2016 Q1
China's banking sector: Performance of listed banks and hot topics

July 2016

INTRODUCTION

China’s banking sector: Performance of listed banks and hot topics is a quarterly publication from KPMG China that provides its readers with analysis of important topics and key performance indicators in China's banking industry. It aims to track the latest developments in the sector and provides commentary on issues affecting the future direction of the industry. This publication also gathers considerable data to assess the financial performance of China's listed banks and combined with KPMG China's professional experience helps readers better grasp the current environment in China's banking sector.

This issue focuses on important recent trends including the impact of full-blown VAT reform on the banking sector, the effects of Notice No. 82 from the China Banking Regulatory Commission (CBRC) on the transfer of the income right to credit assets and strategies for disposal of non-performing assets (NPLs) such as debt-to-equity swaps. These topics are receiving more and more attention in the banking industry and we hope that our discussion will help our readers firmly understand these issues. Furthermore, this issue provides an overview of the financial position and performance of listed banks in the first quarter of 2016, which will allow readers to better understand the overall performance of the sector.

For more information, please do not hesitate to contact any of the KPMG China professionals listed in the ‘contact us’ section.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved. Printed in China.

Content

1	2016 Q1 economy and finance	4
2	Analysis of 2016 Q1 financial data of listed banks	14
3	Hot topics	35
4	Appendix: 2016 Q1 financial data of listed banks	70

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved.
Printed in China.

1 2016 Q1 economy and finance

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.
Printed in China.

Q1 data analysis

In the first quarter of 2016, the Chinese government led efforts in the face of the economic slowdown to help transition China's economy towards more balanced growth. It strived to push for supply-side structural reform and expand domestic demand. Thanks to these efforts, the Chinese economy was able to record continued sound growth, ushering in a favourable start to the new year.

In terms of demand, fixed asset investment grew steadily in the first quarter of 2016, while consumption increased slightly even though the price of consumer goods rose. Import and export trade fell year-on-year, while household income increased steadily as the economy continued to improve. The services sector accounted for 56.9% of overall GDP. In terms of supply, agricultural and industrial production remained stable. The government has strengthened its efforts to advance supply side-reform in order to maintain a medium to high rate of economic growth and to achieve moderate to high income levels for its citizens.

- **GDP growth slowdown in the first quarter:** based on preliminary calculations, China's GDP in the first quarter of 2016 was RMB 15.8526 trillion, a YoY increase of 6.7% at comparable prices. In terms of sectors, the value added by the primary, secondary and tertiary sectors was RMB 880.3 billion, RMB 5.951 trillion and RMB 9.0214 trillion respectively, representing an increase of 2.9%, 5.8% and 7.6% YoY. China's GDP in the first quarter of 2016 increased by RMB 985.1 billion at 2015 prices, RMB 22.2 billion more than during the same period in the previous year.
- **Drop in import and export trade:** in the first quarter of 2016, the total volume of import and export trade amounted to RMB 5.2144 trillion, a YoY decrease of 5.9%. Exports reached RMB 3.0123 trillion, down 4.2%, while imports reached RMB 2.2021 trillion, down 8.2%. The trade balance provided China with a surplus of RMB 810.2 billion. The total export and import volume in March was RMB 1.9056 trillion, a YoY increase of 8.6%. Exports were RMB 1.0501 trillion, up 18.7%, while imports were RMB 855.5 billion, down 1.7%.
- **Steady growth of consumption:** in the first quarter of 2016, total retail sales of consumer goods reached RMB 7.8024 trillion, a nominal increase of 10.3% (9.7% in real terms without the price impact). This was 0.4% lower than the growth rate of the previous year but 0.1% higher than the growth rate between January and February this year.

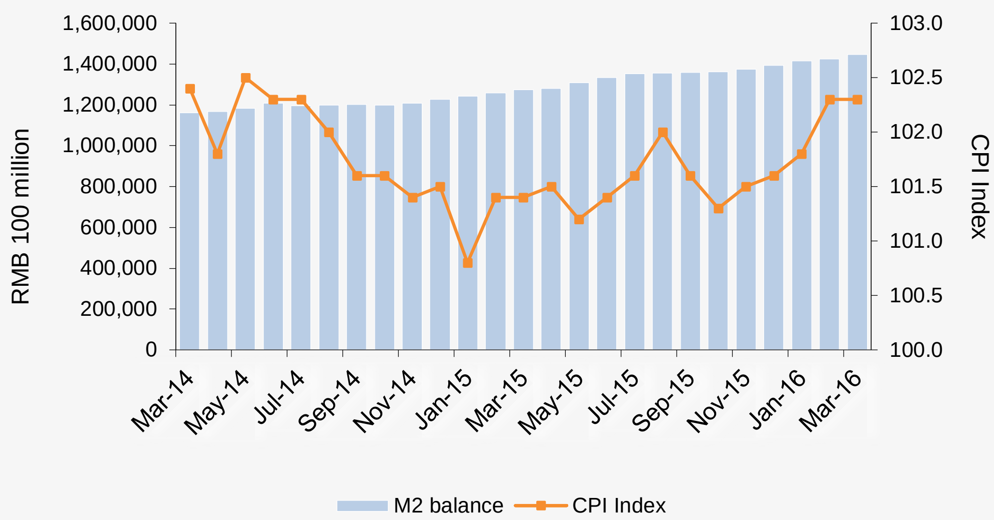
Overview of key macroeconomic indicators	Unit	2014Q1	2014Q2	2014Q3	2014Q4	2015Q1	2015Q2	2015Q3	2015Q4	2016Q1
GDP	YoY（%）	7.3	7.4	7.1	7.2	7.0	7.0	6.9	6.8	6.7
CPI	YoY（%）	2.3	2.3	2.2	2.0	1.2	1.3	1.4	1.4	2.1
PPI	YoY（%）	(2.0)	(1.7)	(1.6)	(1.9)	(4.6)	(4.6)	(5.0)	(5.2)	(4.8)
Industrial added value	YoY（%）	8.7	8.8	8.5	8.3	6.4	6.3	6.2	6.1	5.8
Total retail sales of consumer goods	YoY（%）	12.0	12.1	12.0	12.0	10.6	10.4	10.5	10.7	10.3
Fixed asset investment	YoY（%）	17.6	17.3	16.1	15.7	13.5	11.4	10.3	10.0	10.7
Exports	YoY（%）	(3.4)	0.9	5.1	4.9	4.9	0.9	(1.8)	(1.8)	(4.2)
Imports	YoY（%）	1.6	1.5	1.3	(0.6)	(17.3)	(15.5)	(15.1)	(13.2)	(8.2)
Trade surplus	$100 million	165.9	859.4	1,280.8	1,495.0	1,237.3	1,401.6	1,636.1	1,747.8	1,257.4
M2	YoY（%）	12.1	14.7	12.9	12.2	11.6	11.8	13.1	13.3	13.4
RMB loan growth	YoY（%）	13.9	14.0	13.2	13.6	14.0	13.4	15.4	14.3	14.7

Source: National Bureau of Statistics of the People's Republic of China and Wind Info

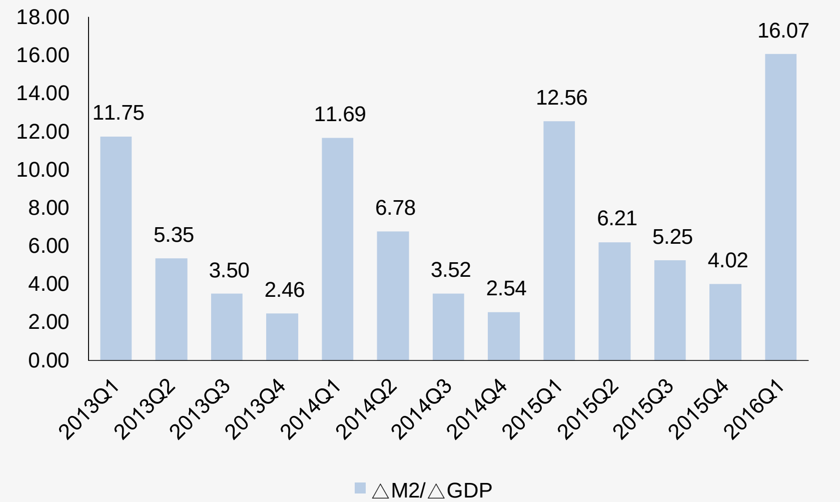
© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Monetary expansion and national economic output

Money supply and inflation rate



Velocity of money



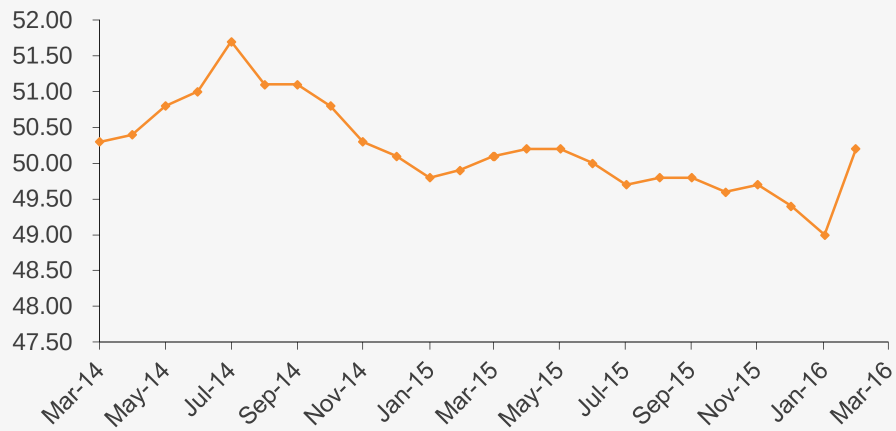
- The Consumer Price Index (CPI) grew 2.1% YoY in the first quarter of 2016. It increased by 2.1% in urban areas and 2% in rural areas.
- Specifically, food, tobacco and liquor prices increased by 5.1% YoY, clothing prices by 1.7%, house prices by 1.3%, prices for household equipment and maintenance services by 0.4%, prices for educational and entertainment products and services by 1.3%, prices for medical and healthcare products by 2.9% and prices for other products and services by 0.6%, while prices for transportation and communication fell by 2%.
- In the first quarter of 2016, the broad money (M2) balance was RMB 144.6 trillion, a YoY increase of 13.4%. The RMB loan balance was RMB 98.6 trillion and the RMB deposit balance was RMB 141.1 trillion. The RMB loan increment amounted to RMB 4.6 trillion, representing a YoY increase of RMB 0.9 trillion, while the RMB deposit increment was RMB 5.4 trillion, representing a YoY increase of RMB 1.3 trillion.
- At the end of March 2016, the narrow money (M1) balance was RMB 41.2 trillion, a YoY increase of 22.1%. The balance of money in circulation (M0) was RMB 6.5 trillion, a YoY increase of 4.4%.
- In the first quarter of 2016, the overall financing increment reached RMB 6.6 trillion, a YoY decrease of RMB 1.9 trillion compared with the same period for the previous year, representing an historical high. The financing increment in March amounted to RMB 2.3 trillion, RMB 1.5 trillion more than the previous month and RMB 1.1 trillion more than the same period for the previous year.
- Structurally, RMB loans and direct financing to the real economy increased significantly with both registering historical highs. Off-balance-sheet financing also recorded a noticeable increase.

Source: National Bureau of Statistics of the People's Republic of China and the People's Bank of China

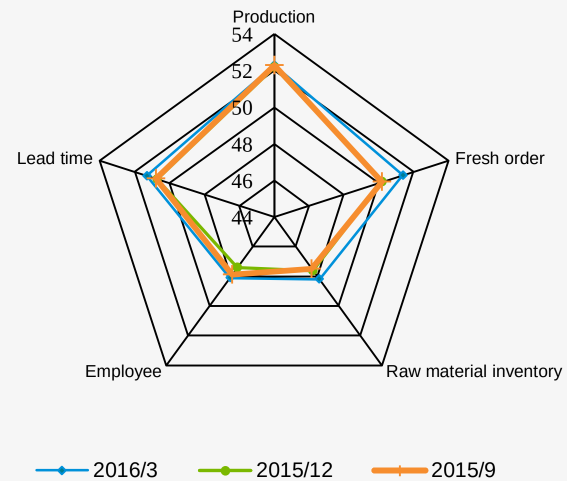
© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Operating performance

China manufacturing PMI



China manufacturing PMI sub-index



- Overall, China's economy expanded within an appropriate range in the first quarter of 2016. Many key indicators posted positive results, although concerns over the global economy and the effect this has had on China still exist.
- In the first quarter of 2016, China's manufacturing Purchasing Manager Index (PMI) fell before increasing. Affected by supply-side reform and the slowdown in the economy, PMI in the first two months of 2016 declined. In March 2016, PMI experienced a noticeable recovery to 50.2%, 1.2% higher than the previous month and above the 50% break-even mark for the first time in eight months. This was mostly due to the effects of the Spring Festival, changes in macroeconomic policy, the improved performance of property markets in first and second tier cities and an improved external economic environment. The PMI of large enterprises was 51.5%, 1.6% higher than the previous month and well above the break-even mark. The PMI of medium-sized enterprises was 49.1%, 0.1% higher than the previous month but still below the break-even mark. The PMI of small enterprises was 48.1% having recovered by 3.7% compared with the previous month.

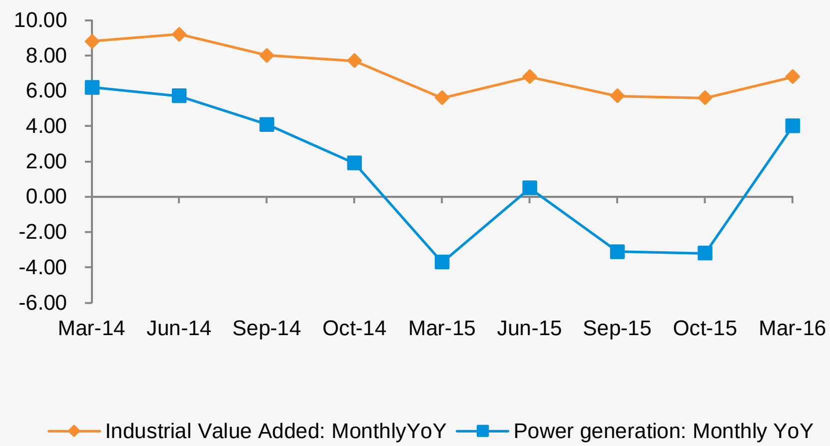
Source: National Bureau of Statistics of the People's Republic of China

- In March 2016, out of the five sub-indexes that make up the manufacturing PMI, the production, fresh orders and lead time indexes were above the break-even mark, while the employment and raw materials inventory indexes were below this threshold.
- The production index was 52.3%, up 2.1% compared with the previous month. This was again above the break-even mark, indicating accelerated growth of manufacturing production.
- The fresh orders index was 51.4%, up 2.8% compared with the previous month. It recovered to the improvement range, indicating that demand for manufacturing products improved.
- The employment index was 48.1%, up 0.5% compared with the previous month but still below the break-even mark, indicating that the number of workers employed by manufacturing enterprises continued to fall at a slower rate.
- The raw materials inventory index was 48.2%, up 0.2% compared with the previous month but still below the break-even mark, indicating that the raw materials inventory used by manufacturing enterprises has been declining at a slightly slower rate.
- The lead time index was 51.3%, above the break-even mark, indicating that the delivery of raw materials by suppliers accelerated.

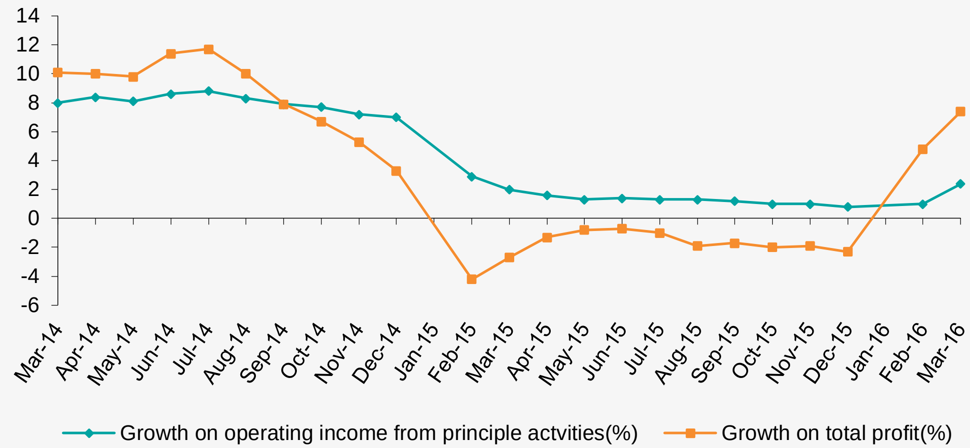
© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Operating performance (continued)

Industrial production



YoY growth of accumulative operating income from principal activities and total profits



- The value added by the above-scale industry in March 2016, net of price factors, increased by 6.8% in real terms, up 1.4% compared with January and February and up 0.6% compared with the previous month. In the first quarter of 2016, the added value of the above-scale industry increased by 5.8% YoY. In terms of the type of companies, state-owned and state-held enterprises, collective enterprises, joint-stock enterprises, and foreign-invested and Hong Kong, Macau and Taiwan invested enterprises grew by 3.2%, 0.2%, 7.6% and 4.8% respectively in March 2016.
- With regards to specific industries, the value added by the mining, manufacturing and the electricity, heating power, gas and water production and supply industries grew in March 2016 by 3.1%, 7.2% and 4.8% respectively. As for specific regions, the value added by the eastern, central and western regions increased by 7.3%, 7.8% and 8% respectively, while the north-east region decreased by 0.2%. In March 2016, the sales to output ratio of above-scale industrial enterprises reached 97.1%, flat compared with the same period for the previous year.
- In March 2016, power generation amounted to 477.9 billion kWh, a YoY increase of 4%.

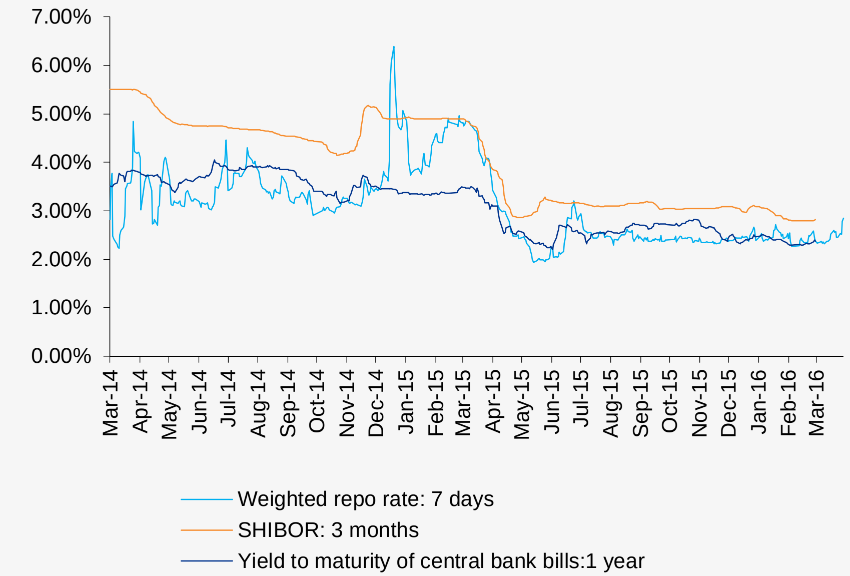
- In the first quarter of 2016, operating income from the principal activities of above-scale industrial enterprises was RMB 24.66596 trillion, a YoY increase of 2.4%. Operating costs from these principal activities was RMB 21.05528 trillion, a YoY increase of 2%, indicating that operating income grew slightly faster than operating costs. Above-scale industrial enterprises realised total profits of RMB 1.34215 trillion, a YoY increase of 7.4%. The profit rate of operating income from principal activities was 5.4%, in other words for every RMB 100 of operating income from principal activities, the operating costs were RMB 85.4. The income arising from every RMB 100 of assets was RMB 102.4.
- On the other hand, in terms of industries, the mining industry recorded total losses of RMB 5.41 billion, an improvement of RMB 63.35 billion compared with the previous year, while the manufacturing industry realised total profits of RMB 1.21999 trillion, a YoY increase of 14.6% and the electricity, heating power, gas and water production and supply industry realised total profits of RMB 127.57 billion, an increase of 4.6%.

Source: National Bureau of Statistics of the People's Republic of China and Wind Info

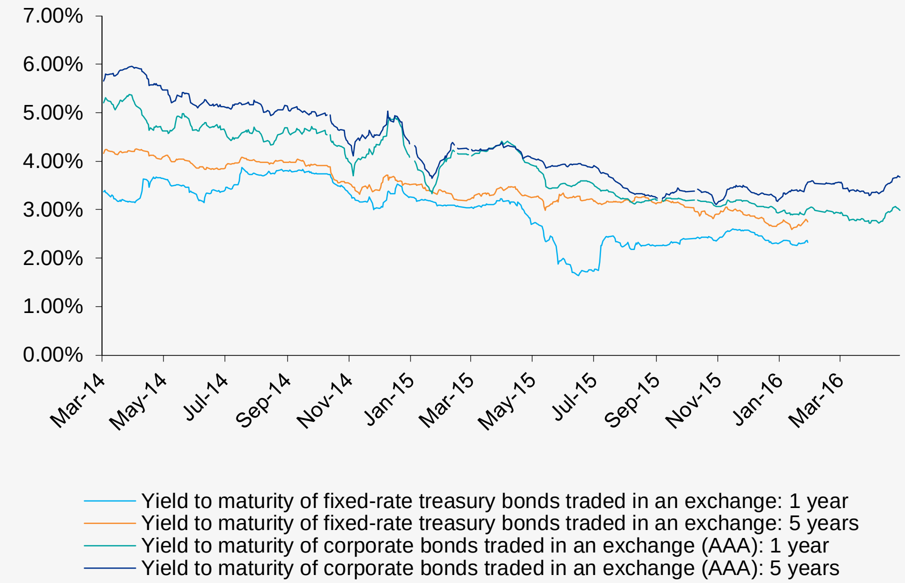
© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Dynamics of money and bond market interest rates

Money market rate



Bond yields



- Overall, the financial markets were stable in the first quarter of 2016. Based on data published by the People's Bank of China (PBOC), the total turnover of the currency markets in the first quarter of 2016 amounted to RMB 154.2 trillion, a YoY increase of 106.7%. In March, the total turnover of the currency markets amounted to RMB 62.1 trillion, a YoY increase of 104.2% and a month-on-month increase of 59.2%.
- At the end of the first quarter of 2016, the yield to maturity of one-year central bank bills fell significantly compared with notes issued in the same period in the previous year. At the end of March 2016, average yields were down 2.37%, 112 basis points lower compared with the previous year and down 1 basis point compared with the end of the previous year.
- Compared with early 2016, the overnight Shanghai Interbank Offered Rate (Shibor) increased slightly by 2.6 basis points and closed at 2.017% at the end of March 2016, seven-day Shibor fell slightly by 3 basis points and closed at 2.3250% and one-month Shibor fell by 19.50 basis points closing at 2.8070%.
- In the first quarter of 2016, global macroeconomic data was weaker than expected and China's economy experienced a noticeable dip, while trading volumes experienced a YoY decline. As a result, the yield curve of all bonds retreated.
- In the first quarter of 2016, the accumulated turnover of the inter-bank bond market was RMB 26.6 trillion, representing a YoY increase of 111.1%. In March, the turnover of the inter-bank bond market was RMB 11.3 trillion, a YoY increase of 105.3% and a MoM increase of 46.8%. At the end of March, the total inter-bank index was 173.26, up 1.08 basis points or 0.6% from the end of the previous month.

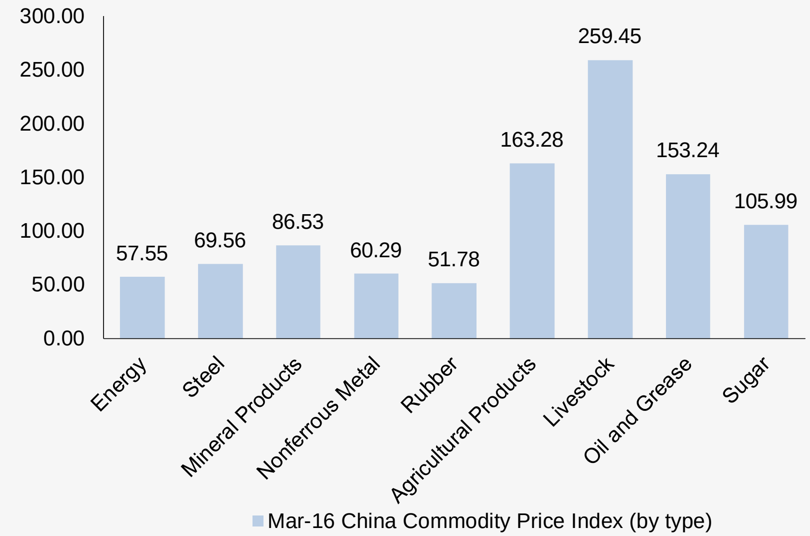
Source: Wind Info and the People's Bank of China

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Analysis of the commodity price index

China commodity price index (general index)

China commodity price index (by type)



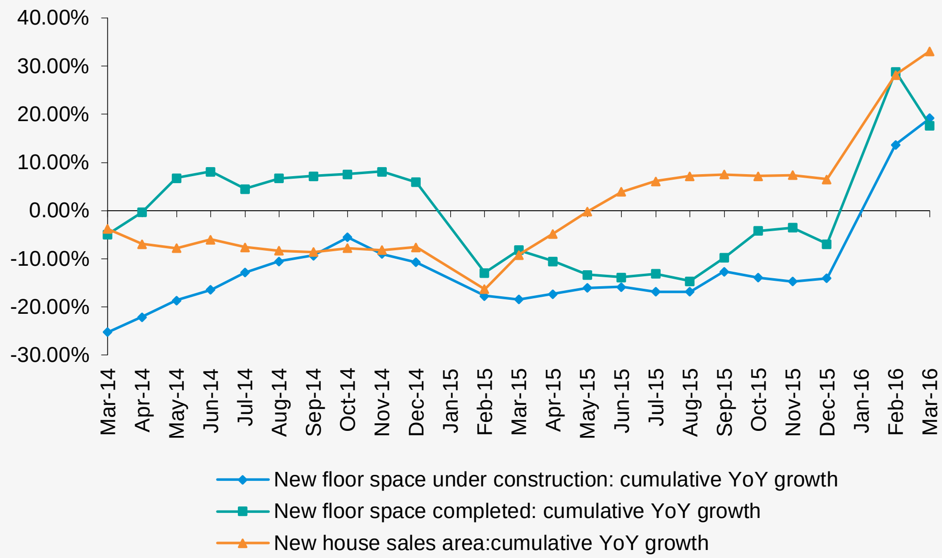
- In the first quarter of 2016, the China commodity price index (CCPI) recorded a noticeable increase but was still low when compared with the same period for the previous year.
- In March 2016, the CCPI continued to rise. Statistics show that the CCPI average in March was 91.41 points, up 7.5 points or 8.9% from the previous month. The growth rate was 5.9% higher than that of the previous month. The CCPI recorded growth in two consecutive months and was 11.9 points or 11.6% lower than it was during the same period in the previous year and 9.9 points or 12.2% higher than at the beginning of the year.
- Commodity prices by type: compared with the same period for the previous year, price indices of livestock and sugar increased by 24.6% and 13.2% in March respectively, while price indices of the seven other major commodities decreased. Price indices of energy, rubber, nonferrous metal, steel, agricultural products, mineral products and oil and grease declined by 26.1%, 13.2%, 10%, 7.4%, 7.1%, 5.1% and 3.4% respectively.
- Compared with the beginning of the year, the price index of agricultural products decreased by 1.1% in March, while price indices of the other eight commodities all increased. Price indices of mineral products, steel, energy, rubber, nonferrous metal, livestock, oil and grease and sugar increased by 20.4%, 18.3%, 17.9%, 12.8%, 5.6%, 4.6%, 4.3% and 2.6% respectively.

Sources: E-circulation.cn

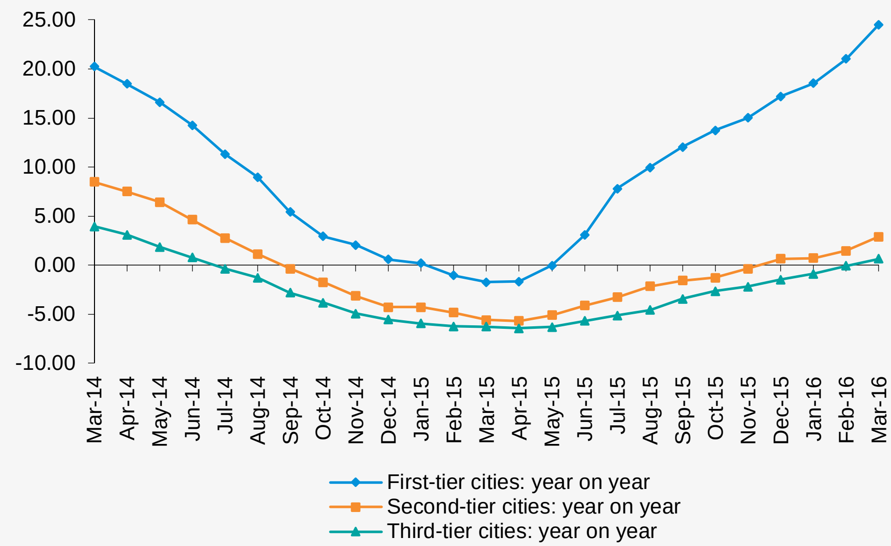
© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Residential housing

Growth of saleable area, floor space completed and new floor space under construction



Housing price indexes of 100 cities



- In the first quarter of 2016, real estate investment amounted to RMB 1.7677 trillion, a nominal YoY increase of 6.2% (excluding the 9.1% growth in prices during the same period) and an overall increase of 5.2 percent from the previous year. Out of this total, residential housing investment increased by 4.6%. The new floor space under construction was 282.81 million m^2, a YoY increase of 19.2%, while the new floor space under construction for residential housing increased by 14.8%.
- The saleable area of commodity housing amounted to 242.99 million m^2, a YoY increase of 33.1%, while the saleable area of residential housing increased by 35.6%. Commodity housing totaled RMB 1.8524 trillion, a YoY increase of 54.1%, while sales of residential housing increased by 60.3%. The area of land acquired by real estate developers was 35.77 million m^2, a YoY decrease of 11.7%.
- At the end of March, the available-for-sale areas of commodity housing amounted to 735.16 million m^2, a YoY increase of 13.1%. The capital of real estate development enterprises in the first quarter was RMB 3.1992 trillion, a YoY increase of 14.7%.

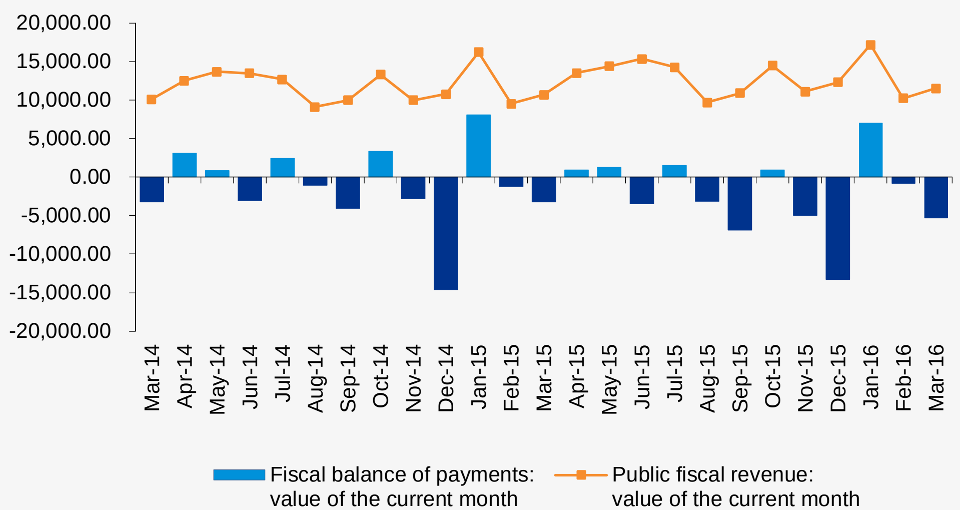
Source: National Bureau of Statistics of the People's Republic of China and Wind Info

- In the first quarter of 2016, the price of new commodity housing and second-hand residential housing sustained a slight MoM growth, while the number of cities building new commodity housing in March increased compared with the previous month. At the same time, house prices continued to surge. Compared with last month, there were 15 more cities experiencing higher MoM prices for their new commodity housing and 8 fewer cities experiencing flat MoM prices. As for second-hand residential housing, there were 20 more cities experiencing higher MoM prices and five fewer cities experiencing flat MoM prices. In March, among 70 large and mid-sized cities, the average increase of new commodity and second-hand residential housing MoM was 0.6% and 1.2% respectively. The rapid increase in house prices was mostly felt by first tier cities along with a handful of popular second tier cities. Other second and third tier cities maintained stable house prices.
- The price of new commodity and second-hand residential housing grew YoY as more cities experienced an increase in prices. In March, 40 cities experienced an increase in the price of new commodity housing, while 46 cities experienced an increase in the price of second-hand residential housing, representing a MoM increase of eight and five cities respectively. All of the cities that experienced an increase in the price of new commodity housing also saw a MoM increase in prices, while 43 out of the 46 cities that experienced a YoY increase in the price of second-hand residential housing also saw a MoM increase in prices.

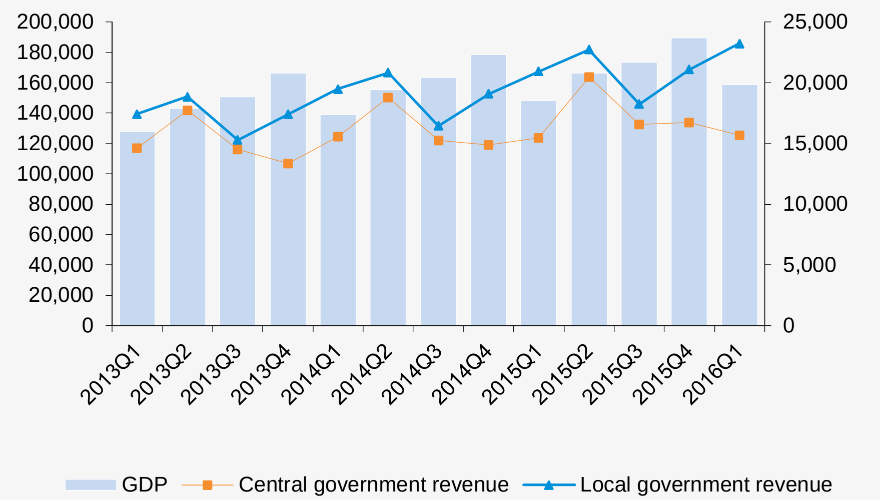
© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Government finance

Monthly fiscal balances (RMB 100 million)



Fiscal revenue and GDP (RMB 100 million)



- In the first quarter of 2016, public fiscal revenue amounted to RMB 3.8896 trillion at the national level, a YoY increase of 6.5% and an increase of 0.7% in terms of YoY growth. The general budgetary revenue of the central government reached RMB 1.5666 trillion, a YoY increase of 1.2% and the general budgetary revenue of local governments reached RMB 2.3230 trillion, a YoY increase of 10.4%. Taxes raised by central government amounted to RMB 3.2954 trillion, a YoY increase of 7.8%. In summary, the fall in imports along with changes to vehicle purchase tax led to a decline in central government tax revenue, whereas local government tax revenue grew due to the increase in property sales in some areas.
- In the first quarter of 2016, national public expenditure reached RMB 3.7958 trillion, a YoY increase of 15.4%. The central government spent RMB 505.0 billion, a YoY increase of 4.3%, while local governments spent RMB 3.2908 trillion, a YoY increase of 17.4%.

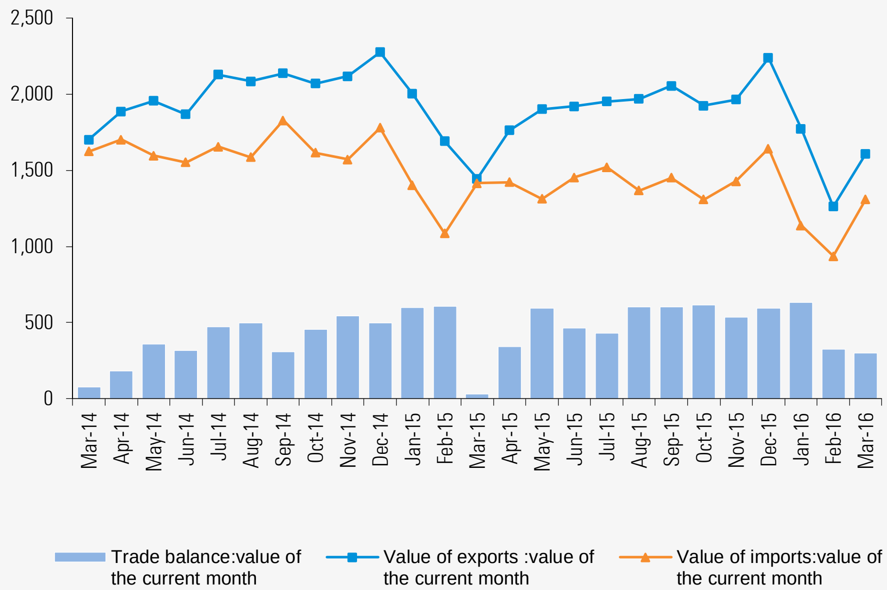
- GDP amounted to RMB 15.8526 trillion in the first quarter of 2016, representing a YoY increase of 6.7% calculated by comparable prices. In term of sectors, the value added by the primary, secondary and tertiary sectors was RMB 880.3 billion, RMB 5.9510 trillion and RMB 9.0214 trillion respectively, which represented an increase of 2.9%, 5.8% and 7.6%. When compared with last year, GDP grew in the first quarter of 2016 by RMB 985.1 billion, an increase of RMB 22.2 billion compared with the same period for the previous year.
- The proportion of national fiscal revenue to GDP stabilised at around 25% in the first quarter of 2016, which is similar to the corresponding period for 2015.

Source: National Bureau of Statistics of the People's Republic of China and Wind Info

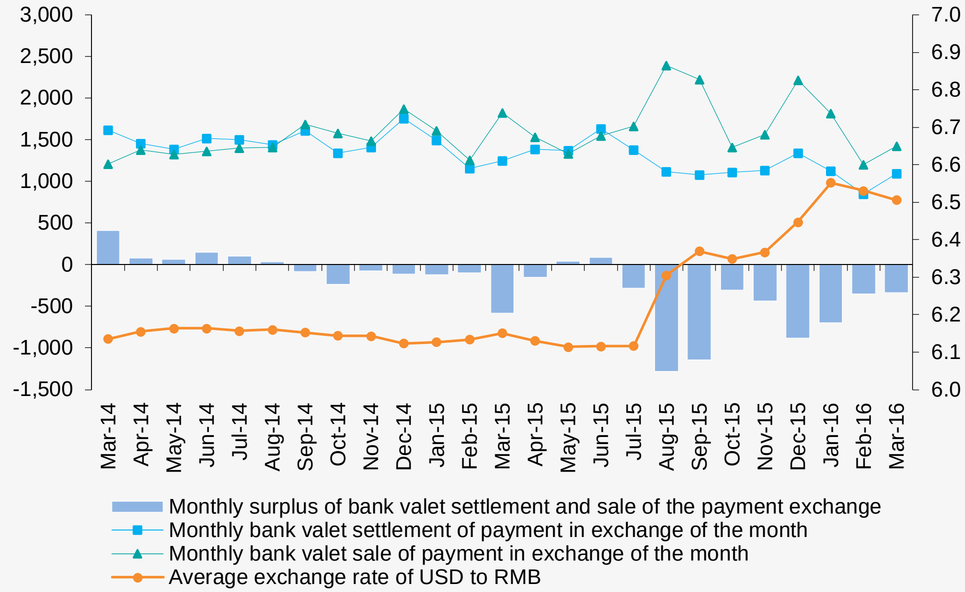
© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Foreign trade and exchange rate

Import and export trade (USD hundred million)



Bank valet exchange settlement and sale and exchange rate



- In the first quarter of 2016, the total volume of import and export trade was USD 802.1 billion, which represents a YoY decline of 5.9%.
- The volume of export trade reached USD 463.9 billion, a decline of 4.2% and the volume of import trade was USD 338.2 billion, a decline of 8.2%. The trade surplus was USD 125.7 billion.
- In March 2016, the total volume of import and export trade reached USD 291.8 billion, a YoY increase of 8.6%. Exports accounted for USD 160.8 billion, up 18.7% and imports accounted for USD 131.0 billion, down 1.7%.

- In the first quarter of 2016, bank valet exchange settlements added up to USD 350 billion, a YoY decline of 21.3% excluding the effects of foreign exchange. Bank valet exchange sales reached USD 474.7 billion, a YoY decline of 5.2%. Settlement and sales accounted for a deficit of USD 124.8 billion, down 14.6% compared with the fourth quarter of 2015.
- Compared with the fourth quarter of 2015, RMB depreciated against USD in the first quarter of 2016. The monthly average exchange rate of USD to RMB rose from 6.4476 to 6.5064.

Source: National Bureau of Statistics, Wind Info and State Administration of Foreign Exchange

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

2 Analysis of 2016 Q1 financial data of listed banks

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.
Printed in China.

Conditions of assets – Asset scale and quality

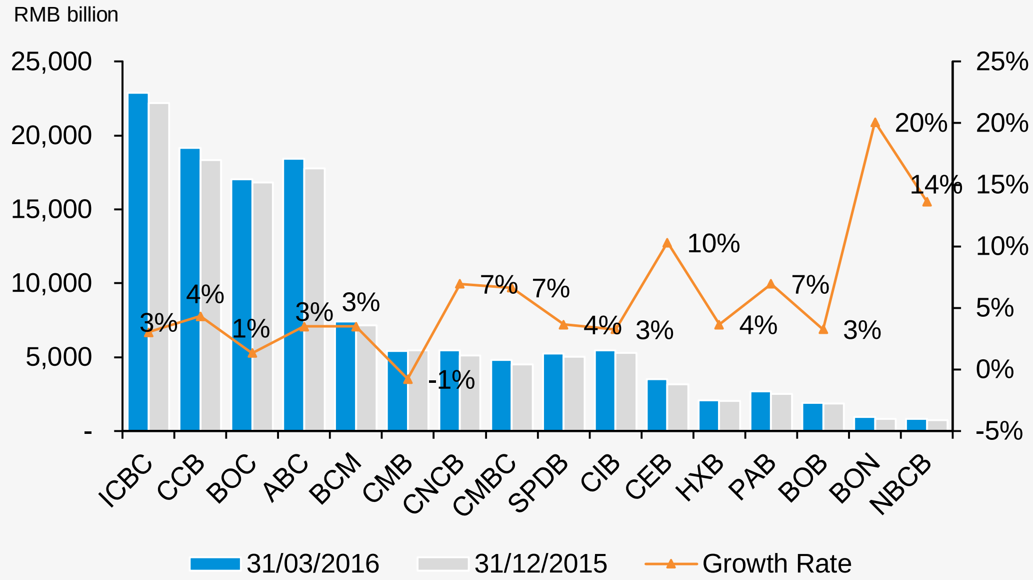
In the first quarter of 2016, the assets and liabilities of the banking sector continued to expand. Banks placed more emphasis on balancing capital, risk and income and further optimising their asset allocation structures. While striving to expand interest-bearing assets, they also intensified risk control efforts. As non-credit assets became increasingly important, banks started to take an active stance on their liability businesses and tried to diversify the risk though their bond, interbank deposits and asset securitisation businesses.

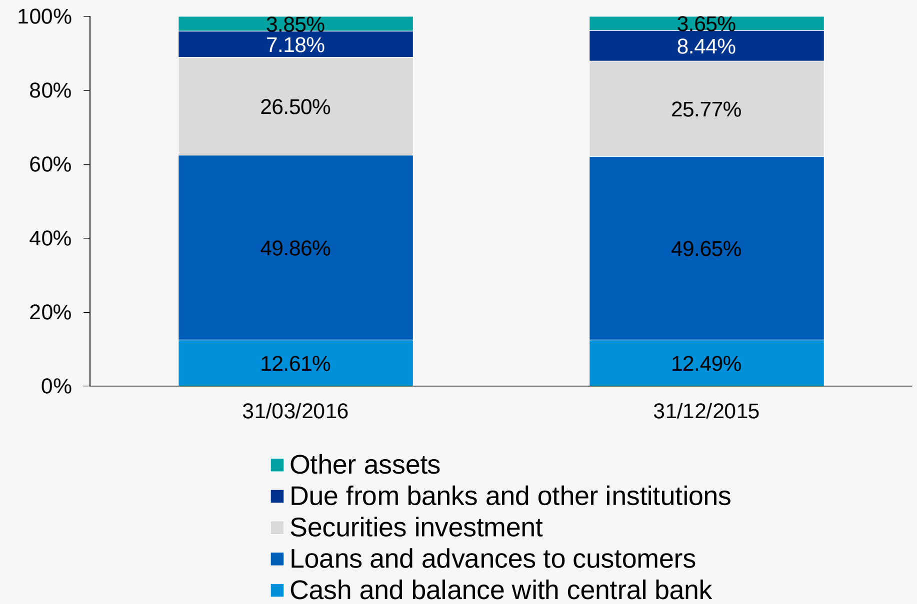
In the first quarter of 2016, securities investment took up an increasing share of banks' total assets. Affected by the exposure to bill risks in early 2016 and narrowed gains from interest arbitrage resulting from stronger regulations in the interbank market, interbank assets declined in the first quarter of 2016, while securities investment increased. Bank deposits grew at a slower rate and saw no significant change in their share in banks' asset structures. Optimisation of liability structures continued to be an ongoing process for listed banks.

In the midst of the economic slowdown, credit demand remained sluggish. Interest-bearing assets grew at a slow but steady rate. Buoyed by destocking policies, property markets across the country recovered, which led to an increase in real estate loans and a significant increase in loans to small businesses and consumers to buy property. With an increase in credit risk, listed banks saw an increase in total non-performing loans (NPLs) and most recorded an increase in NPL ratios.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Conditions of assets – Asset scale and structure





In the first quarter of 2016, the total asset size of all listed banks expanded, mainly due to increased securities investment as well as loans and advances to customers.

Compared with the five major state-owned banks, some of the joint-stock commercial banks were more aggressive in their pursuit of expansion. The total asset size of BON increased by 20%, which represented the largest increase out of the listed banks. This was mainly due to the growth in its securities investment and loans and advances to customers. The total asset sizes of NBCB and CEB, the banks that experienced the next largest expansion, increased by 14% and 10% respectively.

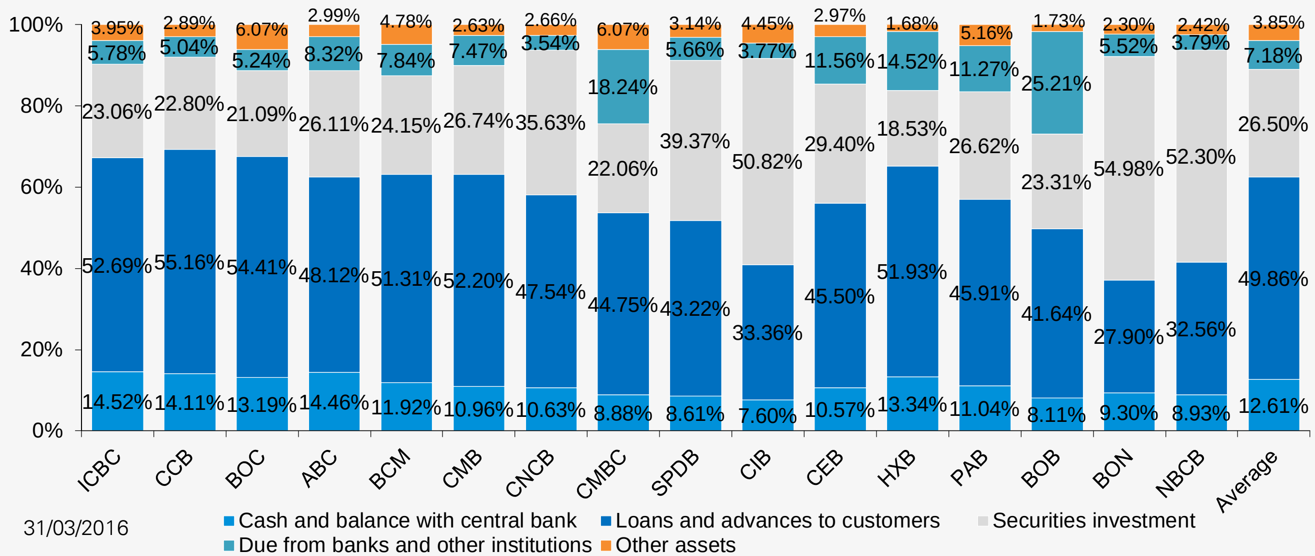
The asset structures of the listed banks also changed when compared with the end of last year. The ratio of securities investment increased by 0.73%, the ratio of loans and advances to customers increased by 0.21%, the ratio of other assets increased by 0.2% and the ratio of cash on hand and deposits with central bank increased by 0.12%, while the ratio of amounts due from banks and other institutions fell by 1.26%.

Following the slowdown in China's economy and heightened credit risk, listed banks sought to mitigate any risk through measures such as raising the credit threshold for borrowers and reducing their lending to industries or sectors with high risk. At the same time, banks also tried to lower their risk exposure by adjusting the direction of loans being approved towards different industries and optimising asset structures.

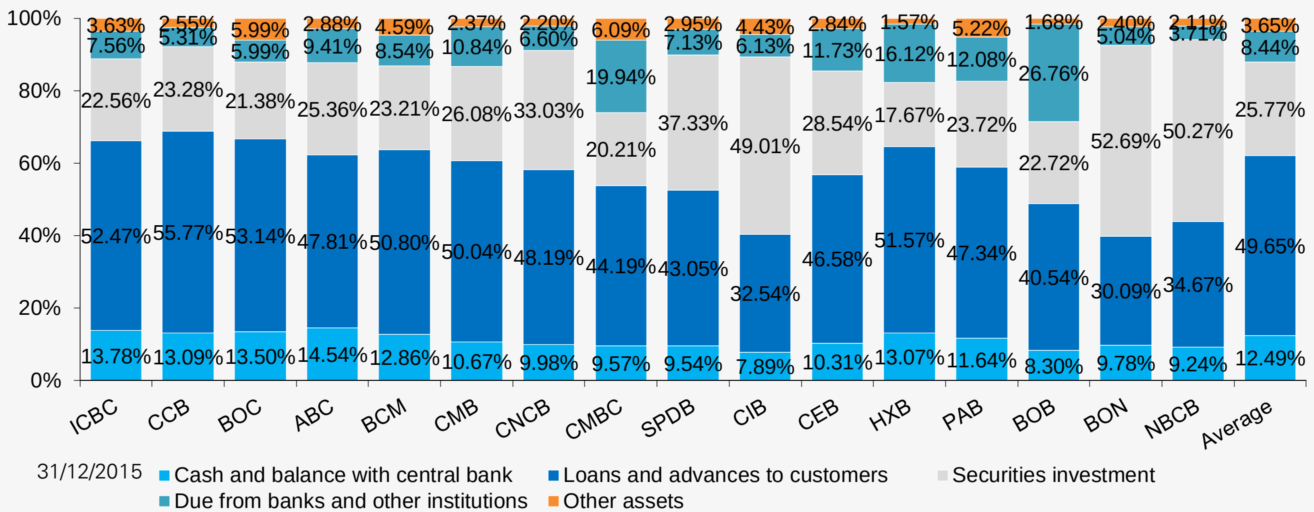
Sources: The banks' 2015 annual reports and 2016 Q1 reports; KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Conditions of assets – Asset structure



Compared with the end of 2015, the average ratio of loans and advances to customers among 10 listed banks increased in the first quarter of 2016 with CMB recording the highest growth rate with 2.16%. Among the four major state-owned banks, only CCB saw its ratio of loans and advances to customers fall. The ratio of securities investment among most listed banks increased with the ratios of CNCB and PAB growing 2.6% and 2.9% respectively. Meanwhile, compared with the end of 2015, the average ratio of amounts due from banks and other institutions to 14 listed banks decreased with the highest decline recorded by CMB with 3.37% followed by CNCB with 3.06%.



In the first quarter of 2016, the banking sector remained supportive of China's real economy, strengthened risk management and control functions and adjusted loan structures accordingly.

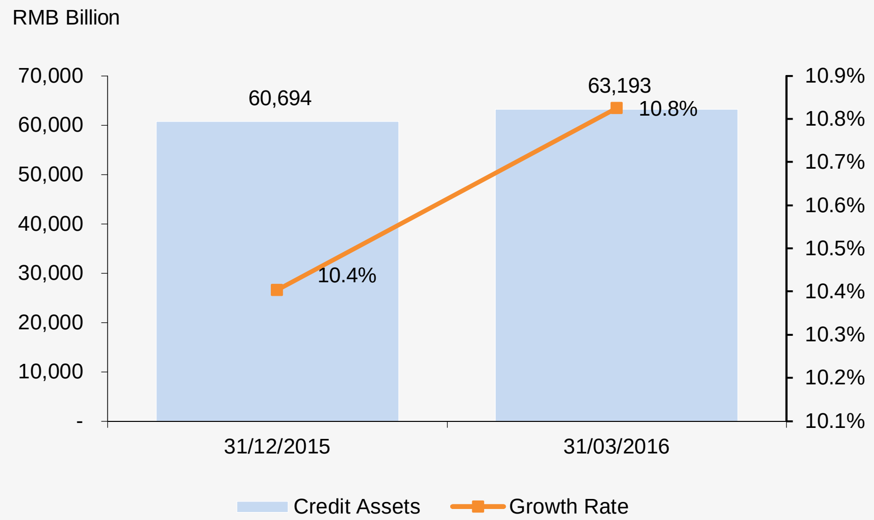
Meanwhile, with tougher regulations, interbank assets increasingly served the purpose of liquidity management. Amid internal structural adjustments to interbank assets, changes in risk weighting reduced the gains banks were able to make from interest arbitrage, resulting in a decline in the growth of the share of interbank assets in banks' total assets.

Sources: The banks' 2015 annual reports and 2016 Q1 reports; KPMG China research

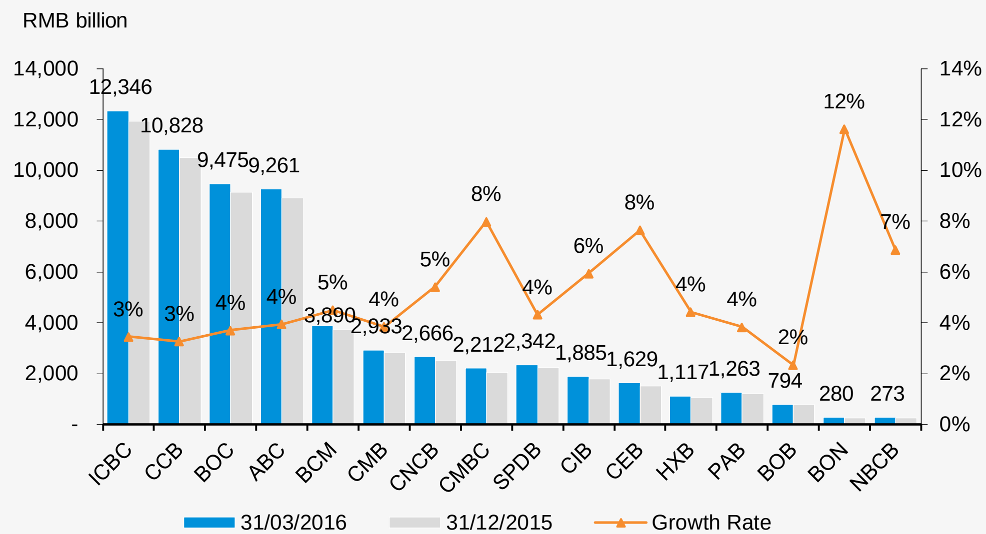
© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Conditions of assets – Total loans

Credit assets



Credit assets



In the first quarter of 2016, the total scale of credit assets of listed banks was RMB 63.19 trillion, which represents a YoY increase of 10.8%.

Since the beginning of 2016, China's government has begun to make progress with its economic reforms and the central bank has continued to pursue prudent monetary policies. Under these circumstances, demand for loans has risen and while listed banks expanded their lending, they also engaged in asset restructuring and strengthened their risk control efforts.

In the first quarter of 2016, the growth rate of credit assets among listed banks began to slow even though the credit assets of 16 banks still increased compared with the end of last year.

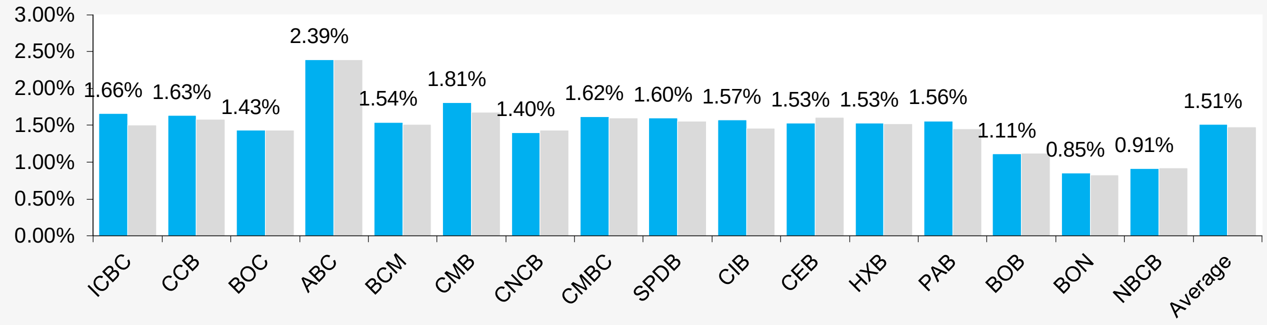
Some of the smaller banks recorded higher than average growth rates such as BON, CMBC and CEB. BON's new loans were mostly granted to support the development of the real economy, small and micro businesses and San Nong (agriculture, farming and rural areas) and livelihood projects. CMBC's loans were more targeted towards supporting the growth of consumption, while CEB's loans were used for the benefit of a number of large projects as well as small and micro businesses.

Sources: The banks' 2015 annual reports and 2016 Q1 reports; KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

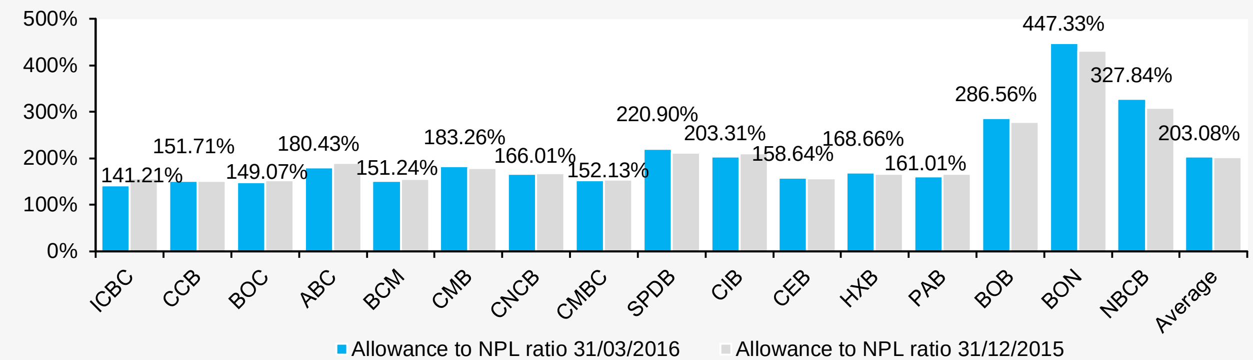
Conditions of assets — Loan quality

NPL ratio



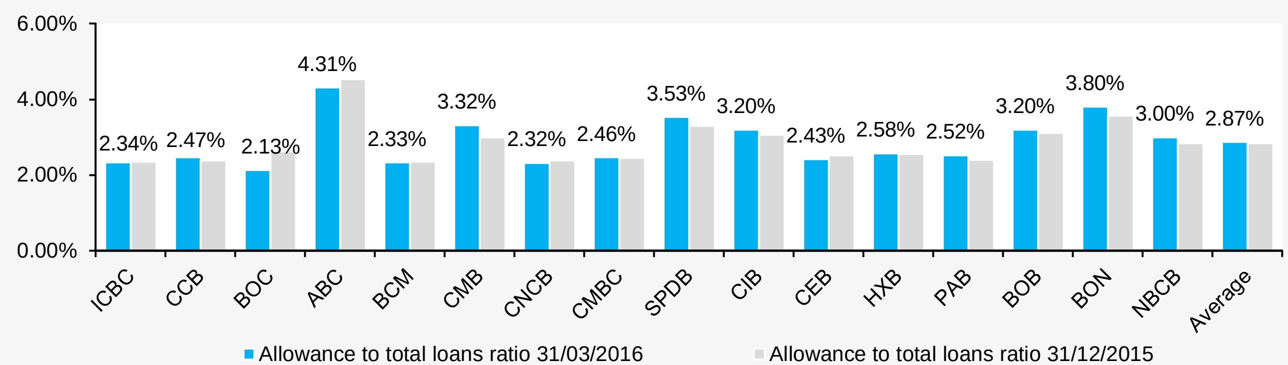
In the first quarter of 2016, NPL ratios among most listed banks increased when compared with the end of 2015 with the ratio for 11 listed banks exceeding 1.5%. This meant that the average NPL ratio was 1.51% compared with 1.47% during the previous year. NBCB recorded the lowest NPL ratio with 0.85%, which represents an increase of 0.02% compared with the end of last year. ABC recorded the highest NPL ratio with 2.39%, which was the same as last year.

Allowance to NPL ratio



When compared with international banks, the allowance provided by domestic banks to offset losses arising from NPLs remains high. However, rising NPL ratios mean that allowance to NPL ratios increased among eight listed banks. BON recorded the highest allowance to NPL ratio with 447.33%.

Allowance to total loans ratio

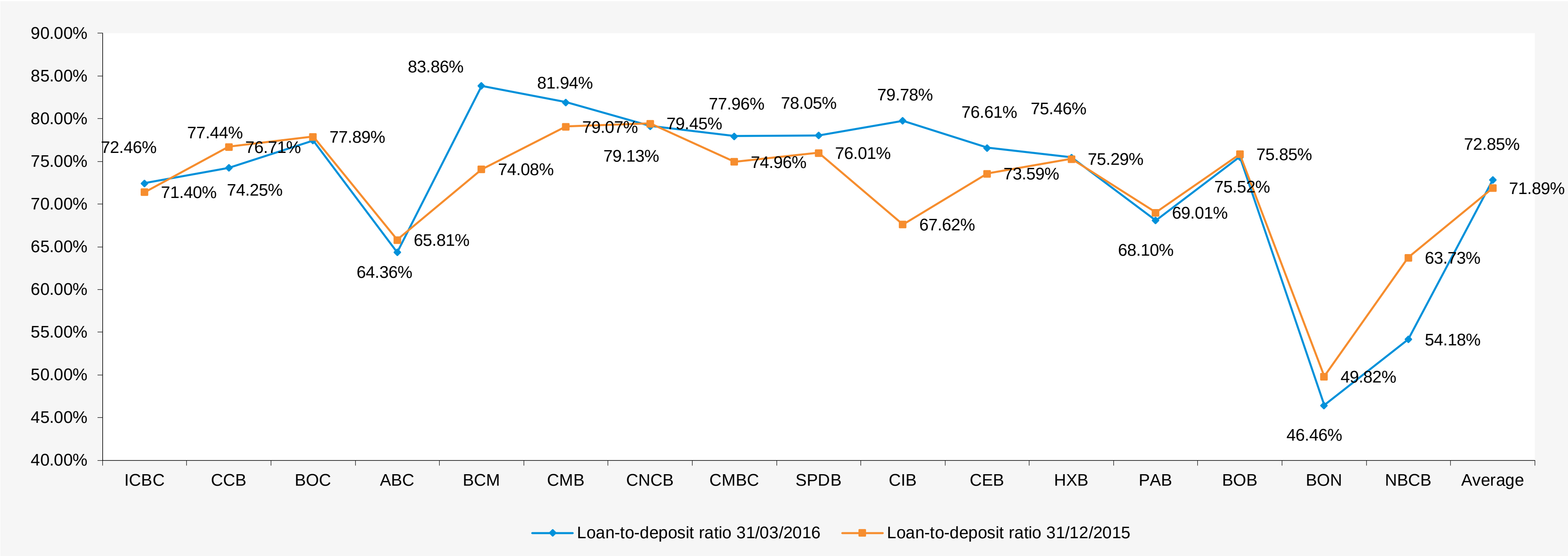


The allowance to total loans ratio of listed banks varied between 2.13% and 3.80% with the exception of ABC, which had a ratio of 4.31%.

Sources: The banks' 2015 annual reports and 2016 Q1 reports; KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Conditions of assets — Loan-to-deposit ratio

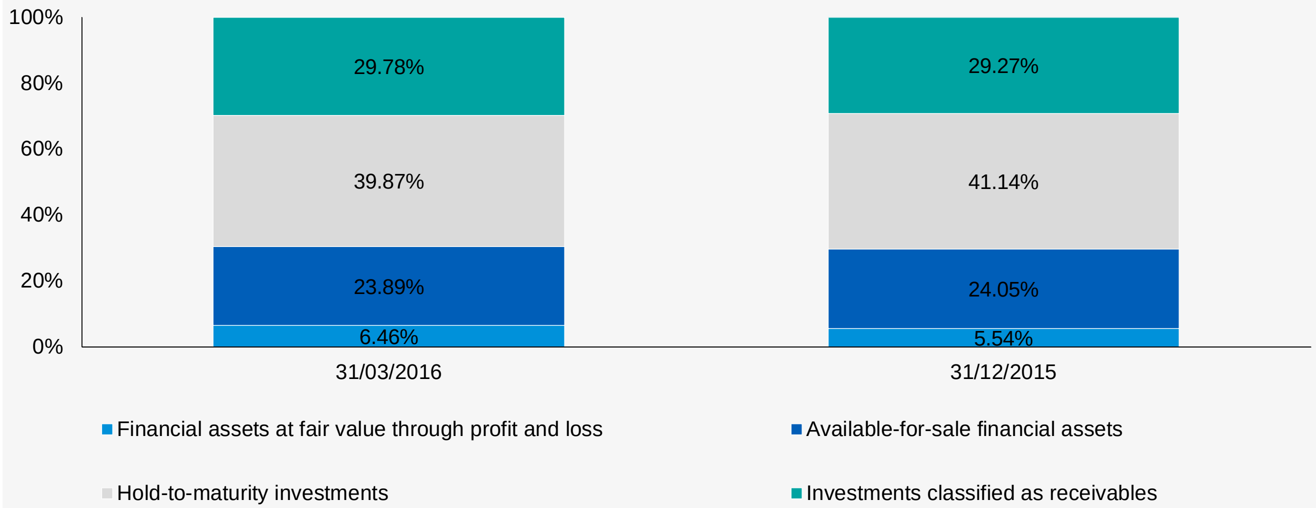


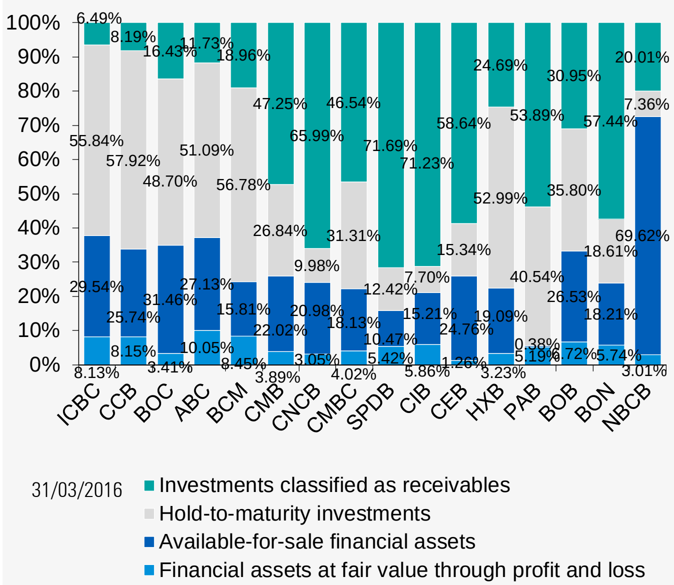
In the first quarter of 2016, the loan-to-deposit ratio (LDR) for most listed banks increased compared with the end of 2015. The overall deposit amounts increased during this same period along with the growth rate when compared with the same period for the previous year. According to statistics published by the PBOC, deposit rates rose by 2.9%, while the growth rate for loans rose by 0.7% compared with the same period for the previous year. The widening disparity between the growth rate of deposits and loans resulted in an increase in LDR. CIB experienced the biggest growth in LDR, posting an increase of 12.16%. CIB increased the size of its loan book to support the development of the real economy. As a result, its growth rate for deposits was lower than its growth rate for loans. NBCB experienced the sharpest decrease with its ratio falling 9.55%.

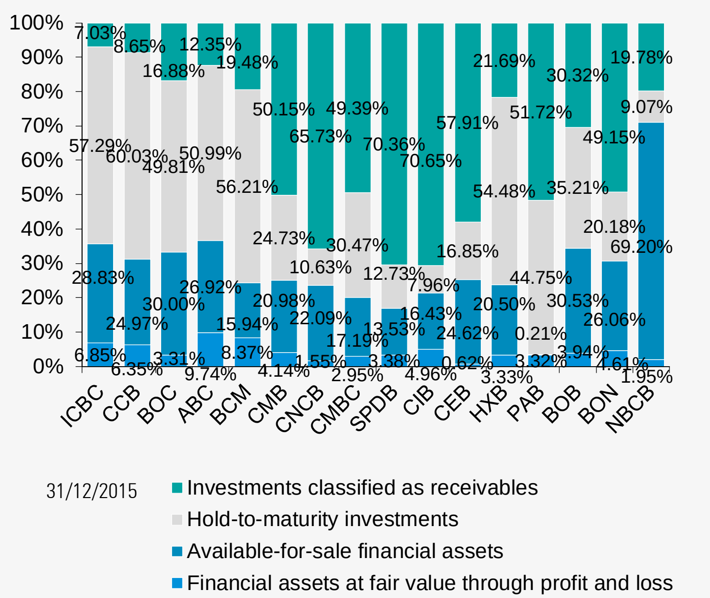
Sources: The banks' 2015 annual reports and 2016 Q1 reports; KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Conditions of assets – Securities investment







Sources: The banks' 2015 annual reports and 2016 Q1 reports; KPMG China research

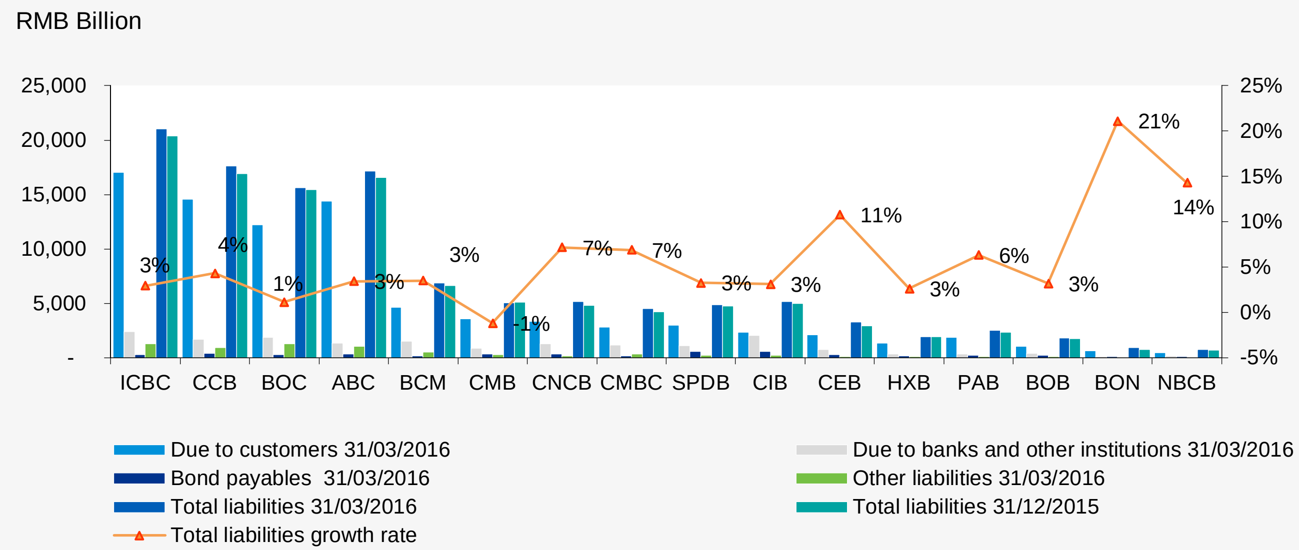
During the first quarter of 2016, listed banks increased the scale of their securities investment within their asset structures. Overall investment increased by an average rate of 6.67% compared with the end of 2015.

As for general securities investment structures, held-for-trading financial assets and investments classified as receivables took up a larger share compared with the end of last year, while available-for-sale financial assets and held-to-maturity investments recorded a smaller share. The held-for-trading financial assets to securities investment ratios of ABC, BCM, CCB and ICBC all hovered around 8%.

In the first quarter of 2016, securities investment structures of listed banks differed. The five major state-owned banks still held a high percentage of held-to-maturity investments, while other commercial banks increased the proportion of their investments classified as receivables and available-for-sale financial assets to varying degrees.

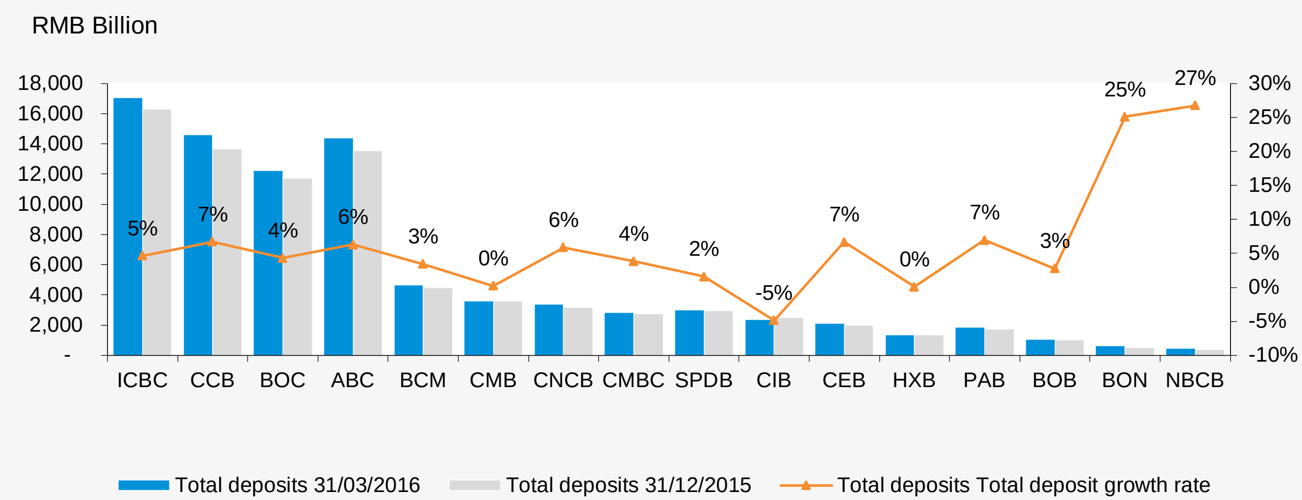
© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Conditions of liabilities — Liability structure



In the first quarter of 2016, the total liabilities of listed banks increased on average by 6% when compared with the end of 2015, demonstrating a similar trend to total assets.

Joint-stock commercial banks' liabilities grew much faster. BON recorded the highest increase with 21% followed by NBCB with 14% and CEB with 11%. This increase was mainly due to the increase in deposits from customers and the increase in other liabilities.



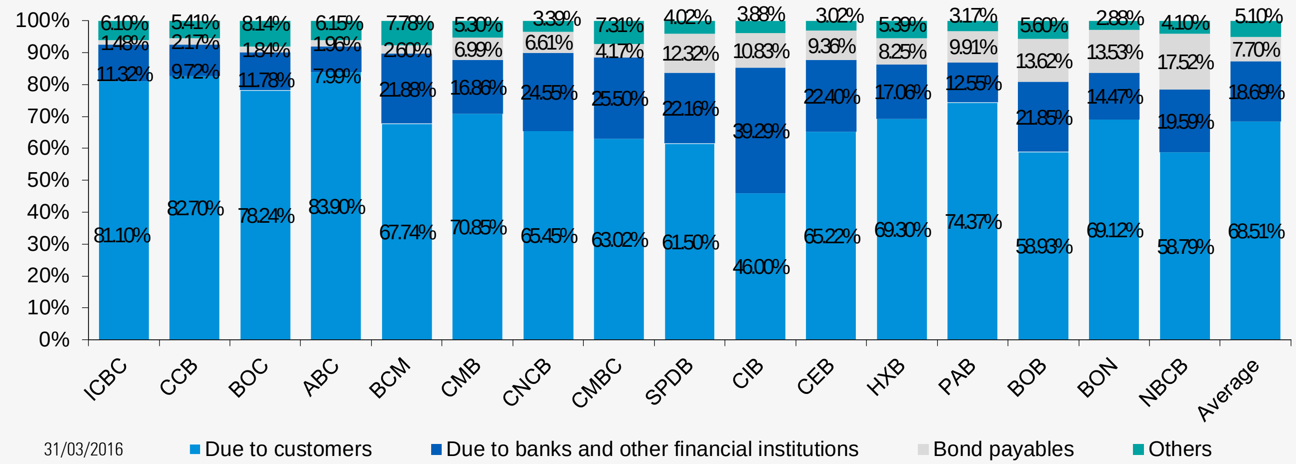
In the first quarter of 2016, total deposits reached RMB 85.5 trillion, an increase of 5% compared with the end of 2015, mainly due to capital flows from sluggish equity markets. NBCB recorded the highest increase in deposits with 27% followed by BON with 25%.

Sources: The banks' 2015 annual reports and 2016 Q1 reports; KPMG China research

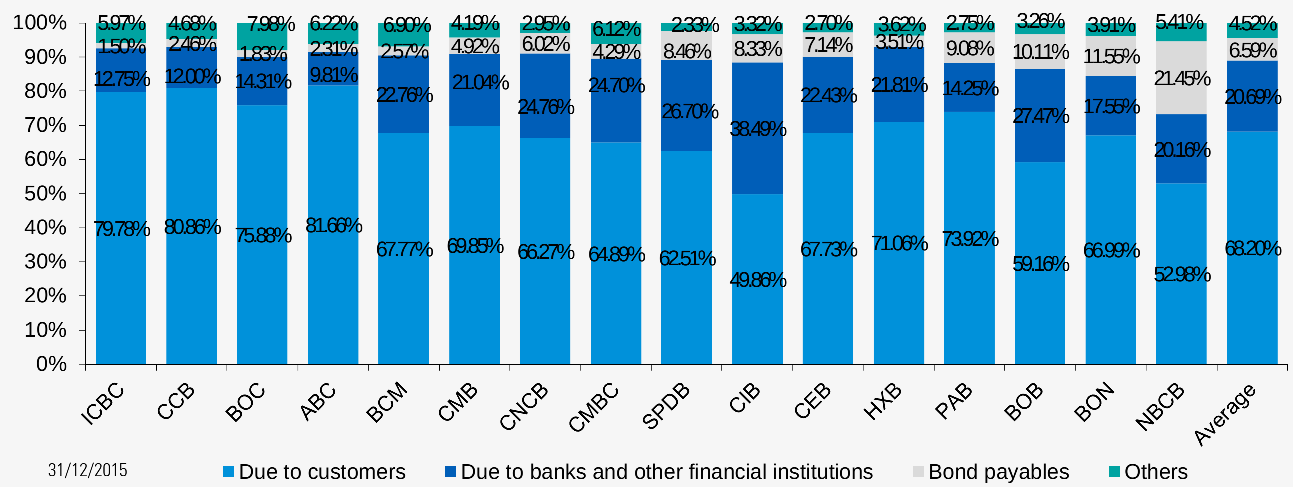
© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Conditions of liabilities – Liability structure (continued)

Liability structures



Liability structures



In the first quarter of 2016, customer deposits formed the largest component of listed banks' liabilities. The five major state-owned banks had higher deposit totals with ICBC, CCB and ABC each recording proportions of over 80%, reflecting the advantages they hold in attracting customers.

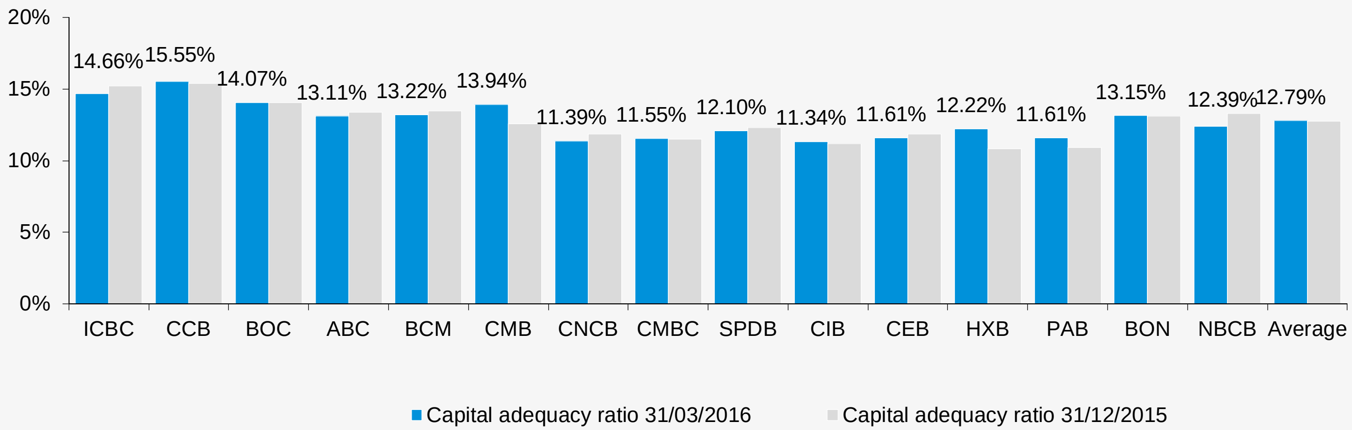
In comparison, joint-stock commercial banks held a higher proportion of interbank liabilities than the big five state-owned banks, for example the proportion of interbank liabilities held by CIB was 39.29%. Since joint-stock banks often lack deposit resources, they need to regularly borrow in the interbank market. At the same time, they also have to take steps to develop a diversified range of products in order to optimise asset allocation. Liquidity gaps arising from allocation of interbank assets often need to be filled by their interbank liability businesses. During the first quarter of 2016, the liability structure of listed banks remained the same as it was at the end of the previous year.

Amid interest rate liberalisation and the emergence of various FinTech start-ups, there exists intense competition for funding. In response to this, listed banks continue to improve the structure of their liability businesses, increase efforts to boost deposits and expand the channels for raising liabilities in order to develop their liability businesses.

Sources: The banks' 2015 annual reports and 2016 Q1 reports; KPMG China research

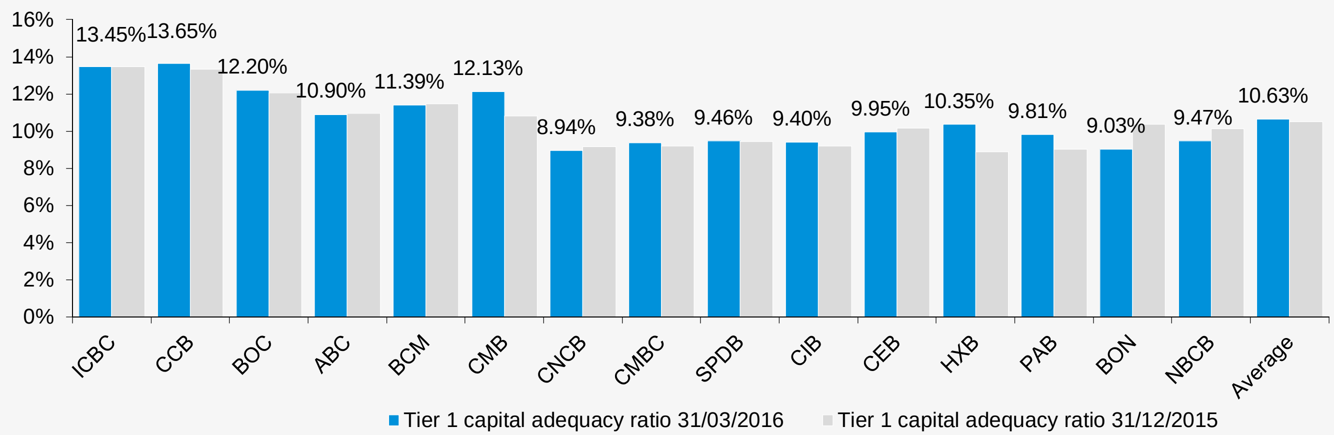
© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Risk management – Capital adequacy ratio and tier 1 capital adequacy ratio



NOTE: BOB did not disclose the relevant data.

As of 31 March 2016, the average capital adequacy ratio of listed banks was 12.79%, an increase of 0.05% compared with the end of 2015. Half of the listed banks saw their capital adequacy ratios increase with the highest increases recorded by CMB and HXB with 1.37% each. This is explained by the fact that the growth rate of average risk-weighted assets was significantly lower than the growth rate of net capital.



NOTE: BOB did not disclose the relevant data.

As of 31 March 2016, the average tier 1 capital adequacy ratio of listed banks was 10.63%, an increase of 0.12% compared with the end of 2015. BON posted the sharpest decrease with its ratio falling 1.32%, due to the fact that the growth rate of its average risk-weighted assets was higher than the growth rate of its tier 1 core capital.

Sources: The banks' 2015 annual reports and 2016 Q1 reports; KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Profitability — Analysis

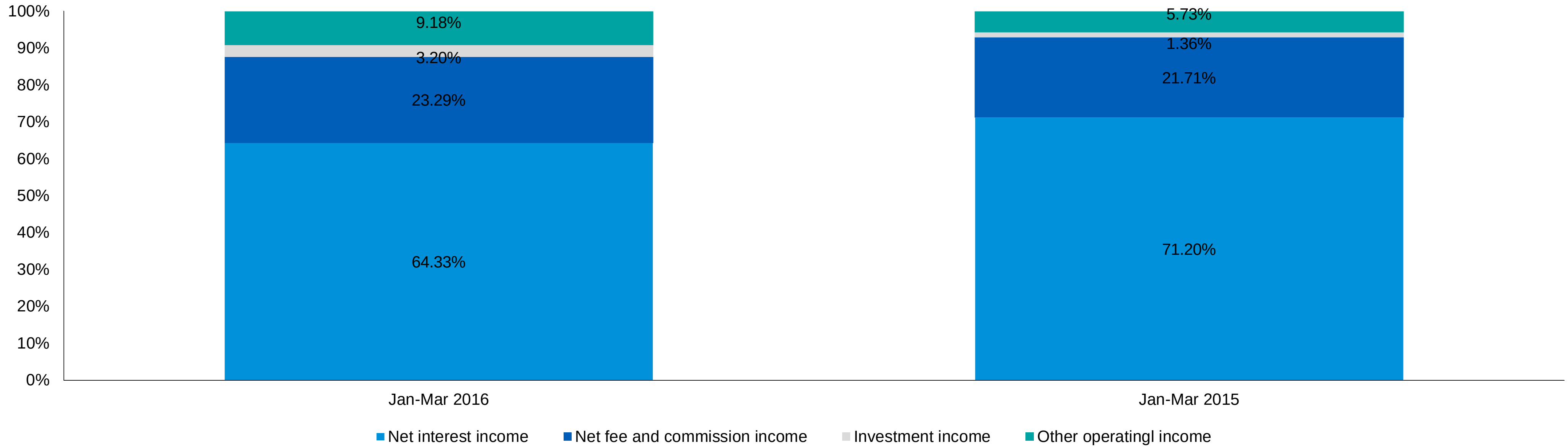
During the first quarter of 2016, net profits among listed banks increased YoY, albeit at a slower rate as the central bank released a lower benchmark loan rate. This assisted listed banks in their asset re-pricing, resulting in narrower net interest margins.

The expansion of interest-bearing assets and non-interest income along with cost reducations has been the main driver of listed banks' net profits. In the first quarter of 2016, interest-bearing assets grew steadily. Thanks to banks' intensified efforts to adjust income structures in 2016, non-interest income was growing at a fast rate. Banks also strengthened cost management initiatives, resulting in an improvement in their cost to income ratios.

At the same time, banks' NPL ratios continued to rise with credit costs hovering at a high level. Accrued allowances remained high and have become a major drag on net profits.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Profitability — Operating income and income structure analysis



The total operating income of listed banks increased by 10.56% YoY in the first quarter of 2016.

Components of operating income during the first quarter of 2016 were as follows:

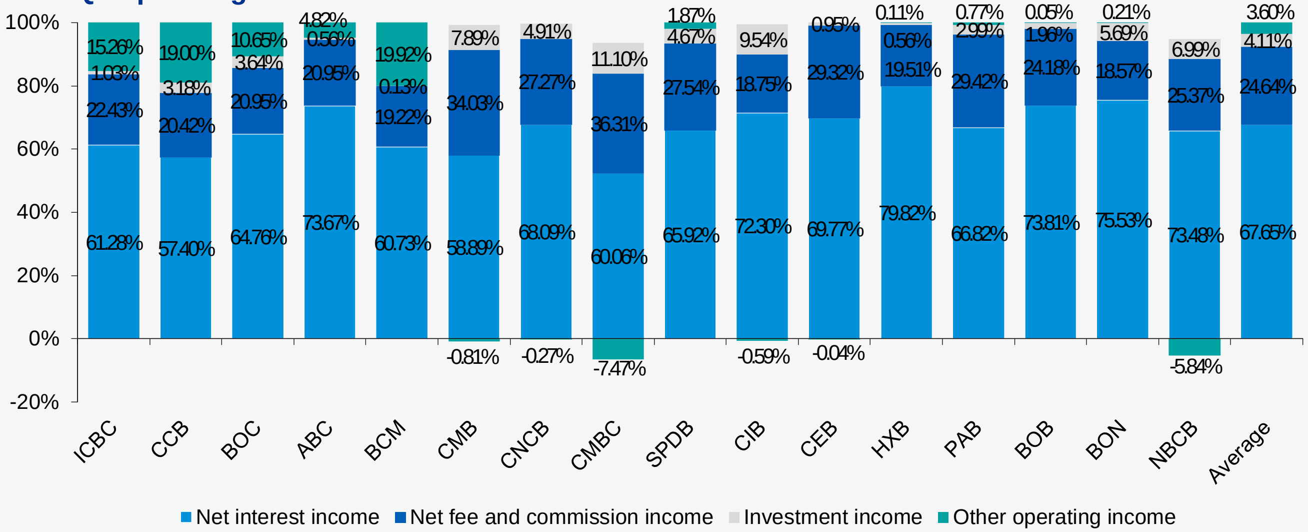
- net interest income accounted for 64.33%, declining by 6.87% YoY,
- net fee and commission income accounted for 23.29%, increasing by 1.58% YoY,
- investment income accounted for 3.2%, increasing by 1.84% YoY,
- other operating income accounted for 9.18%, increasing by 3.45% YoY. Other operating income mainly consists of gains from changes in fair value, foreign exchange and other operating income.

Sources: The banks' 2015 annual reports and 2016 Q1 reports; KPMG China research

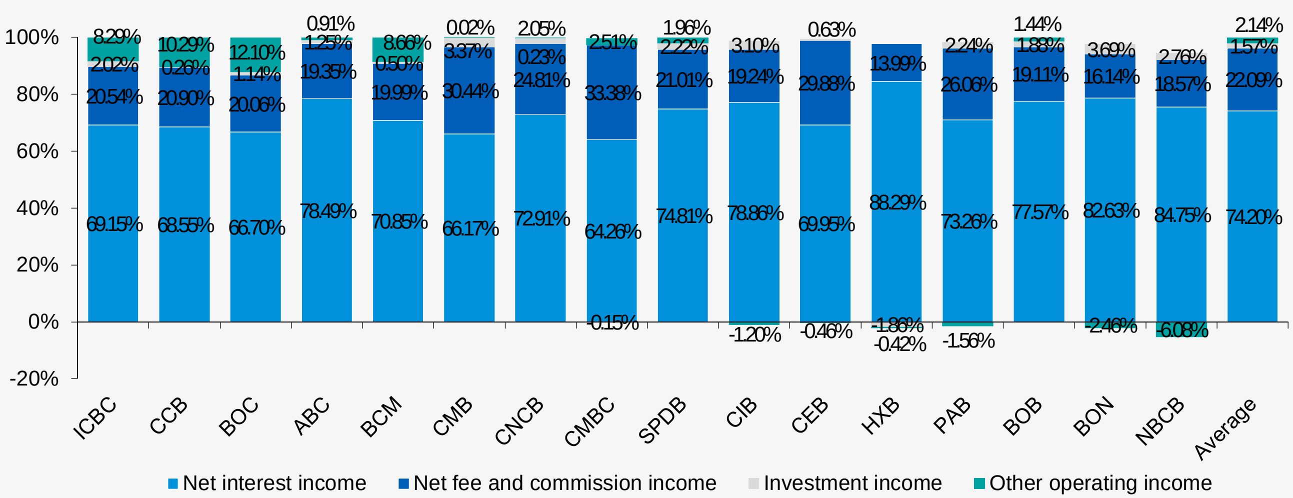
© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Profitability – Operating income and income structure analysis (continued)

2016 Q1 operating income structure



2015 Q1 operating income structure



In the first quarter of 2016, net interest income among listed banks accounted for 67.65% of operating income on average, while net fee and commission income and investment income accounted for 24.64% and 4.11% respectively.

Compared with the first quarter of 2015, the average ratio of net interest income among listed banks declined, mainly due to listed banks adjusting their income structures and reducing their reliance on interest income against the backdrop of tightening net interest spreads and net interest margins.

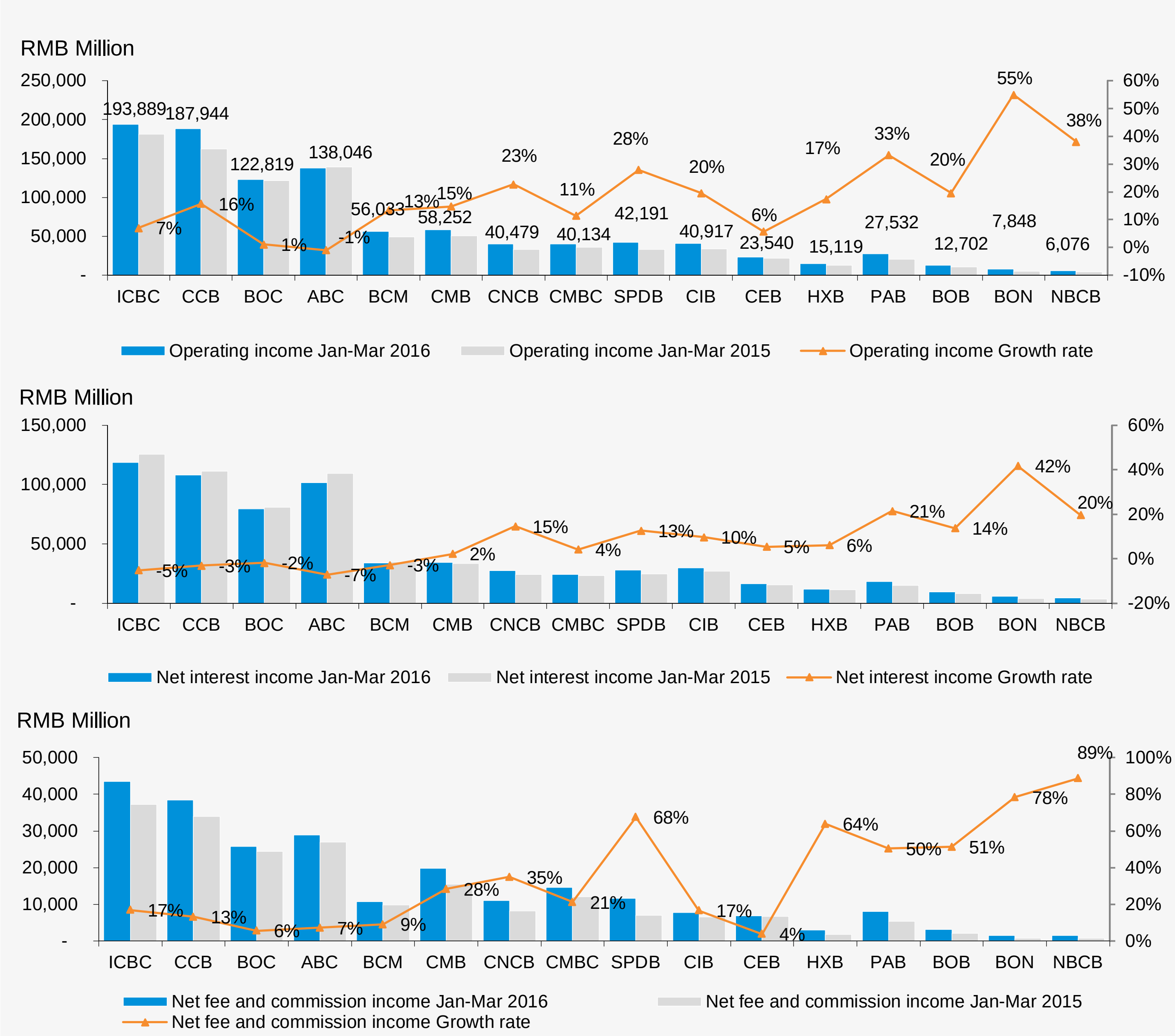
In the first quarter of 2016, the average ratio of net fee and commission income for listed banks increased by 2.55% YoY, mainly due to the increase in income sourced from consulting, wealth management, agency and commission and bank card services.

In the first quarter of 2016, the average ratio of investment income for listed banks increased by 2.54%, while other operating income increased by 1.46% YoY. CCB and BCM had the highest proportion of other operating income among the listed banks with 19% and 19.92% respectively.

Sources: The banks' 2015 annual reports and 2016 Q1 reports; KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Profitability – Operating income and income structure analysis (continued)



In the first quarter of 2016, many listed banks experienced an increase in operating income compared with the same period for the previous year. This was due to the increase in net interest income and net commission income. BON enjoyed the largest increase with 55%, while NBCB posted an increase of 38%. In addition, the operating income of joint-stock banks grew significantly faster than that of the four major state-owned banks.

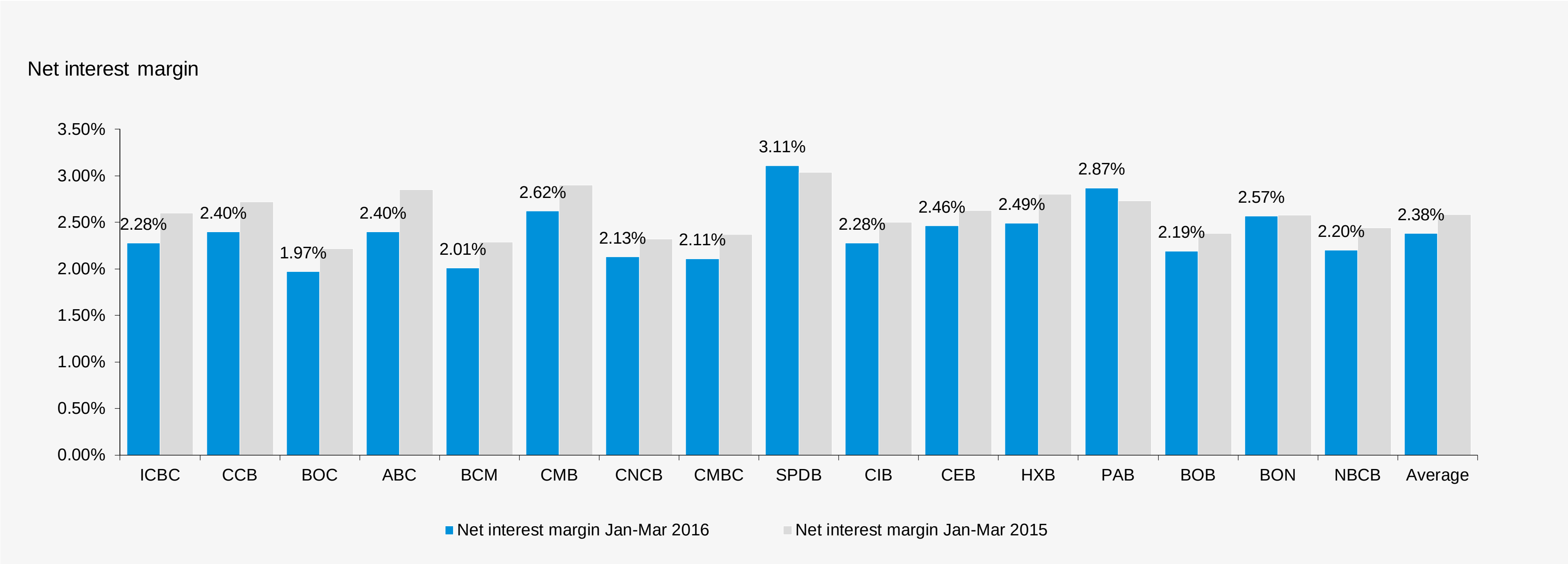
In the first quarter of 2016, the big four banks experienced a decline in net interest income YoY, mainly due to narrower interest margins. Many joint-stock banks saw their net interest income increase compared with the same period in the previous year. In the context of accelerating interest rate liberalisation, the increase in net interest income was mainly derived from the continued growth of interest-bearing assets. The net interest income of BON and PAB increased by 42% and 21% respectively compared with the same period for 2015.

In the first quarter of 2016, all listed banks experienced an increase in net commission income compared with the same period for last year. In spite of stricter monitoring of fee policy, new financial shocks and intense market competition, China's banks took proactive steps to adjust their income structures, promote financial innovation, diversify profit-making sources and reduce their reliance on traditional businesses. At the same time, they were responsible for a significant increase in investment banking, bank card and custody business, gold leasing and other intermediary business. As a result, NBCB's net commission income increased by 89% and that of BON and SPDB increased by 78% and 68% respectively.

Sources: The banks' 2015 annual reports and 2016 Q1 reports; KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Profitability — Net interest margin



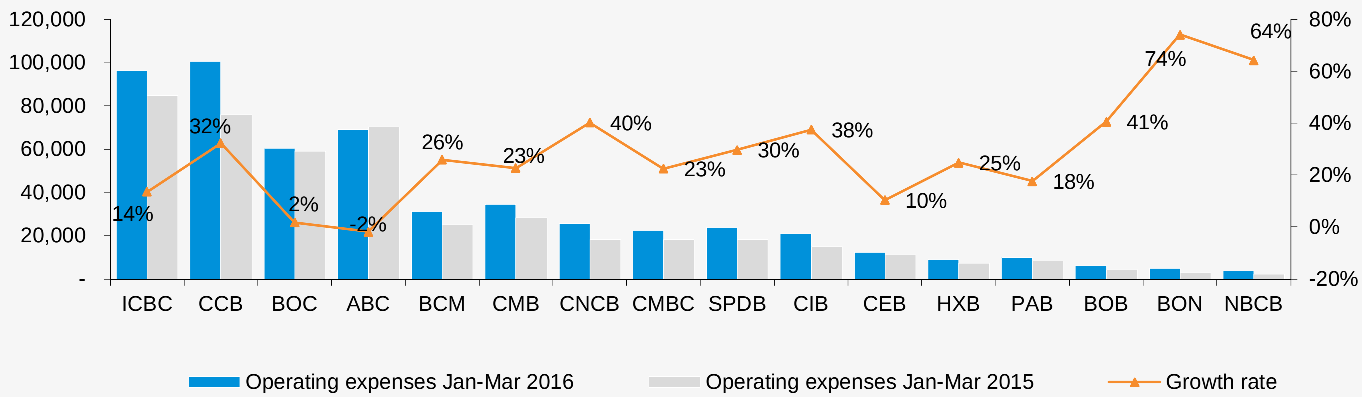
In the first quarter of 2016, the average net interest margin was 2.38%, down from the same period for 2015. Affected by the ongoing process of interest rate liberalisation and the impact of a lowered benchmark interest rate in 2015 on re-pricing in early 2016, net interest margins narrowed for the 16 listed banks. However, thanks to improved asset-liabilities structures and re-pricing management, some joint-stock commercial banks, such as PAB and SPDB, recorded a slight YoY increase in their net interest margins.

Sources: The banks' 2015 annual reports and 2016 Q1 reports; Wind info; KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

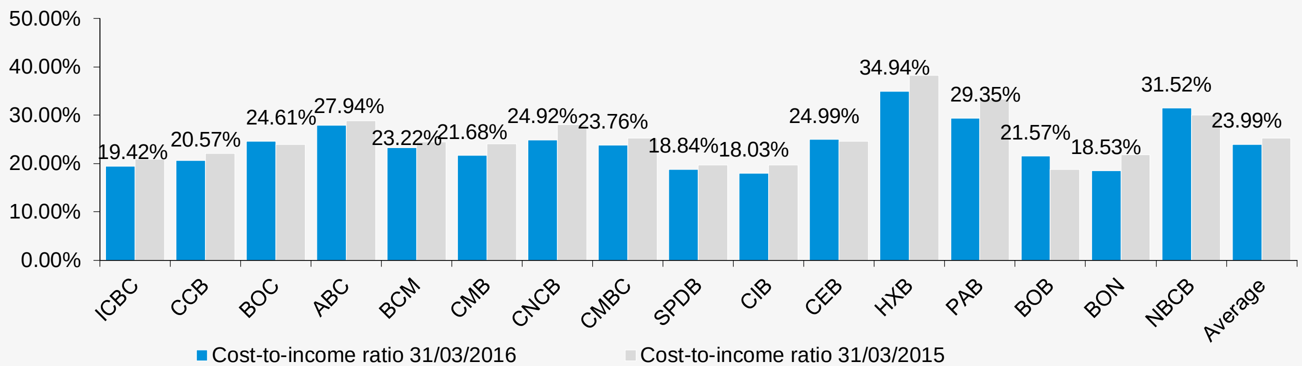
Profitability — Cost controls — Operating expenses and cost-to-income ratio

Operating expenses



The operating costs of all listed banks increased in the first quarter of 2016. The increase in asset impairment and the expansion of business scale drove the increase in their operating expenses. BON, NBCB and BOB experienced the highest growth rates of 74%, 64% and 41% respectively. The main reason for this was the increase in asset impairment provision for loans and advances among all three banks.

Cost-to-income ratio



In the first quarter of 2016, the average cost-to-income ratio among listed banks was 23.99%, a decline of 1.26% compared with the same period for the year prior. PAB and BON experienced the sharpest decline, falling 4.03% and 3.29% respectively. This was caused by optimisation in cost control.

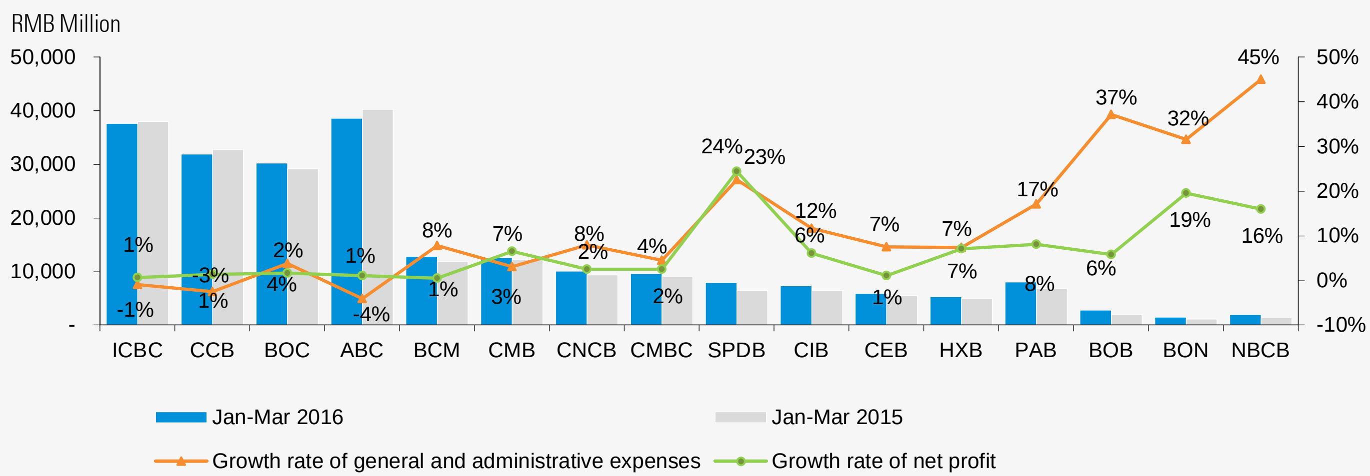
Given the increasing rigour of external regulations along with banks' need to remain competitive through continual innovation with respect to products and services, whether or not this low cost-to-income ratio can be sustained will be a key challenge affecting listed banks' profitability going forward.

Sources: The banks' 2015 annual reports and 2016 Q1 reports; KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

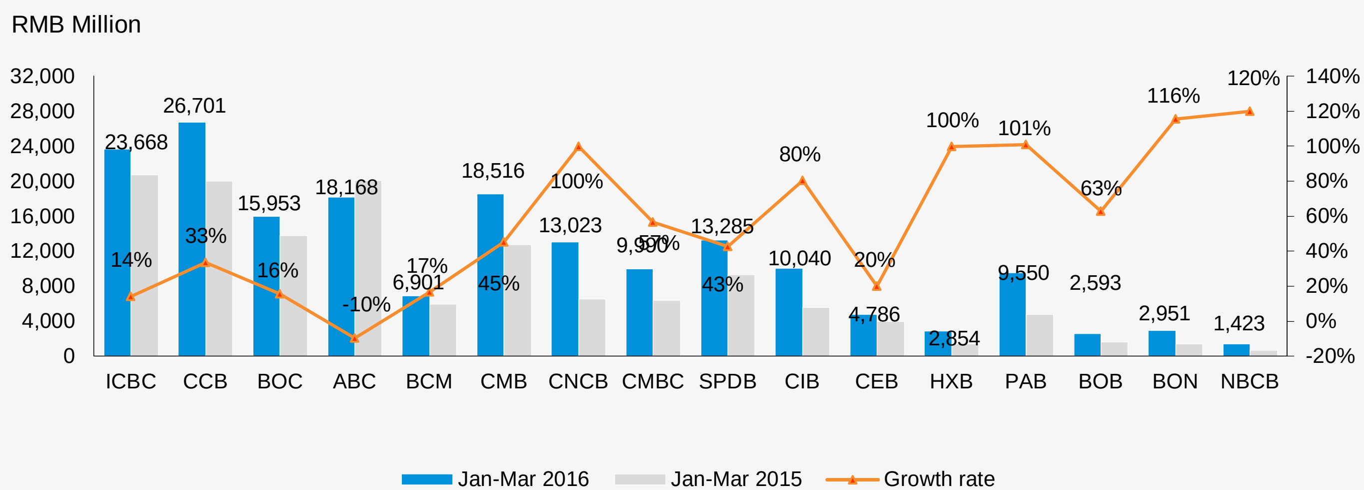
Profitability – Cost controls – General and administrative expenses and impairment losses

General and administrative expenses



In the first quarter of 2016, most listed banks saw an average increase of 12% in general and administrative expenses. NBCB and BOB experienced the highest growth rates, reporting increases of 45% and 37% respectively. This was mainly due to the expansion in business scale, establishment of new outlets, adjustments to business strategies and stricter control over expenditure for business management.

Impairment losses

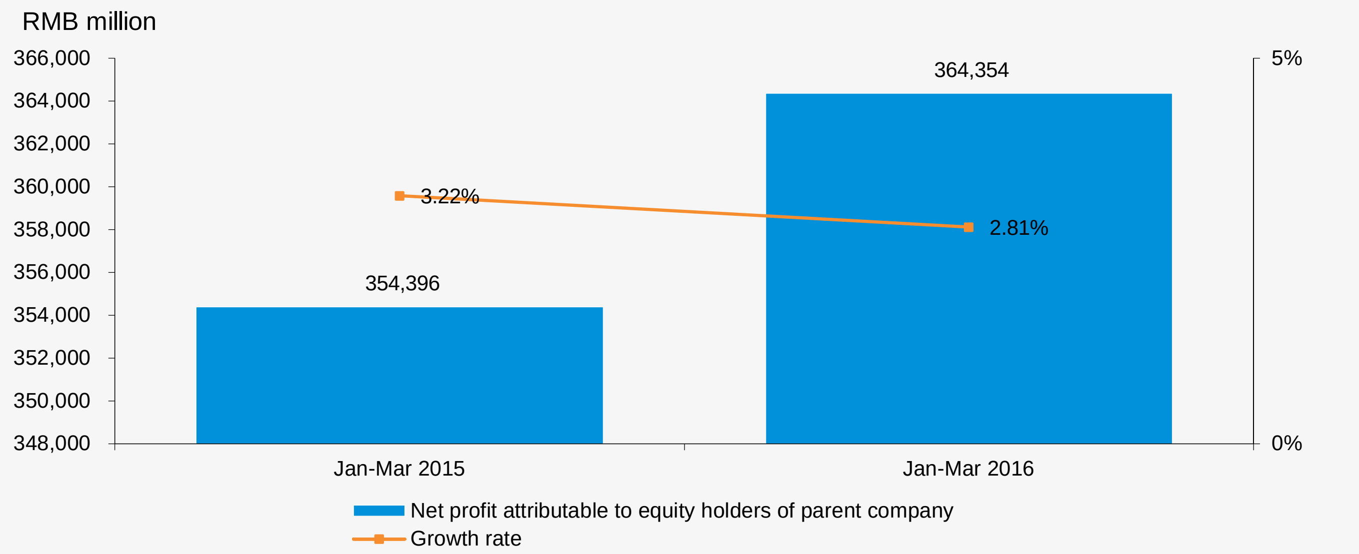


In the first quarter of 2016, due to the effects of the economic slowdown, accelerated industrial restructuring and other factors, the banking sector faced continued pressure in relation to asset quality with credit risk remaining at a high level. In order to remain prepared for risks, banks made more asset impairment provision with an average growth rate of 34%. NBCB, BON, PAB, HXB and CNCB led the way with a YoY increase of over 100%.

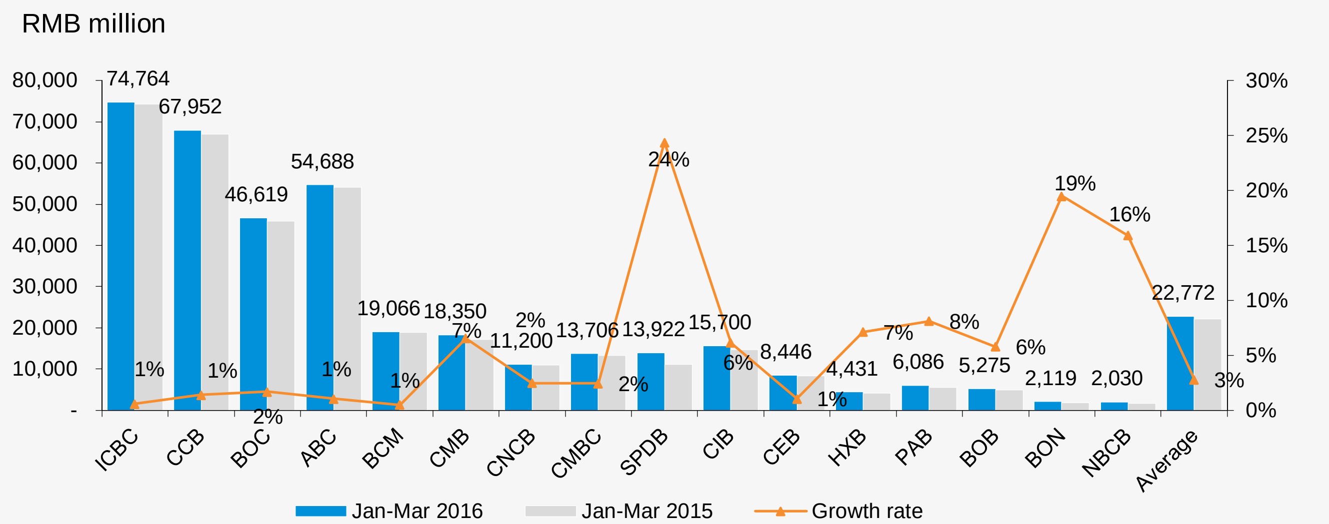
Sources: The banks' 2015 annual reports and 2016 Q1 reports; KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Profitability — Net profit attributable to equity holders of the parent company



Overall, net profit attributable to parent company equity holders increased in the first quarter of 2016 but the growth rate was slower than it was for the same period in 2015, falling from 3.22% to 2.81%.

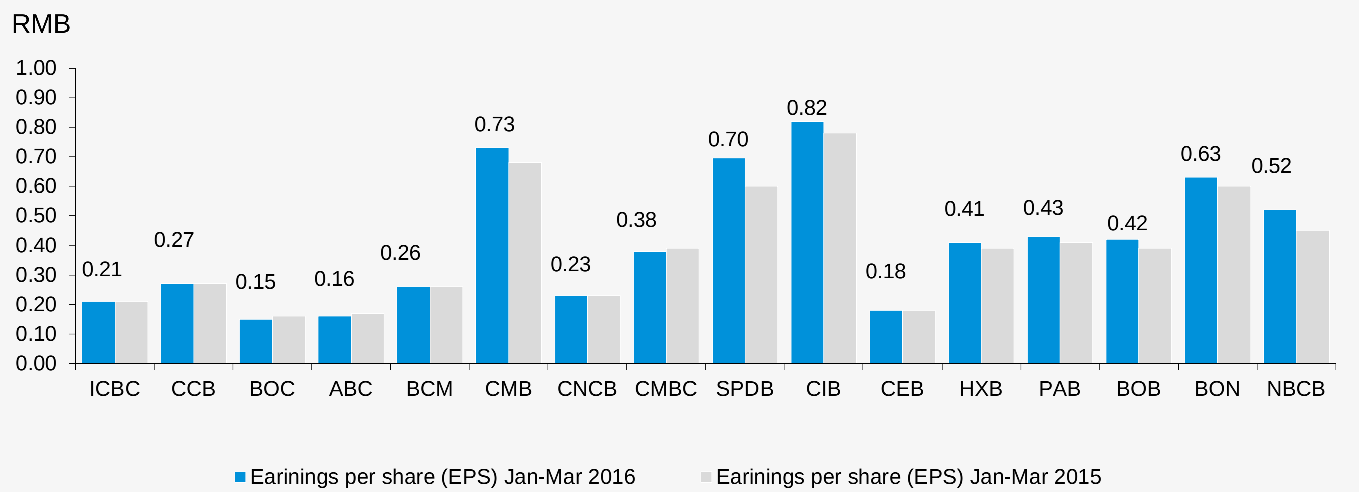


SPDB enjoyed the fastest growth rate with 24% and BON posted a growth rate of 19%.The increase in net profit recorded by SPDB, BON and other joint-stock commercial banks was mainly due to an increase in net interest income and net fee and commission income.

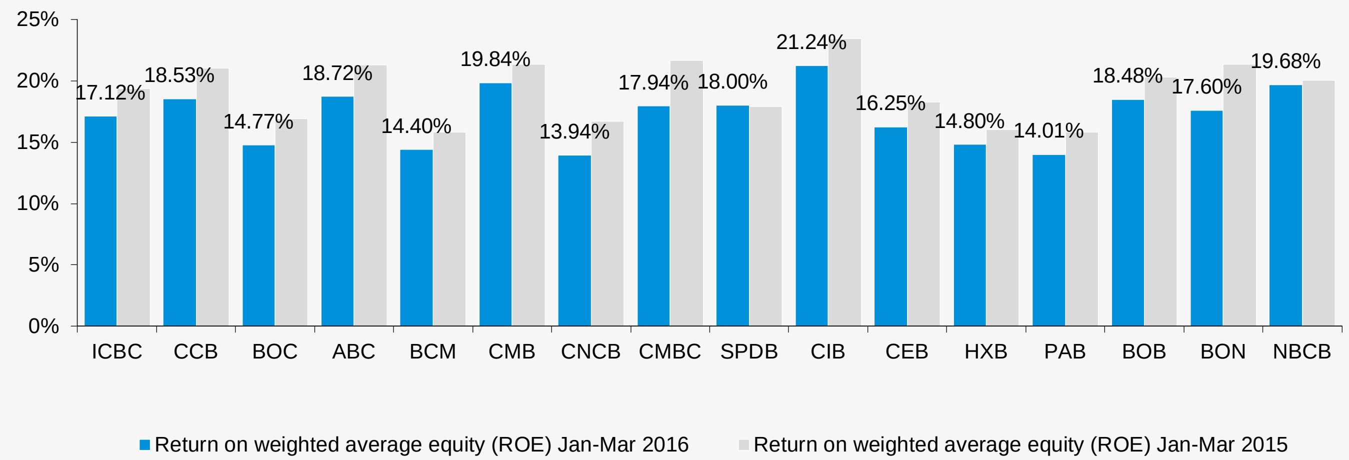
Sources: The banks' 2015 annual reports and 2016 Q1 reports; KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Profitability — Financial performance indicators



In the first quarter of 2016, most listed banks experienced flat earnings per share (EPS). SPDB's EPS was RMB 0.1 higher than that for the same period during the previous year. This was due to significantly higher income in the current period compared with the same period for the previous year.

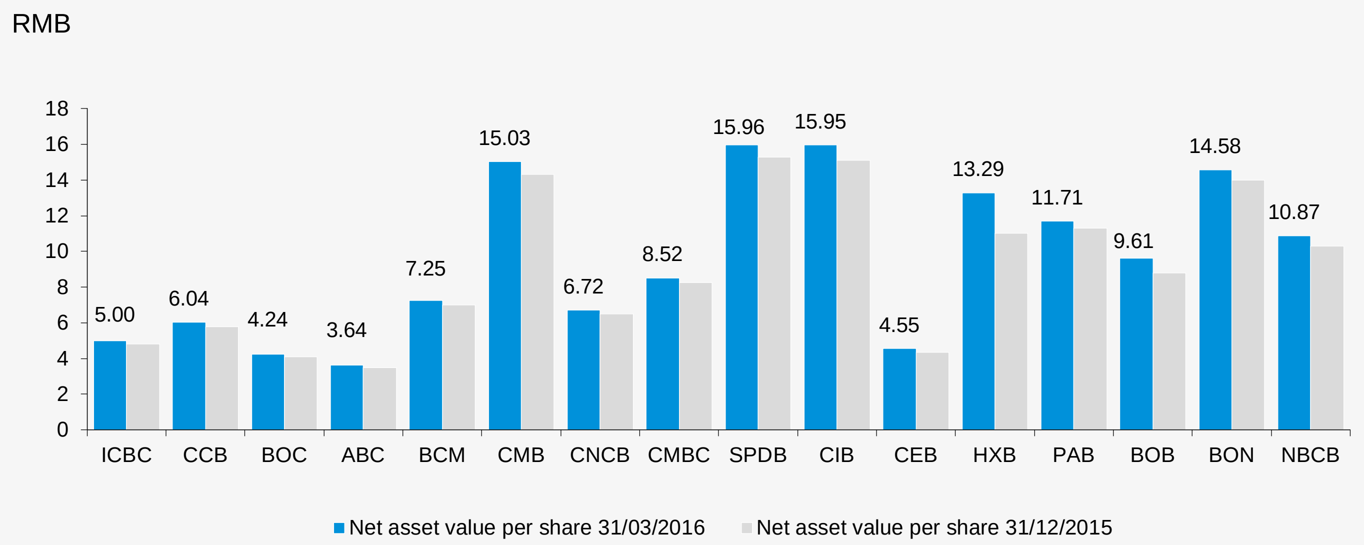


In the first quarter of 2016, the return on weighted average equity (ROE) among listed banks decreased by 1.99% YoY, mainly due to the flat-lining of the increase in net profit as net assets increased in line with the expansion of banking business. The ROE of CMBC and BON fell by 3.7% and 3.76% respectively.

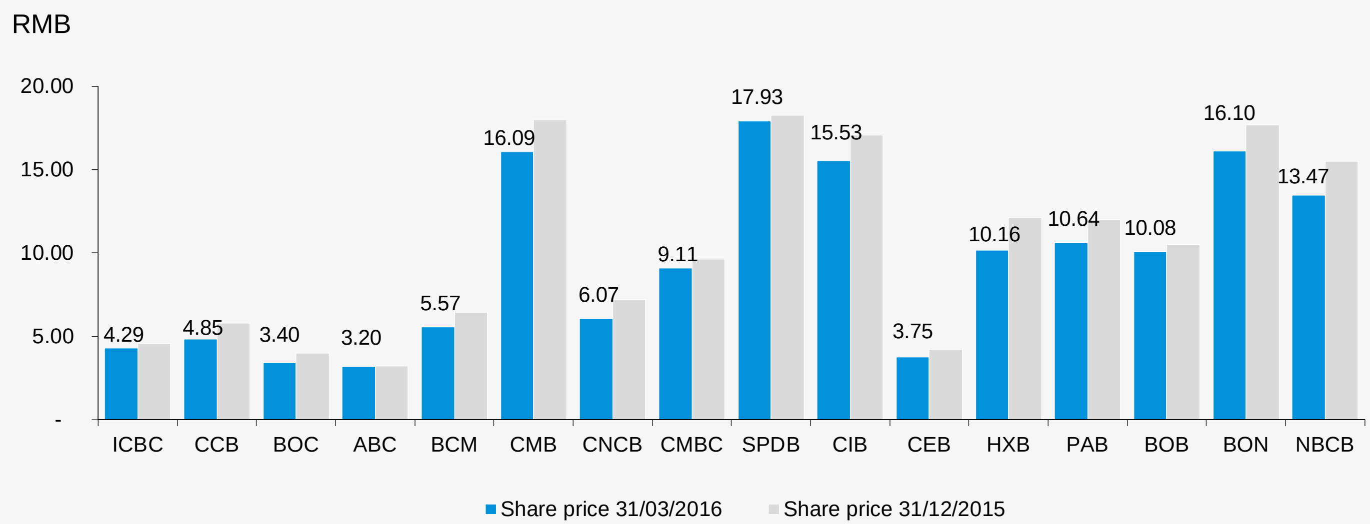
Sources: The banks' 2015 annual reports and 2016 Q1 reports; KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Profitability — Financial performance indicators (continued)



Generally speaking, the net asset value per share of all listed banks continued its upward trend in the first quarter of 2016. By the end of the first quarter, SPDB and CIB enjoyed the highest net asset value per share with RMB 15.96 and RMB 15.95 respectively, which represents an increase of 4.38% and 5.63% respectively YoY.



Due to pressure from the economic downturn, competition from the growth of internet finance and interest rate liberalisation, the share price level of all listed banks fell in the first quarter of 2016. The share prices of CCB, CNCB and HXB recorded the sharpest decline to RMB 4.85, RMB 6.07 and RMB 10.16 respectively. This represented a YoY decrease of 16% for all three banks.

Sources: The banks' 2015 annual reports and 2016 Q1 reports; KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

3 China' banking sector: Hot topics

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.
Printed in China.

China's banking sector: Hot topics

Hot topic One: The impact of full-blown VAT reform on the banking sector /37

Hot topic two: Understanding notice no. 82 from the CBRC on the transfer of the income right to credit assets and its impact on the banking sector /44

Hot topic Three: Strategies for the disposal of NPLs amid declining performance among banks /52

Hot topic four: Analysis of debt-to-equity swaps for NPLs /57

Academic insights: Studies on the financial services sector providing support for supply-side reform /63

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Hot topic one: The impact of full-blown VAT reform on the banking sector

Background to the VAT reforms

For many years, China's indirect tax system has been characterised by the presence of two taxes: the value-added tax (VAT), generally imposed on industries engaged in the production and sale of commodities, and the business tax on service industries, which is levied on the services sector including banking. This dual taxation system has created many barriers for the manufacturing and services industries and discouraged specialised cooperation and division of work. As the business tax is imposed on total revenue, double taxation becomes an important issue as more intermediate processes are involved in circulation.

Beginning in 2012, the Chinese government has been pressing ahead with various taxation reforms that aim to phase out business tax in favour of VAT. During the pilot programmes that form part of the reforms, different tax policies were trialled in different provinces for certain industries. The government recently expanded these policies nationwide and has been making steady progress with its supply-side reform.

At the opening ceremony of the fourth Session of the 12th National People's Congress on 5 March 2016, Chinese Premier Li Keqiang announced further plans to phase out business tax in favour of VAT. Starting from 1 May, the real estate & construction, financial services and consumer markets industries will be incorporated into the pilot programme for VAT reform.

Out of the 160 countries that have already adopted VAT (or a similar system), China will have the most extensive VAT tax base once the reforms are implemented. VAT in China applies to practically all services carried out in banking including interest income, which is unique to China. China's efforts to impose VAT on its banking sector have caught the eyes of many countries in the world and if these efforts prove successful, other countries may follow suit and adopt similar tax policies to China's.

On 24 March 2016, the Ministry of Finance and the State Taxation Administration jointly issued Announcement No. [2016] 36, clarifying VAT tax and specific policies applicable to the real estate & construction, financial services and consumer markets industries. On 29 April 2016, the two authorities jointly issued Announcement No. [2016] 46, providing further clarification on relevant policies related to the VAT pilot programmes in the financial services sector.

VAT policies for the banking sector

Businesses on which VAT is imposed mainly include lending services, financial services with direct charges, transfer of financial products, financial agency services and purchase and sale of general merchandise. Business tax is imposed on interest income from general loans, fee and commission income and other taxable income at a rate of 5%. Following the VAT reforms, the banking industry will be subject to a VAT rate of 6%. When comparing the VAT rate with business tax, it is worth keeping in mind the fact that input tax is deductible in the case of VAT, whereas total business turnover is taxable for business tax purposes. Specific VAT treatment is as follows:

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Hot topic one: The impact of full-blown VAT reform on the banking sector (continued)

VAT policies for the banking sector (continued)

Definition of taxable service		VAT policies	Previous business tax treatment
Transfer of financial products	Transfer of financial products refers to the transfer of ownership of foreign exchange, negotiable securities, non-commodity futures and other financial products. Transfer of other financial products refers to the transfer of asset management products and financial derivatives of various kinds including funds, trusts and wealth management products.	• In the case of transfer of financial products, a sales turnover is the difference between the selling and buying price. • The balance is the sales turnover and a negative balance can be carried forward to the next tax period and offset against the sales turnover. However, if the resulting balance is still negative at the end of the year, this cannot be carried forward to the next accounting period. • A VAT special invoice will not be issued for the transfer of financial products.	• Starting from 1 December 2013, an offset of negative differences against positive differences of financial products of various types within the same year is subject to business tax.
Financial services with direct charges	Financial services with direct charges refers to any business activity in which services related to monetary and fund financing and other financial businesses are provided. These services include currency conversion, account management, e-banking, credit cards, L/C, financial guarantees, asset management, trust management, fund management, financial trading floor (platform) management, fund settlement, fund liquidation and financial payment.	• In the case of financial services with direct charges, a sales turnover refers to the processing fee, commission, reward, administrative fee, service fee, brokerage, activation fee, transfer fee, settlement fee, custody fee and other fees that are charged commission income and is also subject to VAT. • The input tax on financial services with direct charges purchased by a taxpayer can be deducted from the output tax.	• A business tax rate of 5% is imposed on fee income.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Hot topic one: The impact of full-blown VAT reform on the banking sector (continued)

VAT policies for the banking sector (continued)

Definition of taxable service		VAT policies	Previous business tax treatment
Lending services	Lending services refer to any business activity where funds are provided in the form of loans to others and accrue interest. Income from occupied or borrowed funds is subject to VAT as income from lending services including income from interest paid before or on the maturity date of financial products (principal guaranteed income, rewards, fund occupancy fees, compensations, etc.), interest income from credit card overdrafts, financial assets purchased under resale, margin trading and short selling and income from businesses such as sale and leaseback financing, documentary credit, penalty interest, discounted bills and re-lending. Fixed profit or guaranteed profit from monetary investment is subject to VAT as income from lending services.	• A sales turnover is the total interest income and income that is of the same nature as interest from lending services. • Input tax on lending services accepted by a taxpayer and investment and financing advisery fees, processing fees and consulting fees paid by a lender that are directly related to the loan in question shall not be deducted from output tax.	• Interest income from financial intermediary businesses provided by domestic banks is subject to a business tax rate of 5% based on total interest income (including non-price charges) and cannot be used for deduction purposes with regards to turnover tax on corresponding cost and expenditures. • In addition, where a borrower or lender is located within China, interest income shall be taxed in China for business tax purposes.
Financial agency services	Various brokerage, intermediary and agency services related to financial services such as insurance agency services.	• The balance of total payments and non-price charges minus government managed funds or administrative and institutional fees charged to an entrusting party and paid on behalf of such a party is the sales turnover. A VAT special invoice will not be issued for government managed funds or administrative and institutional fees charged to an entrusting party.	• The balance of all payments and non-price expenses charged to an entrusting party minus deductible amounts allowed by prevailing tax policies is the taxable turnover.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Hot topic one: The impact of full-blown VAT reform on the banking sector (continued)

VAT policies for the banking sector (continued)

Definition of taxable service		VAT policies	Previous business tax treatment
Purchase and sale of general merchandise	This business includes precious metal trading, debt-repaid asset trading and disposal of fixed assets.	• Subject to VAT in accordance with rules under 'General Taxation'.	• Currently within the scope of VAT taxation.
Interbank transactions	Fund transactions between financial institutions.	• Free tax on interest income from interbank transactions. • Interbank transactions eligible for tax exemption include: - fund transactions between a financial institution and the PBOC including loans provided by the PBOC to general financial services institutions and rediscounts offered by the PBOC to commercial banks, - intra-bank transactions: fund transactions between branches of a bank, - fund transactions between financial services institutions - short-term, non-guaranteed financing (one year or less) through a nationwide interbank network between financial services institutions permitted by the PBOC to enter the interbank market, - transfer of discounts between financial services institutions, - financial assets purchased with pledges under resale: a short-term financing business with bonds and other financial products as pledges of rights, - policy financial bonds held: bonds issued by development-oriented and policy-based financial institutions.	• Income from interbank transactions are exempt from business tax.
Cross-border borrowing	Borrowers within China borrow from overseas banks.	• A withholding model will be used. Service users within China pay VAT on the service fees paid but input tax on interest expenses is not deductible.	• As long as the borrower is within China, an overseas bank should pay business tax on interest income obtained.
Cross-border lending	Banks within China lend to overseas borrowers.	• According to current VAT policy, financial services provided for overseas entities are subject to VAT except for financial services with direct charges provided for monetary financing and other financial businesses between overseas entities and insurance services for export goods.	• Interest income from financial services provided by banks within China to overseas entities is subject to business tax at a rate of 5%.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Hot topic one: The impact of full-blown VAT reform on the banking sector (continued)

Impact of VAT reform on the banking sector

Firstly, as part of the financial services sector, banks enjoy limited deductible input tax. According to Announcement No. 36, input tax on interest expenses as well as investment and financing advisery fees, processing fees and consulting fees paid by a taxpayer to a lender in relation to a loan shall not be deducted from output tax. This means that input tax on loans as the main source of banks' profit is not deductible. In addition, labour costs, welfare expenses, transportation expenses and hospitality expenses that take up a large proportion of banks' business related expenses are not eligible for input tax deduction. As banks only have limited leeway in subjecting their output items to VAT through improved efficiency, the VAT burden is usually borne by banks themselves. As a result, banks that are not engaged in the purchase of large value fixed assets and immovable properties for the current period may face a larger tax burden following the VAT reforms.

Secondly, the complexity and difficulties involved in the implementation of the VAT reforms will exceed enterprises' expectations. The difficulties are unprecedented, especially for large banks with enormous scale, complex organisational structures, complex business types and large trading volumes. The VAT reforms will also impact the operating model of all business lines and internal procedures in the banking sector. Before the reforms, banks' business procedures were designed to deal with business tax. But with VAT banks need to put in place significantly more risk controls to satisfy VAT policies and regulatory requirements compared with business tax. We have noticed that some banks have already made adjustments to businesses that are not in line with VAT requirements.

Thirdly, the VAT reforms are by no means simply about replacing one tax with another. Rather, the reforms will bring disruptive changes to most of the key departments within banks. These reforms affect not only work carried out in financial departments such as accounting, budget management, financial reporting, tax filing and invoice management but also frontline businesses and middle and back office work such as business procedure management, marketing plan management, key account management, supplier management, procurement management, contract management and IT systems management. For instance, the business department may need to adjust pricing strategies in a timely fashion in accordance with changes in tax policies. The procurement department may need to organise supply materials and determine procurement procedures. The legal department may need to review or modify contractual terms. As a result, responses to the VAT reforms not only need the support of the human and material resources of the financial departments but also call for concerted efforts of various departments from front to back offices. Experience from other industries shows that as the VAT reforms are being implemented, how to achieve effective cross-departmental communication and redefine and differentiate departmental responsibilities is a major obstacle to be overcome.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Hot topic one: The impact of full-blown VAT reform on the banking sector (continued)

How to respond to the VAT reform

As not much time is reserved between the formulation of the policy and its implementation, enterprises in the financial services sector need to give priority to their VAT work so that they can accurately calculate prices, record accounts, issue invoices and file taxes for VAT compliance purposes. Based on our experience in assisting numerous large financial institutions in adopting VAT practices, we suggest the following timetable for VAT work:

From the release date of the VAT policy to its effective date (1 May 2016):

Before the effective date of the VAT policy, banks should formulate VAT accounting methods, separate prices from taxes for businesses with VAT impacts, connect the financial system to the tax system, purchase and properly deploy tax control equipment, conduct VAT general taxpayer registration, determine the number of invoices purchased and received, organise customers and suppliers, review contracts and update contractual modules in accordance with the new policy.

Many large banks currently have already completed the work above. But as there is only a 40-day gap between the release of the policy and its implementation, updates and fine-tuning will be required. The VAT system needs to be optimised and developed for the specific needs of a bank.

From the release of the policy to the first filing period:

Banks will file tax returns on a quarterly basis and the first filing period is expected to occur on 15 July therefore banks will need to establish connection between the financial system and the tax system. Alternatively, banks may file tax returns either through a tax filing system or do so manually on a temporary basis.

Local tax filing policies are not yet clear. According to tax filing policies already released in some areas, three tax filing methods may be applied to the banking sector: withholding tax, tax quotas calculated based on the proportion of the taxable sales turnover of a head office and its branches in relation to total sales turnover in a particular province and direct tax returns not subject to withholding tax. Different provinces may take different approaches. In addition, local tax authorities may have different filing requirements for some special businesses. These businesses include the sale of precious metals, leasing and sale of immovable properties and the sale of fixed assets already used. Banks are advised to communicate with local tax authorities to obtain a better understanding of applicable tax filing policies.

Banks should also build and execute internal management procedures and relevant risk controls in relation to VAT invoice management and VAT risk management, provide targeted training to employees of the financial, operating, tax, legal and IT departments and prepare a VAT manual to institutionalise VAT treatment plans and practices already implemented and updated in real time.

After the first filing period:

At the early stage of VAT reform, how tax policies are understood and executed may differ between banks and tax authorities and between the tax authorities of different provinces. According to the VAT law, banking businesses are classified into the following types: lending services, financial services with direct charges, transfer of financial products, financial agency services and purchase and sale of general merchandise. With the growth of banking businesses, new innovative products will keep emerging. As many businesses may be complex in nature and have overlapping characteristics that defy a clear-cut classification, the inability to render an accurate judgment with respect to classification for VAT purposes may have profound implications as tax treatment differs for each type of business. In addition, the scope of tax exemption policies applicable to the banking sector is hard to grasp. One of the key tasks therefore for banks preparing to transition to a VAT regime is to make inquiries, exercise judgment, obtain confirmation and receive feedback with respect to specific VAT policies.

Both taxpayers and tax authorities need time to understand and assimilate the new VAT policy during which time financial and tax authorities may or may not unveil a series of application guidelines. Therefore, financial institutions are advised to prepare themselves for some unexpected developments. If VAT policies for the financial services sector are updated, banks should make corresponding changes to their VAT manuals and procedures.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Hot topic one: The impact of full-blown VAT reform on the banking sector (continued)

How to respond to the VAT reform (continued)

It is worth noting that due to limited preparation time, most financial services enterprises made small changes to their financial tax systems and this only constitutes a transition or contingency plan. As policies are made clearer, enterprises need to organise and analyse their business procedures and income and, if necessary, make front-end modifications to their business systems and affect optimised VAT chain management.

In addition, banks also need to consider whether their business models need to be adjusted following the VAT reforms. Currently, many enterprises have designed multiple business models to minimise their business tax burden. Following the implementation of the VAT reforms, they need to reconsider their business models to maximise the effect of preferential policies and circumvent tax risks.

The above observations show that the VAT reforms are not simply about replacing one tax with another. How to respond to the reforms does not just fall on the shoulders of the financial departments of banks but rather calls for the active participation, collaboration and execution of all departments within the organisation. Therefore, banks need to strengthen communication lines between the financial and tax departments as well as with the tax authorities and understand VAT developments in the industry. They should form a special VAT team to formulate the objectives and execution plans for VAT programmes and, if necessary, introduce agencies with VAT experience to provide assistance in facilitating VAT progress.

It is expected that regulations for VAT practices in the financial services sector will be unveiled at some point. The regulations will provide clarification on unclear matters in VAT policies for the financial services sector and help alleviate the tax burden facing some banks following the reforms. Banks should pay close attention to the release of new regulations, refer to the practices of the sector, communicate with tax authorities and adjust VAT measures in a timely manner.

After the implementation of the VAT reforms, banks need to consider what measures to take under the new tax climate to optimise their overall tax burden and enhance tax risk control.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Hot topic two: Understanding Notice No. 82 of the CBRC on the transfer of the income right to credit assets and its impact on the banking sector

Evolution of regulatory requirements

2009-12

The CBRC issued the circular on 'Issues Concerning Further Regulation of Cooperation between Banks and Trust Companies', prohibiting the "investment of bank-trust company financial products in credit assets or commercial papers issued by the issuing bank of the financial products". This requirement is restricted to the cooperation between banks and trust companies and does not extend to others.

2010-12

According to the circular from the CBRC on 'Further Regulating Transfer of Credit Assets of Banking Financial Institutions' (CBRC Fa [2010] No. 102), issued in December 2010, financial services institutions transferring credit assets should follow the principle of truthfulness. Any untruthful transfer of assets is prohibited. No repurchase agreements may be entered into by the two participating parties to evade regulation.

2012-1

The Ministry of Finance (MOF) and the CBRC issued the circular, 'Administrative Measures for Batch Transfer of Non-performing Assets of Financial Institutions' (Cai Jin [2012] No. 6), providing guidelines on liquid non-performing assets and non-credit assets of financial services institutions.

2015-6

The circular on 'Central Registration of Transfer of Banking Credit Assets' (No. 108), issued by the CBRC, requires financial services institutions to centrally register the transfer of their credit assets (the transfer of credit assets held and their corresponding beneficial rights).

2015-8

In August 2015, the 'Administrative Measures for Non-performing Assets Business Conducted by Financial Asset Management Companies' (Cai Jin [2015] No.56) was issued by the MOF. This allows state-owned asset management companies to acquire and dispose of the non-performing assets of non-financial services institutions.

2015-8

The circular on 'Regulation of Acquisition of Non-performing Assets of Financial Asset Management Companies' (No. 56), issued by the CBRC, prohibits asset management companies from providing channels for financial services institutions to circumvent asset quality regulations for the first time.

2016-5

The circular on 'Regulating Transfer of Right to Receive Income from Credit Assets of Banking Financial Institutions' (No. 82), issued by the CBRC, aims to promote the healthy and orderly development of the income right transfer business related to credit assets.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Hot topic two: Understanding Notice No. 82 of the CBRC on the transfer of the income right to credit assets and its impact on the banking sector (continued)

Analysis of the impact of No. 82 Circular:

1. Further specifying the regulatory guidelines for the development of financial instruments: transparency principle, 'sunniness' and standardisation
2. The lack of recognition in financial statements does not lead to a reduction in the required capital, which would eliminate opportunities for regulatory arbitrage and put pressure on capital adequacy ratios.
3. Prohibiting the direct or indirect investment of the transferer's funds in the income right of its credit assets via various channels to reduce step-in risk
4. Regulating the policy, risk management and information disclosure for the transfer of income right, resulting in greater compliance pressure

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Hot topic two: Understanding Notice No. 82 of the CBRC on the transfer of the income right to credit assets and its impact on the banking sector (continued)

Regulatory requirements of No. 82 Circular and interpretation of the provisions

No. 82 Circular	Interpretation
In recent years, financial services institutions have been conducting business related to the transfer of income rights of credit assets, which helps them to liquidate their assets and accelerate capital turnover. However, the structure of transactions is irregular and opaque with problems arising in relation to accounting treatment, capital accrual and provision. To promote the healthy and orderly development of the income rights transfer business, the following provisions should be adhered to:	At present, the size of credit asset transfers conducted by financial services institutions is large and the structure of transactions is complicated and diverse. Some banks engage in regulatory arbitrage via various channels. In some income right transfers related to credit assets of banks, the transferer removes the loans from its financial statements, while the transferee accounts for the income right as an investment. In this way, a loan is turned into an investment and the size of credit assets decreases as a result of such irregular accounting.
1. Income right transfer related to credit assets should comply with the requirements on “filing approach, reporting of products and registration of transactions”.	Creditors’ right of credit assets is the basic right, which includes the right to mortgage and pledge, income right and file ownership. Income right of credit assets are attached to the creditors’ rights. No. 82 Circular regulates the income right of credit assets. The major differences between the income right and creditors’ right include: ▪ transfer of income rights where the debtor continues to make payments to the original creditor when the creditor’s rights are not transferred. Where the creditor’s rights are transferred, the debtor pays the full amount specified in the original contracts to the transferee. ▪ transfer of income rights where uncertainties exist in assets, especially with respect to future creditor’s rights. The debtor-creditor relationship is relatively clear in the transfer of creditors’ rights, especially in the transfer of well-defined debtors’ rights receivables and credit assets. ▪ transfer of creditors’ rights facilitates the segregation of the creditors’ rights and transferer’s assets in the case of bankruptcy. Some legal flaws exist in the transfer of income rights.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved. Printed in China.

Hot topic two: Understanding Notice No. 82 of the CBRC on the transfer of the income right to credit assets and its impact on the banking sector (continued)

Regulatory requirements of No. 82 Circular and interpretation of the provisions (continued)

No. 82 Circular	Interpretation
(1) Filing approach. Financial services institutions should formulate policies to manage the transfer of income rights of credit assets. The Credit Asset Registration and Exchange Center ("CARE Center") should, based on CBRC requirements, formulate and issue rules and procedures for this business and promptly submit them to the CBRC for filing purposes.	▪ Given that No. 82 Circular aims at regulating deal structure, accounting treatment, capital accrual and provision, the management policies of financial services institutions for the income right transfer business should specify asset composition, deal structure, accounting treatment, capital accrual, provisioning and regulatory related requirements. In addition, the transfer of non-performing credit assets and normal credit assets should be distinguished with appropriate risk management policies formulated based on their risk characteristics. ▪ Registered in June 2014, the CARE Center is responsible for the registration, custody, exchange and settlement of credit assets and other financial assets, provision of agency principal and interest payment services, transaction management and market monitoring as well as the provision of financial information and related advisery and technical services, etc. ▪ As of the end of March 2016, the underlying assets recorded at the CARE Center were merely RMB 34 billion. Compared with the size of the asset backed securitisation industry and businesses comprising other asset management channels, there is ample room for development.
(2) Reporting of products. The CARE Center should formulate and issue product reporting procedures and approval requirements according to CBRC requirements. Financial services institutions should submit the information for each transaction to the CARE Center.	▪ The submission of information for each transaction shows adherence to the transparency principle. ▪ The disclosure of information may include debtors' information (its industry, operations and credit rating, etc.), mortgaged/pledged assets and risk disclosure statements. Based on the above, regulators may further standarise asset types. Give registration permission to qualified assets and reject applications of unqualified assets.
(3) Registration of transactions. The transferer should follow the requirements of the circular from the General Office of CBRC on 'Central Registration of Transfer of Banking Credit Assets' (CBRC Fa [2015] No. 108) and promptly complete central registration for the transfer of income rights of credit assets with the CARE Center.	▪ No. 108 Circular requires financial services institutions to carry out the transfer of credit assets (the credit assets held and their corresponding beneficial rights to be transferred) and to centrally register the transfer of their credit assets. ▪ On the one hand, central registration gives non-standardised loans some standardised attributes, turning them into financial assets with specific codes thus allowing trading parties to conduct more transparent and standardised transactions; it supports the exclusion of these assets in the calculation of non-standardised assets. On the other hand, it helps regulators obtain a true picture of the credit asset transfers of the banking industry and to keep track of items added to or removed from the balance sheet. This makes off-balance sheet items more transparent and market-oriented like asset backed securitisation and serves to drive regulated asset securitisation.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Hot topic two: Understanding Notice No. 82 of the CBRC on the transfer of the income right to credit assets and its impact on the banking sector (continued)

Regulatory requirements of No. 82 Circular and interpretation of the provisions (continued)

No. 82 Circular	Interpretation
2. Income rights transfer related to credit assets should comply with the law to effectively mitigate associated risks.	
(1) The transferer should fully accrue capital based on the amount of the original credit assets after the transfer in accordance with the 'Measures for Managing Capital of Commercial Banks' (Trial).	▪ The risk capital for assets no longer recognised in financial statements should be accrued based on the original risk weighting. Banks cannot decrease capital by removing credit assets from their balance sheets thereby reducing opportunities for regulatory arbitrage and putting pressure on capital adequacy ratios. ▪ In substance, this rule converges with the concept of step-in risk proposed by the Basel Committee. For unconsolidated entities, banks exposed to step-in risk are required to accrue capital in accordance with specific rules even though the assets are no longer recognised in the financial statements.
(2) Transfer of income rights of credit assets should be accounted for and recorded in accordance with the 'Accounting Standards for Business Enterprises'. For the transfer of non-performing assets in which the transferer has a continued involvement after the transfer, the continued involvement part should be included when calculating the NPL balances, NPL ratios as well as provision coverage ratios and other indicators.	▪ Accounting for the transfer of credit assets' income rights should comply with the requirements of the accounting standards by making judgment as to whether risk and reward are transferred. ▪ NPLs seeing continuing involvement should be included in the calculation of NPLs to prevent banks from disguising loans as investments.
(3) In accordance with the 'Measures for Managing Loan Loss Provision of Commercial Banks, Guidelines for Loan Loss Provision of Banks and Measures on Managing Provisioning of Reserve by Financial Institutions' and other related regulations, the transferer should make provisions based on the actual risk exposure using appropriate accounting treatment.	▪ Provisioning depends on accounting treatment and risk exposure. From the perspective of accounting treatment, the continuing involvement part should be included in the scope of provisioning. From the perspective of actual risk exposure, when the amount of inferior assets is lower than the risk exposure of credit assets (that is the recoverable amount is lower than the share of priority assets), the good assets will suffer some losses. This means the total amount of provision will decrease compared with provision remaining in the balance sheet.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Hot topic two: Understanding Notice No. 82 of the CBRC on the transfer of the income right to credit assets and its impact on the banking sector (continued)

Regulatory requirements of No. 82 Circular and interpretation of the provisions (continued)

No. 82 Circular	Interpretation
(4) The transferer shall neither directly nor indirectly invest in the income rights of credit assets of the bank using its own WMP nor shall it assume either explicitly or implicitly any repurchase obligation in any form.	▪ In December 2009, the CBRC issued the 'Circular on Issues Concerning Further Regulation of Cooperation between Banks and Trust Companies', which prohibited the "investment of bank-trust company financial products in credit assets or commercial papers issued by the issuing bank of the financial products". This requirement is restricted to the cooperation between banks and trust companies and does not extend to others. In substance, No. 82 Circular keeps the spirit of the Circular. It shows that the regulators have always been firmly committed to prohibiting the use of arbitrage, whether on or off balance sheet. In the wake of various types of channels emerging in recent years, No. 82 Circular has essentially prohibited the investment of the transferer's treasury funds in the income rights of credit assets through various channels (including fund subsidiaries, brokerage asset management companies and fund accounts). ▪ No. 82 Circular agrees with the 'Circular on Regulation of Acquisition of Non-performing Assets of Financial Asset Management Companies' (No. 56). No. 56 Circular prohibits banks from removing non-performing assets from their balance sheets via asset management companies. This is designed to regulate imprudence and risk exposure associated with the acquisition of non-performing assets in order to prevent related risks from remaining in the banking system and not being truly diversified.
(5) Investors of income rights of credit assets should continue to meet the requirements of regulators on qualified investors. The investment of income rights of non-performing assets is limited to qualified institutional investors and not available to financial products, trust plans and asset management plans in which personal investors participate. The transparency principle should apply to the funding sources of institutional investors that are not allowed to obtain direct or indirect funding from individual investors using embedded instruments.	▪ Personal wealth management products cannot be invested in the income rights of credit assets. ▪ Uphold the transparency principle and prohibit direct or indirect participation by individual investors. Non-performing assets, considered to be professional and risky, are not suitable for individual investors. Their risk level suits the needs of qualified institutional investors better. ▪ Banks are expected to transfer existing business to corporate financial products. It is noteworthy that further clarification is required with regards to the definition of qualified institutional investors, the proportion of non-performing assets in the investment portfolio and the disclosure of financial information.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Hot topic two: Understanding Notice No. 82 of the CBRC on the transfer of the income right to credit assets and its impact on the banking sector (continued)

Regulatory requirements of No. 82 Circular and interpretation of the provisions (continued)

No. 82 Circular	Interpretation
(6) The transferer and other related trading entities should prudently assess the quality of credit assets and associated risk and set reasonable prices based on the market-oriented principle. Third-party organisations such as accounting firms, law firms, rating agencies and valuers are engaged to provide their professional opinions on specific matters where necessary.	▪ The introduction of various third-party professional organisations is an arrangement to increase the market-oriented level and 'sunniness'. It helps to improve the reliability and objectivity of judgement with respect to product pricing, accounting treatment, legal risk and other key areas. It supports the exclusion of the asset in the calculation of non-standardised assets.
(7) The transferer and other related trading entities should promptly provide accurate and complete information on the credit asset whose income rights are to be transferred in accordance with the related requirements. Contingency events with significant impact on investors' equity or investment income should be disclosed on a timely basis.	▪ The focus is still on information disclosure. Contingency events could be overdue principal and interests, downgraded rating and involvement in significant litigations. In order to promptly disclose significant contingency events, banks need to manage and monitor underlying assets. This poses quite a challenge to the existing banking and management systems.
(8) Qualified investors that meet the above requirements and purchase income rights of credit assets invested by financial products should complete the transfer and central registration at the CARE Center in accordance with the related requirements. Such assets are excluded from the calculation of non-standardised credit assets. They are presented separately in the national banking financial information registration system.	▪ Income rights of credit assets meeting the requirements are excluded from the calculation of non-standardised credit assets. This can release some investment quota and contribute to market expansion.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Hot topic two: Understanding Notice No. 82 of the CBRC on the transfer of the income right to credit assets and its impact on the banking sector (continued)

Regulatory requirements of No. 82 Circular and interpretation of the provisions (continued)

No. 82 Circular	Interpretation
3. CARE Center should strengthen market monitoring and promptly report major developments	
(1) Examination and approval of products, including but not limited to the composition of assets, deal structure, investor suitability, information disclosure and risk controls.	▪ From the key point of the review of products' registration, banks should regulate the choice of assets, design of deal structure, assessment of investor suitability, information disclosure and risk controls from two dimensions: business management policy and product design.
(2) Strengthen market infrastructure by enhancing the relevant functions of the platform for transfer of credit assets' income right, improve software and hardware facilities to ensure system stability and sustainability.	
(3) Promptly report major developments. Banks should regularly report the transfer of income right of credit assets to the CBRC for filing, register transfer information and related statistics and analyses. Contingency events should also be promptly reported to the CBRC.	

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

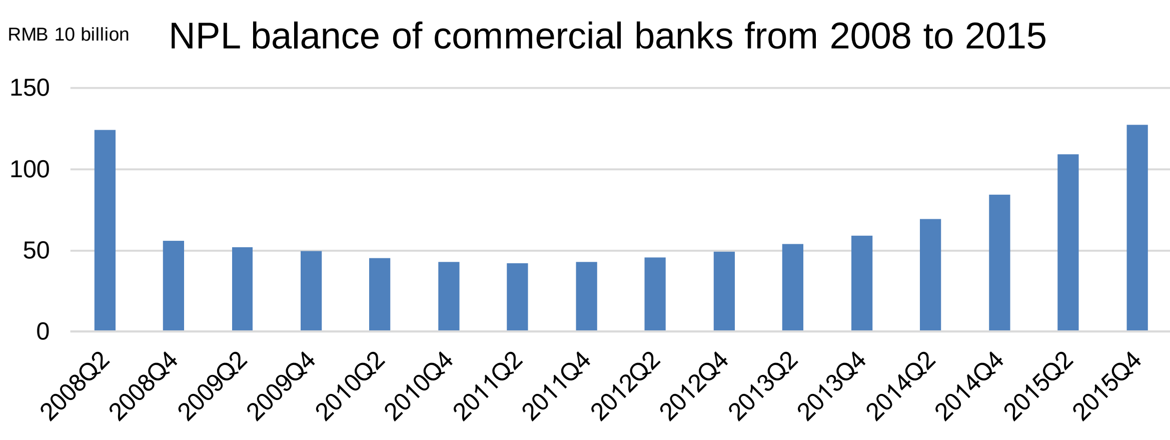
Hot topic three: Strategies for the disposal of NPLs amid declining performance among banks

Over the past two years, in the midst of slower economic growth, China's banking sector experienced slower growth of overall profitability and an increase in NPLs across nearly all sectors. Currently, the banking sector is faced with two main tasks: strengthening asset risk control to curb the increase in NPLs and continuing to dispose of NPLs in order to remove existing burdens and maximise asset recovery. NPLs are the result of various market factors and therefore proper disposal of them calls for a scientific methodology that combines theories with practice as well as a set of effective and tailored disposal strategies that take into perspective China's prevailing economic climate, financial trends and the periodic fluctuations of the industries in which debtors operate.

I.The economic and financial backdrop behind the exponential growth of NPLs

Macroeconomic evolvement: in response to the international financial crisis in 2008 and the subsequent worldwide economic crisis, the government of the United States mobilised hundreds of billions of US dollars to bail out the banks. In order to stabilise the economy, the Chinese government also launched an economic stimulus plan worth trillions of RMB. Under this environment of looser monetary policy, considerable amounts of funding flowed into the manufacturing, real estate & construction and infrastructure sectors. Investment soared and China's GDP grew by almost 9% in 2009. However, as the price of raw materials and energy continued to rise, the inflation that followed made enterprises excessively optimistic about the economy and many failed to take the opportunity to reorganise their businesses in light of the crisis. As a result, after the short-lived effects of the stimulus plan began to wear off, growth started to slow. The steel, concrete, electrolytic aluminium and other low value added industries and traditional low-end manufacturing industries began to suffer from overcapacity, characterised by excessive supplies, high stocks and low demand.

Financial system: following looser credit policies between 2009 and 2010, China's banking sector intensified lending. Seeking expansion and performance increases, some financial services institutions even reduced their lending criteria to provide short-term loans based on a company's long-term projection of its own performance. Through the growth of wealth management, asset management, shadow banking and other financial services institutions, the financial services sector has grown exponentially in the last few years. The additional liquidity that this has created served to postpone the NPL cycle. Since 2011, commercial banks have started to reassess their lending criteria and reduce credit limits under macro-control measures designed to prevent the economy from overheating. This has increased the risk for enterprises with highly leveraged operations. The growth in NPLs has led to heightened risk in China's financial system, which has been driven by the economic slowdown and the deterioration in credit quality among borrowers.



Source: Table of the CBRC of Key Regulatory Indicators for Commercial Banks

In addition to various domestic factors, trade protectionism advocated by some countries has also posed a challenge to China's manufacturing and export industries, making the problems of overcapacity and liquidity even worse.

Against this backdrop, China's economy unsurprisingly started to slow. Since 2013, the slowdown has begun to affect other industries aside from manufacturing. As of the fourth quarter of 2015, the cumulative NPL total among the 16 commercial banks listed on the A-share market was close to RMB 1 trillion, an increase of RMB 325.9 billion from the beginning of the year.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Hot topic three: Strategies for the disposal of NPLs amid declining performance among banks (continued)

II. Disposal of NPLs is a critical component in the cycle of any market-oriented economy

Unlike previous NPL cycles over the past 30 years, this latest round has occured after China embraced market-oriented reforms. Although NPLs are still growing at an accelerated pace, these are simply the result of periodic market adjustments. Market behaviours need to be addressed with market-oriented approaches and these approaches have their own market rules.

The period under which the 13th Five-Year Plan takes place represents a critical period for China as its economy will experience multiple structural adjustments. This will see focus shift in government policy from a growth model emphasising scale and speed to one emphasising quality and efficiency. As a driver for such change, the market will inevitably go through many different cycles. This process is as important as the production and manufacturing of physical assets and the allocation of financial resources. It is an indispensable part of ensuring economic output, improving growth quality and upgrading industrial structures. In addition, the very presence of NPLs and the formulation of a mechanism for their disposal can play a positive role in deepening China's banking reform with respect to areas such as how to revitalise stock assets and how to strengthen credit risk management.

III. Disposal of NPLs will develop well under the market environment in spite of a tough process

In spite of the complex situation involving NPL, we believe that difficulties often coexist with opportunities and that the market economy will provide a good environment for the disposal of NPLs. As the NPLs market is a capital and technology intensive, disposal strategies should be developed in accordance with Williamson's Transaction Cost Economics, which proposed that effective market roles and allocation of resources are mainly determined by two factors: transaction liberty and transaction cost.

Those likely to participate in the disposal of NPLs can be divided into the following groups based on their risk appetite and transaction characteristics:

1. Asset management institutions and investment banks: they prefer bulk transfers, leverage asymmetric information about credit assets within an asset package to earn price differences and carry out arbitrage trading. The bigger the bulk of loans acquired, the higher the transfer cost will be. They will then liquidate the assets and make profits by splitting large packages into smaller packages to be bought by a wider range of potential buyers. In other words, they direct large assets to market players of different types through economic capillaries.

2. Funds specialised in NPL disposals: they are able to liquidate NPLs through litigations, reorganisations and disposals. They are usually well-informed about the background of NPLs and the parties involved and are more willing to purchase and dispose of assets from a specific region, industry or field.

3. Cyclical industrial funds: they have long-term funds and thanks to their unique understanding of certain industries can hold NPLs on a long-term basis to properly realise asset values through cyclical fluctuations. This approach places equal considerations on strategy and value investment.

4. Large and medium-sized banks, trusts and other financial institutions with access to retail capital: although it is difficult for them to have direct contact with NPLs, they can still act as a good supporter in terms of capital for NPL disposal with their large funding scale and minimal appetite for risk.

5. Industry groups and their subsidiary investment institutions: they are in urgent need of expanding capacity and improving their branding. Purchasing high-quality projects that had been poorly managed may be a better option than investing in brand new projects. These type of market players may prefer NPLs with specific characteristics as they place a greater emphasis on strategy.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

• IV. Building an informative environment for NPLs disposals

We should also be aware of the fact that with regards to NPL disposals, another major issue is the significant difference between buyers' and sellers' prices due to asymmetrical information. The most effective way to solve various problems arising from such asymmetry is to allow various market players, especially investment banks, accountants, deal advisers, lawyers, industry experts and other technical advisers to help identify asset risks, assess asset value, design disposal plans, build product structures, expand sales channels and coordinate communications. The reputation of a well-known institution can help improve investor confidence and increase the chances of a successful transaction.

Accounting firms: many small and medium-sized private enterprises incurring NPLs have flawed historical financial data. Thanks to complex related party transactions, their business backgrounds are hard to trace or verify. This makes it difficult for financial institutions to ensure due diligence quality in the lending process. Accounting firms can provide help by organising financial data professionally and reducing bias or misjudgement caused by information asymmetry so that buyers and sellers can engage in effective and open negotiations.

Professional services firms : the complexity involved in the recovery of NPLs entails large uncertainties with respect to future cash flows and timing. Professional services institutions boast specialised insights in specific types of NPLs and can heip identify the relationship between disposal plans and the inherent value of assets in order to fairly present the likely recovery value.

Law firms: complex issues arising resulting from the inherent legal flaws of NPLs and a large number of transaction parties are often to blame for barriers impeding the disposal of NPLs. Experienced lawyers can solve specific legal problems and anticipate risks even at an early stage.

Boutique advisery firms : numerous small advisers and independent advisery institutions form a key part of the process of collecting information and channeling resources. The NPL disposal market needs the participation of large, nationwide professional institutions as much as it needs the participation of flexible, efficient smaller institutions.

Investment banks: they act as investors in the NPL disposal process and also help bring together the different investors and funds. Leveraging various skills such as product structuring and loans bundling, they can help meet the cash flow needs of investors with different appetites and improve asset valuations through the optimal allocation of resources.

This shows that all agencies participating in the disposal of NPLs have their own strengths and play an important role provided they stay impartial and equitable throughout the process. Collectively, they help increase the availability of financial services, reduce risk resulting from asymmetry of financial information and increase efficiency.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Hot topic three: Strategies for the disposal of NPLs amid declining performance among banks (continued)

• V. Revitalisation and reorganisation are the most economically beneficial modes of NPL disposal

There are currently two methods for dissolving NPLs: (1) liquidation following litigation and (2) reorganisation. Though commonly used by traditional financial institutions, liquidation leads to the winding down of the entity in question. The human resources, manufacturing equipment and all other things accumulated bit by bit over a long period by the organisation will be completely wiped out. In addition, when a large number of creditors are involved, liquidation often takes a long time to complete. For instance, the first ever debt restructuring in China involved more than 1,000 trade creditors, 500 companies and 200 creditor banks and took over two years to complete.

Restructuring is more commonly used in mature market economies and is not necessarily realised through unilateral compromises made by debtors but through the rearrangement of existing interests. This usually involves a change of the right to income, whether through shareholders' sale of equity or the lenders waiving a portion of the principal and/or interest. If implemented properly, this can allow companies subject to disposal to resume operations in an effective manner and avoid turning valuable assets into a sunk cost. Examples of this can generally be grouped into the following three scenarios:

Enterprises with normal operations and positive net profits that record negative net cash flows and experience a temporary shortage of liquidity due to leverage: debt-to-equity swaps, absorption of M&A funds, transfers of equity by original shareholders and other restructuring approaches can be carried out to let new management take over. This allows for original assets to be kept intact and helps prevent any adverse consequences for the enterprise.

Enterprises whose severe losses and inadequate short-term cash flows are caused by high interests, taxes and depreciation due to previous large-scale investments but which still record positive operating cash flows: creditors may be subject to certain losses in restructuring such NPLs but after new management takes office, the overall value from maintaining normal operations will surpass any benefits that can be to be gained from liquidation. The key to achieving this is to find management willing to be taken over and provide new liquidity to help improve operations.

Enterprises facing overcapacity and intensified market competition and price pressure: affected by a rise in labour costs and other factors, these enterprises fail to generate positive operating cash flows. Even under such circumstances, it is still possible to opt for restructuring. These enterprises should look for both opportunities in the domestic market, particularly in those areas with insufficient capacity, as well as overseas. In addition, information and communication technologies and internet platforms can help improve sales and optimise operations.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Hot topic three: Strategies for the disposal of NPLs amid declining performance among banks (continued)

• VI. Revitalisation and restructuring can benefit from the network and knowledge advantages of large professional services firms

- ► NPL disposals are complex processes involving various parties of different types and sizes. During this process, large professional services firms such as investment banks and accounting firms have unmatched advantages in terms of their network across the whole industrial chain from upstream to downstream. Leveraging this information can help reduce transaction costs and increase the likelihood of a positive outcome.

- ► Large international accounting firms have extensive service lines and a wide range of clients. A large multinational accounting firm usually works with different types of industrial groups and financial services institutions. By providing audit, advisery and other services on a long-term basis, these firms have usually maintained a sound and trusting relationship with clients and have in place effective communication channels. Boasting both an international network and outlook, these firms also operate for the purpose of providing professional services to multinational corporations and are inherently structured to engage in cooperation with multiple parties. These firms' branches typically have close relationships with local industrial groups, which translates into a strong network with wide coverage and flexibility. Such advantages are unmatched by other institutions and can be leveraged to facilitate cross-border transactions.

- ► Large investment banks have branches in practically every major financial centre globally and their turnover is usually close to exceeding that of domestic financial institutions in their local markets. As the financial markets continue to become more open, large multinational investment banks are well-positioned to utilise their extensive network to help organisations expand into China and also to help Chinese enterprises and investors make forays into other markets. With regards to business lines, large multinational investment banks are improving their M&A, asset management, financial consulting, risk control and other international businesses.

• VII. Recommendations for handling NPLs

Banks' NPLs are a matter of national financial stability. As NPLs continue to rise, methods to facilitate their quick disposal are urgently needed. Based on KPMG China's experience, we offer the following recommendations to financial institutions with NPLs:

- ► Firstly, building a network platform for NPL disposals and forging stable relationships with different types of organisations is important; improving communication channels is also an important part of the disposal process.

- ► Secondly, making proper use of intermediary institutions to draw upon their strengths in various fields can help. Leveraging their information advantages to stay informed about the latest and most comprehensive developments in the market is important.

- ► Finally, building a network of external experts and creating effective communication channels with specialists is crucial.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Hot topic four: Analysis of a new wave of debt-to-equity swaps

In a classic debt-to-equity swap, a country or a commercial bank forms a financial asset management company (AMC) to acquire the bank's assets in the form of loans and in so doing transforms the creditor-debtor relationship between the bank and an enterprise as a borrower into an equity relationship in which the AMC is the controlling party or shareholder of the enterprise. After the debt has been restructured into equity, the original obligation to pay principal and interest becomes an obligation to distribute share-based dividends.

I. Background

In recent years, as China's economy has started to slow, many enterprises are faced with increasing debt costs and operating difficulties. As a source of debt financing for Chinese enterprises, banks saw their NPL ratios rise significantly. Statistics from the CBRC show that as at the end of the fourth quarter of 2015, the NPL ratio of commercial banks amounted to 1.67%, 0.42 % higher than the ratio at the end of 2014. The Chinese government and China's regulatory bodies attach great importance to the ratio of NPLs in the banking sector and have been studying ways to contain such risk. Debt-to-equity swaps, which were used to solve structural problems a decade ago, are being considered once again.

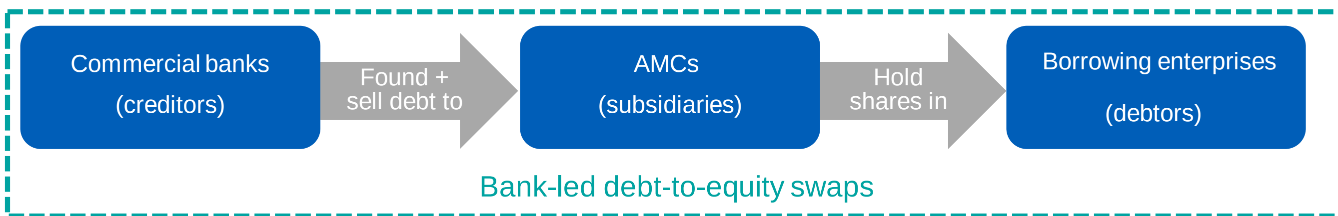
Debt-to-equity swaps, both at home and overseas, comprise two main models:

1. Government-led debt-to-equity swaps

Corporate loans are transferred from commercial banks to third party institutions that will hold the equity. Under this model, as such third party institutions are often governed or financed by governments, this type of NPL divestiture is mostly policy-oriented such as TRC in the United States, Japan's bridge bank and China's debt-to-equity practices in 1999. Unlike bank-led debt-to-equity swaps, following the transfer of NPLs from commercial banks to third party institutions, commercial banks will benefit from a significant improvement in asset quality and at the same time, do not need to bear the risk of change in enterprises' assets following swap execution. Third party institutions can increase the value of NPLs through asset restructuring and operational improvements and benefit from price differences or share-based dividends according to their equity contributions.

2. Bank-led debt-to-equity swaps

Corporate loans are directly transferred to equity held by banks. The rationale underlying this model is that state laws and regulations allow commercial banks to hold certain amounts of equity in non-financial enterprises and this equity may be gained from the direct transfer of banks' NPLs to these enterprises. The effect on enterprises is that they will see their debt reduced, their capital increase and their equity diluted as the result of banks' shareholdings. Banks, on the other hand, can make a distinction between the commercial banking business and investment banking business based on the relationship banks have with the enterprises i.e. whether they are lenders and borrowers or parent companies and subsidiaries. The investment banking business will be charged with directly managing corporate equity restructured from debt. Governments can share part of the liquidity risk and banks' profit-making pressure through capital contributions to banks but should keep banks' decision-making power intact.



© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Hot topic four: Analysis of a new wave of debt-to-equity swaps (continued)

II. Accounting and tax treatment of debt-to-equity swaps

1. Accounting treatment

According to Article 6 and Article 11 of 'Accounting Standards for Business Enterprises No. 12 – Debt Restructuring and Interpretations of Accounting Standards for Business Enterprises', published in 2010, accounting treatment for conversion of debt to capital is as follows:

(1) Debtors

The total carrying value of shares (or equity) held by creditors as a result of their surrender of their rights should be recognised as share capital (or paid-in capital), the difference between the total fair value of shares (or equity) and share capital (or paid-in capital) should be recognised as share premiums (or capital surplus) in capital reserve. The excess of the carrying value of restructured debt over the total fair value of shares (or equity) should be recognised as gains from debt restructuring through profit or loss.

For listed companies since their issued shares have market value, the market value will be the fair value of the shares or equity. For other enterprises, as shares or equity held by creditors as a result of their surrender of their rights may not have market value, appropriate valuation techniques should be employed to determine their fair value.

(2) Creditors

As creditors, banks should recognise the shares held by them as a result of their surrender of their rights as investment to debtors based on the shares' fair value. The difference between the carrying value of restructured debt and the fair value of the shares should be recognised through profit or loss. Taxes incurred should be treated in accordance with standards pertaining to the recognition and measurement of long-term equity investments or financial instruments. The difficulty or uncertainty involved with the accounting treatment of debt-to-equity swaps in the banking sector lies in how to deal with provisions that had been made for impairment of loans and whether intermediate accounts should be set up to account for and settle loans to customers such as issues related to whether such provisions should be reversed when debt is converted to equity and whether loans to customers should be settled through debt repaid assets.

2. Tax treatment

(1) Income tax

Pursuant to the 'Measures for the Treatment of Income Tax in the Debt Restructuring of Enterprises '(State Administration of Taxation Order No.6) and the 'Notice of the Ministry of Finance and the State Administration of Taxation on Several Issues Concerning Corporate Income Tax Treatment for Enterprise Reorganization '(Cai Shui No. [2009] 59), debt-to-equity swaps are treated for income tax purposes based on two approaches-general tax treatment and special tax treatment:

Tax treatment of debt-to-equity swaps

Approach	General tax treatment	Special tax treatment
Debtors	Debtors should recognise the excess of debt settlement payments or the fair value of shares over the tax base of debt as gains from debt restructuring.	Debtors do not recognise the concession made by creditors as gains from debt restructuring on a temporary basis; other income tax matters remain unchanged. If recognised gains from debt-to-equity swaps account for over 50% of debtors' taxable income for the year, debtors can distribute such gains from debt restructuring evenly over each year for up to a period of five tax years.
Creditors	Creditors should recognise the excess of debt settlement payments received or the fair value of shares over the tax base of debt as loss from debt restructuring and determine the tax base of equity gained based on its fair value. Loss from debt restructuring arising from debt-to-equity swaps can only be deducted on a pre-tax basis when approval of tax authorities is obtained.	Creditors do not recognise the concession made for debtors as loss from debt restructuring on a temporary basis and the tax base of equity investment acquired by creditors is determined based on the tax base of the original debt.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Hot topic four: Analysis of a new wave of debt-to-equity swaps (continued)

III. The implementation of debt-to-equity transfers in the banking sector

As debt-to-equity swaps are currently being studied by the authorities, any examples in China are rather rare at the moment. According to publicly available information, banks known to be carrying out this business include Bank of China and Minsheng Bank.

1) Bank of China

On 8 March 2016, one of China's largest private shipmakers announced that it would issue up to 17.1 billion shares to its creditors (including 14.1 billion shares to 22 creditor banks and 3 billion shares to 1,000 creditor suppliers) to offset RMB 17.1 billion of debt. After the debt-to-equity swap, Bank of China, its largest creditor, will become its largest shareholder.

2) Other banks

In 2013, a number of creditor banks filed applications for property preservation with the courts, which paves the way for the bankruptcy and restructuring of a China headquartered shipping company. According to the restructuring plan that was approved in September 2014, every RMB 100 of ordinary debt will be swapped into approximately 4.6 shares. Mingsheng Bank, Bank of Communications (Hubei branch) and China Everbright Bank (Wuhan branch) with 2.91%, 1.97% and 1.75% of equity interest respectively rank fourth, seventh and tenth among the company's top ten shareholders. The 2015 annual reports of Minsheng Bank show that its stake is accounted for as available-for-sale equity investment.

IV. The impact of debt-to-equity transfers on the banking sector

Our analysis of the impact of debt-to-equity swaps on the banking industry is based on the following assumptions:

1. Assumptions

Our analysis is based on the following assumptions:

1) the ratio of any debt-to-equity swap is 1:1, which is debt transaction equivalent equity,
2) there is no fixed dividend income for swapped equity of ordinary shares,
3) pursuant to Article 68 of the 'Measures for Capital Management of Commercial Banks' (Trial), the risk weighting for equity investments of commercial banks in industrial and commercial companies is 400%,
4) net profit arising from any debt-to-equity swap is fully credited to net core tier 1 capital,
5) RMB 10 million is swapped from debt to equity, which is seen as either a swap of normal loans or non-performing loans. A simultaneous swap of both is not considered,
6) the swap of non-performing loans is fully provided for in provision. Thus the provision is reversed at the amount of the swapped amount (i.e. RMB 10 million),
7) interests are accrued on the balance sheet for normal loans but not for non-performing ones,
8) the impact of income tax, stamp duty and other related taxes is not considered.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Hot topic four: Analysis of a new wave of debt-to-equity swaps (continued)

2. General impact on the banking industry

Based on the assumptions mentioned above and available data, our analysis of the impact of debt-to-equity swaps for normal and non-performing loans on the banking industry is as follows:

1) Swap of normal loans

When normal loans are converted into equity, the balance of normal loans decreases and with all other variables held constant, no interest income is generated, resulting in a fall in net profit, owners' equity and total assets.

A decline in total loans with the NPL balance and provision for impairment remaining unchanged results in higher NPL ratios and higher provision coverage ratios, while loan provision ratios stay the same.

With respect to the impact on capital adequacy ratios, a fall in net profit leads to a decrease in net core tier 1 capital. Risk-weighted assets increase as a result of additional investment brought by debt-to-equity swaps and a risk weighting of 400%. The combined impact of the two causes the adequacy ratio of core tier 1 capital to fall.

Major impacts:

Swap of normal loans	Decrease in interest income	Impact on indicator of loan quality	Decrease in core tier 1 capital adequacy ratio
• Decrease in balance of normal loans • NPL balance remains unchanged • Provision for impairment remains unchanged	• Decrease in net profit • Decrease in owners' equity • Decrease in total assets	• Increase in NPL ratio • Increase in loan provision ratio • Provision coverage ratio remains unchanged	• Decrease in net core tier 1 capital • Increase in risk weighted assets

Detailed calculation:

		Normal loans		
		Before swap	After swap	Impact
Unit: RMB 1 million		A	B	C=B-A
Total loans	a=b+c	2500	2490	-10
-Normal loans	b	2450	2440	-10
-NPLs	c	50	50	0
Provisions for impairment	d	-100	-100	0
Balance of loans	e=a+d	2400	2390	-10
Net core tier 1 capital	f	1000	999.50	-0.50
Risk-weighted assets	g	10000	10040	40
Weight of additional investment from debt-to-equity swap	h	0	400%	400%
Additional investment from debt-to-equity swap	i	0	10	10
Lending rate	j	5%	5%	0
Interest income	k=b*j	122.50	122.00	-0.50
Investment income (dividend)	l	0	IND	IND
Impairment loss	m	0	0	0
Net profit	n=k+l+m	122.50	122.00	-0.50
Owners' equity	o	122.50	122.00	-0.50
Total assets	p	122.50	122.00	-0.50
NPL ratio	q=c/a	2.00%	2.01%	0.01%
Provision coverage ratio	r=d/c	200%	200%	0.00%
Loan provision ratio	s=d/a	4.00%	4.02%	0.02%
Core tier 1 capital adequacy ratio	t=f/g	10.00%	9.96%	-0.04%

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Hot topic four: Analysis of a new wave of debt-to-equity swaps (continued)

2. General impact on the banking industry (continued)

2) Swaps of NPLs

When NPLs are converted into equity, the NPL balance decreases, having no impact on normal loans. With all other variables held constant, interest income is not affected. The need to reverse impairment provisions for NPLs causes impairment losses to decrease, while net profit, owners' equity and total assets increase.

A decline in total loans, NPL balance and provision for impairment results in lower NPLs ratios, an increase in provision coverage ratios and a decline in loan provision ratios.

The impact on capital adequacy ratios is more complex. Debt-to-equity swaps affect the numerator and denominator used to calculate the capital adequacy ratio, therefore specific changes in the magnitude and trends depend on changes in the numerator and denominator. In this example, an increase in profit leads to higher net core tier 1 capital. Risk-weighted assets grow as a result of additional investment brought by debt-to-equity swaps and a risk weighting of 400%. The combined impact of the two causes core tier 1 capital adequacy ratio to increase. Core tier 1 capital adequacy ratio may rise if the magnitude of change is different from this example.

Major impacts:

Swap of NPLs	Decrease in impairment loss	Impact on indicator of loan quality	Increase in core tier 1 capital adequacy ratio
• Balance of normal loans remains unchanged • Decrease in NPL balance • Decrease in provision for impairment	• Increase in net profit • Increase in owners' equity • Increase in total assets	• Decrease in NPL ratio • Decrease in loan provision ratio • Increase in provision coverage ratio	• Increase in net core tier 1 capital • Increase in risk weighted assets

Detail calculation:

		Normal loans		
		Before swap	After swap	Impact
Unit: RMB 1 million		A	B	C=B-A
Total loans	a=b+c	2500	2490	-10
-Normal loans	b	2450	2450	0
-NPLs	c	50	40	-10
Provisions for impairment	d	-100	-90	10
Balance of loans	e=a+d	2400	2400	0
Net core tier 1 capital	f	1000	1010	10
Risk-weighted assets	g	10000	10040	40
Weight of additional investment from debt-to-equity swap	h	0	400%	400%
Additional investment from debt-to-equity swap	i	0	10	10
Lending rate	j	5%	5%	0
Interest income	k=b*j	122.50	122.50	0
Investment income (dividend)	l	0	IND	IND
Impairment loss	m	0	10	10
Net profit	n=k+l+m	122.50	132.50	10
Owners' equity	o	122.50	132.50	10
Total assets	p	122.50	132.50	10
NPL ratio	q=c/a	2.00%	1.61%	-0.39%
Provision coverage ratio	r=d/c	200%	225%	25.00%
Loan provision ratio	s=d/a	4.00%	3.61%	-0.39%
Core tier 1 capital adequacy ratio	t=f/g	10.00%	10.06%	0.06%

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Hot topic four: Analysis of a new wave of debt-to-equity swaps (continued)

V. Unclear matters of this wave of debt-to equity swaps in banking sector
As the latest round of debt-to-equity swaps have not yet been rolled out and laws and regulations pose many obstacles for commercial banks to directly hold equity in industrial and commercial companies, many questions currently remain unanswered.

Target companies and scope
Most loans are presented as special mention or even normal loans instead of NPLs in banks' statements. 'Zombie companies' are expected to be excluded from any swap exercises. The first round of any pilot programme will include only those companies with specified production capacities and projects that are in line with the government's economic policies. These are mostly state-owned enterprises and their subsidiaries.In reality, some zombie companies may be able to continue operating since the company's industry and size will be an important factor taken into consideration and this may outweigh other factors.

Ordinary shares or preference shares
Commercial banks may be faced with two options when converting debt into equity: ordinary shares or preference shares. Both have their advantages and disadvantages. Preference shares grant holders the right to receive fixed income payments (dividends) but not participate in the daily operation and decision-making process. Preference shares are still being piloted and create more difficulties for banks potentially. Ordinary shares give holders the right to participate in day-to-day operations and decision-making of the companies without receiving fixed income payments. This better serves banks' purpose and is easier for them to manage.

Operations
Commercial banks face two options when converting NPLs into equity. One option, as in 1999, is government-led debt-to equity swaps, which involves the four major state-owned asset management companies. This round of debt-to-equity swaps is more likely to be led by the banks. Banks may set up new asset management companies and equity investment funds to acquire bank debts. Equity investment funds will likely be structured general partnerships or financial funds with limited partnership structures.

The pressure of use of bank capital
According to the 'Measures for Capital Management of Commercial Banks', the risk weighting for equity investments in industrial and commercial companies passively held by commercial banks within the specified disposal period is 400%, the risk weighting for equity investments in industrial and commercial companies held by commercial banks is 400% and the risk weighting for other equity investments by commercial banks in industrial and commercial companies is 1250%.The proportion of capital used for equity investments is significantly higher than that used for general lending. A balance of the two requires banks to perform detailed calculations.

Exit after debt-to-equity swaps
Channels for commercial banks to exit investments after debt-to-equity swaps are limited. The transfer or sale of equity interest involves complicated pricing negotiations and can easily lead to losses. Methods to exit investments after swaps have been executed have yet to be explored.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.
Printed in China.

Academic Insights: Studies on the mechanism of the financial sector providing support for supply-side reform

Supply-side structural reform represents a major shift in policy from China's government. The reform is designed to promote sustainable economic growth and encourage the efficient use of resources and their rational allocation. As the financial services industry serves as the lynchpin of modern commerce, financial reform plays a crucial role in aiding the restructuring of China's economy. This means that supply-side structural reform is inseparable from the deepening of financial reform and innovation. How government can speed up the pace of innovation in the financial sector to fuel supply-side reform has become an important policy issue. For this reason, it is important to study the issue in depth.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Academic Insights: Studies on the mechanism of the financial sector providing support for supply-side reform (continued)

1 Impact and meaning of providing financial support for supply-side structural reform

The Chinese government has sought to promote supply-side reform as the country's economy begins to adapt to the economic new normal. As the core of the modern economy, the financial services sector plays a pivotal role in this process. According to the Chinese government when outlining the five objectives of supply-side structural reform proposed during the Central Economic Work Conference in 2016 - cutting overcapacity, de-stocking, de-leveraging, reducing costs and fixing shortcomings in the economy - reform of financial services will help support this process in the following ways:

The first step is to improve macro-financial regulation and support cost reduction and de-stocking. Supply-side structural reform requires a relatively stable financial environment and the creation of a sound and efficient financial regulatory system. Promoting reforms on interest and exchange rates and allowing the price of various funds to play a decisive role in allocating financial resources will eventually lead to a reduction in investment and financing costs and aid de-stocking efforts.

The second step is to foster financial innovation and support efforts to reduce overcapacity and de-leverage. The internationalisation of the renminbi should help increase funding for Chinese enterprises and reduce overcapacity. Besides, stronger capital markets will help financial product innovation, particularly following corporate mergers and acquisitions.

The third step is to support internet finance and other emerging areas in the financial services sector. The government will continue to regulate internet finance and strengthen financial support for small and medium-size enterprises and micro-enterprises, especially those working in the Fintech sector.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.
Printed in China.

Academic Insights: Studies on the mechanism of the financial sector providing support for supply-side reform (continued)

2 Research status in China and abroad

The relationship between supply and demand has always been a popular topic among scholars studying the economy and supply-side economics is an established academic field in its own right. This was developed in the United States in response to the inflation caused by Keynesian economic policies. It aims to mobilise economic activity through tax reductions and boost production and supply. At the same time, it also emphasises technological innovation and investment in up-skilling workforces.

Chinese scholars have also made an important contribution to the study of supply-side economics. In an article in 2013, Jia Kang first proposed the concept of new supply-side economics. The article not only focuses on how governments can further release supply potential including supply of factors of production and institutional supply to promote a new round of economic reforms but also points out that China's current economic stagnation is caused by undersupply, not by lack of demand. Jia Kang and Su Jingchun in 2014 put forward their concept of the 'integration of five dimensions' based on traditional supply-side economics, institutional economics, transition economics, development economics and information and behavioural economics. Xiao Lin in 2016 further enhanced the theory of supply-side reform by analysing its relationship with the 'five concepts for development'. He argues that supply-side structural reform is crucial based on China's current stage of economic development.

Wang Yiming has argued that it is important to expand aggregate demand modestly, while at the same time accelerating supply-side structural reform. He believes that reform should be utilised to correct the mismatch between supply and demand.

China has made supply-side structural reform a major part of its economic reforms and discussion about providing financial support for these reforms has become a widely debated topic. Guo Honghai has said that supply-side structural reform is inseparable from discussions about financial services and reform of the financial services industry is necessary if China's economy is to adapt. Wang Wenjian in 2016 also said that financial reform serves as the cornerstone of supply-side structural reform and the that success of supply-side structural reform also depends on the deepening of financial reform. Ji Min in 2016 said that the financial services industry will inevitably play a crucial role in supply-side structural reform based on his analysis of the effects of monetary policy and the industry's regulatory framework.

The emergence of supply-side economics within academia has provided the theoretical basis for China's supply-side reform programme. As China's economy begins to transition from one dependent upon exports and manufacturing to one reliant upon services and innovation, boosting the supply side is crucial, particularly with regards to the financial services industry.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Academic Insights: Studies on the mechanism of the financial sector providing support for supply-side reform (continued)

3 Comparison of international supply-side reform

As there may be some discrepancy between the perception and implementation of supply-side reform and the risk of lack of effective coordination between government and market forces during the course of reform, it is important to learn from historical experience. The most well-known supply-side reforms were the ones carried out under American President Reagan and British Prime Minister Margaret Thatcher and we can compare these two examples to China's current reform agenda.

Table 1 Comparison of Chinese and foreign supply-side reform

	Background and issue	Reform	Results and hidden trouble
Regan revolution	Severe inflation, economic slowdown; decreased labour productivity; declining competitiveness among traditional industries.	Adjusted tax rates and reduced individual and corporate income tax; reduced government's intervention in and regulation of enterprises; cut government's non-defence expenditure; implemented tight monetary policy.	Inflation was curbed, the economy recovered and science and technology benefited. However the financial deficit and income inequality grew.
Margaret Thatcher's reforms	The economy was suffering from recession and stagflation; state-owned enterprises were inefficient; labour unions were powerful and the labour market was heavily distorted; high spending on welfare created pressures.	Anti-inflation; reform of state-owned enterprises; the influence of labour unions declined and regulation over the labour market was relaxed; market-oriented reforms of the welfare system were carried out; adjustment of regional development policies to adapt to regional conditions and issues.	Economic growth resumed and inflation was effectively curbed; privatisation has helped reduce the deficit; greater economic freedom was achieved and productivity improved; the influence of the unions was curbed and the labour market became more flexible. However, unemployment also increased significantly.
China's supply-side structural reform	Economic slowdown; serious overcapacity; agriculture failed to modernise; personal and corporate borrowing rose.	Strengthened management of the coal and steel industries; accelerated reform of state-owned enterprises.	There may be some discrepancy between the perception and implementation of supply-side reform; there is a risk of lack of effective coordination between the government and market; speculation may increase.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Academic Insights: Studies on the mechanism of the financial sector providing support for supply-side reform (continued)

3 Comparison of international supply-side reform (continued)

- As Table 1 shows, even though the Reagan administration went through a short-term economic crisis after taking office, economic growth was gradually restored with inflation bottoming out. However, many problems arose. Firstly, the deficit was very large since the government carried out massive tax cuts and increased spending on defence policy. In order to boost liquidity and avoid deflation, the government had to raise debt. As a result, the United States gradually became most indebted country in the world. Secondly, the country's low savings rate made it impossible to make up for the huge deficit so it had to keep interest rate levels low to attract foreign investment. High interest rates also led to the appreciation of the US dollar and the country's trade deficit rose from USD 42.7 billion in 1982 to USD 144.6 billion in 1985 as a result. The US even lost its advantage in the export of high technology products, which used to help balance its international trade. Finally, during the Reagan administration, the gap between household incomes widened. There was great disparity between the benefits that people from different strata derived from the reforms to the tax system.The taxes paid by the top 10% of earners fell 6.4%, while the tax burden of the bottom 10% rose 20%. The poor also received less subsidies after welfare reforms.

- The Thatcher government removed the controls over foreign exchange in the early stages of monetary policy tightening, resulting in upward pressure for M3. In order to stabilise the money supply, the UK Treasury was obliged to raise interest rates. A strong currently considerably reduced the competitiveness of goods made in the UK, leading to fewer employment opportunities. The unemployment rate remained at a high level meaning that the government needed to pay more in unemployment benefits and government debts increased as a result. Unemployment rates only ceased rising in 1986. The growth of the UK economy during this period, including in the UK manufacturing industry, was achieved at the cost of mass unemployment. The Thatcher government did not generate enough jobs to restore the unemployed to work.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved. Printed in China.

Academic Insights: Studies on the mechanism of the financial sector providing support for supply-side reform (continued)

4 Path for promoting supply-side reform through reform to the financial services sector

1. Allocate financial resources appropriately to promote the development of emerging industries

Firstly, the financial services industry should focus its attention on the key areas covered in 'Made in China 2025', the main strategy for China's manufacturing sector that was outlined by the government last year, and broaden the channels for serving emerging industries. Secondly, the banking industry should dedicate more resources to providing support for technological innovation and start-ups. Thirdly, different types of financial institutions need to identify their approach in leveraging private capital to serve these industries. Finally, the banking industry should provide customised services for different types of customers under the guidance of the government's supply-side reforms.

2. Deepen financial reform

The government will continue to promote interest rate liberalisation, improve market-based interest rate formation, urge financial institutions to enhance their capabilities for independent pricing, improve the market-based exchange rate formation system, promote the development and internationalisation of the renminbi to open up the country to the foreign exchange markets and continue to promote the use of free trade zones.

3. Provide diversified financial services to promote the upgrading of traditional industries

Firstly, the banking industry should target enterprises in traditional industries and allow enterprises to choose from a variety of different financial products based on their circumstances. They should also make the provision of guarantees easier and improve the efficiency of asset utilisation. Secondly, banks should help enterprises revitalise their inventories and reduce the cash flow pressure resulting from increasing inventories. Thirdly, the banking industry should tide over enterprises and provide support for transforming traditional production capacities, particularly those suffering from excess capacity. Finally, financial institutions should help large enterprises, promote industrial optimisation and restructure, revitalise available funds and remove existing financing bottlenecks.

4. Help alleviate customised financing difficulties faced by innovative new start-ups and entrepreneurs

Firstly, banks should establish a small and micro enterprise credit system in order to lay the groundwork for extending credit to small and medium sized companies. Secondly, banks should establish a bespoke credit system for evaluating applications for loans from smaller enterprises based on different criteria for those used for larger companies. Thirdly, banks should establish a reasonable credit management system for managing the loan approval process. Finally, related financial institutions should clean up unreasonable charges for financial services as soon as possible to reduce the burden on small and micro enterprises.

5. Deepen capital market reforms in order to increase the proportion of direct financing available

Firstly, banks should open up the channels connecting the credit and capital markets so that the resources of different types of financial institutions are better integrated. Secondly, banks should use the opportunities provided by the government, which is actively seeking to stimulate the capital and inter-bank bond markets, by encouraging qualified enterprises, particularly those in emerging industries, to raise funds through bond and note issuances. Thirdly, financial institutions should push for the reform of the IPO registration system to help companies access a wider range of funding sources. Finally, financial institutions should aid private equity investment in order to make funding available for entrepreneurial start-ups.

6. Regulate the development of internet banking in order to expand the scope of financial services

Expand the coverage of internet payment and settlements and expand the range of services involving Fintech available to customers.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Academic Insights: Studies on the mechanism of the financial sector providing support for supply-side reform (continued)

5 Suggestions on policies for promoting the supply-side reform through reform of the financial services sector

(1) If the financial services industry is able to make headway in cutting excess industrial capacity, destocking, deleveraging and lowering costs, it will have gone along way towards ensuring that the policies of the central government are properly implemented. Banks, securities companies, insurers and other financial institutions should recognise their respective advantages, provide financial support for new industries and accelerate technological and product innovation based on their own individual circumstances.

(2) It is important to maintain a suitable monetary environment in order to promote structural reforms. In pursuing prudent monetary policies, banks should be flexible and make use of a mix of tools such as interest rates, exchange rates, open market operations and deposit reserve ratios to make sure that macro adjustments are carried out on a reasoned basis. Monetary policy has become reasonably flexible in China and banks should make sure to utilise these tools with aims of providing a reasonable amount of liquidity and achieving a moderate growth in lending. At the same time, banks should seek to reduce their cost of financing, expand the availability of direct financing, optimise credit structures and improve existing exchange rate formation mechanisms.

(3) Importance must be attached to guarding against financial risk. Under the economic new normal, all kinds of risks that might not have appeared in the past will gradually begin to emerge. In order to ensure that structural reforms are carried out smoothly, default cases must be addressed in accordance with existing laws and regulations. In order to ensure neither systemic nor regional financial risks occur, it is important to standardise financing activities and enhance risk control.

Contributors :

Financial Research Center Fudan University — Zhou Guangyou

School of Finance Shanghai University of Finance and Economics — Luo Sumei

References

Robert. E. Lucas, Supply-Side Economics: An Analytical Review, *Oxford Economic Papers*, 1990, 42(2):pp. 295-297

Hu Xining, Supply Economics and China's Supply-Side Reform, Theoretical Horizon, 2016 , 01 : 5—7

Jia Kang, China Needs to Develop a New Supply Economics That is Focused On Reform, Public Finance Research, 2013 , 01 : 2—15

Jia Kang and Su Jingchun, The Inclusive Boundary Between "Five-Dimensional" Supply Theory and the New Supply Economics, Research on Financial and Economic Issues , 2014 , 11 : 3—10

Xiao Lin, The Implementation of the Supply-Side Reform under the New Normal in Shanghai, Wen Wei Po, 2015/12/12

Xiao Lin, Do You Understand the Logic Behind the Supply-Side Reform? Liberation Daily, 2016/3/29

Wang Wenjian, What Does the Financial Services Sector Need to Do in The Supply-Side Reform? new.hexun.com, 2016/3/31

Create a Suitable Monetary and Financial Environment for Promoting the Supply-Side Reform, Financial Times, 2016/3/16

Guo Honghai, Provide Financial Support for the Supply-Side Reform, www.gov.cn, 2016/3/31

Wang Yiming and others, How to Understand the Supply-Side Reform in The Right Way, People's Daily, 2016/03/29, 07 layout.

Ji Min, The Financial Services Sector Has a Big Role to Play in the Supply-Side Reform, m.stcn.com, 2016/03/27

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

4 Appendix: 2016 Q1 financial data of listed banks

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.
Printed in China.

Appendix - Net profit attributable to equity holders of the parent company

RMB million	2016/01/01-2016/03/31	2015/01/01-2015/03/31	Growth rate
ICBC	74,764	74,324	0.59%
CCB	67,952	67,005	1.41%
BOC	46,619	45,838	1.70%
ABC	54,688	54,116	1.06%
BCM	19,066	18,970	0.51%
CMB	18,350	17,220	6.56%
CNCB	11,200	10,928	2.49%
CMBC	13,706	13,377	2.46%
SPDB	13,922	11,194	24.37%
CIB	15,700	14,790	6.15%
CEB	8,446	8,358	1.05%
HXB	4,431	4,136	7.13%
PAB	6,086	5,629	8.12%
BOB	5,275	4,986	5.80%
BON	2,119	1,773	19.51%
NBCB	2,030	1,752	15.87%
Total	364,354	354,396	2.81%

Source: The banks' 2015 Q1 & 2016 Q1 report, KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Appendix - Financial performance indicator

	Return on weighted average equity (ROE)		Basic earnings per share (EPS)		Net asset value per share (in RMB)	
	2016/01/01-2016/03/31	2015/01/01-2015/03/31	2016/01/01-2016/03/31	2015/01/01-2015/03/31	2016/03/31	2015/12/31
ICBC	17.12%	19.35%	0.21	0.21	5.00	4.80
CCB	18.53%	21.03%	0.27	0.27	6.04	5.78
BOC	14.77%	16.93%	0.15	0.16	4.24	4.09
ABC	18.72%	21.28%	0.16	0.17	3.64	3.48
BCM	14.40%	15.79%	0.26	0.26	7.25	7.00
CMB	19.84%	21.33%	0.73	0.68	15.03	14.31
CNCB	13.94%	16.71%	0.23	0.23	6.72	6.49
CMBC	17.94%	21.64%	0.38	0.39	8.52	8.26
SPDB	18.00%	17.88%	0.70	0.60	15.96	15.29
CIB	21.24%	23.44%	0.82	0.78	15.95	15.10
CEB	16.25%	18.24%	0.18	0.18	4.55	4.36
HXB	14.80%	16.00%	0.41	0.39	13.29	11.01
PAB	14.01%	15.83%	0.43	0.41	11.71	11.29
BOB	18.48%	20.32%	0.42	0.39	9.61	8.81
BON	17.60%	21.36%	0.63	0.60	14.58	14.01
NBCB	19.68%	20.04%	0.52	0.45	10.87	10.30
Average	17.21%	19.20%	0.41	0.39	9.56	9.02

Source: The banks' 2015 Q1 & 2016 Q1 report, KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Appendix - Net interest margin

	2016/01/01-2016/03/31	2015/01/01-2015/03/31
ICBC	2.28%	2.60%
CCB	2.40%	2.72%
BOC	1.97%	2.22%
ABC	2.40%	2.85%
BCM	2.01%	2.29%
CMB	2.62%	2.90%
CNCB	2.13%	2.32%
CMBC	2.11%	2.37%
SPDB	3.11%	3.04%
CIB	2.28%	2.50%
CEB	2.46%	2.63%
HXB	2.49%	2.80%
PAB	2.87%	2.73%
BOB	2.19%	2.38%
BON	2.57%	2.58%
NBCB	2.20%	2.44%
Average	2.38%	2.59%

Source: The banks' 2015 Q1 & 2016 Q1 report, KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Appendix - Operating income

RMB million	Net interest income	Net fee and commission income	Investment income	Other operating income	Total operating income
2016/01/01-2016/03/31	651,988	236,024	32,446	93,063	1,013,521
2015/01/01-2015/03/31	652,708	199,022	12,454	52,503	916,687

	Net interest income			Net fee and commission income			Investment income			Other operating income			Operating income		
RMB million	2016/01/01-2016/03/31	2015/01/01-2015/03/31	Growth rate	2016/01/01-2016/03/31	2015/01/01-2015/03/31	Growth rate	2016/01/01-2016/03/31	2015/01/01-2015/03/31	Growth rate	2016/01/01-2016/03/31	2015/01/01-2015/03/31	Growth rate	2016/01/01-2016/03/31	2015/01/01-2015/03/31	Growth rate
ICBC	118,810	125,283	-5%	43,485	37,210	17%	1,998	3,666	-45%	29,596	15,005	97%	193,889	181,164	7%
CCB	107,886	111,300	-3%	38,376	33,928	13%	5,972	416	1,336%	35,710	16,723	114%	187,944	162,367	16%
BOC	79,536	81,000	-2%	25,727	24,355	6%	4,467	1,379	224%	13,089	14,706	-11%	122,819	121,440	1%
ABC	101,704	109,442	-7%	28,918	26,978	7%	772	1,750	-56%	6,652	1,273	423%	138,046	139,443	-1%
BCM	34,028	35,002	-3%	10,772	9,875	9%	72	248	-71%	11,161	4,280	161%	56,033	49,405	13%
CMB	34,306	33,579	2%	19,824	15,446	28%	4,598	1,709	169%	-476	13	-3,762%	58,252	50,747	15%
CNCB	27,562	24,053	15%	11,037	8,184	35%	1,987	675	194%	-107	80	-234%	40,479	32,992	23%
CMBC	24,106	23,152	4%	14,572	12,026	21%	4,455	-54	-8,350%	-2,999	906	-431%	40,134	36,030	11%
SPDB	27,812	24,679	13%	11,618	6,932	68%	1,969	731	169%	792	649	22%	42,191	32,991	28%
CIB	29,581	26,976	10%	7,673	6,583	17%	3,903	1,060	268%	-240	-412	-42%	40,917	34,207	20%
CEB	16,424	15,574	5%	6,902	6,653	4%	223	141	58%	-9	-105	-91%	23,540	22,263	6%
HXB	12,068	11,368	6%	2,949	1,801	64%	85	-239	-136%	17	-54	-131%	15,119	12,876	17%
PAB	18,398	15,144	21%	8,101	5,387	50%	824	464	78%	209	-324	-165%	27,532	20,671	33%
BOB	9,375	8,242	14%	3,071	2,030	51%	249	200	25%	7	153	-95%	12,702	10,625	20%
BON	5,928	4,184	42%	1,457	817	78%	447	187	139%	16	-124	-113%	7,848	5,064	55%
NBCB	4,464	3,730	20%	1,542	817	89%	425	121	251%	-355	-266	33%	6,076	4,402	38%
Total	651,988	652,708	0%	236,024	199,022	19%	32,446	12,454	161%	93,063	52,503	77%	1,013,521	916,687	11%

Source: The banks' 2015 Q1 & 2016 Q1 report, KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Appendix - Operating income structure

	Net interest income %		Net fee and commission income %		Investment income %		Other operating income %	
	2016	2015	2016	2015	2016	2015	2016	2015
	01/01-03/31	01/01-03/31	01/01-03/31	01/01-03/31	01/01-03/31	01/01-03/31	01/01-03/31	01/01-03/31
ICBC	61.28%	69.15%	22.43%	20.54%	1.03%	2.02%	15.26%	8.29%
CCB	57.40%	68.55%	20.42%	20.90%	3.18%	0.26%	19.00%	10.29%
BOC	64.76%	66.70%	20.95%	20.06%	3.64%	1.14%	10.65%	12.10%
ABC	73.67%	78.49%	20.95%	19.35%	0.56%	1.25%	4.82%	0.91%
BCM	60.73%	70.85%	19.22%	19.99%	0.13%	0.50%	19.92%	8.66%
CMB	58.89%	66.17%	34.03%	30.44%	7.89%	3.37%	-0.81%	0.02%
CNCB	68.09%	72.91%	27.27%	24.81%	4.91%	2.05%	-0.27%	0.23%
CMBC	60.06%	64.26%	36.31%	33.38%	11.10%	-0.15%	-7.47%	2.51%
SPDB	65.92%	74.81%	27.54%	21.01%	4.67%	2.22%	1.87%	1.96%
CIB	72.30%	78.86%	18.75%	19.24%	9.54%	3.10%	-0.59%	-1.20%
CEB	69.77%	69.95%	29.32%	29.88%	0.95%	0.63%	-0.04%	-0.46%
HXB	79.82%	88.29%	19.51%	13.99%	0.56%	-1.86%	0.11%	-0.42%
PAB	66.82%	73.26%	29.42%	26.06%	2.99%	2.24%	0.77%	-1.56%
BOB	73.81%	77.57%	24.18%	19.11%	1.96%	1.88%	0.05%	1.44%
BON	75.53%	82.63%	18.57%	16.14%	5.69%	3.69%	0.21%	-2.46%
NBCB	73.48%	84.75%	25.37%	18.57%	6.99%	2.76%	-5.84%	-6.08%
Average	67.65%	74.20%	24.64%	22.09%	4.11%	1.57%	3.60%	2.14%

Source: The banks' 2015 Q1 & 2016 Q1 report, KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Appendix - Intermediate business income ratio

	2016/01/01-2016/03/31	2015/01/01-2015/03/31
ICBC	24.62%	22.48%
CCB	21.41%	21.59%
BOC	22.63%	21.62%
ABC	21.97%	20.07%
BCM	20.36%	21.45%
CMB	35.82%	32.25%
CNCB	28.37%	26.06%
CMBC	38.69%	35.61%
SPDB	28.58%	21.97%
CIB	19.44%	20.11%
CEB	30.84%	31.32%
HXB	21.47%	16.11%
PAB	32.31%	28.87%
BOB	24.87%	20.08%
BON	19.48%	16.79%
NBCB	28.18%	20.46%
Average	24.78%	23.06%

Source: The banks' 2015 Q1 & 2016 Q1 report, KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Appendix - Operating expenses

RMB million	2016/01/01-2016/03/31	2015/01/01-2015/03/31	Growth rate
ICBC	96,367	84,775	13.67%
CCB	100,425	75,860	32.38%
BOC	60,296	59,213	1.83%
ABC	69,162	70,408	-1.77%
BCM	31,393	24,933	25.91%
CMB	34,557	28,146	22.78%
CNCB	25,738	18,347	40.28%
CMBC	22,293	18,190	22.56%
SPDB	23,758	18,305	29.79%
CIB	20,745	15,077	37.59%
CEB	12,419	11,248	10.41%
HXB	9,180	7,349	24.91%
PAB	9,968	8,473	17.64%
BOB	6,080	4,322	40.68%
BON	5,014	2,878	74.23%
NBCB	3,659	2,226	64.37%
Total	531,054	449,750	18.08%

Source: The banks' 2015 Q1 & 2016 Q1 report, KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Appendix - Cost to income ratios

	2016/01/01-2016/03/31	2015/01/01-2015/03/31	Growth rate
ICBC	19.42%	20.96%	-7.35%
CCB	20.57%	22.03%	-6.63%
BOC	24.61%	23.97%	2.67%
ABC	27.94%	28.85%	-3.15%
BCM	23.22%	24.48%	-5.15%
CMB	21.68%	24.14%	-10.19%
CNCB	24.92%	28.04%	-11.13%
CMBC	23.76%	25.33%	-6.20%
SPDB	18.84%	19.65%	-4.12%
CIB	18.03%	19.76%	-8.76%
CEB	24.99%	24.58%	1.67%
HXB	34.94%	38.20%	-8.53%
PAB	29.35%	33.38%	-12.07%
BOB	21.57%	18.80%	14.73%
BON	18.53%	21.82%	-15.08%
NBCB	31.52%	29.99%	5.10%
Average	23.99%	25.25%	-4.97%

Source: The banks' 2015 Q1 & 2016 Q1 report, KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Appendix - General and administrative expenses

RMB million	2016/01/01-2016/03/31	2015/01/01-2015/03/31	Growth rate
ICBC	37,646	37,973	-0.86%
CCB	31,891	32,714	-2.52%
BOC	30,231	29,106	3.87%
ABC	38,573	40,227	-4.11%
BCM	12,812	11,892	7.74%
CMB	12,627	12,252	3.06%
CNCB	10,088	9,350	7.89%
CMBC	9,534	9,126	4.47%
SPDB	7,948	6,484	22.58%
CIB	7,305	6,539	11.71%
CEB	5,882	5,472	7.49%
HXB	5,282	4,918	7.40%
PAB	8,080	6,901	17.08%
BOB	2,740	1,997	37.21%
BON	1,454	1,105	31.58%
NBCB	1,915	1,320	45.08%
Total	224,008	217,376	3.05%

Source: The banks' 2015 Q1 & 2016 Q1 report, KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Appendix - Impairment losses

RMB million	2016/01/01-2016/03/31	2015/01/01-2015/03/31	Growth rate
ICBC	23,668	20,748	14.07%
CCB	26,701	20,005	33.47%
BOC	15,953	13,784	15.74%
ABC	18,168	20,088	-9.56%
BCM	6,901	5,923	16.51%
CMB	18,516	12,744	45.29%
CNCB	13,023	6,519	99.77%
CMBC	9,990	6,376	56.68%
SPDB	13,285	9,313	42.65%
CIB	10,040	5,569	80.28%
CEB	4,786	3,991	19.92%
HXB	2,854	1,429	99.72%
PAB	9,550	4,751	101.01%
BOB	2,593	1,592	62.88%
BON	2,951	1,369	115.56%
NBCB	1,423	647	119.94%
Total	180,402	134,848	33.78%

Source: The banks' 2015 Q1 & 2016 Q1 report, KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Appendix - Total assets

RMB million	Cash and balances with central bank		Loans and advances to customers		Securities investments		Interbank assets		Other assets		Total assets	
	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
	03/31	12/31	03/31	12/31	03/31	12/31	03/31	12/31	03/31	12/31	03/31	12/31
ICBC	3,323,225	3,059,633	12,056,705	11,652,812	5,275,444	5,009,963	1,323,758	1,680,126	904,193	807,246	22,883,325	22,209,780
CCB	2,701,506	2,401,544	10,560,189	10,234,523	4,364,240	4,271,406	964,218	974,472	553,638	467,544	19,143,791	18,349,489
BOC	2,246,584	2,269,434	9,272,248	8,935,195	3,593,852	3,595,095	893,299	1,007,855	1,033,986	1,008,018	17,039,969	16,815,597
ABC	2,661,987	2,587,057	8,861,208	8,506,675	4,806,986	4,512,047	1,532,465	1,673,984	550,824	511,630	18,413,470	17,791,393
BCM	883,002	920,228	3,798,965	3,634,568	1,787,899	1,661,100	580,839	611,191	353,712	328,275	7,404,417	7,155,362
CMB	595,289	584,342	2,835,496	2,739,444	1,452,458	1,427,841	405,915	593,396	142,884	129,955	5,432,042	5,474,978
CNCB	582,208	511,189	2,603,911	2,468,283	1,952,003	1,692,127	193,978	338,140	145,658	112,553	5,477,758	5,122,292
CMBC	428,039	432,831	2,157,006	1,997,625	1,063,456	913,562	879,536	901,302	292,761	275,368	4,820,798	4,520,688
SPDB	450,048	481,157	2,259,817	2,171,413	2,057,997	1,883,327	296,020	359,412	164,098	149,043	5,227,980	5,044,352
CIB	415,615	417,911	1,825,057	1,724,822	2,780,505	2,597,027	206,037	324,607	243,569	234,513	5,470,783	5,298,880
CEB	369,353	326,735	1,589,781	1,475,424	1,027,113	903,871	403,765	371,717	103,939	89,963	3,493,951	3,167,710
HXB	279,536	264,094	1,087,671	1,041,937	388,075	357,075	304,050	325,763	35,125	31,735	2,094,457	2,020,604
PAB	296,144	291,715	1,230,985	1,186,872	713,650	594,803	302,128	302,973	138,248	130,786	2,681,155	2,507,149
BOB	154,452	153,182	793,549	747,917	443,996	419,104	480,177	493,628	32,882	31,078	1,905,056	1,844,909
BON	89,910	78,780	269,735	242,227	531,461	424,149	53,412	40,558	22,224	19,306	966,742	805,020
NBCB	72,761	66,189	265,083	248,399	425,814	360,200	30,838	26,563	19,715	15,114	814,211	716,465
Total	15,549,659	14,846,021	61,467,406	59,008,136	32,664,949	30,622,697	8,850,435	10,025,687	4,737,456	4,342,127	123,269,905	118,844,668

Source: The banks' 2016 Q1 report, KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Appendix - Total asset structure

	Cash and balances with central bank %		Loans and advances to customers %		Securities investment %		Interbank assets %		Other assets %	
	2016	2015	2016	2015	2016	2015	2016	2015	2016	2015
	03/31	12/31	03/31	12/31	03/31	12/31	03/31	12/31	03/31	12/31
ICBC	14.52%	13.78%	52.69%	52.47%	23.06%	22.56%	5.78%	7.56%	3.95%	3.63%
CCB	14.11%	13.09%	55.16%	55.77%	22.80%	23.28%	5.04%	5.31%	2.89%	2.55%
BOC	13.19%	13.50%	54.41%	53.14%	21.09%	21.38%	5.24%	5.99%	6.07%	5.99%
ABC	14.46%	14.54%	48.12%	47.81%	26.11%	25.36%	8.32%	9.41%	2.99%	2.88%
BCM	11.92%	12.86%	51.31%	50.80%	24.15%	23.21%	7.84%	8.54%	4.78%	4.59%
CMB	10.96%	10.67%	52.20%	50.04%	26.74%	26.08%	7.47%	10.84%	2.63%	2.37%
CNCB	10.63%	9.98%	47.54%	48.19%	35.63%	33.03%	3.54%	6.60%	2.66%	2.20%
CMBC	8.88%	9.57%	44.75%	44.19%	22.06%	20.21%	18.24%	19.94%	6.07%	6.09%
SPDB	8.61%	9.54%	43.22%	43.05%	39.37%	37.33%	5.66%	7.13%	3.14%	2.95%
CIB	7.60%	7.89%	33.36%	32.54%	50.82%	49.01%	3.77%	6.13%	4.45%	4.43%
CEB	10.57%	10.31%	45.50%	46.58%	29.40%	28.54%	11.56%	11.73%	2.97%	2.84%
HXB	13.34%	13.07%	51.93%	51.57%	18.53%	17.67%	14.52%	16.12%	1.68%	1.57%
PAB	11.04%	11.64%	45.91%	47.34%	26.62%	23.72%	11.27%	12.08%	5.16%	5.22%
BOB	8.11%	8.30%	41.64%	40.54%	23.31%	22.72%	25.21%	26.76%	1.73%	1.68%
BON	9.30%	9.78%	27.90%	30.09%	54.98%	52.69%	5.52%	5.04%	2.30%	2.40%
NBCB	8.93%	9.24%	32.56%	34.67%	52.30%	50.27%	3.79%	3.71%	2.42%	2.11%
Average	12.61%	12.49%	49.86%	49.65%	26.50%	25.77%	7.18%	8.44%	3.85%	3.65%

Source: The banks' 2016 Q1 report, KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Appendix - Scale of loan

RMB million	2016/03/31	2015/12/31	Growth rate
ICBC	12,345,706	11,933,466	3.45%
CCB	10,827,847	10,485,140	3.27%
BOC	9,474,727	9,135,860	3.71%
ABC	9,261,073	8,909,918	3.94%
BCM	3,889,728	3,722,006	4.51%
CMB	2,932,746	2,824,286	3.84%
CNCB	2,665,723	2,528,780	5.42%
CMBC	2,211,513	2,048,048	7.98%
SPDB	2,342,499	2,245,518	4.32%
CIB	1,885,313	1,779,408	5.95%
CEB	1,629,339	1,513,543	7.65%
HXB	1,116,541	1,069,172	4.43%
PAB	1,262,786	1,216,138	3.84%
BOB	793,500	775,390	2.34%
BON	280,415	251,198	11.63%
NBCB	273,277	255,689	6.88%
Total	63,192,733	60,693,560	4.12%

Source: The banks' 2016 Q1 report, KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Appendix - Loan quality

	NPL ratio		Allowance to NPL		Allowance to total loans ratio	
	2016/03/31	2015/12/31	2016/03/31	2015/12/31	2016/03/31	2015/12/31
ICBC	1.66%	1.50%	141.21%	156.34%	2.34%	2.35%
CCB	1.63%	1.58%	151.71%	150.99%	2.47%	2.39%
BOC	1.43%	1.43%	149.07%	153.30%	2.13%	2.62%
ABC	2.39%	2.39%	180.43%	189.43%	4.31%	4.53%
BCM	1.54%	1.51%	151.24%	155.57%	2.33%	2.35%
CMB	1.81%	1.68%	183.26%	178.95%	3.32%	3.00%
CNCB	1.40%	1.43%	166.01%	167.81%	2.32%	2.39%
CMBC	1.62%	1.60%	152.13%	153.63%	2.46%	2.46%
SPDB	1.60%	1.56%	220.90%	211.40%	3.53%	3.30%
CIB	1.57%	1.46%	203.31%	210.08%	3.20%	3.07%
CEB	1.53%	1.61%	158.64%	156.39%	2.43%	2.52%
HXB	1.53%	1.52%	168.66%	167.12%	2.58%	2.55%
PAB	1.56%	1.45%	161.01%	165.86%	2.52%	2.41%
BOB	1.11%	1.12%	286.56%	278.39%	3.20%	3.11%
BON	0.85%	0.83%	447.33%	430.95%	3.80%	3.57%
NBCB	0.91%	0.92%	327.84%	308.67%	3.00%	2.85%
Average	1.51%	1.47%	203.08%	202.18%	2.87%	2.84%

Source: The banks' 2016 Q1 report, KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Appendix - Liability

RMB million	Deposits from customers		Liabilities from banks and other financial institutions		Debt certificates issued		Other liabilities		Total	
	2016 03/31	2015 12/31	2016 03/31	2015 12/31	2016 03/31	2015 12/31	2016 03/31	2015 12/31	2016 03/31	2015 12/31
ICBC	17,038,081	16,281,939	2,377,744	2,603,051	311,938	306,622	1,281,483	1,217,649	21,009,246	20,409,261
CCB	14,582,213	13,668,533	1,714,766	2,029,119	381,975	415,544	954,613	791,210	17,633,567	16,904,406
BOC	12,234,691	11,729,171	1,841,825	2,212,264	288,125	282,929	1,272,371	1,233,628	15,637,012	15,457,992
ABC	14,389,805	13,538,360	1,369,812	1,626,464	336,114	382,742	1,054,644	1,031,942	17,150,375	16,579,508
BCM	4,638,570	4,484,814	1,498,126	1,505,919	178,258	170,106	532,554	456,431	6,847,508	6,617,270
CMB	3,579,090	3,571,698	851,805	1,075,984	353,156	251,507	267,940	214,031	5,051,991	5,113,220
CNCB	3,368,747	3,182,775	1,263,601	1,188,960	340,317	289,135	174,524	141,736	5,147,189	4,802,606
CMBC	2,836,851	2,732,262	1,147,928	1,039,904	187,349	181,233	329,219	257,506	4,501,347	4,210,905
SPDB	3,001,159	2,954,149	1,081,543	1,261,742	600,816	399,906	196,112	109,955	4,879,630	4,725,752
CIB	2,363,274	2,483,923	2,018,308	1,917,401	556,064	414,834	199,498	165,345	5,137,144	4,981,503
CEB	2,126,783	1,993,843	730,630	660,244	305,156	210,061	98,512	79,515	3,261,081	2,943,663
HXB	1,352,576	1,351,663	333,025	414,832	160,927	66,893	105,136	68,828	1,951,664	1,902,216
PAB	1,854,365	1,733,921	312,850	334,249	247,360	212,963	79,011	64,516	2,493,586	2,345,649
BOB	1,050,687	1,022,300	389,524	474,786	243,019	174,639	99,824	56,370	1,783,054	1,728,095
BON	630,683	504,197	132,062	132,077	123,334	86,887	26,322	29,445	912,401	752,606
NBCB	450,823	355,686	150,222	135,331	134,378	144,057	31,454	36,294	766,877	671,367
Total	85,498,398	81,589,234	17,213,771	18,612,327	4,748,286	3,990,058	6,703,217	5,954,401	114,163,672	110,146,019

Source: The banks' 2016 Q1 report, KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Appendix - Total liability structure

	Deposits from customers %		Liabilities from banks and other financial institutions %		Debt certificates issued %		Other liabilities %	
	2016 03/31	2015 12/31	2016 03/31	2015 12/31	2016 03/31	2015 12/31	2016 03/31	2015 12/31
ICBC	81.10%	79.78%	11.32%	12.75%	1.48%	1.50%	6.10%	5.97%
CCB	82.70%	80.86%	9.72%	12.00%	2.17%	2.46%	5.41%	4.68%
BOC	78.24%	75.88%	11.78%	14.31%	1.84%	1.83%	8.14%	7.98%
ABC	83.90%	81.66%	7.99%	9.81%	1.96%	2.31%	6.15%	6.22%
BCM	67.74%	67.77%	21.88%	22.76%	2.60%	2.57%	7.78%	6.90%
CMB	70.85%	69.85%	16.86%	21.04%	6.99%	4.92%	5.30%	4.19%
CNCB	65.45%	66.27%	24.55%	24.76%	6.61%	6.02%	3.39%	2.95%
CMBC	63.02%	64.89%	25.50%	24.70%	4.17%	4.29%	7.31%	6.12%
SPDB	61.50%	62.51%	22.16%	26.70%	12.32%	8.46%	4.02%	2.33%
CIB	46.00%	49.86%	39.29%	38.49%	10.83%	8.33%	3.88%	3.32%
CEB	65.22%	67.73%	22.40%	22.43%	9.36%	7.14%	3.02%	2.70%
HXB	69.30%	71.06%	17.06%	21.81%	8.25%	3.51%	5.39%	3.62%
PAB	74.37%	73.92%	12.55%	14.25%	9.91%	9.08%	3.17%	2.75%
BOB	58.93%	59.16%	21.85%	27.47%	13.62%	10.11%	5.60%	3.26%
BON	69.12%	66.99%	14.47%	17.55%	13.53%	11.55%	2.88%	3.91%
NBCB	58.79%	52.98%	19.59%	20.16%	17.52%	21.45%	4.10%	5.41%
Average	68.51%	68.20%	18.69%	20.69%	7.70%	6.59%	5.10%	4.52%

Source: The banks' 2016 Q1 report, KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.
Printed in China.

Appendix - Securities investment structure

RMB million	Financial assets at fair value through profit or loss		Available-for-sale financial assets		Held-to-maturity investment		Investment classified as receivables		Total	
	2016 03/31	2015 12/31	2016 03/31	2015 12/31	2016 03/31	2015 12/31	2016 03/31	2015 12/31	2016 03/31	2015 12/31
ICBC	428,620	343,272	1,558,482	1,444,195	2,945,719	2,870,353	342,623	352,143	5,275,444	5,009,963
CCB	355,932	271,173	1,123,260	1,066,752	2,527,692	2,563,980	357,356	369,501	4,364,240	4,271,406
BOC	122,476	119,062	1,130,748	1,078,533	1,750,263	1,790,790	590,365	606,710	3,593,852	3,595,095
ABC	483,192	439,261	1,304,277	1,214,542	2,455,824	2,300,824	563,693	557,420	4,806,986	4,512,047
BCM	151,025	138,999	282,779	264,739	1,015,120	933,683	338,975	323,679	1,787,899	1,661,100
CMB	56,510	59,081	319,865	299,559	389,766	353,137	686,317	716,064	1,452,458	1,427,841
CNCB	59,600	26,220	409,556	373,770	194,819	179,930	1,288,028	1,112,207	1,952,003	1,692,127
CMBC	42,738	26,959	192,847	157,000	332,961	278,364	494,910	451,239	1,063,456	913,562
SPDB	111,606	63,746	215,441	254,846	255,608	239,703	1,475,342	1,325,032	2,057,997	1,883,327
CIB	162,984	128,685	423,010	426,634	213,993	206,802	1,980,518	1,834,906	2,780,505	2,597,027
CEB	12,962	5,637	254,335	222,495	157,493	152,312	602,323	523,427	1,027,113	903,871
HXB	12,543	11,872	74,093	73,200	205,612	194,543	95,827	77,460	388,075	357,075
PAB	37,060	19,757	2,746	1,245	289,276	266,166	384,568	307,635	713,650	594,803
BOB	29,835	16,522	117,771	127,941	158,966	147,562	137,424	127,079	443,996	419,104
BON	30,532	19,552	96,786	110,546	98,899	85,577	305,244	208,474	531,461	424,149
NBCB	12,812	7,040	296,459	249,258	31,333	32,672	85,210	71,231	425,814	360,201
Total	2,110,427	1,696,838	7,802,455	7,365,255	13,023,344	12,596,398	9,728,723	8,964,207	32,664,949	30,622,698

Source: The banks' 2016 Q1 report, KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Appendix – Loan-to-deposit ratio

	2016/03/31	2015/12/31
ICBC	72.46%	71.40%
CCB	74.25%	76.71%
BOC	77.44%	77.89%
ABC	64.36%	65.81%
BCM	83.86%	74.08%
CMB	81.94%	79.07%
CNCB	79.13%	79.45%
CMBC	77.96%	74.96%
SPDB	78.05%	76.01%
CIB	79.78%	67.62%
CEB	76.61%	73.59%
HXB	75.46%	75.29%
PAB	68.10%	69.01%
BOB	75.52%	75.85%
BON	46.46%	49.82%
NBCB	54.18%	63.73%
Average	72.85%	71.89%

Source: The banks' 2016 Q1 report, KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved. Printed in China.

Appendix - Capital adequacy ratio and Tier 1 capital adequacy ratio

	Capital adequacy ratio		Tier 1 capital adequacy ratio	
	2016/03/31	2015/12/31	2016/03/31	2015/12/31
ICBC	14.66%	15.22%	13.45%	13.48%
CCB	15.55%	15.39%	13.65%	13.32%
BOC	14.07%	14.06%	12.20%	12.07%
ABC	13.11%	13.40%	10.90%	10.96%
BCM	13.22%	13.49%	11.39%	11.46%
CMB	13.94%	12.57%	12.13%	10.83%
CNCB	11.39%	11.87%	8.94%	9.17%
CMBC	11.55%	11.49%	9.38%	9.19%
SPDB	12.10%	12.29%	9.46%	9.45%
CIB	11.34%	11.19%	9.40%	9.19%
CEB	11.61%	11.87%	9.95%	10.15%
HXB	12.22%	10.85%	10.35%	8.89%
PAB	11.61%	10.94%	9.81%	9.03%
BON	13.15%	13.11%	9.03%	10.35%
NBCB	12.39%	13.29%	9.47%	10.12%
Average	12.79%	12.74%	10.63%	10.51%

Source: The banks' 2016 Q1 report, KPMG China research

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.
Printed in China.

Glossary of abbreviated terms

Bank names

- PBOC – People's Bank of China
- ICBC – Industrial and Commercial Bank of China
- CCB – China Construction Bank
- BOC – Bank of China
- ABC – Agricultural Bank of China
- BCM – Bank of Communications
- CMB – China Merchants Bank
- CNCB – China CITIC Bank
- CMBC – China Minsheng Bank
- SPDB – Shanghai Pudong Development Bank
- CIB – Industrial Bank
- CEB – China Everbright Bank
- HXB – Hua Xia Bank Co.,Ltd
- PAB – PingAn Bank Co., Ltd
- BOB – Bank of Beijing Co., Ltd
- BON – Bank of Nanjing Co., Ltd
- NBCB – Bank of Ningbo Co., Ltd

General terms

- MOF – Ministry of Finance
- CBRC – China Banking Regulatory Commission
- CSRC – China Securities Regulatory Commission
- SAFE – State Administration of Foreign Exchange
- SSE – Shanghai Stock Exchange
- SEHK- The Stock Exchange of Hong Kong
- SHIBOR – Shanghai Interbank Offered Rate
- NIM – Net interest margin

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.
Printed in China.

Contact us

KPMG China has around 10,000 staff, working in 16 offices: Beijing, Chengdu, Chongqing, Foshan, Fuzhou, Guangzhou, Hangzhou, Nanjing, Qingdao, Shanghai, Shenyang, Shenzhen, Tianjin, Xiamen, Hong Kong SAR and Macau SAR.

Our dedicated financial services team brings together partners from audit, tax and advisory practices and is linked closely to other member firms in the KPMG network.

For more information, contact one of the financial services partners listed below.

Simon Gleave
Asia Pacific Partner-in-charge, Financial Services
☎ :+86(10)8508 7007
✉ : simon.gleave@kpmg.com

Thomas Chan
☎ :+86(10)8508 7014
✉ : thomas.chan@kpmg.com

Christine Song
☎ :+86(10)8508 7015
✉ : christine.song@kpmg.com

Walkman Lee
☎ :+86(10)8508 7043
✉ : walkman.lee@kpmg.com

Raymond Li
☎ :+86(10)8508 7114
✉ : raymond.li@kpmg.com

Larry Choi
☎ :+86(20)3813 8883
✉ : larry.choi@kpmg.com

Edwina Li
China Partner-in-charge, Financial Services Assurance
☎ :+ 86(21)2212 3806
✉ : edwina.li@kpmg.com

Arthur Wang
Head of banking KPMG China
☎ :+86(10)8508 7104
✉ : arthur.wang@kpmg.com

Terence Fong
☎ :+852 2978 8953
✉ : terence.fong@kpmg.com

Kenny Shi
☎ :+86(21)2212 2261
✉ : kenny.shi@kpmg.com

James Chen
☎ :+86(21)2212 2424
✉ : james.chen@kpmg.com

Ivan Li
☎ :+86(755)2547 1218
✉ : ivan.li@kpmg.com

Christopher Abbiss
ASPAC Regional Lead Partner, Tax
☎ :+852 2826 7226
✉ : chris.abbiss@kpmg.com

Tracy Zhang
Tax
☎ :+86(10)8508 7509
✉ : tracy.h.zhang@kpmg.com

Thomas Li
Tax
☎ :+86(10)8508 7574
✉ : thomas.li@kpmg.com

Kevin Liu
IT Advisory
☎ :+86(10)8508 7094
✉ : kevin.liu@kpmg.com

Derrick Day
DPP Accounting
☎ :+86(10)8508 5008
✉ : derrick.day@kpmg.com

Tony Cheung
Partner-in-charge, Advisory
☎ :+86(21)2212 2705
✉ : tony.cheung@kpmg.com

Egidio Zarrella
Management Consulting
☎ :+852 2847 5197
✉ : egidio.zarrella@kpmg.com

Simon Topping
Financial Risk Management
☎ :+852 2826 7283
✉ : simon.topping@kpmg.com

Wilson Pang
Restructuring Services
☎ :+86(21)2212 3280
✉ : wilson.pang@kpmg.com

Louis Ng
Transaction Services
☎ :+86(10)8508 7090
✉ : louis.ng@kpmg.com

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved. Printed in China.

Mainland China

Beijing
8th Floor, KPMG Tower, Oriental Plaza
1 East Chang An Avenue
Beijing 100738, China
Tel : +86 (10) 8508 5000
Fax : +86 (10) 8518 5111

Beijing Zhongguancun
Room 603, Flat B, China Electronic Plaza
No.3 Danling Street, Haidian District
Beijing 100080, China
Tel : +86 (10) 5875 2555
Fax : +86 (10) 5875 2558

Chengdu
17th Floor, Office Tower 1, IFS
No. 1, Section 3 Hongxing Road
Chengdu, 610021, China
Tel : +86 (28) 8673 3888
Fax : +86 (28) 8673 3838

Chongqing
Unit 1507, 15th Floor Metropolitan Tower
68 Zourong Road,
Chongqing 400010, China
Tel : +86 (23) 6383 6318
Fax : +86 (23) 6383 6313

Foshan
8th Floor, One AIA Financial Center
1 East Denghu Road
Foshan 528200, China
Tel : +86 (757) 8163 0163
Fax : +86 (757) 8163 0168

Fuzhou
25th Floor, Fujian BOC Building
136 Wu Si Road
Fuzhou 350003, China
Tel : +86 (591) 8833 1000
Fax : +86 (591) 8833 1188

Guangzhou
38th Floor, Teem Tower
208 Tianhe Road
Guangzhou 510620, China
Tel : +86 (20) 3813 8000
Fax : +86 (20) 3813 7000

Hangzhou
8th Floor, West Tower, Julong Building
9 Hangda Road
Hangzhou 310007, China
Tel : +86 (571) 2803 8000
Fax : +86 (571) 2803 8111

Nanjing
46th Floor, Zhujiang No. 1 Plaza
1 Zhujiang Road
Nanjing 210008, China
Tel : +86 (25) 8691 2888
Fax : +86 (25) 8691 2828

Qingdao
4th Floor, Inter Royal Building
15 Donghai West Road
Qingdao 266071, China
Tel : +86 (532) 8907 1688
Fax : +86 (532) 8907 1689

Shanghai
50th Floor, Plaza 66
1266 Nanjing West Road
Shanghai 200040, China
Tel : +86 (21) 2212 2888
Fax : +86 (21) 6288 1889

Shenyang
27th Floor, Tower E, Fortune Plaza
59 Beizhan Road
Shenyang 110013, China
Tel : +86 (24) 3128 3888
Fax : +86 (24) 3128 3899

Shenzhen
9th Floor, China Resources Building
5001 Shennan East Road
Shenzhen 518001, China
Tel : +86 (755) 2547 1000
Fax : +86 (755) 8266 8930

Tianjin
Unit 15, 47th Floor, Office Tower
Tianjin World Financial Center
2 Dagu North Road
Tianjin 300020, China
Tel : +86 (22) 2329 6238
Fax : +86 (22) 2329 6233

Xiamen
12th Floor, International Plaza
8 Lujiang Road
Xiamen 361001, China
Tel : +86 (592) 2150 888
Fax : +86 (592) 2150 999

Hong Kong SAR and Macau SAR

Hong Kong
8th Floor, Prince's Building
10 Chater Road
Central, Hong Kong
Tel : +852 2522 6022
Fax : +852 2845 2588

23rd Floor, Hysan Place
500 Hennessy Road
Causeway Bay, Hong Kong

Macau
24th Floor, B&C, Bank of China Building Avenida Doutor Mario Soares
Macau
Tel : +853 2878 1092
Fax : +853 2878 1096

kpmg.com/cn

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative ("KPMG International"), a Swiss entity. All rights reserved.
Printed in China.

The information contained herein has been prepared for the Industrial and Commercial Bank of China. It should not be relied upon by any other party for any other purpose and we expressly disclaim any liability or duty to any other party in this respect. It should not be disclosed, referred to or quoted in whole or in part without our prior written consent.

© 2016 KPMG Huazhen LLP, a special general partnership in China, is member firm of the KPMG network of independent member firms affiliated with KPMG International Cooperative (“KPMG International”), a Swiss entity. All rights reserved. Printed in China.

The KPMG name and logo are registered trademarks or trademarks of KPMG International.