuan)

Items/Year	2010		2011		2012		2013		2014	
	Number	Value	Number	Value	Number	Value	Number	Value	Number	Value
HVPS	29 121.66	11 043 680.19	37 211.44	3 552 814.97	47 035.96	7 719 972.13	59 548.66	20 607 617.10	71 256.49	23 468 933.87
BEPS	38 672.84	162 124.36	56 304.92	183 614.11	75 393.50	185 477.54	104 027.48	203 154.11	143 580.15	220 751.23
IBPS					26 580.35	35 630.14	71 784.34	94 684.65	163 914.52	177 893.21
ACH	44 957.39	731 904.25	41 803.08	709 484.72	39 135.21	665 182.46	41 871.79	682 892.87	38 381.54	632 193.30
CDFCPS	54.48	9 506.38	76.24	17 103.76	111.05	33 614.79	139.44	44 294.86	191.13	52 809.80
Intra-bank Payment Systems of Banking Institutions	524 460.31	4 580 717.89	729 076.77	5 305 821.12	895 492.15	6 245 593.61	1 075 915.50	7 452 224.44	1 431 813.80	8 962 797.55
UnionPay Bankcard Interbank Clearing System	845 329.81	112 267.74	1 038 147.93	159 285.29	1 248 897.88	217 631.82	1 513 946.08	322 972.28	1 867 366.07	411 097.10

Note: HVPS(High-value Payment System), BEPS(Bulk Electronic Payment System), IBPS(Internet Banking Payment System), ACH(Automated Clearing Houses), CDFCPS(China Domestic Foreign Currency Payment System).

Source: The PBC.

责任编辑：董　飞
责任校对：刘　明
责任印制：裴　刚

图书在版编目（CIP）数据

中国金融稳定报告（Zhongguo Jinrong Wending Baogao）2015：英文/中国人民银行金融稳定分析小组编. —北京：中国金融出版社，2015.7
ISBN 978－7－5049－8073－1

Ⅰ.①中…　Ⅱ.①中…　Ⅲ.①金融市场—研究报告—中国—2015—英文　Ⅳ.①F832.5

中国版本图书馆CIP数据核字（2015）第179104号

出版发行　中国金融出版社
社址　北京市丰台区益泽路2号
市场开发部　（010）63266347，63805472，63439533（传真）
网 上 书 店　http://www.chinafph.com
（010）63286832，63365686（传真）
读者服务部　（010）66070833，62568380
邮编　100071
经销　新华书店
印刷　北京市松源印刷有限公司
尺寸　210毫米×285毫米
印张　16
字数　360千
版次　2015年7月第1版
印次　2015年7月第1次印刷
定价　228.00元
ISBN 978－7－5049－8073－1/F. 7633