



September 2004

Huijin: A SASAC for China's financial sector?

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Summary

- In December 2003, China's central government used \$45bn worth of the country's foreign exchange reserves to partially bail-out two state-owned banks, China Construction Bank (CCB) and Bank of China (BOC). At the same time, Huijin Investment (*Zhongyang Huijin Touzi Youxian Gongs*) was established as a special-purpose state-owned commercial vehicle to manage the capital injection.
- As a joint effort by four powerful government bodies – the State Council, the People's Bank of China (PBoC), the State Administration of Foreign Exchange (SAFE) and the China Banking Regulatory Commission (CBRC), Huijin became, at a stroke, a hugely important company. At least on the surface – to the author's knowledge no other PRC Chinese enterprises has a registered capital of \$45bn.
- However, exactly what Huijin is – and what it might become – are still unclear. Given that it took ownership rights over two of China's largest banks, some speculate that the firm may evolve into a financial sector State-owned Assets Supervision and Administration Commission (SASAC), the commission established in March 2003 to assume ownership of some 180 central enterprise groups. However, an alternative future is as the PBoC's asset management arm, taking responsibility for the 'bad' lending that the PboC has been forced to engage in recent years. The evidence thus far does not so far indicate which direction it will take.

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The creation of Huijin

China has long planned to publicly list its major state-owned banks, the BOC, CCB, Industrial and Commercial Bank (ICBC) and Agricultural Bank of China (ABC). The restructuring involved is being overseen by four government bodies: the PBoC and Ministry of Finance (MoF) oversee the banks' restructuring, the CBRC governs the establishment of their governance structure and financial health and the China Securities Regulatory Commission (CSRC) manages preparations for share issuance. In addition to commercialising lending operations, developing fee-based services, introducing systematic risk controls, downsizing staff numbers, integrating the banks' networks nation-wide, writing-off and otherwise disposing of bad lending, the restructuring of the banks has involved capital injections to improve their balance sheets and asset quality. In 1998, the central government injected Rmb270bn (\$33bn) into the four banks, in 1999 it transferred wrote-off Rmb1400bn (\$169bn) worth of non-performing loans (NPLs) from the big four banks to four asset management companies (AMCs), Xinda, Orient, Huarong and Changcheng, all owned by the MoF. In December 2003, BOC and COB received a capital injection of \$45bn, a much more controversial move since it involved converting the country's foreign currency reserves into an investment in two state-owned commercial entities.

The move was defended on the basis that this money was not another free lunch for the banks, but rather a long-term investment on which market returns would be expected. Meanwhile, a special-purpose vehicle – the Huijin Investment Company – was established to manage this investment on behalf of the central government. Huijin's sole 'investor' was the State Council, and it was established with registered capital of \$45bn, which was then split and directly invested in the two banks. Guo Shuqing, deputy governor of the PBoC and director of the SAFE, was appointed Huijin chairman while Hu Xiaolian, deputy director of the SAFE became general manager of the company. Other board members came from the SAFE (which appear to have taken a powerful presence), PBoC and MoF, as shown below.

Core personnel of Central Huijin Investment¹

Senior staff

Guo Shuqing – Chairman, and deputy governor of the PBoC and director of SAFE

Ma Delun – Deputy chairman, and first deputy director of SAFE

Hu Xiaolian – General Manager, and deputy director of SAFE

Board of directors

Li Dongrong – Deputy director of SAFE

Huang Guobo – Director of Reserve Administration Department, SAFE

Xu Fangming – Director of Finance Department, MoF

Sun Xiaoxia – Deputy director of Finance Department, MoF

Wang Weixing – Director of Budget Department, MoF

Xie Ping – Director of Financial Stability Bureau, PBoC

Ye Yingnan – Director of Currency and Gold Bureau, PBC

Board of supervisors

Geng Hong – Director of Fiscal Supervision Department, MoF

Hu Zhengheng – Director of Accounting and Finance Department, PBoC

Deng Xianhong – Director of General Affairs Department, SAFE

Following the move, Huijin became the only shareholder in BOC and COB. In its 2003 annual report, BOC disclosed that it had assigned all of its shareholder's equity prior to 2003 – a total of Rmb219.4bn (\$26.4bn) – to its provision fund for future write-offs of bad loans, and that on December 30th 2003, the central government had injected equity capital worth Rmb186.4bn (\$22.5bn) via Huijin into the bank. At the time there was considerable uncertainty about whether this was a capital injection (which would have been counted as tier-one capital) or a loan (which would not have been). Thus, on its balance sheet, the bank showed this amount as its owner's equity (*jingziben*).² In other words, Huijin appears to now hold a 100% stake in both BOC and COB, and although the money was not directly used for provisions or write-offs, it did allow retained profits (past and future) to be used for this purpose.³

In some respects, this was a step forward. In terms of governance, the central government had separated and transferred its ownership rights (previously held by the MoF) in the two banks to a non-administrative entity, while retaining regulatory functions.⁴ Assuming the firm

¹ Sun Ming, 'Jiemi zhongyang huijin gongsi, jinrong guozhiwei chuxing zhaxian', *21st Century Economic Report*, January 10th 2004, <http://news.rednet.com.cn/Articles/2004/01/511423.HTM>, August 2004.

² *The Annual Report of Bank of China*, 2003, <http://www.bank-of-china.com/report/index.shtml>.

³ Xiao Linlin, 'Huijin xu zhuan shi, yunchou yanghang 7000yi zaidiankuan', *21st Century Financial Report*, August 7th 2004, <http://resource.stockstar.com/news2004/darticle.asp?id=SS,20040807,00768287&columnid=947>, August 2004.

⁴ Between 1998-2003, the Central Finance Working Committee (*Zhongyang jinrong gongwei*) was in charge of senior personnel appointments at the financial institutions, but since March 2003 the committee has been disbanded and these powers have been dispersed among the regulatory bodies and the Central Committee's Organisation Department. 'Jinrong zichan

can be adequately staffed, Huijin should be better placed than the MoF to fulfil the role of an owner/shareholder in disciplining and monitoring the banks. (Strictly speaking, Huijin is not yet a shareholder in the banks since they are not yet incorporated. Bank of China plans to have its incorporation completed by year end 2004, and to introduce other shareholders in the process, although it is likely that Huijin will be its majority shareholder.)⁵

The question is to what extent Huijin can effectively fulfil this ownership ambition. Yi Xiangrong, a researcher at the Institute of Finance and Banking at the Chinese Academy of Social Sciences, believes that Huijin will not be able to function as a commercial enterprise but will inevitably operate under the State Council as a quasi-government entity.⁶ It is not only the name – no other firm in China has the moniker '*Zhongyang*' attached to it, a term usually used to refer to the central political leadership. Certainly, the evidence thus far bears this judgement out. Huijin remains a 'shell company', with no dedicated office or staff. Sun Ming, a journalist at the *21st Century Economy Report* (*21st Shiji Jingji Baodao*) attempted to locate Huijin using its registered business location (in a building also occupied by the SAFE) – but no evidence of the company was found there.⁷ The answer to the question of what return Huijin and its backers, hope to make from the \$45bn investment is also illustrative of its quasi-administrative status. Guo Shuqing has said that the firm will not take 'all the dividends that we are meant to receive. On the contrary, we will collect as few as possible as long as the rate of return is no lower than the normal return on the state's foreign reserves.'⁸

Neither do either of the two banks yet have any Huijin staff sitting on their boards. According to its 2003 annual report, all BOC board members were executive, i.e. were employed as senior bank staff and until the time of writing no Huijin staff had entered the board. For instance, Xiao Gang is chairman of the board and director of the bank (*dongshizhang jian zongjingli*), while Sun Changji works as deputy chairman and deputy director (*fu dongshizhang jian fu zongjingli*). This lack of representation on the board would appear to limit Huijin's ability to act as an owner. Wan Dayong, deputy director of the Experts

guanli yinjianhui yu shen cengci gaige', *Caijing Zazhi*, February 20th 2003, <http://www.caijing.com.cn/mag/preview.aspx?ArtID=3884>, August 2004.

⁵ The State Council has designated the BOC and CCB as the first of the big four to incorporate, Xinhua Net, 'Zhanghang jianhang shishi gufenzhi gaizao shidian', June 1st 2004, http://news.xinhuanet.com/fortune/2004-01/06/content_1263013.htm, August 2004.

⁶ 'Top adviser slams bank bailout', *The Standard*, March 12th 2004, http://www.thestandard.com.hk/txtarticle_v.cfm?articleid=45864, August 2004.

⁷ Sun then visited the Reserve Administration Department of the SAFE, located in the same building as Huijin is officially located to be, and staff there informed him that there were no Huijin offices located within the department itself either. Sun Ming, 'Jiemi zhongyang huijin gongsi, jinrong guozhiwei chuxing zhaxian', *21st Century Economic Report*, January 10th 2004, <http://news.rednet.com.cn/Articles/2004/01/511423.HTM>, August 2004.

⁸ Li Qing, 'Guo Shuqing jiaodai zhuzi sanyidian', *Zhongguo Caijingbao*, March 10th 2004. Electronic source irretrievable.

Committee of the State Development Bank of China, also raises questions.⁹ If Huijin does send staff as board members they will inevitably encounter conflicts of interest – they can not be senior regulatory officials and shareholders at the same time.¹⁰ And if Huijin flexes its muscles as a controlling shareholder either independently, or on behalf of the PBoC, over senior personnel appointments and major firm decisions, it will inevitably result in tensions with the CBRC.

A financial-sector SASAC or the PBoC's asset management arm?

So what will Huijin become? To some extent the move had the appearance of not being entirely thought through, Huijin being only an impromptu vehicle for an unexpected decision to use foreign exchange to recapitalise the banks. Senior Huijin staff appear unclear as to their role, and the firm's.

When the SASAC was established in March 2003, it assumed ownership rights in the majority of central level state-owned industrial enterprises. However, it did not take on ownership of any financial enterprises nor of State Council level financial conglomerates CITIC and Everbright.¹¹ Since then, the question of how the government would structure the ownership arrangements for its banks, securities, insurance, trust and investment companies et al. has not been resolved. The creation of Huijin and its assumption of ownership of two major state-owned banks raised speculation that the firm would be developed into the equivalent of SASAC in the financial sector. To allow the MoF to concentrate on its fiscal duties, and to allow the firms to be controlled by commercially-oriented shareholders would be beneficial after all.

Officials have denied that Huijin will be a financial-sector SASAC, however.¹² There are a number of differences between the two entities that suggest this is indeed not the intention.

- One important difference between the industrial and financial sectors is that while multiple agencies vied for ownership of the industrial enterprise groups, the four large banks and most other state-owned (non-shareholding) financial institutions are owned by the MoF, or State Council directly, and so the governance problems involved are not so immediate.

⁹ Wang was one of the architects of the central government's injection of Rmb270bn (\$33bn) into the four big banks in 1998 when he was the director of the Inspection and Statistical Bureau of the PBoC.

¹⁰ Li Zhenhua, 'Zhongyang huijin gongsi cheng xuke, renshiquan shouyiquan guishu nanjie', *21st Century Financial Report*, March 23rd 2004, http://stock.163.com/economy2003/editor_2003/040323/040323_191132.htm, August 2004

¹¹ Ownership of which remains unclear. SASAC does, however, own China Merchant Group (Zhaoshangju jituan youxian gongsi), under which China Merchant Bank operates.

- As a commercial entity, Huijin invested a capital injection from the central government's coffers to become an owner, while the SASAC's assumption of ownership in its firms did not require any financial transfer.
- Huijin was not established as an administrative entity (*shiye danwei*) like the SASAC, but rather a wholly-state-owned enterprise (*Guoyou duzi qiye*) operating under the State Council, rather like CITIC or Everbright.¹³ In August 2004, *21st Century Economy Report* reported that the firm would begin commercial operations, hire staff, and develop its organisational structure.

What other business might Huijin do? One possibility is that the firm would oversee and collect the defaulted loans that the central bank has lent to troubled financial institutions; it would be the PBoC's AMC.¹⁴ The PBoC has long wanted to establish its own asset management arm to resolve problems in its own (re)lending.¹⁵ It is reported that sometime in the second half of 2003, the PBoC's (re-)lending to troubled commercial financial institutions, such as trust and investment companies (TICs), urban credit co-operatives, securities companies and the four AMCs that was judged to be not likely to be repaid totalled Rmb700bn (\$84bn).¹⁶ In 2003, the PBoC's proposal to set up a new entity to deal with these loans was opposed by the MoF, whose officials reportedly argue that the four AMCs are better positioned to resolve the debts. Moreover, since this re-lending was to troubled firms, and mostly used to pay creditors, any aggressive attempts to claw back the money would

¹² Sun Ming, 'Jiemi zhongyang huijin gongsi, jinrong guozhiwei chuxing zhaxian', *21st Century Economic Report*, January 10th 2004, <http://news.rednet.com.cn/Articles/2004/01/511423.HTM>

¹³ 'Yanghang guanyuan cheng jinqi meibiyao jiaxi shebaojijin youwang niannei rushi', *Beijing Qingnianbao*, March 5th 2004, <http://www.gzstats.gov.cn/Admin/gnjidtp030801.htm>, August 2004.

¹⁴ At the time of writing, there was press speculation that Wang Jianxi, assistant to the CSRC chairman, could be appointed as a Huijin director to oversee such a transformation.

¹⁵ Re-lending operations by a central bank usually involves short-term loans to cover short-term liquidity constraints. In this case, the PBoC's 'lending' appears to be long-term transfers to insolvent institutions which has been used to repay creditors, and which will not be repaid.

¹⁶ The central bank's total re-lending to financial institutions as of the end of June 2003 was estimated to total Rmb2.5trn (\$300bn). Mo Fei estimates that Rmb700bn (\$84bn), some 28% of the total and 6% of China's GDP, is likely not to be repaid. This sum includes Rmb141.1bn (\$17bn) lent to TICs and urban credit cooperatives in 1997 of which only Rmb2bn (\$240m) has been repaid; Rmb540bn (\$65bn) lent to the four AMCs in 1999, of which no money has yet been repaid; and loans of Rmb1.5bn (\$180m), Rmb1.45bn (\$175m) and Rmb8bn (\$963m) to Anshan Securities, Xinhua Securities and Nanfang Securities (all in administration) respectively during 2002-03, none of which is likely to be repaid. Mo Fei, 'Yanghang yu ling chengli jinrong zichan guanli gongsi caizhengbu chiyou yiyi', *21st Century Economy Report*, July 22nd 2004, <http://www.wforum.com/newspool/articles/economy/31265.html>, August 2004. Xiao Linlin, 'Huijin xu zhuan shi, yunchou yanghang 7000yi zaidiankuan', *21st Century Financial Report*, August 7th 2004, <http://resource.stockstar.com/news2004/darticle.asp?id=SS,20040807,00768287&columnid=947>, August 2004.

likely be extremely difficult. However, PboC officials are reluctant to pass these 'assets' to the four MoF-owned AMC's for fear that its officials would lose any control of recovery rates.

A third option is for Huijin to continue to operate as a passive vehicle through which the government is able to channel public funds into equity injections in the banks, and perhaps other financial institutions. In early 2004, the firm invested Rmb3bn (\$360m) into the Bank of Communications during its restructuring, alongside investments from the National Social Security Fund and HSBC. This investment apparently appears on Huijin's balance sheet as an asset. But where did Huijin derive these funds from? According to Li Xiaoming, deputy general manager of Huijin, they did not come from the state's foreign exchange reserves. However, there was neither any change in Huijin's registered capital. It appears that the money is essentially a type of liability, and it is currently unclear how it will be financed, perhaps through a bond issue, or a loan from the PBoC or MoF. At the time of writing, Huijin itself appeared to be waiting for further instructions from the central bank regarding how to account for the money and the transaction on its books. If such investments continue, then Huijin may well evolve into a hugely-powerful CITIC-like entity: a commercial, though wholly-government owned, entity which has controlling stakes in numerous financial institutions, including perhaps the AMC's if a debt-equity swap can be arranged.

Concluding remarks

China needs a commercial entity to take ownership of the state's financial companies (at least in the period before which privatisation is possible) and an asset resolution agency for non-performing re-lending by the PboC. Whether Huijin will evolve into either is still open to question. Despite its superficial scale and its ownership of two of China's largest state banks, the powers, responsibilities, organisation and mandate of Huijin are all as yet unclear.

The author wishes to thank Stephen Green for valuable comments.

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