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Synopsis

At the end of October 2011, the heads of the three financial sector regulators were rotated. It is time to ask what are the rules behind the scenes for the process of “revolving doors” in China, how far the Party interference reaches and what the future holds for the Chinese financial sector.

Changes at the top in Chinese Banking

Every now and then, China’s bank executives play a round musical chairs, or so it seems. As always the play is orchestrated by the secretive Organisation Department whenever a new generation needs to replace the retiring one or whenever scandals and corruption take their toll on Chinese executives.

Executives move between and within banks. Among the personnel moves in 2006 was the promotion of Bank of Communications’ president, Zhang Jianguo, to become vice-chairman and president of the China Construction Bank (CCB). The CCB vacancy arose when its then president, Chang Zhenming, returned to the CITIC Group to become its deputy chairman. The Bank of Shanghai’s president, Chen Xin, took over the chairmanship from Fu Jianhua, who had moved to the Shanghai Pudong Development Bank (SPDB) to be its president. In 2007, Tang Shuangning, previously vice-chairman at the China Banking Regulatory Commission (CBRC), moved to become director at China Everbright Bank. Xu Feng, an ex-director at CBRC, was named president of SPDB and Xiang Junbo, previously deputy governor at the central bank and before that vice-director at the China National Audit Office, would chair Agricultural Bank of China’s (ABC) board. In exchange, Yang Mingsheng, up to then president of ABC, moves to become a vice-chairman at the insurance regulator. Niu Ximing, previously president with behemoth Industrial and Commercial Bank of China (ICBC), will move to preside over ABC’s next reforms. Meanwhile, Yang Chao remained chairman but moved from China Life Insurance to PICC Property & Casualty.

This time in 2011 the musical chairs involved regulators as well. Both the heads of the CBRC and of the China Insurance Regulatory Commission (CIRC), Liu Mingkang and Wu Dingfu, retired. What is worth mentioning is that nobody was internally promoted, rather bank and regulatory executives had an opportunity to swap jobs. The previously China Securities Regulatory Commission (CSRC) chairman, Shang Fulin, took up the job as bank regulator, while his post was filled by Guo Shuqing who went from deputy director at the People’s Bank of China (PBOC, the central bank), director at the State Administration of Foreign Exchange to finally escort China Construction Bank to the stock markets. His colleague at the CIRC, Xiang Junbo, was already part of the last round of revolving doors. It goes without saying that the posts left empty by these officials need to be filled quickly.

Already, Wang Hongzhang was named Party Secretary at the top of CCB. He comes from PBOC and also worked during the 1980-90s with ICBC. Jiang Chaoliang was named as successor at ABC. He comes from China Development Bank - a policy bank with a strong impetus for reform and innovative ideas about banking (see also table 1 below). Since their posts will also need to be filled, one can expect more fine tuning over the next few months – thus ending a process that started well before outsiders were aware of it.

Normally the appointment process starts with the Organisation Department (OD) searching for an adequate candidate - normally one recommended by previous or current Politburo members. If he is found appropriate as well by the Central Discipline Inspection Commission (CDIC) (under the Party) and is willing to take up the post, then the candidacy is submitted to the Standing Committee of the National People’s Congress and the Politburo, and at very last to the regulators and the shareholders, if necessary. The latter two instances are more of a procedural nature and normally rubber stamp decisions. In the media, the communication is then made by the bank concerned and by the regulators - thus creating the impression of a western corporate governance structure.

The OD's responsibilities are similar to those of a human resources department in any enterprise - although it does so for the Chinese Communist Party. It penetrates every state entity within the country – regardless of it being private or not. As for the Party it concentrates its strengths on industries and entities that are crucial to the State. It acts behind closed doors: it conducts candidates' interviews and investigations, removes and changes positions of senior managers and bureaucrats. As a result it is also the place of strong political battles so far that posts can be bought and sold. Appointments depend on experience, education, and so on – but preference is given on seniority in that industry. Indicators inform about the executive's performance. OD's professional head-hunter practices work up to a certain official rank only however. Promising officials are rotated between enterprises, even industries, departments and regions.

Along with the intransparent ways of the OD, new processes are being tried out: at PBOC a recent innovative move entails open and competitive applications¹ within the organization for posts that are above a certain hierarchical level. This does not preclude however investigations of the candidates to reveal their political acumen. Candidates need also to sit exams and go through interviews. That is instead of the previous scheme of being proposed by their respective senior manager to the vice-president whose office then finally takes a decision. Such experimentation will be extended and broaden where successful.

The supervision of the bank managers after their appointment is twofold: political acumen or party discipline is the responsibility of the CDIC which encompasses corruption, compliance with party policies, and so on. The second one is based on professional standards encompassing compliance with lending ratios and quotas as well as quality indicators. Bank performance is linked to compliance with regulatory prudential ratios and market shares.

Banks are key to the stability and development goals of the Communist Party of China (CPC). The CPC needs to ensure its long-term survival and draws also heavily on the purported proud image of China. To keep the political and financial elite in power, the environment needs to be predictable and stable but it also needs to be able to direct funds where they are most needed. Large state-owned enterprises require the banks' funding as well as consumers require a venue to invest their savings (e.g. the stock markets). Therefore it is crucial to remain in control of the financial markets as well as in control of its managing elite. Financial supervision in the Chinese context, that is in the form of higher interference in institutions, has a small but negative impact on loan portfolio quality and profitability.

To ensure control over managers, party members answer to the Party first. For state-owned banks, as the majority or sole shareholder, the authorities have the right to choose senior managers. The Party permeates every level of the state – but it remains on the sidelines – without being a simple watcher: it has the strings in its hands. To be able to concentrate on the most important tasks, the Party has relinquished control over middle management appointments within banks. This ensures the alignment of interests between the Party or the state and the individual banks. To ensure social stability and successful macroeconomic policies, the Party – through the bank's individual Party Committees² – is in charge of personnel and strategic issues.

Table 1: Chairmen's and presidents' previous positions (selection, at end-2010)

Bank name	Chairman name and other previous positions	President name and other previous positions
Industrial and Commercial Bank of China	Jiang Jianqing* Member of Central	Yang Kaisheng Huarong AMC

¹ "Open" means however that the positions are open for competition, but applicants need to be from the head quarters, the PBOC Shanghai office and units directly under the head quarters.

² The Party Secretary is *higher* in rank than the Chairman of the Board.

Bank of China	Committee of CPC, PBOC Xiao Gang Member of Central Committee of CPC, Orient AMC, PBOC	Li Lihui Vice Governor Hainan, ICBC
China Construction Bank	Guo Shuqing* Member of Central Committee of CPC, SAFE, PBOC, NDRRC	Zhang Jianguo ICBC
Agricultural Bank of China	Xiang Junbo* Member of Central Committee of CPC, PBOC	Zhang Yun -
Industrial Bank	Gao Jianping* -	Li Renjie PBOC
Huaxia Bank	Wu Jian* ICBC, BoComm	Fan Dazhi Smaller NBFIs
China Minsheng Banking Corp.	Dong Wenbiao PBOC	Hong Qi BoComm
Shanghai Pudong Development Bank	Ji Xiaohui* ICBC, Shanghai municipal government	Fu Jianhua CCB
Bank of Communication	Hu Huaibang CBRC, PBOC	Niu Ximing ICBC
China Merchants Bank	Fu Yuning -	Ma Weihua -
Everbright Bank	Tang Shuangning* CBRC, PBOC, CCB	Guo You SAFE, PBOC

Note: the selection should not suggest that all other banks' senior managers have similar career paths. The positions show only the name of the institution – other than their current institution, the positions held might have been numerous and at different levels of hierarchy. The list entails only presidents and chairmen of the boards as of end-2009. The information does not include other positions held in universities and other non-bank or non-government institutions.

* Those with an asterisk are also mentioned as Party Committee secretaries in the annual reports. This information is given in a few annual reports only.

“-“ Means that the person did not held any positions in other banks or authorities.

Sources: banks' annual reports for 2010 and <http://www.chinavitae.com/index.php>.

This is in line with the government's policy of choosing senior managers and board members reflecting political credentials rather than business acumen. This activity is euphemistically called "leadership" rather than "interference"³. The authorities also have the power to remove or transfer the managers as it sees fit, in *all* banks in China: some 80% of CEOs and 56% of senior executives in SOEs are appointed by the party⁴.

Under such conditions, managers are given the incentive to reach a higher position in their (political) career rather than profit maximisation⁵. In Victor Shih's interviews, he found that

³ McGregor, R. (2010) *The party – the secret world of China's communist rulers* (New York: HarperCollins Publishers).

⁴ Pei, M. (2006b) How rotten politics feeds a bad loan crunch in China. *Financial Times*, 8 May.

⁵ Goodhart, C. and Zeng, X. (2005) *China's Banking Reform: Problems and Potential Solutions*. Financial Markets Group Special Paper sp163.

“the single clearest message that emerges [...] is that, above all else, Chinese leaders care about political survival and actively formulate strategies to expand or maintain power”⁶.

Moreover, the influence of the Communist Party should not be underestimated at local level either. Formally, it operates at local level through “financial services offices” which are set up to provide administrative services to financial institutions (such as encouraging their establishment in certain geographic areas). But local level financial supervision can be influential⁷ and can go as far as to require banks to support local economic development as happened after the wave of suicides in Wenzhou’s entrepreneurial but indebted community – even though they do not possess the right to do so legally. Meddling in appointing bank managers at their administrative level (for nationwide banks but not for local banks) has been officially stopped since the approval of appointments has been centralized in the head quarters.

Anyone naïve enough to think that private bank China Minsheng Banking Corp is free of government interference, would be disappointed. Since a high-profile disagreement in 2000 between some board members and party officials over the appointment of two candidates for a senior position at the bank, board members have been careful to iron out disagreements over candidates before board meetings. The appointment of Eddy Wang, a Hong Kong banker and former head of HSBC’s China business division, to the position of president of China Minsheng in 2006 was reported to have had the blessing of the party. Indeed, China’s bank regulator has strongly encouraged newly formed local banks to engage foreign professionals so as to learn more about international practices.

Chinese commentators, including *Caixin* magazine’s chief editor Hu Shuli, argue that local bankers must be politically independent to be able to perform their duties effectively. Ms Hu believes Chinese bankers are graft-prone because their selection is based on political criteria rather than business competence. The party, however, is not ready to let go—and for good reasons. The pool of qualified bankers available to run Chinese banks remains very small, and will take time to expand. Foreign expertise may be tapped, but most Chinese banks cannot afford to pay international salaries. Wang Xuebing, the disgraced former head of the Bank of China and CCB, reportedly commented during his posting in Hong Kong that he felt embarrassed when he found that his salary was little better than that of a junior bank clerk’s in the city. But, as he was a party cadre, he was expected to make the sacrifice. Mr Wang, however, yielded to temptation and was punished by the Party.

What is also important is that the new regulatory dream team will also be soon staffed by a successor for Zhou Xiaochuan at the helm of the central bank. This team will lead the way to further development and perhaps even reforms in the financial sector. How much will they be able to drive through and how much are they prepared to take upon themselves is open to debate. If Shang Fulin was the architect of the long overdue state-owned shares reform, many more issues such as insider trading, the (de-)listing processes on the exchanges or the segregation between markets loom over and were left over his successor, Guo Shuqing. With many issues left open, will Shang Fulin, who is actually known for his steady ways, have the drive and the stringency to require from banks ever increasing transparency and risk management skills? For now, the bank regulations are pressured by international ever tighter requirements and the only flexibility the CBRC seems to possess is the time limit until which to implement the rules. Shang Fulin already made clear internally that laxer rules are not on the agenda, but that he is prepared to take time to understand the issues at stake such as local authorities’ financing, real estate overheating and the shadow banking system - all three have burst regularly. Xiang Junbo has no less challenges to master - low interest rates environments and lack of investment opportunities in a country prone to natural

⁶ Shih, V. (2009) *Factions and finance in China – elite conflict and inflation* (New York: Cambridge University Press).

⁷ Heilmann, S. (2009) Maximum tinkering under uncertainty: unorthodox lessons from China. *China Analysis* 73, May 2009 under www.chinapolitik.de.

catastrophes. Also the question of cross-industry regulation and of competition between regulating agencies (also including the Ministry of Finance (MoF), the National Development and Reform Commission (NDRC) to name just a few at national level) remains largely unanswered. Moreover, the issue of transparency remains a tricky one – which needs to be tackled at all levels and in all realms of the industry, including in the party.

For true reforms in the banking system though, experience with rural credit cooperatives has already clearly showed that without substituting all managers, the old ways and allegiances continue to persist without injecting any new ideas and processes. The arrangement permits controls and ensures rapid enforcement across many institutions, bridging knowledge and process gaps, as well as instituting caps on compensation; unfortunately it also underlines continuity and seniority even though a rapidly changing environment contrasts with the need for more flexibility in grooming tomorrow's leaders. At least more and more are educated overseas.

About the author, Violaine Cousin

Violaine Cousin, fluent in Chinese, is a long time observer and researcher of the Chinese banking system and financial sector. She worked in various financial institutions as a credit analyst and consultant for Chinese banks. Apart from that she recently published the second edition of "Banking in China" with Palgrave where you can find more details about the above subject and she contributes to the China Hand publication of the Economist Intelligence Unit every year. Where needed she is available to answer your queries, or to provide research on issues of banking - ranging from products, to stress testing and Basel III, and to write rating and credit analysis on selected Chinese banks. You can reach her at: cousinviolaine@yahoo.com.