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Guidelines on Due Diligence of Commercial Banks in Extension of Credit

商业银行授信工作尽职指引

【**Issued By**】 China Banking Regulatory Commission (CBRC)

【**Subject**】 Due Diligence

【**Promulgated on**】 July 26th 2004

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【**Source**】 www.cbrc.gov.cn

The CBRC, making reference to the concept of due diligence adopted by the Basel Committee and practice of other jurisdictions, published the Guidelines drawn up in accordance with Law on Commercial Banks, Law on Banking Administration and Supervision, and General Principles for Loans. The Guidelines is composed of 7 parts. In addition to general principles and miscellaneous matters, it deals with due diligence requirements in the whole process of credit extension, including investigations into the clients' background and acceptance of business, analysis and assessment, decision-making and implementation, post-credit-extension management and disposal of problematic credit. It also lays down rules for establishing due diligence

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mechanisms by banks and for accountabilities of the staff responsible for credit extension.

Credit for the purpose of the Guidelines refers to credit extended to clients who are not natural persons, both on and off the balance sheet. Credit on the balance sheet includes loan, project finance, trade finance, commercial papers discounting, overdrawing, factoring, inter-bank borrowing, redemption, etc. Credit off the balance sheet includes loan commitment, guarantee, letter of credit, acceptance of commercial instruments, etc.

The Guidelines require commercial banks to create independent positions in charge of due diligence investigation and provide clear description of these positions. Staff handling credit extension will not be held liable for problematic credit when they have discharged their due diligence responsibilities in each stage of credit extension. On the other hand, they may be held accountable based on the results of investigation conducted by the staff responsible for due diligence in the following circumstances:

- Make false record, misleading statements and material omission;
- Fail to conduct thorough check of information about clients
- Act *ultra vires* and violate procedural rules for approval;
- Fail to inspect the credit and the assets placed under security in accordance with prescribed time limit and procedure;
- Fail to conduct prompt on-site investigation in the event of material changes and contingencies happened to clients;
- Fail to seek provisional measures faced with early warning signals;
- Deliberately conceal information;
- Being not cooperative with the staff in charge of due diligence investigation or furnish false information.

Implementing Rules for Regulation on Administration of Foreign Invested Financial Institutions (Revised)

中华人民共和国外资金融机构管理条例实施细则

【Issued By】 China Banking Regulatory Commission (CBRC)

【Subject】 Foreign Invested Financial Institutions

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【Closing Date】 September 1st 2004

【Source】 www.cbrc.gov.cn

As a reaction to developments since China's entry into the WTO, the CBRC initiated the revision process in last September and adopted the revamped Implementing Rules based on comments from interested parties. The following guiding principles were observed when proposals for revision were considered: (1) reflect the change of the regulatory body (from People's Bank of China to CBRC); (2) simplify the procedure of market access; (3) revise within the framework of existent Implementing Rules; (4) continuity and legal certainty; (5) highlight the principle of prudent supervision; (5) simplify procedure for approval and supervision; (6) equal treatment of Chinese invested and foreign invested banks in respect of supervision.

Eleven provisions have been added to the existent Implementing Provisions, which address respectively the change of the regulatory body, prudential establishment of new business and expansion of existent business, restructuring between institutions with independent personality and branches of foreign banks, acknowledgment of senior members of the management, principle of prudent accounting, reserves for loss from loans, eligibility of new shareholders of foreign invested financial institutions with independent personality, submission of business reports to the CBRC and its local offices, and priority of debts in liquidation.

Meanwhile, four provisions have been deleted, which were respectively relevant to the one-year interval between applications for opening new branches by foreign banks and the interval between new applications and failed prior applications for establishing institutions, reporting of RMB business conducted outside the place of the seat, transfer or sale of assets after submitting applications for winding-up, and the arrangement of enacting provisions on administration of outlets within the same city (the said regulation has been promulgated).

Provisions on Administration of Financial Service Companies of Enterprise Groups (Revised)

企业集团财务公司管理办法

【Issued By】 China Banking Regulatory Commission

【Subject】 Financial Service Companies

【Promulgated on】 July 27th 2004

【Effective From】 September 1st 2004

【Source】 www.cbrc.gov.cn

The new Provisions are based on an earlier regulation with the same name adopted by the People's Bank of China in 2000. Compared to its parent regulation, the new one is novel in the following respects:

- Altered definition of the business field (functions) of financial service companies: In the earlier regulation, the functions of those companies were defined as "mainly engage in medium and long term financial business to provide financial service for members of enterprise groups in respect of the improvement of technologies, development of new products and marketing of products". In the new regulation, the

business field is defined as “provide financial management service for members of enterprise groups with a view to reinforce the collective management of fund and improving efficiency of fund utilization”.

- Reduction of market access requirements: The earlier regulation set high threshold for financial service companies. Its establishment was limited to large enterprise groups in such industries as manufacturing, energy and transportation. These requirements were difficult to be met by most foreign invested enterprises and enterprises in industries other than the foresaid ones. The revised regulation hence significantly lower the requirements in respect of registered capital and business revenue for enterprise groups that wish to establish their own financial service companies.
- Permission of financial service companies to establish branches: The revised regulations expressly open the possibility of establishing outlets by financial service companies. However, these outlets can only either be branches or representative offices, both without independent personality. That also means that the business scopes of such outlets are limited to specific areas based on the fact they are branches or representative offices.
- Adjustment of business scope of financial service companies: This is the logical result after changing the business field (see above at (1)) of financial service companies. As a general rule, it is highly likely to obtain consent for conducting business with the aim of reinforcing collective management of funds and providing financial services for the members of enterprise groups.

It should be noted that since the establishment of financial service companies by foreign invested companies is subject to this regulation, foreign invested financial service companies are governed by Regulation on Administration of Foreign Invested Financial Institutions.

Circular on Issues Concerning Investment by Insurance Companies in Convertible Corporate Bonds

关于保险公司投资可转换公司债券有关事项的通知

【Issued By】 China Insurance Regulatory Commission (CIRC)

【Subject】 Investment in Capital Market

【Promulgated on】 July 23rd 2004

【Effective From】 July 23rd 2004

【Source】 www.circ.gov.cn

To implement Observations of the State Council on the Promotion of Reform, Opening Up and Steady Development of the Capital Market (“国务院关于推进资本市场改革开放和稳定发展的若干意见”, CLB No. 60), the CIRC announced that insurance companies forthwith might invest in convertible corporate bonds (CCB). The investment must satisfy the following prerequisites:

- The CCB to be invested shall have been approved by the China Securities Regulatory Commission (CSRC) and comply with Provisional Rules on Administration of Convertible Corporate Bonds (“可转换公司债券管理暂行办法”) and Implementing Measures on Issue of Convertible Corporate Bonds by Public Companies (“上市公司发行可转换公司债券实施办法”)
- Overall investment in bonds (including the CBC) calculated on the basis of purchase price shall not exceed 20% of total assets of the preceding month;
- The investment of a single issue in one CCB shall neither exceed 15% of the said bond of that issue, nor 2% of the total assets of the preceding month, whichever is lower.
- Investment decisions shall be observed prudentially. The CCB may not at present be converted to shares, the conversion of which is subject to later provisions.

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