



# China Bond Market Risk Management

September 2011, New York

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

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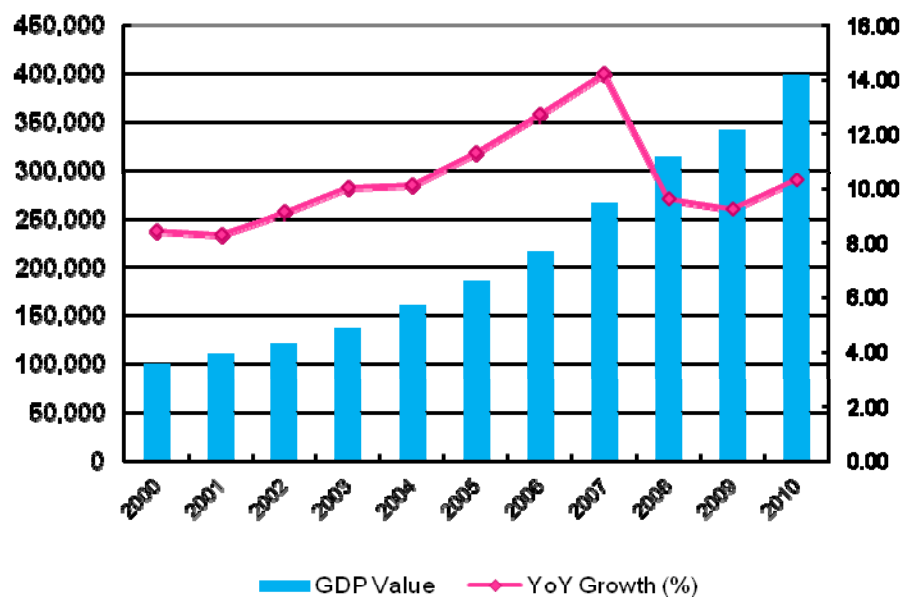
## ◀ Sound and Rapid Development of China Bond Market

- Review of China Bond Market Development
- Bond Issuers
- Bond Investors

## 1.1.1 Rapid Growth of China Economy

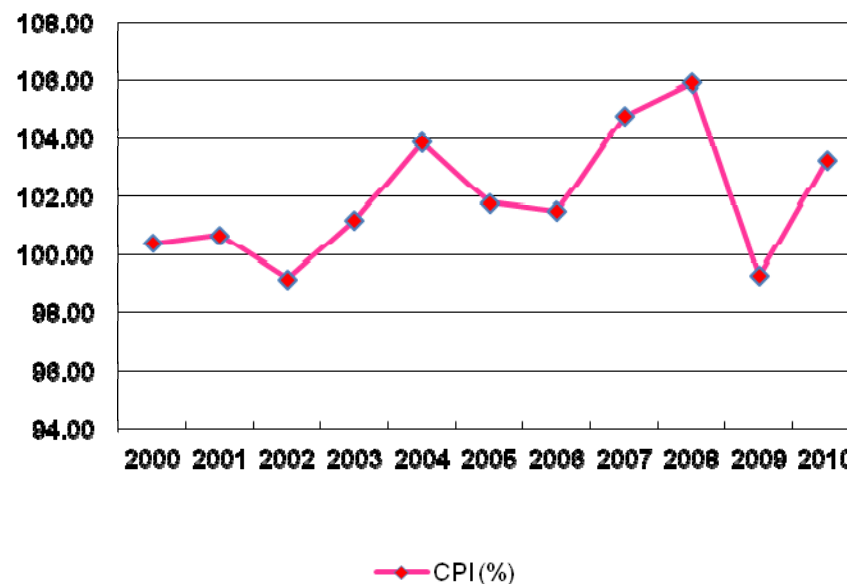
### GDP Growth during 2000 –2010

Unit : 100 Million RMB



### CPI during 2000 - 2010

Unit : Percentage Point



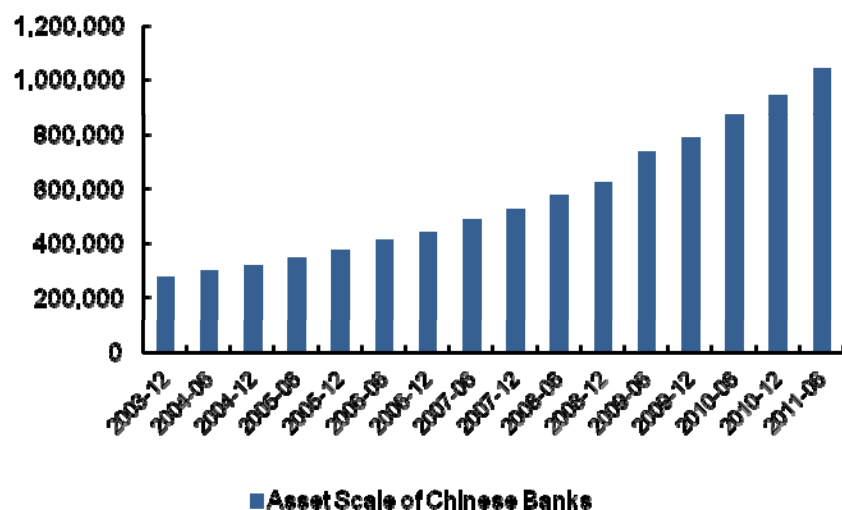
\* Source: Wind Information Co., Ltd.

**Rapid GDP growth during 2000-2010 whilst a low inflation rate is maintained.**

## 1.1.2 Improved Risk Management of China's Banking System

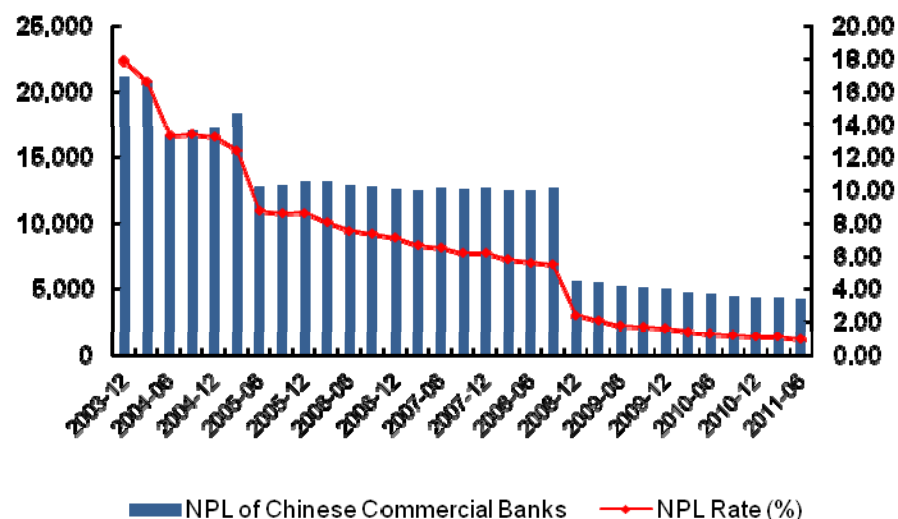
### Assets Volume of Major Chinese Banks

Unit: 100 Million RMB



### NPL Volume and NPL Rate

Unit: 100 Million RMB



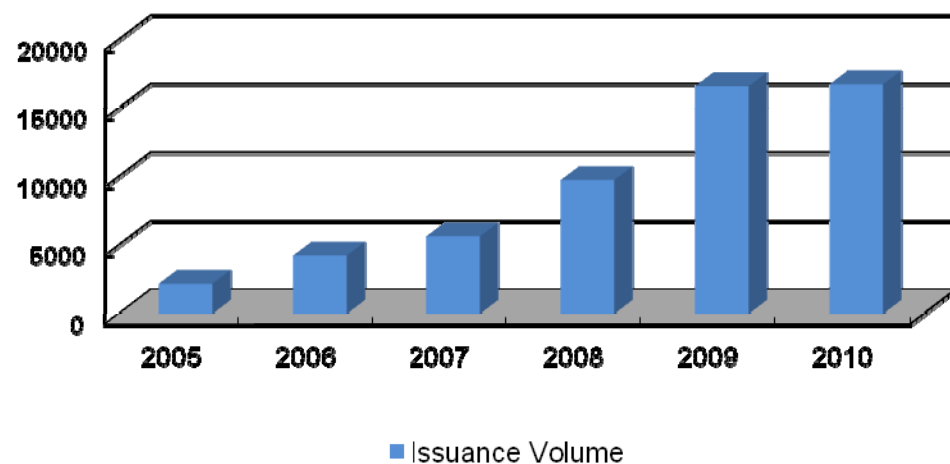
\* Source: Wind Information Co., Ltd.

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

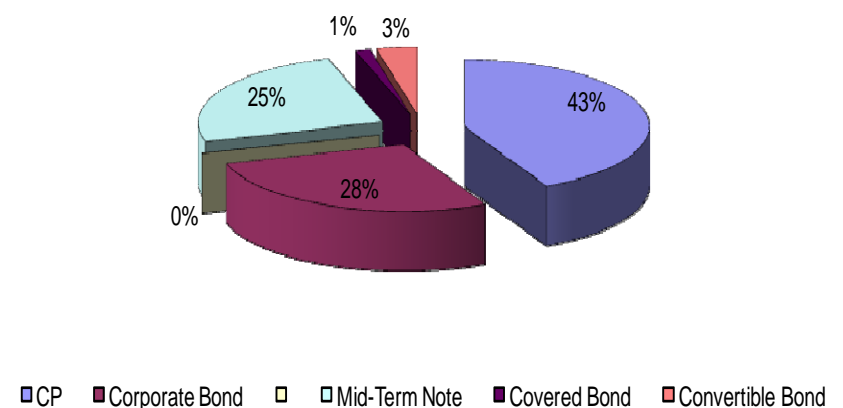
## 1.1.3 Rapid Growth of Chinese Bond Market

Overall Bond Issuance Volume during 2005-2010

Unit: 100 Million RMB



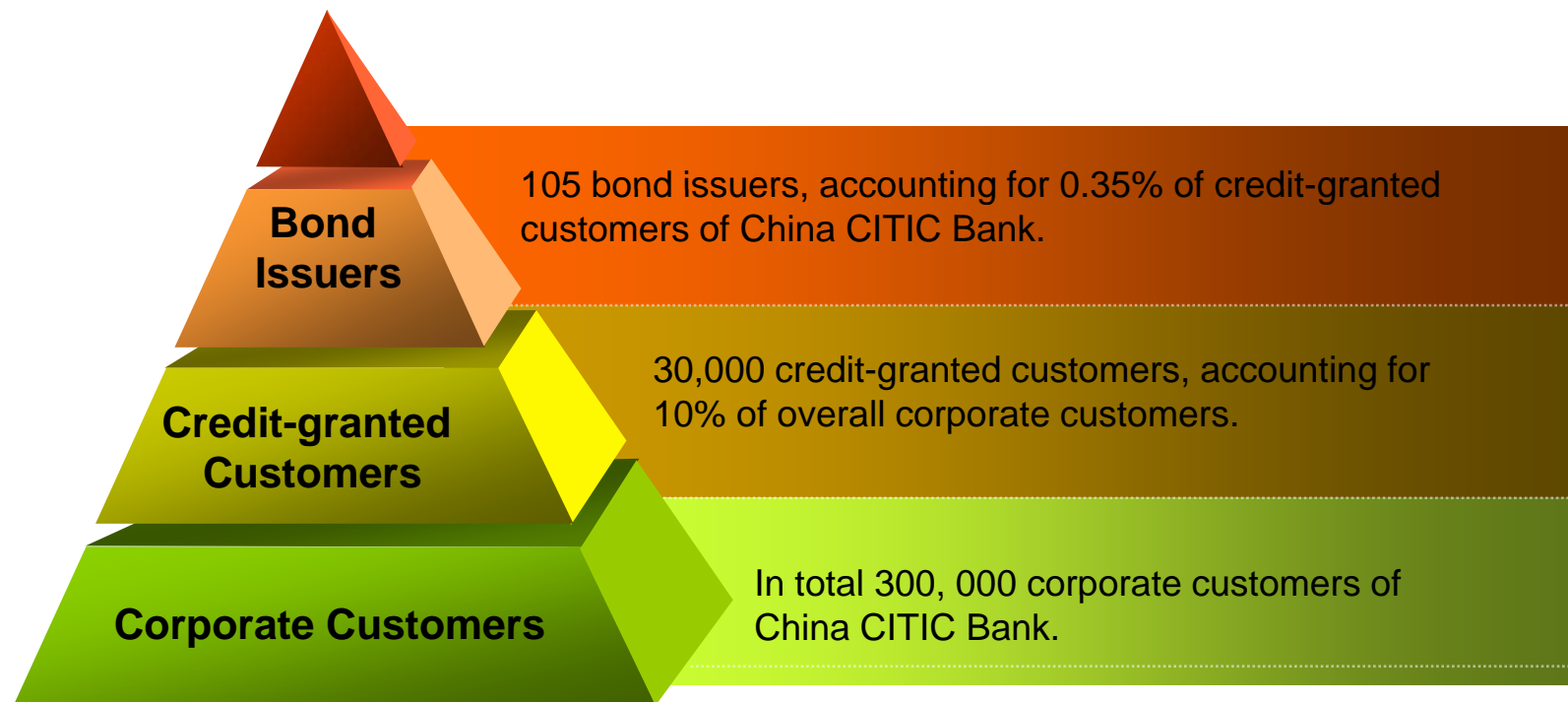
Bond Issuance Structure



\* Source: Wind Information Co., Ltd.

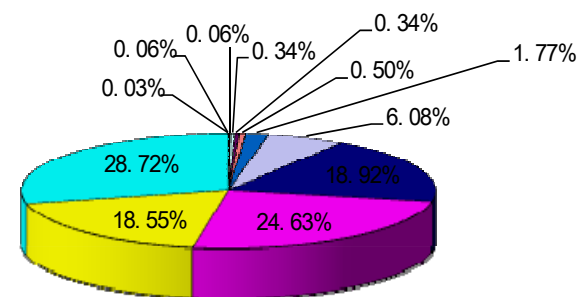
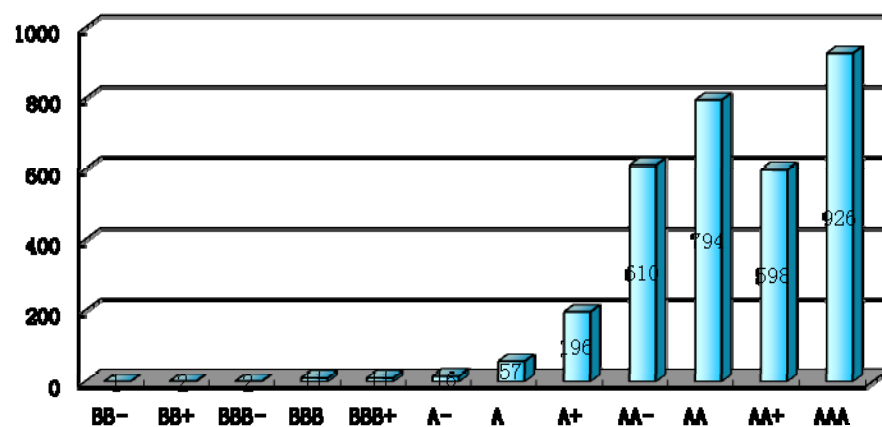
**2010 issuance volume amounted to USD253mn and achieved CAGR of 50.23% during 2005 to 2010. 67% of overall issuance were contributed by debt financing instruments.**

## 1.2.1 Bond Issuers : Core Clients of Banks (Take China CITIC Bank's Data For Example)



## 1.2.2 Bond Issuers

### Credit Ratings of the Issuers



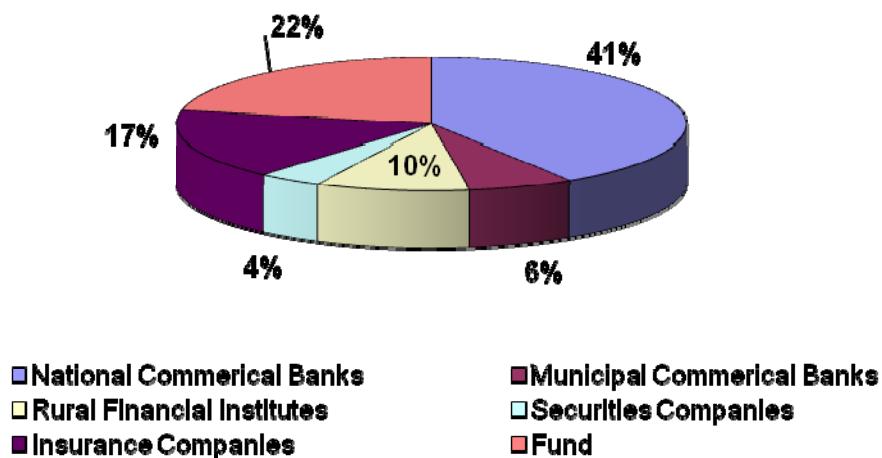
■ BB- ■ BB+ ■ BBB- ■ BBB ■ BBB+ ■ A- ■ A ■ A+ ■ AA- ■ AA ■ AA+ ■ AAA

Source: [www.ChinaBond.com.cn](http://www.ChinaBond.com.cn)

**90.82% of bond issuers being rated above AA-.**

## 1.3.1 Bond Investors

Structure of Bond Investors



Source: [www.ChinaBond.com.cn](http://www.ChinaBond.com.cn)

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

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

## 1.3.2 Bond Investors

**Investment  
Strategy**



**Explore Alternative to Bank Loans**



**Increase Proportion of Quality Credit Assets**



**Improve Assets Liquidity**



**Upgrade Service Level to High End Customers**

## ◀ 2. Challenges of China Bond Market

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

## 2.1 Challenges– Macro Economy

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### Challenges

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

### Mitigants

- Economy Structure Adjustment during the 12<sup>th</sup> Five-year Plan
- Economy Growth Driven by Consumption
- Lower Risk of Economy Hard-Landing

## 2.2 Challenges–Local Governmental Financing Platform (LGIV)’s Bond

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### Challenges

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

### Mitigants

- Less than 7% of LGIV Companies Ever Issued Bonds
- Priority of Repayment for Bonds
- Enhanced Collaterals
- Strong Support from the Local Government
- Low Possibility of Large-Scale Breach of Contract

## 2.3 Challenges– Over-Capacity Industries

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### Challenges

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

### Mitigants

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

## 2.4 Challenges – Investor Structure

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### Challenges

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

### Mitigants

- Permission for Bond Trade and Arbitrage
- Non-Bank Financial Institution (NBFI) and Private Equity (PE) as bond investors
- Admittance of Overseas Investors
- Foreign banks licensed for bond underwriting

## 2.5 Challenges– Credit Rating System

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### Challenges

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

### Mitigants

- Cooperation with Moody's, S&P and Fitch
- Enhanced Independence and Precision of Credit Rating
- Charge-on-Investor Rating Services

## 2.6 Challenges– Risk Allocation Channels

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### Challenges

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

### Mitigants

- Rapid Growth of Financial Market
- Establishment of *China Bond Insurance Co., Ltd.*
- Introduction of Credit Risk Mitigation Instruments

## ◀ 3. Ongoing Development of China Bond Market System

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

## 3.1 Legislation & Regulation

### National People's Congress

《Bank Law》、《Commercial Bank Law》、《Company Law》、《Securities Law》, etc.

### State Council

《Regulations on Enterprises Bond》 and related regulations

### PBOC

《Administrative Regulation of Non-Financial Company's Financing Tools》、《Administrative Regulation on Bond Trading》、《Administrative Regulation on Register of Bond and Settlement》, etc.

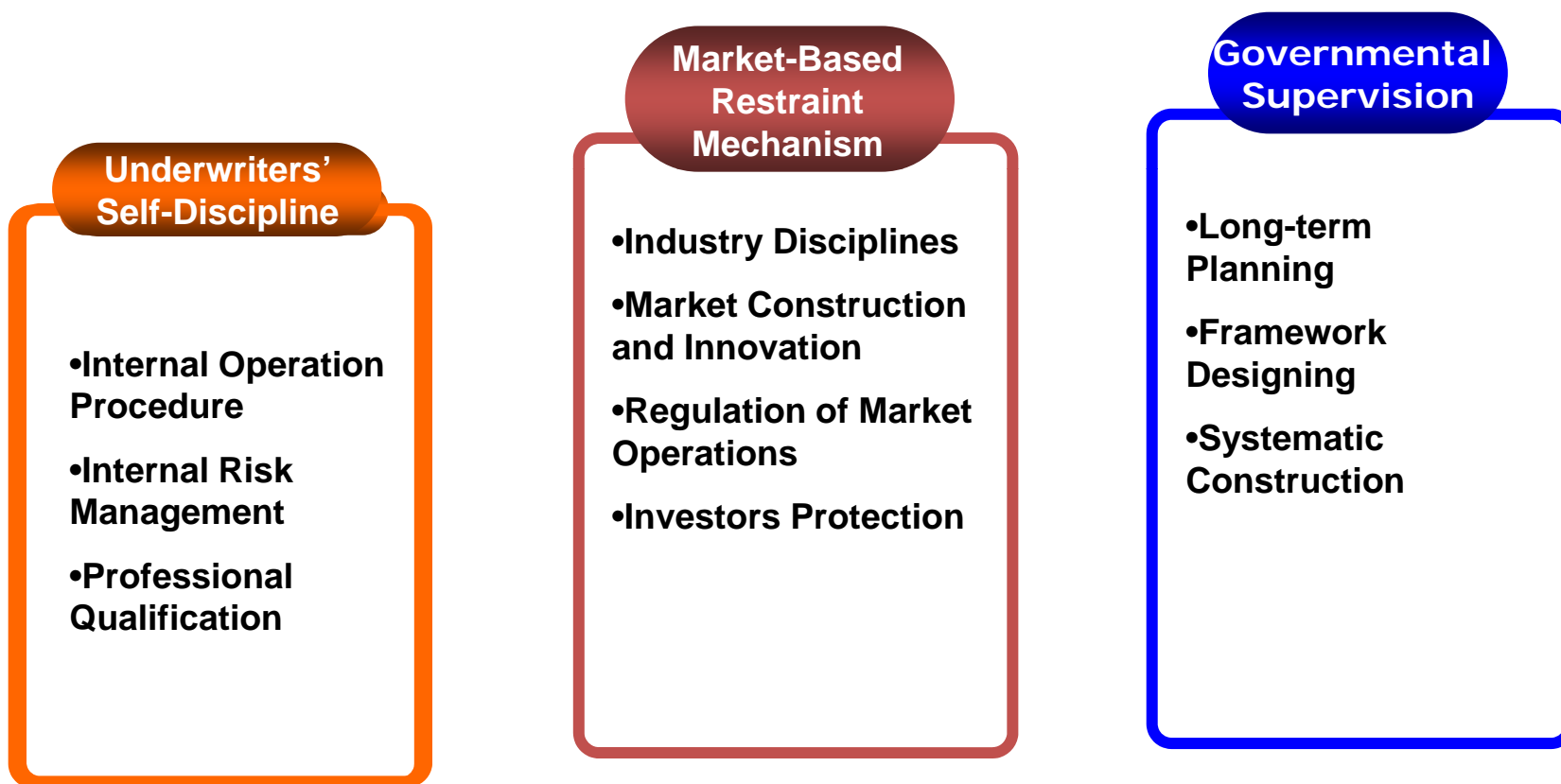
### Nafmii

7 Guidance, 3 Rules, 2 Standard Agreements and 1 Rule of Conduct

## 3.2 Self-Discipline

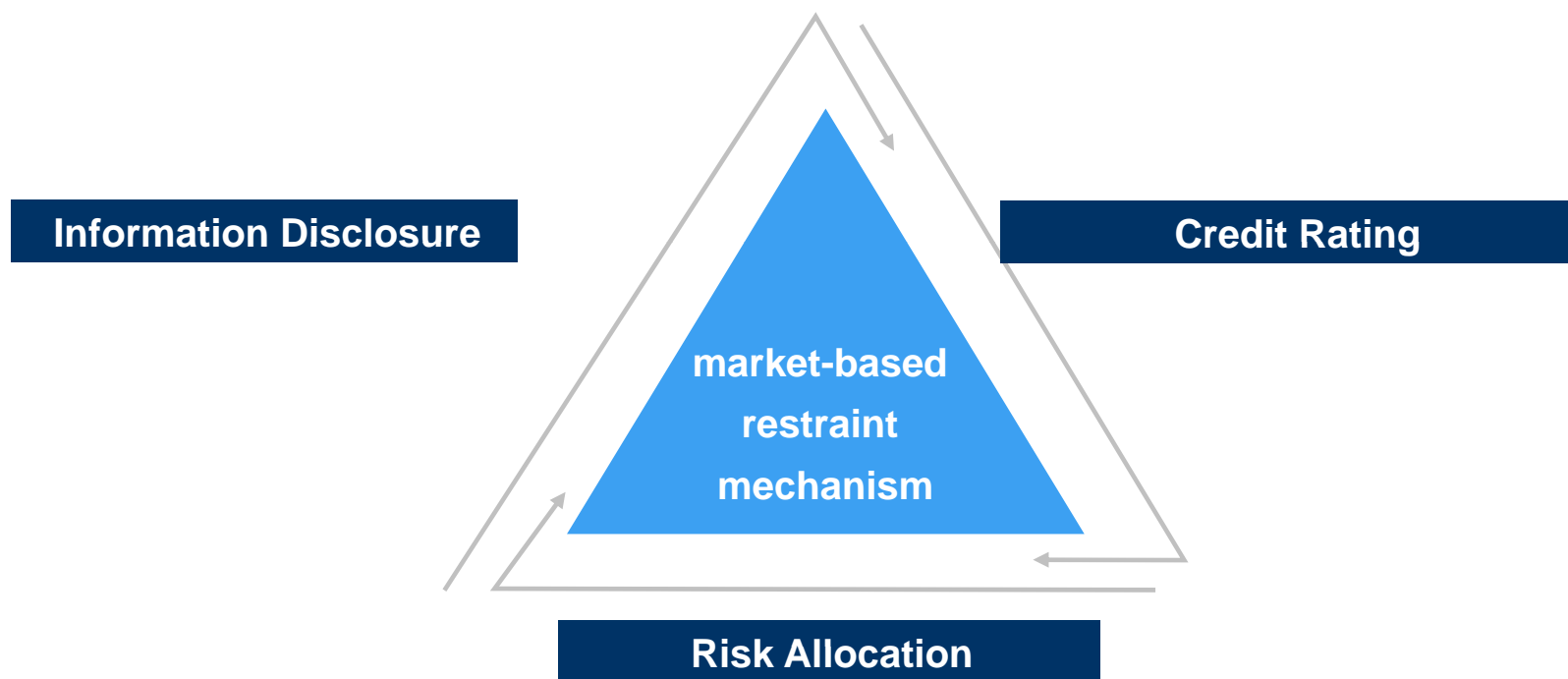
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### Dimensional Self-Discipline System



### 3.3 Market-based Restraint Mechanism

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### 3.3.1 Information Disclosure



### 3.3.2 Credit Rating System

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- PBOC Regulations related to Rating Agencies:
  - 《Guidance on Credit Rating》
  - 《Notice on Enhancing Inter-bank Bond Market Credit Rating》
  - 《Standard of Credit Rating for Lending and Inter-bank Bond Market》
- National Association of Financial Market Institutional Investors (NAFMII) and NAFMII Professional Committee of Credit Rating (established in October 2010).
- Charge-on-investors mode adopted by China Credit Rating Co., Ltd. (*established in September 2010*).

### 3.3.3 Risk Allocation

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- Establishment of China Bond Insurance Co., Ltd. in October 2009.
- Introduction of Credit Risk Mitigation Instruments for Inter-bank Market in October 2010.

## 3.4 Investor Protection

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- NAFMII Guidance on Post-registration Administration in April 2010.
- NAFMII Guidance on Procedures for Bond-holder's Meeting in September 2010.

### 3.5 Bond Market Infrastructure Construction

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- Establishment of Shanghai Exchange House for Netting Settlement Services, Management of Registration, Custody and Settlement of Bonds.
- New PRC GAAP's Integration with IAS, Memorandum between China Account Standard Committee and IASB in January 2008 to Enhance the Cooperation.

*To Strengthen the Cooperation  
with SIFMA.*

