

Banking Regulation and SME Lending in China

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Importance of SMEs in China

- 99% of business establishments, 60% of GDP, 53% of tax revenues and 60% of imports and exports
- 75% of all urban workforce, 70% of the people entering the labor force and 70% of the rural migrants
- 66% of new patents and 82% of new product development

Government Efforts in Promoting SME Financing

- 50% enterprise income tax reduction for small enterprises whose taxable income does not exceed RMB 30,000 (US\$ 4,600)
- RMB 11 billion (US\$ 1.7 billion) SME subsidy funding in 2009 and 2010
- 6000 guarantee companies in operation guaranteeing RMB 1.15 trillion loans as of end-2010

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Challenges in SME Lending

- **Commercial sustainability is key**
- **Characteristics of many SMEs**
 - Mom and pop shops or backyard operations
 - Volatile cash flows
 - Lack of eligible collateral
 - Poor corporate governance, e.g. lack of transparency
 - No audited financial reports

Challenges in SME Lending (Cont'd)

- Risk analysis needs to go beyond analyzing audited financial reports
- Lengthy and multi-layered credit approval process does not fit
- Data is not sufficient for pricing SME loans
- Bank managers and representatives need to understand people's character and the business
- A different incentive system is needed

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CBRC's Approach to SME Lending

- Financial disintermediation creates business model risk for China's banks
 - SME lending offers opportunities for diversification
- The CBRC has asked banks to maintain the growth rate of small business lending at or above the rate of total credit growth
- Banks should undertake small business lending at the basis of commercial sustainability and under the principle of safety and soundness

Favorable Capital Treatment and Differentiated Regulatory Policy

- Risk weighting for lending to small businesses has been reduced from 100% to 75%
- Easy-to-use loan classification system based on delinquency
- Simplified bad loan writing off policy

CBRC's Guidances to Small Business Lending

- Guidelines on Banks' Lending to Small Enterprises (2005)
- Guidelines on Due Diligence of Commercial Banks in Lending to Small Enterprises (Tentative, 2006)
- Guidance on the Set-up Default Information Reporting of Small Enterprise Finance (2006)
- Guidelines on Bank' Credit Business to Small Enterprises (2007)
- Guidance on Small Enterprise Loan Risk Classification Scheme (Tentative, 2007)
- Policies on Further Improving the Financial Services to Small Enterprises (2008)
- Guidance on the Set-up of the SBUs by Banking Institutions (2008)
- Provisional Rules Governing Credit Guarantee Companies (2010)

Capacity Building – “Six Mechanisms”

■ Mechanism for risk pricing

- NPL ratio for small business lending stands at 5.5%

■ Mechanism for separate business line accounting

- Product pricing and evaluating business unit performance
- Establish specific business units for small business lending

■ Mechanism for efficient credit approval

- Empower frontline bank representatives to make credit decisions
- Develop a set of tools, including credit scoring systems and investigation techniques that take into account non-financial business information
- Encourage bank representatives to establish social network to gain knowledge of local business

Capacity Building – “Six Mechanisms” (Cont’d)

■ Incentive mechanism

- Evaluate small business lending performance of banks’ branches in terms of the quantity and quality of loans as well as small business customers
- Establish specific performance evaluation standards for frontline small business managers

■ Training mechanism

- Enhance information gathering and investigation techniques and credit evaluation skills

■ Default information sharing mechanism

- The national credit-register system established by the central bank covers over 2 million SMEs
- The CBRC established an information sharing system, where the local CBRC branch aggregates and shares default information on small business lending
- The default information sharing system has been established at all 36 CBRC branch offices across the country

Other CBRC Initiatives

■ Technical Support

- Established an expert network (together with the Ministry of Science and Technology) that would provide advice on the value of new technologies
- Banks can consult the experts on the value of new technologies in lending to technology start-ups

■ Expanding Institutional Presence

- The CBRC has been promoting the establishment of micro-finance institutions, including village or township banks, lending companies and rural mutual cooperatives
- As of end-2010, 395 new-type financial institutions were established

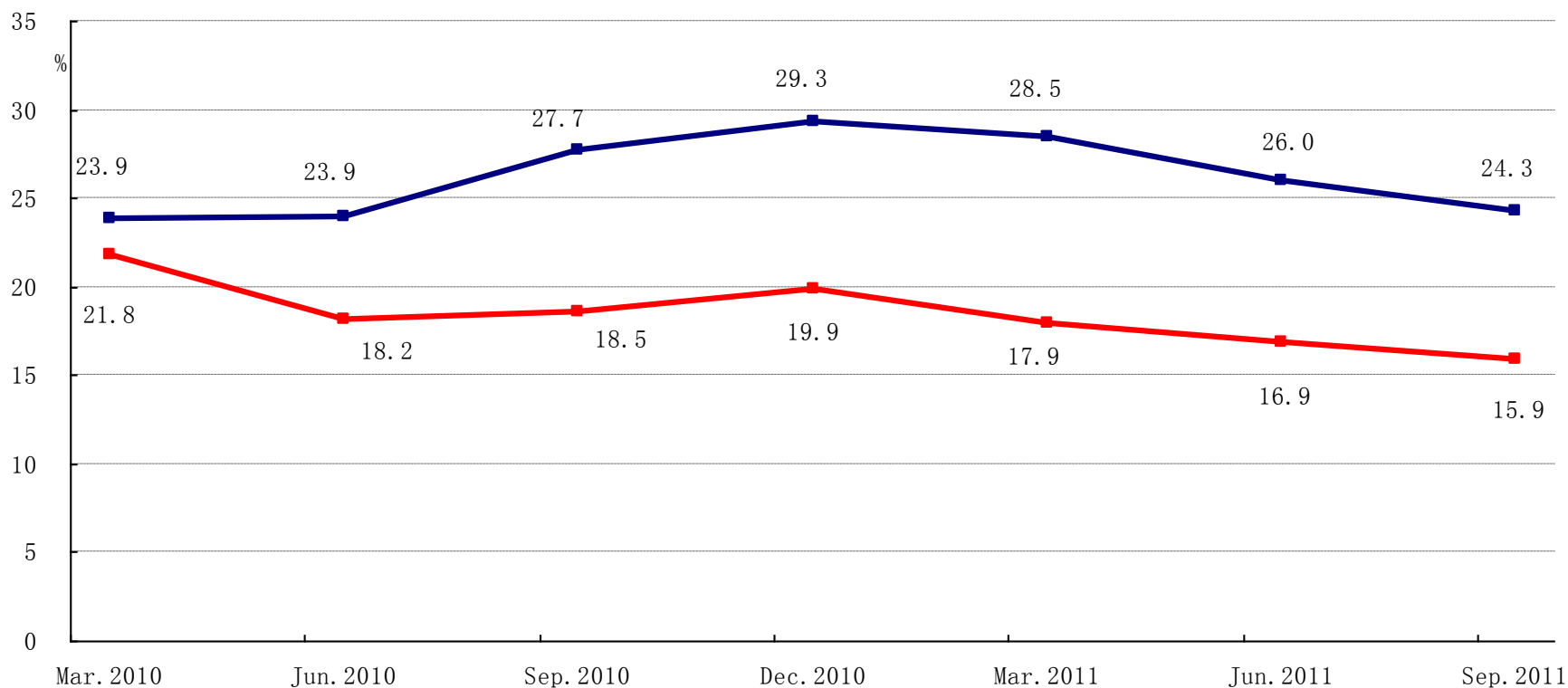
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Development of Small Business Lending

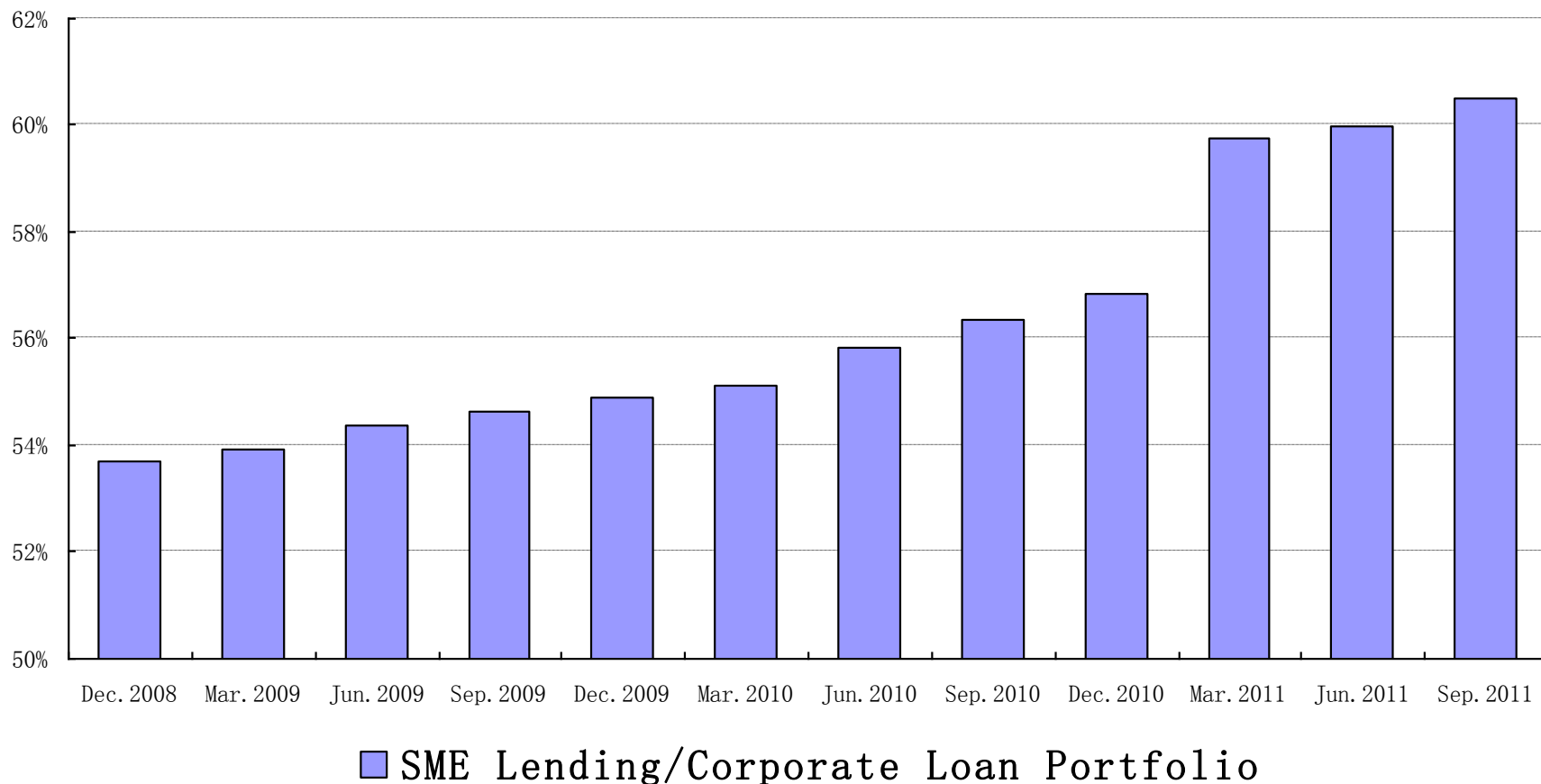
- **Significant changes in bank's organization, processes and conduct**
 - Banks have established special business units (SBUs) dedicated to small business lending, which have facilitated improvements in independent budgeting, resource allocation, credit approval, pricing and performance evaluation
 - Product innovation catering to the needs and risk characteristics of small business
 - New types of collaterals are being accepted, such as intellectual property rights and export tax rebate certificates
- **Rapid growth in SME lending**

Growth Rate of Lending to Small Enterprises

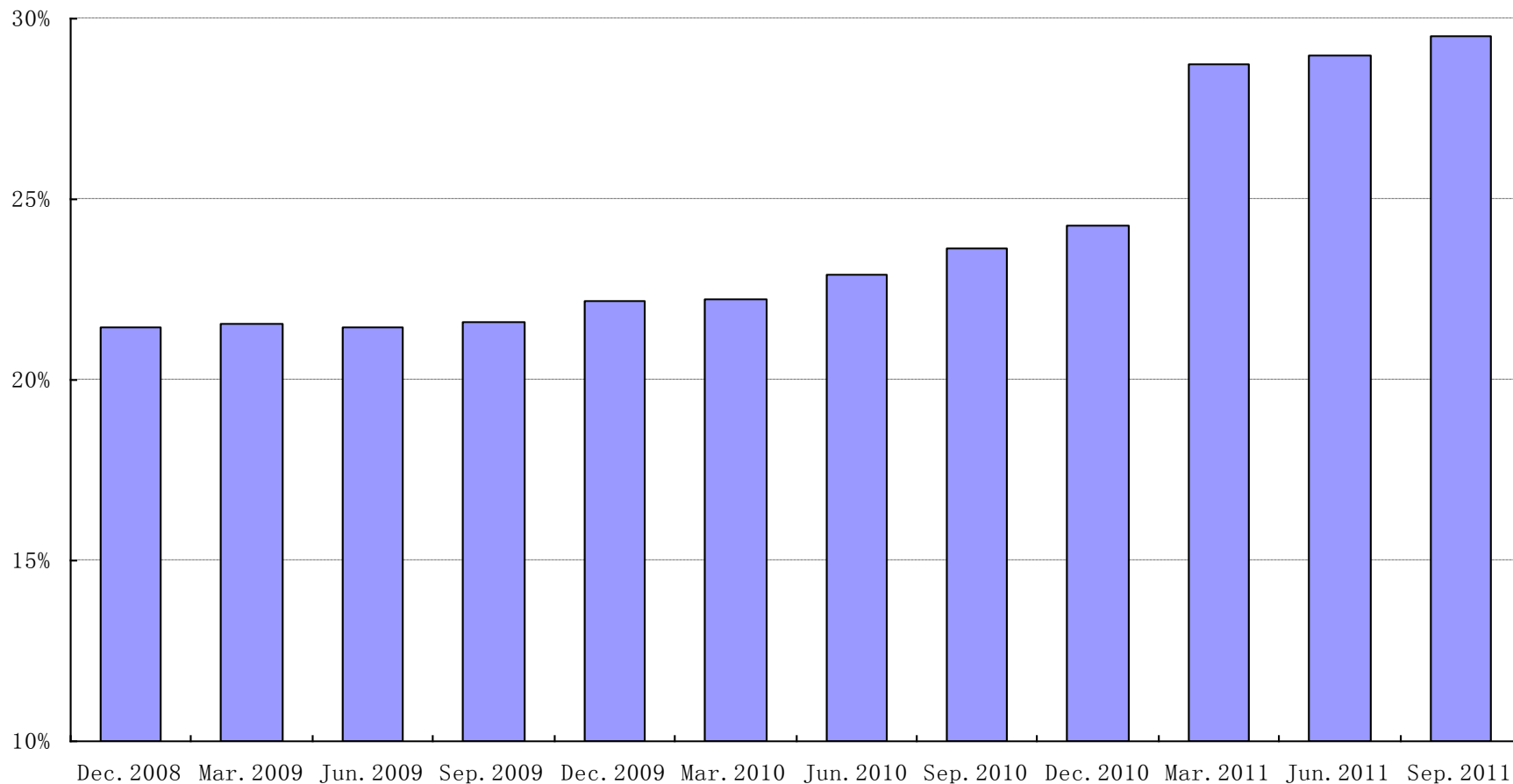


■ Growth Rate of Lending to Small Enterprises
■ Growth Rate of Total Loan

SME Lending as Percent of Corporate Loan Portfolio



Lending to Small Enterprise as Percent of Corporate Loan Portfolio



■ Lending to Small Enterprise/Corporate Loan Portfolio

Future Challenges

- Broadening the coverage of banking services in China's vast and complex terrain
- Increasing the depth and breadth of capital markets
- Promoting micro-finance to serve the needs of people that may not have access to the formal banking sector
- ...

THANK YOU !