

## BANKING INDUSTRY IN THE PRC

*This section contains information and statistics on the industry in which our Group operates. We have extracted and derived such information and statistics, in part, from various official or publicly available sources. We believe that the sources of this information are appropriate sources for such information and have taken reasonable care in extracting and reproducing such information. We have no reason to believe that such information is false or misleading or that any fact has been omitted that would render such information false or misleading. The information has not been independently verified by us, the Joint Sponsors, the Underwriters or any other party involved in the Global Offering and no representation is given as to its accuracy. In addition, certain financial data contained in this section, including data relating to our Group, have been compiled in accordance with PRC GAAP, and differ from financial data of our Group presented elsewhere in this prospectus. We believe that the use of such financial data is appropriate for the section below and have taken reasonable care in including such information.*

### OVERVIEW

China's economy has grown significantly over the past three decades largely as a result of the PRC government's extensive economic reforms. At the outset, these reforms focused on transforming China from a centrally planned economy to a more market-based economy. More recently, particularly following China's accession to the WTO in 2001, such economic reforms have also aimed, among other things, to enhance the competitiveness of Chinese enterprises. As a consequence of these reforms, China's nominal GDP grew at a CAGR of 16.5% between 2002 and 2008, according to the National Bureau of Statistics of China, and, as of December 31, 2008, China was the third largest economy in the world, with a GDP of RMB30,067.0 billion in 2008. Despite the adverse effects of the global financial crisis, the Chinese economy has remained relatively stable in 2009. China's real GDP grew at a 7.7% annual rate over the first nine months of 2009. The following table sets forth China's GDP and total import and export volume and the respective CAGR from 2002 to 2008.

	As of and for the year ended December 31,							CAGR (2002-2008)
	2002	2003	2004	2005	2006	2007	2008	
GDP (RMB billions) <sup>(1)</sup> . . . . .	12,033.3	13,582.3	15,987.8	18,321.8	21,192.4	25,730.6	30,067.0	16.5%
GDP per capita (in RMB) . . . . .	9,398	10,542	12,336	14,053	16,165	19,524	22,698	15.8%
Total import and export (US\$ billions) . . . . .	620.8	851.0	1,154.6	1,421.9	1,760.4	2,173.7	2,561.6	26.6%

Source: National Bureau of Statistics of China.

(1) Based on current prices.

As an important component of the country's overall economic system, the Chinese financial system has also grown rapidly. According to the National Bureau of Statistics of China, M2 money supply of China grew at a CAGR of 16.9% from December 31, 2004 to December 31, 2008. The following table sets forth China's M2 money supply and its CAGR as of the dates indicated.

	As of December 31,					CAGR (2004-2008)
	2004	2005	2006	2007	2008	
M2 money supply . . . . .	25,410.7	29,875.6	34,560.4	40,344.2	47,516.7	16.9%

(in billions of RMB, except percentages)

Source: National Bureau of Statistics of China and PBOC.

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China's banking industry has experienced rapid growth, consistent with the economic development of the Chinese financial system. Banks have historically been, and are likely to remain, the principal providers of capital for enterprises and the primary choice for domestic savings in China. According to information published by the PBOC, bank loans accounted for 83.1% of total financing by non-financial institutions in 2008 with the remaining 16.9% raised through bond and equity issuances.

Total RMB-denominated loans and RMB-denominated deposits of China's banking industry have increased at a CAGR of 14.2% and 17.9%, respectively, from December 31, 2004 to December 31, 2008. The following table sets forth total RMB-denominated loans, total RMB-denominated deposits, and the respective CAGR of banking institutions in China as of the dates indicated.

	As of December 31,					CAGR (2004-2008)
	2004	2005	2006	2007	2008	
	(in billions of RMB, except percentages)					
Total RMB-denominated loans . . .	17,819.8	19,469.0	22,534.7	26,169.1	30,339.5	14.2%
Total RMB-denominated deposits . . . . .	24,142.4	28,716.3	33,546.0	38,937.1	46,620.3	17.9%

Source: National Bureau of Statistics of China.

China's eastern coastal areas, which consist of the Yangtze River Delta, the Bohai Rim and the Pearl River Delta, have historically been a focus of the PRC government's economic development policies and account for a relatively higher percentage of China's GDP. According to the China Statistical Abstract 2009, eastern coastal areas accounted for 54.3% of the total GDP of the PRC in 2008, with a combined GDP of RMB17,580 billion. Residents of these areas tend to be more affluent than those in the rest of the country as evidenced by a higher GDP per capita of RMB37,213 in 2008, compared to the national average of RMB22,698. In light of the faster growth in income levels and corporate activities in the eastern coastal areas, the banking industry in such areas is also more developed in comparison with that in other parts of China. According to the PBOC, deposits and loans of banking institutions in the eastern coastal areas accounted for 60.3% and 61.3%, respectively, of total deposits and loans in the PRC in 2008.

Since the second half of 2008, global capital markets have experienced tremendous fluctuation as a result of the financial turmoil originating from the United States sub-prime mortgage crisis. This financial upheaval has brought about a worldwide economic downturn. Economists and other observers remain uncertain as to when a general recovery will take place. In response to the economic crisis, many governments around the world have adopted recovery programs. China was somewhat less affected by the crisis as compared to many of the world's other major economies in part due to its highly regulated financial and banking system. Nonetheless, the PRC government has implemented a series of measures to mitigate the impact of the financial crisis. This includes a four-trillion Renminbi fiscal stimulus program to stimulate domestic demand, of which a major component is public infrastructure spending. To implement China's pro-growth policies, the PBOC decreased interest rate by five instances in less than three months following the outbreak of the global financial crisis. One-year benchmark interest rate for RMB loans was slashed by an aggregate of 216 basis points to 5.31% and remained unchanged since December 23, 2008. In addition, the PBOC decreased the required reserve ratio a total of four instances in the second half of 2008 to improve liquidity of the market.

In addition, the CBRC has promulgated a series of measures to encourage banking institutions to implement the PRC government's macroeconomic policies, and, in particular, to support healthy economic growth by increasing lending activities on the precondition of effective risk control. See "— Industry Trends — Enhanced Regulation and Supervision." New RMB loans made in China in the first nine months of 2009 soared to RMB8,701.3 billion, which was about 2.5 times of the total value of new RMB loans made in the first nine months of 2008.

## HISTORY AND DEVELOPMENT OF CHINA'S BANKING SECTOR

Between 1949 and 1970, the PRC's banking industry operated primarily as a centrally controlled system in which the PBOC served as China's central bank as well as the primary deposit taking and lending institution. Since the late 1970s, the banking industry underwent a significant transformation as many of the PBOC's commercial banking functions were separated from its central bank function. Some of the Large Commercial Banks, namely Bank of China, Industrial and Commercial Bank of China, China Construction Bank and Agricultural Bank of China, assumed the role of state-operated specialized banks, while the PBOC remained China's central bank and the principal regulator of the Chinese banking system.

In the late 1980s, new commercial banks and non-bank financial institutions were established. Some of these commercial banks, known as the Other Joint Stock Commercial Banks, were permitted to offer nationwide commercial banking services, while others were permitted to operate generally only in local markets. Since the mid-1990s, the PRC government has taken a series of measures to reform the commercial banking sector, including the establishment of three policy banks in 1994 to undertake most policy lending functions. In 2003, the CBRC was established to serve as the primary banking industry regulator and assumed the majority of regulatory functions from the PBOC.

China's banking industry has historically been burdened with large portfolios of non-performing loans. From 1998 to 2003, the PRC government undertook numerous initiatives to improve asset quality and strengthen the capital base of the Large Commercial Banks by the issuance of special government bonds, acquisition of non-performing loans and equity injections. Further, in 2008, the PRC government, through Central SAFE Investments Limited (also known as "*Huijin*"), contributed RMB130.0 billion as equity into Agriculture Bank of China after the latter's conversion into a joint stock limited liability company.

On the other hand, many Other Joint Stock Commercial Banks have relied on their own resources to improve asset quality and reduce non-performing loan ratios. Most of the Other Joint Stock Commercial Banks have not received government assistance and have raised asset quality through such measures as strengthening credit risk management and writing off or transferring non-performing loans. Furthermore, over the past decade, numerous PRC commercial banks have listed their shares on domestic or overseas stock markets to strengthen their capital base and have adopted international best management practices, which in turn have contributed to an improvement in asset quality. For instance, as the first and largest nationwide joint stock commercial bank in the PRC primarily founded by non-stated-owned enterprises, we listed our shares on the Shanghai Stock Exchange in December 2000. See "*— Industry Trends — Listing of China's Commercial Banks.*"

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### CURRENT COMPETITIVE LANDSCAPE

China's banking institutions are generally divided into seven broad categories: the Large Commercial Banks, the Other Joint Stock Commercial Banks, city commercial banks, rural cooperative financial institutions, urban credit cooperatives, foreign-invested banks and other banking institutions. The following table sets forth, as of December 31, 2008, certain information relating to the total assets, loans, deposits and the number of outlets of each category.

	As of December 31, 2008						
	Total assets		Total loans <sup>(4)</sup>		Total deposits		Number of outlets
	Total amount	Market share	Total amount	Market share	Total amount	Market share	
	(in billions of RMB, except number of institutions and percentages)						
Large Commercial Banks . . .	33,961.6	52.5%	16,090.8	48.5%	27,664.6	58.2%	5
Other Joint Stock Commercial Banks . . . . .	9,045.9	14.0%	4,961.4	15.0%	6,641.5	14.0%	12
City commercial banks . . . . .	4,132.0	6.4%	2,079.8	6.3%	3,316.5	7.0%	136
Rural cooperative financial institutions <sup>(1)</sup> . . . . .	7,143.6	11.0%	3,726.9	11.2%	5,642.6	11.9%	5,150
Urban credit cooperatives . .	80.4	0.1%	43.5	0.1%	76.2	0.2%	22
Foreign-invested banks <sup>(2)</sup> . . .	1,344.8	2.1%	728.6	2.2%	562.8	1.2%	311
Other banking institutions <sup>(3)</sup> . . . . .	<u>9,041.9</u>	<u>13.9%</u>	<u>5,546.0</u>	<u>16.7%</u>	<u>3,666.4</u>	<u>7.5%</u>	<u>277</u>
<b>Total . . . . .</b>	<b><u>64,750.2</u></b>	<b><u>100%</u></b>	<b><u>33,177.0</u></b>	<b><u>100%</u></b>	<b><u>47,570.6</u></b>	<b><u>100%</u></b>	<b><u>5,913</u></b>

Sources: PBOC, CBRC and annual reports of relevant banks.

- (1) Consist of rural cooperative banks, rural commercial banks and rural credit cooperatives.
- (2) Consist of head offices, branches and subsidiaries of locally incorporated foreign banks and foreign bank branches.
- (3) Consist of policy banks, the Postal Savings Bank of China and other non-bank financial institutions including asset management companies, finance companies, trust and investment companies, financial leasing companies, money brokerage firms, auto financing companies, village or township banks, lending companies and rural mutual credit cooperatives. Data of the total loans and total deposits consist of data relating to the policy banks, the Postal Savings Bank of China, finance companies, trust and investment companies and financial leasing companies.
- (4) Amounts shown are before allowance for impairment losses.

### Large Commercial Banks

The Large Commercial Banks play a major role in China's banking market. All of them have undergone restructuring to become joint stock companies. Bank of Communications, China Construction Bank, Bank of China, and Industrial and Commercial Bank of China are listed on both the Hong Kong Stock Exchange and the Shanghai Stock Exchange. As of December 31, 2008, the total assets and the total loans of the Large Commercial Banks represented 52.5% and 48.5% of the total assets and the total loans of banking institutions in China, respectively.

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The following table sets forth, as of December 31, 2008, total assets, loans, deposits and the number of outlets of each of the Large Commercial Banks.

	As of December 31, 2008						Number of outlets
	Total assets		Total loans <sup>(2)</sup>		Total deposits		
	Amount	% of total	Amount	% of total	Amount	% of total	
(in billions of RMB, except percentages and number of outlets)							
Industrial and Commercial							
Bank of China <sup>(1)</sup> . . . . .	9,757.1	28.7%	4,572.0	28.3%	8,223.4	29.7%	16,386
China Construction Bank <sup>(1)</sup> . . . . .	7,555.5	22.2%	3,793.9	23.6%	6,375.9	23.0%	13,383
Agricultural Bank of China . . . . .	7,014.4	20.7%	3,100.2	19.3%	6,097.4	22.0%	24,064
Bank of China <sup>(1)</sup> . . . . .	6,951.7	20.5%	3,296.1	20.5%	5,102.1	18.5%	10,789
Bank of Communications <sup>(1)</sup> . . . . .	2,682.9	7.9%	1,328.6	8.3%	1,865.8	6.8%	2,749
<b>Total</b> . . . . .	<b><u>33,961.6</u></b>	<b><u>100%</u></b>	<b><u>16,090.8</u></b>	<b><u>100%</u></b>	<b><u>27,664.6</u></b>	<b><u>100%</u></b>	<b><u>67,371</u></b>

Sources: Relevant banks' annual reports.

(1) Listed on the Hong Kong Stock Exchange and the Shanghai Stock Exchange.

(2) Amounts shown are before allowance for impairment losses.

### Other Joint Stock Commercial Banks

As at the date of this prospectus, there were 12 Other Joint Stock Commercial Banks in China. These Other Joint Stock Commercial Banks are licensed to engage in commercial banking activities nationwide and have played an increasingly important role in China's banking industry. See "— Industry Trends — Increasing Role of Other Joint Stock Commercial Banks in China's Banking Industry." Established predominantly in the late 1980's and early 1990's, the Other Joint Stock Commercial Banks have gradually increased their collective market share while the market share of the Large Commercial Banks has gradually decreased. The total assets of the Other Joint Stock Commercial Banks represented 14.0% of the total assets of banking institutions in China as of December 31, 2008, compared to 11.6% as of December 31, 2005. As of December 31, 2008, total loans of China Minsheng Bank accounted for 13.3% and 2.0% of the total loans of the Other Joint Stock Commercial Banks and banking institutions respectively.

The following table sets forth, as of December 31, 2008, the total assets, loans, deposits, and the number of outlets of the Other Joint Stock Commercial Banks.

	As of December 31, 2008						Number of outlets
	Total assets		Total loans <sup>(4)</sup>		Total deposits		
	Amount	Ranking	Amount	Ranking	Amount	Ranking	
(in billions of RMB, except number of outlets)							
China Merchants Bank <sup>(1)(2)</sup> . . . . .	1,571.8	1	874.4	1	1,250.6	1	674
Shanghai Pudong Development Bank <sup>(2)</sup> . . . . .	1,309.4	2	697.6	2	947.3	2	491
China CITIC Bank <sup>(1)(2)</sup> . . . . .	1,188.2	3	664.9	3	945.8	3	544
China Minsheng Bank <sup>(2)</sup> . . . . .	1,054.4	4	658.4	4	785.8	4	374
Industrial Bank <sup>(2)</sup> . . . . .	1,020.9	5	499.4	5	632.4	5	441
China Everbright Bank . . . . .	851.8	6	464.6	6	605.2	6	457
Huaxia Bank <sup>(2)</sup> . . . . .	731.6	7	355.5	7	485.3	7	313
Guangdong Development Bank . . . . .	546.4	8	311.0	8	420.4	8	511
Shenzhen Development Bank <sup>(3)</sup> . . . . .	474.4	9	283.7	9	360.5	9	282
Evergrowing Bank . . . . .	151.0	10	65.8	10	88.1	10	N/A
China Zheshang Bank . . . . .	83.8	11	51.4	11	71.5	11	31
China Bohai Bank . . . . .	62.2	12	34.7	12	48.6	12	24
<b>Total</b> . . . . .	<b><u>9,045.9</u></b>		<b><u>4,961.4</u></b>		<b><u>6,641.5</u></b>		<b><u>4,142</u></b>

Sources: Relevant banks' annual reports and websites. Data related to our Group are derived from audited consolidated financial statements included in the Accountant's Report in Appendix I prepared in accordance with IFRS.

(1) Listed on the Hong Kong Stock Exchange.

(2) Listed on the Shanghai Stock Exchange.

- (3) Listed on the Shenzhen Stock Exchange.
- (4) Amounts shown are before allowance for impairment losses, except for Guangdong Development Bank of which only net loans balance is reported.

### **City Commercial Banks**

City commercial banks are permitted to engage in commercial banking activities, primarily within specific geographic areas. Some city commercial banks have undergone restructuring, introduced strategic investors and sought initial public offerings in recent years to further enhance capitalization and increase management capabilities. Bank of Nanjing and Bank of Beijing completed their listing on the Shanghai Stock Exchange in July 2007 and September 2007 respectively while Bank of Ningbo also completed its listing on the Shenzhen Stock Exchange in July 2007. As of December 31, 2008, the total assets and the total loans of city commercial banks represented 6.4% and 6.3% of the total assets and the total loans of banking institutions in China, respectively.

### **Rural and Urban Cooperative Institutions**

Rural and urban cooperative institutions include rural commercial banks, rural cooperative banks, rural credit cooperatives and urban credit cooperatives. They provide a limited range of banking products and services, including personal deposit, lending and settlement services, to small enterprises and local residents in rural and urban areas, respectively. Due to the rapid growth of other banking institutions in the urban areas, in particular the establishment of city commercial banks, the total assets of urban credit cooperatives as a percentage of the total assets of banking institutions in China have declined in recent years. As of December 31, 2008, the total assets of rural credit cooperative financial institutions (including rural commercial banks, rural cooperative banks and rural credit cooperatives) and urban credit cooperatives represented 11.0% and 0.1%, respectively, of the total assets of banking institutions in China.

### **Foreign-Invested Banks**

Foreign-invested banks include head offices, branches and subsidiaries of locally incorporated foreign banks and foreign bank branches. As with other types of banking institutions in China, foreign-invested banks are subject to the supervision of and regulation by the CBRC. See "Supervision and Regulation — PRC Banking Supervision and Regulation — Regulation of Foreign-invested Banks in the PRC." Pursuant to its WTO accession commitments, China has progressively opened RMB-denominated banking activities to foreign-invested banks. Effective from December 11, 2006, all restrictions on the geographic presence, customer base and operational licenses of foreign-invested banks have been lifted although some other restrictions continue to exist. As a result, there has been an increase in investments by foreign investors in Chinese commercial banks which has helped to strengthen the capital base of Chinese commercial banks in the past few years. By the end of 2008, 196 banks from 46 countries and regions had set up 237 representative offices in China, while 28 foreign-owned banks have incorporated in China. The total assets and the total loans from these banking institutions represented 2.1% and 2.2% of the total assets and the total loans of banking institutions in China.

### **Other Banking Institutions**

Other banking institutions include policy banks (i.e., PRC government-established banks focusing on policy lending, such as the China Development Bank, the China Export and Import Bank and the Agriculture Development Bank of China), the Postal Savings Bank of China and other non-bank financial institutions including asset management companies, finance companies, trust and investment companies, financial leasing companies, money brokerage firms, automobile finance companies, village or township banks, lending companies and rural mutual credit

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cooperatives. As of December 31, 2008, other banking institutions represented 13.9% of the total assets and 16.7% of the total loans of banking institutions in China.

### INDUSTRY TRENDS

#### Increasing Role of Other Joint Stock Commercial Banks in China's Banking Industry

While the Large Commercial Banks have historically dominated the banking industry in China, their market share has declined over the past few years. The aggregate market share of the Other Joint Stock Commercial Banks has increased from 11.6% in 2005 to 14.0% in 2008 in terms of total assets. Other Joint Stock Commercial Banks generally focus their operations on the relatively more economically developed regions of China and have gained market share by providing innovative products and high-quality customer service. Moreover, as compared with most other regional banking institutions, the Other Joint Stock Commercial Banks enjoy certain competitive advantages such as a national distribution network, a larger capital base, access to more resources, more diverse product and service offerings and more advanced information technology infrastructure.

The following table sets forth the respective market share based on the total assets of each category of China's banking institutions as of the dates indicated.

	As of December 31,		
	2006	2007	2008
Large Commercial Banks . . . . .	56.3%	53.8%	52.5%
Other Joint Stock Commercial Banks . . . . .	12.1%	13.7%	14.0%
City commercial banks . . . . .	5.8%	6.3%	6.4%
Rural cooperative institutions . . . . .	9.8%	10.5%	11.0%
Urban credit cooperatives . . . . .	0.4%	0.2%	0.1%
Foreign-invested banks . . . . .	2.1%	2.3%	2.1%
Other banking institutions . . . . .	13.5%	13.2%	13.9%
<b>Total</b> . . . . .	<b>100%</b>	<b>100%</b>	<b>100%</b>

Source: PBOC, CBRC and annual reports of relevant banks.

Generally, Other Joint Stock Commercial Banks have higher asset quality compared to the Large Commercial Banks due to their relatively smaller exposure to policy lending and have fewer legacy non-performing loans given their shorter operating history. As compared to the city commercial banks and rural cooperatives financial institutions, the Other Joint Stock Commercial Banks also generally have higher asset quality due to their lower geographic concentration. The non-performing loan ratios of the Other Joint Stock Commercial Banks have historically been lower than other categories of banking institutions in the PRC. As of September 30, 2009, the non-performing loan ratios of Large Commercial Banks and Other Joint Stock Commercial Banks were 1.86% and 0.99% respectively.

#### Enhanced Regulation and Supervision

In recent years, the CBRC and other PRC regulatory authorities have promulgated a number of regulations in an effort to enhance supervision in the banking industry. Such measures include the following:

- *Improving corporate governance.* The CBRC has encouraged banks to establish a corporate governance structure that includes a board with independent directors, audit, compensation and other board committees, as well as a supervisory board. Additionally, banks have been instructed to create an independent internal audit function that is supported by clearly defined policies and procedures;

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- *Enhancing risk management.* The CBRC has promulgated a series of risk management guidelines and undertaken measures to more closely monitor and enforce the adoption and implementation of the five-category loan classification system and the risk rating system, compliance with due diligence requirements during the credit extension process, as well as enhanced management of market, liquidity, and operational risks in addition to credit risks by banking institutions;
- *Strengthening supervision over capital adequacy.* In March 2004, the CBRC implemented a set of new and more stringent capital adequacy guidelines which were based on Basel I and also took into consideration Basel II. Under these guidelines, all banks in China are required to comply with these new capital adequacy requirements as of January 1, 2007;
- *Enhancing supervision over information disclosure.* The CBRC has required commercial banks to enhance disclosure in their annual reports; and
- *Improving regulation of related-party transactions of commercial banks.* In April 2004, the CBRC promulgated guidelines on related-party transactions between a bank and its insiders or shareholders, in an attempt to control the risks represented by such transactions and to ensure the orderly operation of commercial banks.

In 2008, the CBRC undertook several regulatory measures in response to the global financial crisis, including the following:

- *Optimizing risk management for foreign currency assets.* Since August 2008, the CBRC has required banking institutions to closely monitor market changes by re-assessing losses generated through trading with high-risk international financial counterparties for each account and for each trade on a daily basis. The CBRC has also required banks to improve risk management over offshore correspondent banks and adjust their credit risk exposure to foreign currency bonds issuers. Banks are also required to adjust their portfolio structure of foreign currency bonds promptly;
- *Strengthening information disclosure.* The CBRC has required banking institutions to disclose to customers the performance of their QDII products and the impact of the global financial crisis on their operations and financial positions accurately and on a timely and ongoing basis; and
- *Implementing the PRC government's pro-growth policies.* The CBRC promulgated a series of measures including the Guidance of Risk Management on Merger and Acquisition Loans of Commercial Banks and the Guidance on Issues Relevant to Establishing Special Agencies for Small Business Lending by Banks to encourage banking institutions to implement the state's macroeconomic policies, and, in particular, to proactively support continued healthy economic growth by increasing lending activities while effectively controlling risk.

See "Supervision and Regulation — PRC Banking Supervision and Regulation" for more information regarding PRC regulations affecting banking institutions. PRC regulatory authorities are expected to continue to promulgate new regulations in an effort to enhance the risk management capabilities of China's commercial banks and to ensure the healthy development of the Chinese banking industry.



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### Improvement of Asset Quality

Since the late 1990s, the PRC government has taken various measures to improve the asset quality and strengthen the capital base of the Large Commercial Banks. See “— History and Development of China’s Banking Sector.” In an effort to enhance and standardize non-performing loan disclosure by banks and to allow regulators to better monitor banks’ asset quality in accordance with international practices, the CBRC formally implemented a five-category classification system in 2002. In addition, pursuant to the PRC government’s regulatory requirements, PRC commercial banks have adopted various measures designed to enhance risk management capabilities and improve asset quality. The following table sets forth certain information regarding non-performing loans in China’s banking industry as a whole, the Large Commercial Banks and Other Joint Stock Commercial Banks as of the dates indicated:

	<u>As of December 31, 2008</u>		<u>As of September 30, 2009</u>	
	<u>Amount</u>	<u>% total loans</u>	<u>Amount</u>	<u>% total loans</u>
	(in billions of RMB, except percentages)			
<b>Non-performing loans by categories</b>				
Substandard . . . . .	262.6	1.13%	214.1	0.70%
Doubtful . . . . .	240.7	1.04%	229.5	0.75%
Loss . . . . .	<u>57.0</u>	<u>0.25%</u>	<u>61.0</u>	<u>0.20%</u>
	<u>560.3</u>	<u>2.42%</u>	<u>504.6</u>	<u>1.66%</u>
<b>Non-performing loans by types of banks</b>				
Large Commercial Banks . . . . .	420.8	2.81%	364.2	1.86%
Other Joint Stock Commercial Banks . . . . .	65.7	1.35%	65.5	0.99%

Source: CBRC.

### Listing of China’s Commercial Banks

In an effort to accelerate the development of China’s banking industry, China’s commercial banks have increasingly sought to list their shares on domestic and overseas stock markets to enhance capitalization, increase internationalization and improve management capabilities. In June 2005, Bank of Communications became the first Chinese bank to conduct an initial public offering on the Hong Kong Stock Exchange, followed by China Construction Bank, Bank of China, China Merchants Bank, Industrial and Commercial Bank of China and China CITIC Bank.

### Bank Lending Remains the Most Important Source of Financing

The Chinese economy has historically relied on bank loans as the primary source of financing. Despite the development of domestic capital markets since the late 1980s and the emergence of other direct financing channels, commercial banks remain the principal providers of financing to businesses in China. On the other hand, direct financing channels (such as the issuance of bonds or commercial paper) have become an increasingly important source of financing for enterprises in the PRC. The following table sets forth the relative proportion of bonds issued, equity raised and bank loans by non-financial institutions in China between 2004 and 2008:

	<u>2004</u>	<u>2005</u>	<u>2006</u>	<u>2007</u>	<u>2008</u>
Bank loans . . . . .	82.9%	80.2%	82.0%	78.7%	83.1%
Corporate bonds . . . . .	1.1%	6.6%	5.7%	4.6%	9.1%
Equity . . . . .	5.2%	3.4%	5.6%	13.1%	6.1%
Government bonds . . . . .	<u>10.8%</u>	<u>9.8%</u>	<u>6.7%</u>	<u>3.6%</u>	<u>1.7%</u>
Total . . . . .	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>	<u>100%</u>

Source: PBOC.

### **Interest Rate Deregulation**

Historically, interest rates on deposits and loans were set by and subject to restrictions established by the PBOC. Thus, the interest spread in China is generally wider than other less regulated markets. In recent years, as part of the overall reform of the banking system, the PBOC has implemented a series of initiatives designed to gradually liberalize interest rates and promote a more market-oriented interest rate regime. See "Supervision and Regulation — PRC Banking Supervision and Regulation — Pricing of Products and Services — Interest Rates for Loans and Deposits." In addition, the interbank interest rates have been largely liberalized. Since its establishment in January 2007, Shanghai Interbank Offered Rate has become an independent benchmark in the interbank market in China. The on-going interest rate liberalization is likely to facilitate the ability of banks to develop and market innovative products and services and adopt risk-based pricing.

### **Further Globalization of Renminbi**

According to the National Bureau of Statistics of China, from 2004 to 2008, China's foreign trade volume nearly doubled, reaching approximately US\$2,561.6 billion at the end of 2008, representing a CAGR of 22.0%. This soaring foreign trade and increasing inflow of foreign investment into China created greater demand for further globalization of Renminbi. Under the CEPA, banks in Hong Kong are allowed to provide RMB-denominated services to individuals, including RMB deposits, remittances, exchange business and issuance of RMB bank cards in the territory since early 2004. RMB deposits in Hong Kong rose from RMB12.0 billion in 2004 to RMB56.1 billion in 2008. To facilitate more efficient settlement with trading partners, China has signed several currency swap contracts with the central banks of Hong Kong, South Korea, Malaysia, Belarus, Indonesia and Argentina since late 2008. In April 2009, China's State Council further announced a pilot program to allow exporters and importers in Shanghai and the southern Chinese cities, namely Guangzhou, Shenzhen, Zhuhai and Dongguan, to settle cross-border trade deals in Renminbi.

### **Increasing Focus on SME Banking**

Historically, SME banking activities were primarily the focus of city commercial banks and rural cooperative financial institutions. However, given the gradual liberalization of interest rates and the growing bargaining power of large corporate borrowers resulting from the increasing availability of alternative financing sources, the Large Commercial Banks and the Other Joint Stock Commercial Banks have put increasing focus on SME banking to diversify their corporate banking business. SME banking grew rapidly in recent years and represented the majority of corporate lending business. As of December 31, 2008, RMB-denominated loans issued to SMEs amounted to RMB10,310.6 billion, accounting for 53.1% of all corporate loans in China.

## BANKING INDUSTRY IN THE PRC

### Increasing Demand for Retail Banking Products and Services

Although corporate banking continues to be the predominant business for most commercial banks in China, demand for retail banking products and services has grown significantly due to rising income among China's households. The following table sets forth, for the periods indicated, key personal income data for China and their respective CAGR.

	For the year ended December 31,					CAGR (2004-2008)
	2004	2005	2006	2007	2008	
	(in RMB, except percentages)					
Per capita GDP . . . . .	12,336	14,053	16,165	19,524	22,698	16.5%
Per capita annual disposable income of urban households . . . . .	9,422	10,493	11,760	13,786	15,781	13.8%
Per capita annual net income of rural households . . . . .	2,936	3,255	3,587	4,140	4,761	12.8%

Sources: National Bureau of Statistics of China.

The anticipated rapid increase in personal income in China will likely continue to drive demand for retail banking products, especially wealth management services. The number of relatively affluent individuals in China is expected to grow as a result of China's growing economy. Such trend is likely to increase the demand for more comprehensive and personalized wealth management advice in addition to traditional banking products and services.

### Further Expansion of Fee and Commission-based Business

As the domestic PRC economy has become increasingly sophisticated, Chinese commercial banks have increased their efforts to provide diversified financial products and services, especially fee and commission-based products and services.

Historically, commercial banks in China were restricted in their ability to provide fee and commission-based products and services. Since 2001, however, the PRC government has promulgated regulations permitting banks to charge for certain fee and commission-based products and services. See "Supervision and Regulation—PRC Banking Supervision and Regulation—Pricing of Products and Services." Fee and commission income accounted for less than 10% of the total income of PRC banks in 2008, substantially lower than the ratio in more mature markets. This ratio is expected to increase as domestic banks continue to expand their product and service offerings in response to demands for increasingly sophisticated financial products and services by corporate and retail customers.

### Expansion of Overseas Presence

In recent years, China's banking institutions have accelerated the pace of their overseas expansion, as evidenced by their active engagement in mergers and acquisitions, strategic investment and the establishment of their presence abroad. For example, following the acquisition of a 90% stake in PT Bank Halim Indonesia in December 2006, the Industrial and Commercial Bank of China purchased Macao's Seng Heng Bank in August 2007 and 20% of Standard Bank, South Africa's largest banking group, in October 2007.