Washington International Law Journal

Volume 28 | Number 1

1-1-2019

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CROUCHING TIGERS AND HIDDEN DRAGONS ON THE GREAT WALL STREET: DECODING THE CORPORATE GOVERNANCE OF CHINESE COMMERCIAL BANKS

Yueh-Ping (Alex) Yang *

Abstract: As China's economic influence on the world grows, its system of state capitalism is likewise receiving increasing scrutiny. Behind the state capitalism, China's banking sector, the "Great Wall Street"—parallel to the "Wall Street" in the United States—plays a fundamental role in financing and supporting China's economy. Contemporary studies of China's state capitalism, however, focus mainly on Chinese state-owned enterprises, leaving less attention specific to China's state-owned banking sector which adopts a rather different corporate governance practice. In this paper, I conduct a comprehensive and critical review of the bank governance practice in China. Statutorily, Chinese commercial banks generally follow corporate governance best practices, including the requirement of independent directors and board sub-committees and the separation between chairpersons and CEOs. In reality, however, the Chinese party-state manages to dominate Chinese commercial banks by shifting the power center to the executive team, capturing power through its appointment and reward system, and separating the ownership from control. External governance mechanisms, such as market competition, bank regulation and supervision, and hostile takeovers, are inadequate to pose an effective constraint on the Chinese party-state. Under this practice, the Chinese party-state dominates Chinese commercial banks in a less visible manner and thus becomes the "Hidden Dragon" behind the Great Wall Street. In contrast, private capital, which is also a significant source of investment, only possesses marginal influence on the operational decision of Chinese commercial banks and thus becomes the "Crouching Tiger" on the Great Wall Street. Based on these observations, this article critically assesses this Crouching-Tiger-Hidden-Dragon model from an agency theory prospective. I identify three special agency problems underlying this model, including the misalignment between the public welfare vis-à-vis party-state's interest, between the party-state's interest vis-à-vis bank executives' interest, and between the bank executives' interest vis-à-vis the banks' interest. These special agency problems, in turn, account for the current challenges faced by China's banking sector, including the rising risk exposure, the financial constraint of private sectors, and the lack of business innovation.

Cite as: Yueh-Ping Yang, *Crouching Tigers and Hidden Dragons of the Great Wall Street: Decoding the Corporate Governance of Chinese Commercial Banks*, 28 WASH. INT'L L.J. 1 (2019).

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I. INTRODUCTION

Today, no one would ever underestimate the economic influence of China. After four decades of super growth, China's gross domestic product ("GDP") has skyrocketed to US $12.24 trillion as of the end of 2017.[1] China now represents 15.17% of the world GDP[2] and is the second largest economy in the world.[3] The stunning growth of China's economy has given birth to many enormous Chinese companies. In 2016, 103 of Fortune's Global 500 companies were Chinese.[4] Furthermore, after the Global Financial Crisis of 2008-2009 seriously hit the United States and the European Union, China became a major contributor to sustaining global economic growth: between 2010 and 2017, the net growth of the world GDP was US $14.73 trillion,[5] of which China contributed US $6.15 trillion,[6] or 42%. The world economy has become so entangled with China that when China sneezes, the world catches a cold.

Bank lending is the engine fueling China's economy.[7] In 2016, China's bank credits equaled 157% of China's GDP,[8] while in the United States, this figure was only 53%.[9] In contrast, the market capitalization of listed domestic companies equaled only 71% of China's GDP in 2017,[10] while in the United States this figure was 166%.[11] Consequently, unlike the United States where

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[1] *GDP – China*, WORLD BANK OPEN DATA, https://data.worldbank.org/indicator/NY.GDP.MKTP.CD?locations=CN (last visited Sept. 7, 2018).

[2] In 2017, the world GDP was US $80.68 trillion. *GDP–World*, WORLD BANK OPEN DATA, https://data.worldbank.org/ indicator/NY.GDP.MKTP.CD (last visited Sept. 7, 2018).

[3] *Gross Domestic Product 2017*, WORLD BANK (Sept. 21, 2018), http://databank.worldbank.org/data/download/GDP.pdf.

[4] FORTUNE GLOBAL 500, http://fortune.com/global500/2016/list/filtered?hqcountry=China&sortBy=assets (last visited Sept. 18, 2017). Four of the ten largest companies in the world by assets came from China, including the largest company, Industrial and Commercial Bank of China ("ICBC"). *Id.*

[5] *GDP – World*, WORLD BANK OPEN DATA, *supra* note 2.

[6] *GDP – China*, WORLD BANK OPEN DATA, *supra* note 1.

[7] *See generally* Franklin Allen et al., *China's Financial System: Growth and Risk*, 9 FOUNDATIONS AND TRENDS® IN FINANCE 197 (2015) (providing an overview of China's overall financial system, including a review of current status of the bank loan market and capital market in China).

[8] *Domestic Credit to Private Sector by Banks – China*, WORLD BANK OPEN DATA, https://data.worldbank.org/indicator/ FD.AST.PRVT.GD.ZS?locations=CN (last visited Sept. 7, 2018).

[9] *Domestic Credit to Private Sector by Banks – US*, WORLD BANK OPEN DATA, http://data.worldbank.org/indicator/ FD.AST.PRVT.GD.ZS?locations=US (last visited Sept. 7, 2018).

[10] *Market Capitalization of Listed Domestic Companies – China*, WORLD BANK OPEN DATA, http://data.worldbank.org/indicator/CM.MKT.LCAP.GD.ZS?contextual=default&locations=CN (last visited Sept. 7, 2018).

[11] *Market Capitalization of Listed Domestic Companies – US*, WORLD BANK OPEN DATA, http://data.worldbank. org/indicator/CM.MKT.LCAP.GD.ZS?contextual=default&locations=US (last visited Sept. 7, 2018).

economic activities obtain funds mainly from direct finance and capital markets, China's economy heavily relies on indirect financing and banks.[12] The composition of funding sources in China's non-financial sectors is even more telling. As of the end of 2017, China's non-financial sectors received RMB 175 trillion in financing from the financial sector,[13] of which loans accounted for 69.6% while corporate bonds accounted for only 10.5% and stock accounted for only 3.8%.[14]

Furthermore, China's banking sector now represents a huge portion of China's economy. As of January 24, 2018, there were 25 Chinese commercial banks listed on China's stock market,[15] which is an extremely small portion compared to 3,573 listed companies.[16] That said, as of the same date, the total market value of these banks reached RMB 12.14 trillion,[17] which accounted for 17.7% of the total market value in China's stock market.[18] The profitability of these banks is even more stunning. By the end of the first half of 2017, the net profits of the listed banks accounted for 46% of the overall stock market profits.[19] The banking sector is, in fact, the most crucial sector in China now.

Despite the tremendous importance of China's banking sector, little corporate governance literature addresses how the corporate governance of

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12 To be fair, China is not exceptional on this point. Many advanced countries, such as Japan and Australia, adopt this bank-based model as well. In Japan, bank credits equaled 103% of Japan's GDP in 2016; in 1998, this figure was a staggering 196%. In Australia, this figure was 141% in 2017.

13 PEOPLE'S BANK OF CHINA, 2017 NIAN SHEHUI RONGZI GUIMO CUNLIANG TONGJI SHUJU BAOGAO (2017 年社会融资规模存量统计数据报告) [THE STATISTICS REPORT OF THE SCALE OF SOCIAL FINANCE STOCK AS OF 2017] (2018).

14 *Id.*

15 *Commercial Bank List*, HEXUN, http://datainfo.stock.hexun.com, follow link, then click "股票" (Stocks), followed by "数据频道" (Data Channels), then "行业板块" (Industry Sector), then follow the "二级行业" (Second Industry) hyperlink. (last visited Jan. 24, 2018).

16 *Companies Listed on the Chinese Stock Market*, HEXUN, http://datainfo.stock.hexun.com, follow link, then click "股票" (Stocks), followed by "数据频道" (Data Channels), then follow the link for "行业板块" (Industry Sector) (last visited Jan. 24, 2018).

17 *Commercial Bank List*, HEXUN, *supra* note 15.

18 As of this date, the total market value of China's stock market was RMB 68.43 trillion. *Companies Listed*, HEXUN, *supra* note 16.

19 Lin Zehong (林則宏), *Yinhang chao zhuan zhan A gu banshu huo li* (銀行超賺 占 A 股半數獲利) [*Banks are Super Profitable, Accounting for Half of the Profits of A–Stock*], ECON. DAILY (經濟日報), Sept. 5, 2017.

Chinese commercial banks functions in practice. The world is undoubtedly aware that China remains an authoritarian regime dominated by the Chinese Communist Party ("CCP"), which formulates a unique party-state regime.[20] A rich body of literature also discusses how the CCP, under this political setting, intervenes in China's economy through the so-called "state capitalism" and formulates a unique corporate governance regime.[21] These studies, however, mainly focus on Chinese state-owned enterprises ("SOEs"), especially the central SOEs owned by the State-owned Assets Supervision and Administration Commission of the State Council ("SASAC"),[22] leaving a vacuum in the studies of bank governance in China.[23]

While Chinese commercial banks also share some characteristics with state capitalism, their corporate governance practice is different than that of Chinese SOEs in at least three aspects. First, institutionally, they do not belong to the SASAC system;[24] instead, they belong to a fragmented system. The five largest Chinese commercial banks—i.e., the state-owned commercial

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[20] *See generally* RICHARD MCGREGOR, THE PARTY: THE SECRET WORLD OF CHINA'S COMMUNIST RULERS (2010) (providing a comprehensive discussion of the CCP's influence in China's political regime).

[21] *See, e.g.*, Li-Wen Lin & Curtis J. Milhaupt, *We are the (National) Champions: Understanding the Mechanisms of State Capitalism in China*, 65 STAN. L. REV. 697 (2013); Li-Wen Lin, *State Ownership and Corporate Governance in China: An Executive Career Approach*, 3 COLUM. BUS. L. REV. 743 (2013); Curtis J, Milhaupt & Wentong Zheng, *Beyond Ownership: State Capitalism and the Chinese Firm*, 103 GEO. L.J. 665 (2015); Li-Wen Lin, *Behind the Numbers: State Capitalism and Executive Compensation in China*, 12 U. PENN ASIAN L. REV. 140 (2016). *See also* REGULATING THE VISIBLE HAND? THE INSTITUTIONAL IMPLICATIONS OF CHINESE STATE CAPITALISM (Benjamin L. Liebman & Curtis J. Milhaupt eds. 2015).

[22] *See, e.g.*, Lin & Milhaupt, *We are the (National) Champions*, *supra* note 21; Lin, *Behind the Numbers*, *supra* note 21.

[23] For a rare piece of legal literature addressing the corporate governance of Chinese commercial banks, see generally Nicholas Calcina Howson, *China's Restructured Commercial Banks: Nomenklatura Accountability Serving Corporate Governance Reform?*, *in* CHINA'S EMERGING FINANCIAL MARKETS: CHALLENGES AND GLOBAL IMPACT 123 (Zhu Min et al. eds., 2009) (discussing the existence of the Chinese Communist Party in the direction of Chinese state-owned enterprises after their corporatization). *See also* JAMES STENT, CHINA'S BANKING TRANSFORMATION: THE UNTOLD STORY (2017) (providing a comprehensive introduction of the corporate governance practices in a number of major Chinese commercial banks).

[24] SASAC is a state agency instead of a state holding company and is thus more politics-oriented. Compared with SOCBs, the corporate governance practice of SASAC-owned SOEs is even less disciplined. These SOEs are less concerned with their shareholders' interests: for instance, few of them regularly distribute dividends. In contrast, the Central Huijin pushes the commercial performance of SOCBs harder. In particular, it is more concerned with shareholders' interests, this is reflected in SOCBs' regular distribution of dividends. This is perhaps because MOF issued special bonds to establish the CIC for purchasing Central Huijin from the PBOC, which imposes financial pressure on Central Huijin to generate cash flow for repaying the bonds and thus aligns the interest of Central Huijin with ordinary financial investors. See CARL E. WALTER & FRASER J.T. HOWIE, RED CAPITALISM: THE FRAGILE FINANCIAL FOUNDATION OF CHINA'S EXTRAORDINARY RISE 171–73 (2011), for a comparison between the SASAC model and Huijin model.

banks ("SOCBs")[25]—are mainly controlled by the Central Huijin Investment Company ("Central Huijin"), a subsidiary of Central Investment Company ("CIC") controlled by the Ministry of Finance ("MOF").[26] Many local banks are controlled by the corresponding local government.[27] There are also many commercial banks controlled by an SOE[28] or a state agency.[29] Second, in terms of ownership structure, private capital investment in Chinese commercial banks is far more robust than in Chinese SOEs. Many major banks have not only public investors but also private block-holder(s). Among the 35 largest commercial banks in China, 22 of them have a private block-holder owning 5% or more of the bank's shares (see Annex 1).[30] Such diversified ownership structure of Chinese commercial banks influences the bank governance practice. For instance, many private block-holders appoint their representatives to sit on the board of directors, which diversifies the board composition among Chinese commercial banks.[31] Third, in terms of market competition, competition in the banking sector is far more robust. Unlike most SOEs, which only compete with one or two other SOEs in a similar market, the banking market in China is far less monopolistic. As of the end of 2016, there were 4,399 banking institutions in China.[32] Even if we focus on the national banking market, China still had 17 national banks at the time.[33] In light of the above, corporate governance of Chinese commercial banks presents a different picture with that of Chinese SOEs.

China's bank governance model is of particular importance in light of the prospective SOE reform in China. Despite political turbulence, the CCP

[25] These banks are: the Industrial and Commercial Bank of China ("ICBC"), China Construction Bank ("CCB"), Agriculture Bank of China ("ABC"), Bank of China ("BOC"), and Bank of Communications ("BoCom").

[26] On its incorporation in 2003, Central Huijin was mainly operated by the PBOC, then its sole owner. After MOF issued special bonds to raise the funds for CIC to purchase Central Huijin's ownership from the PBOC in 2007, Central Huijin became mainly operated by MOF.

[27] For example, the controlling shareholder of the Industrial Bank is the Bureau of Finance of Fujian Province. The controlling shareholder of the Shanghai Pudong Bank is the Shanghai City through its SOEs.

[28] An example is the CITIC Bank whose controlling shareholder is the CITIC Group, an SOE owned by MOF.

[29] An example is the Merchant Bank whose controlling shareholder is the Bureau of Merchant.

[30] I use five percent as the criterion here because Chinese laws define "major shareholders" as shareholders possessing five percent or more ownership. Shangye yinhang gongsi zhili zhiyin (商业银行公司治理指引) [Guidelines on Corporate Governance of Commercial Banks] (promulgated by China Banking Regulatory Comm'n, July 5, 2011, effective July 5, 2011), CLI.4.184094(EN) (Lawinfochina).

[31] *See infra* Section II.B.

[32] CHINA BANKING REGULATORY COMMISSION, ANNUAL REPORT OF 2016 27 (2017) [hereinafter CBRC 2016 REPORT].

[33] These are the five SOCBs and twelve joint-stock commercial banks ("JSCBs").

consistently declares its commitment to reform Chinese SOEs as a way to invigorate China's economy.[34] Commentators often considered the Huijin model implemented in China's financial sector more successful than the SASAC model implemented in non-financial SOEs.[35] Accordingly, the prospective SOE reform in China is also likely to track the corporate governance model implemented in China's banking sector.[36] A study that specifically addresses the corporate governance practice of Chinese commercial banks, thus, is warranted.

In this paper, I attempt to fill this void by detailing the interaction between two major players in Chinese bank governance: the Chinese party-state and private capital. On one hand, despite the more diversified ownership structure and more robust market competition, the Chinese party-state continues to dominate Chinese commercial banks.[37] Most importantly, such dominance comes less from the state's ownership than from the party's

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[34] In its 2013 Decision, the CCP declared its intention to initiate another round of SOE reforms, which aimed to develop mixed ownership composed of the government and other non-government owners, such as employee ownership. The purpose was to form co-ownership of enterprises between capitalists and labor. *See CCP Central Committee Resolution Concerning Some Major Issues in Comprehensively Deepening Reform*, CHINA COPYRIGHT AND MEDIA (Nov. 15, 2013), [hereinafter 2013 Decision] https://chinacopyrightandmedia.wordpress.com/2013/11/15/ccp-central-committee-resolution-concerning-some-major-issues-in-comprehensively-deepening-reform/; *see also* Zhonggong zhongyang, guowuyuan guanyu shenhua guoyou qiye gaige de zhidao yijian (中共中央、国务院关于深化国有企业改革的指导意见) [Guiding Opinions of the Central Comm. of the Communist Party of China and the State Council on Deepening State–Owned Enterprise Reform] (promulgated by the State Council, Aug. 24, 2015, effective Aug. 24, 2015), CLI.5.256926(EN) (Lawinfochina) [hereinafter Deepening SOE Reform Opinion]; Guo wuyuan guanyu guoyou qiye fazhan hunhe suoyouzhi de yijian (国务院关于国有企业发展混合所有制经济的意见) [Opinions of the State Council on Developing the Mixed Ownership Economy by State-Owned Enterprises] (promulgated by the State Council, Sept. 23, 2015, effective Sept. 24, 2015) CLI.2.257547(EN) (Lawinfochina); Guowuyuan bangong ting gong guanyu jinyibu wanshan guoyou qiye faren zhili jiegou de zhidao yijian (国务院办公厅关于进一步完善国有企业法人治理结构的指导意见) [Guiding Opinions on the Corporate Governance Structure of State-Owned Enterprises] (promulgated by the Office of the State Council, Apr. 24, 2017, effective May 3, 2017), 2017 Guobanfa 36.

[35] *See* Deng Feng, *Indigenous Evolution of SOE Regulation, in* REGULATING THE VISIBLE HAND?: THE INSTITUTIONAL IMPLICATIONS OF CHINESE STATE CAPITALISM 3, 14–17 (Benjamin L. Liebman & Curtis J. Milhaupt eds., 2015).

[36] According to the Deepening SOE Reform Opinion, the future SOE reform in China will transform the function of SASAC into focusing on administering "investment." Deepening SOE Reform Opinion, *supra* note 34, ¶ 12. Some commentators consider that this transformation of the SASAC's function might track the Huijin model. *See, e.g.*, Nie Riming (聂日明), *Guoqi gaige xiang danmaxi xue shenme?* (国企改革向淡马锡学什么？) [*What to Learn from Temasek for SOE Reforms?]*, SOUTHERN METROPOLIS DAILY (南方都市报), Sept. 17, 2015.

[37] STENT, *supra* note 23, at 39 (observing that "today the role of the Party in Chinese banks is one of the distinguishing features of the Chinese banking system.")

function as a human resource headquarter.[38] By holding *de facto* control over the appointment and reward of top executives of Chinese commercial banks, the party-state obtains influence over banks, regardless of the ownership structure of a bank and regardless of the best practices of corporate governance adopted therein. The party-state's influence is generally less visible to outsiders, which makes "Hidden Dragon" a proper metaphor for describing the party-state's role in China's banking sector. Recently, however, increasing attention has been given to this "Hidden Dragon" after a number of Chinese SOEs amended their articles of incorporation and acknowledged the establishment, function, and power of the party committee in their operation.[39]

On the other hand, despite its significant ownership, private capital only plays a marginal role in China's banking sector. China's banking sector has witnessed significant participation from private capital in the past two decades. By the end of 2015, private capital held about 70% of small and medium banks' shares.[40] Specifically, private capital accounted for 53% of city commercial banks' ownership, 90% of rural cooperatives' ownership, and 72% of township banks' ownership.[41] According to the Chinese Banking Regulatory Commission ("CBRC"), the entry of private capital into the banking industry has become "normalized."[42] However, the influence of these Tigers on the Great Wall Street does not match their ownership. Among major Chinese commercial banks, they rarely possess the power to dominate the management team of Chinese banks.[43] The reason is simple: the Chinese party-state does not want a powerful private sector that could compromise its dominance over the economy and financial system in China. Under this rationale, Tigers could only "crouch," awaiting the Hidden Dragon's permission to rise.

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38 *See infra* Section II.B.

39 *See* Jennifer Hughes, *China's Communist Party Writes Itself into Company Law*, FIN. TIMES (Aug. 14, 2017), https://www.ft.com/content/a4b28218-80db-11e7-94e2-c5b903247afd. In short, in 2017, a number of Chinese SOEs, including some Chinese commercial banks, wrote the party committee into their articles of incorporation. According to these amendments, the bank shall establish a party organization, that is, the party committee, which, in turn, possesses a number of powers, including that the board of directors shall consult the party committee's opinion before deciding on the bank's major issues. In this way, the party committee becomes a corporate organ required by the corporate charter, which is more institutionalized than before. *Id.* For a more detailed description, see *infra* Section II.A.e.

40 CHINA BANKING REGULATORY COMMISSION, ANNUAL REPORT OF 2015 39 (2016).

41 *Id.*

42 *Id.*

43 Among the top 35 largest commercial banks in China, private capital only controls the Ping An Bank and Chengdu Rural Commercial Bank.

Based on the above observations, I offer a critical view of this "Crouching-Tiger-Hidden-Dragon" model of bank governance in China. The Chinese party-state might be satisfied with this model. This model allows it to impose party-state policies on Chinese commercial banks, which might not always serve banks' interest but may enhance the overall public welfare.[44] Nevertheless, in recent years, there are some warning signals cautioning the Chinese party-state from being overconfident in this model. For instance, this model orients the operation of Chinese banks toward the party's interest, which can involve political interests that do not concern social welfare or may even harm it. The enhanced political intervention, in turn, results in the rapid rise of bad loans among Chinese banks and the financial constraint of China's private sectors.[45] Moreover, this model prevents Chinese banks from having a more diversified executive composition, which compromises the business innovation and diversity of Chinese banks.[46] These concerns seem controllable at this moment, but the Chinese party-state better nip this evil in the bud before it causes systemic instability.

I will structure this paper as follows. In Part II, I will review the internal governance practice of Chinese commercial banks. I will illustrate both the governance in statutes, and in practice, to explain how the Chinese party-state gets around the related corporate laws to dominate Chinese commercial banks. In Part III, I will review the external governance mechanisms in China's banking sector. I will analyze the market competition in both the banking market and the capital market, the regulatory intervention, and the obstacles to hostile takeovers in China, illustrating how their function is limited under the Chinese party-state system. In Part IV, I will discuss the problems associated with this Crouching-Tiger-Hidden-Dragon model. I will focus on the three specific types of agency problems of this model and illustrate how these problems lead to the rising risk exposure among Chinese commercial banks, the financial constraint of China's private sectors, and the lack of business innovation and diversity in China's banking sector. Part V concludes by urging a reform of this model in China. Through these analyses, this paper

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[44] This echoes article 34 of the Commercial Banks Law, which requires Chinese commercial banks to "conduct their business of lending in accordance with the needs of the national economic and social development and under the guidance of the industrial policies of the State." Zhonghua renmin gongheguo shangye yinhang fa (中华人民共和国商业银行法) [Law of the People's Republic of China on Commercial Banks] (promulgated by Standing Comm. of the Eighth National People's Cong., May 10, 1995, effective July 1, 1995; amended by Standing Comm. of Tenth National People's Congress, Dec. 27, 2003; amended by Standing Comm. of Twelfth National People's Congress on Aug. 29, 2015) [hereinafter Commercial Banks Law], art. 34, CLI.1.256594(EN) (Lawinfochina).

[45] *See infra* Section IV.B.a.

[46] *See infra* Section IV.B.c.

broadens the studies on China's state capitalism from a banking perspective and lays down a foundation for future research of China's banking reform and SOE reform.

II. INTERNAL GOVERNANCE OF CHINESE COMMERCIAL BANKS—TIGERS DOWN TO LEVEL LAND

A Chinese saying goes, "*a tiger going down to the level land would be insulted by dogs,*" which describes that a powerful person, when losing his or her power, can be easily insulted by villains. This depicts the plight of the Tigers—that is, private capital—on the Great Wall Street.

After decades of evolution, Chinese commercial banks have attracted enormous investments from private capital. As of 2017, up to 41 Chinese banks have listed themselves in Hong Kong, Shanghai, or Shenzhen.[47] In addition, according to the CBRC's investigation, as of 2015, private capital held the majority shares of more than 100, or 70%, of small and medium commercial banks.[48] These figures seem to suggest that private capital has taken over the Great Wall Street. That notion, however, is not the reality.

This Section will explore the practice of bank governance in China. It will illustrate how, after four decades of banking reform, the Chinese party-state, or the Dragon, maintains its dominance and marginalizes private capital, the Tigers, thereby contributing to the "Crouching-Tigers-Hidden-Dragons" model of bank governance in China.

A. Governance on the Books

The laws governing the corporate governance of Chinese commercial banks are mainly the Company Act, amended in 2013; Guiding Principles on Governance of Listed Companies, promulgated in 2002; and CBRC's Guidance on Corporate Governance of Commercial Banks, promulgated in 2013. In general, these laws resemble the best practices promoted in the West and reflect the shareholder-oriented model,[49] though with some variations.

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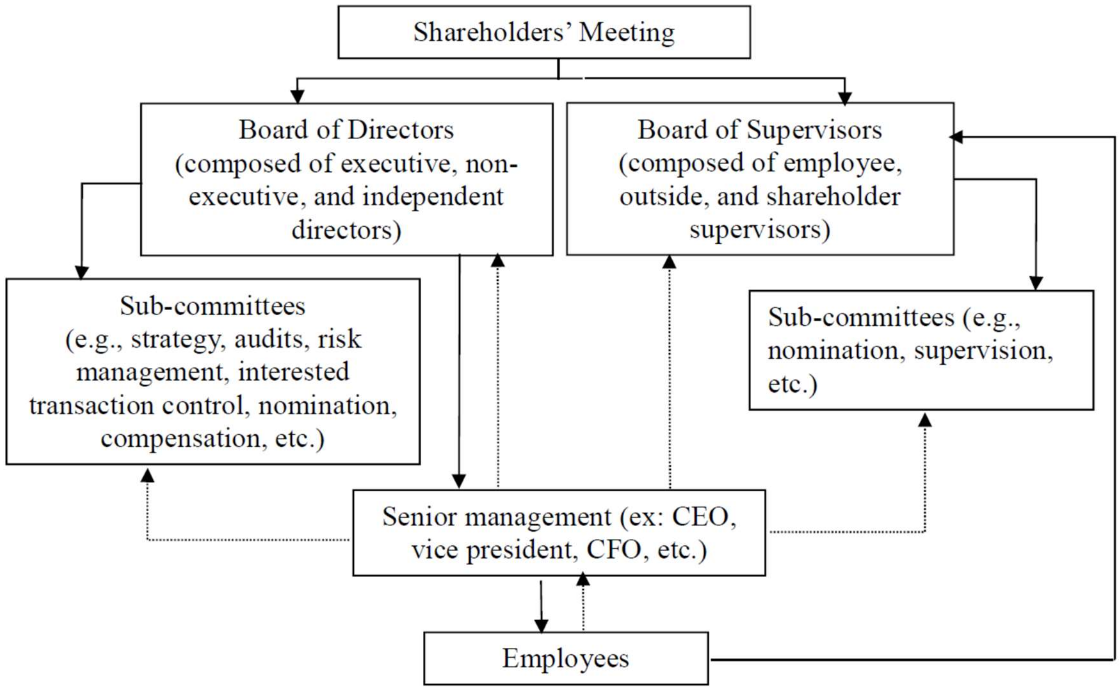
47 *See* ERNST & YOUNG, CHINA, LISTED BANKS IN CHINA: 2017 REVIEW AND OUTLOOK 1 (2018) (for a list of these 41 banks).

48 CBRC 2016 REPORT, *supra* note 32, at 39.

49 Hansmann and Kraakman classified corporate governance practices into five main categories: shareholder-oriented, manager-oriented, labor-oriented, state-oriented, and stakeholder-oriented models. *Henry Hansmann & Reinier Kraakman*, *The End of History for Corporate Law*, *in* CONVERGENCE AND PERSISTENCE IN CORPORATE GOVERNANCE 33 (Jeffrey N. Gordon & Mark J. Roe eds., 2004).

Chart 1 illustrates the basic governance structure of Chinese banks provided in these laws.

Chart 1: Corporate Governance Structure of Chinese Commercial Banks on the Books



Note: The solid line indicates the power to appoint the arrowed subject
The dotted line indicates the obligation to report to the arrowed subject.

Bank governance in China has adopted the two-tier board system.[50] As Chart 1 shows, the decision-making body of a bank consists of the shareholders' meeting on the top,[51] the board of directors and board of supervisors in the middle in charge of managerial and supervisory affairs[52] respectively, and the senior management in charge of daily operational affairs just above the employees.[53] This model has three characteristics. First, in China, employees are also entitled to appoint, unfettered by shareholders, a number of employee supervisors to the board of supervisors.[54] This is

[50] *See* John Armour et al., *The Basic Governance Structure: The Interests of Shareholders as a Class, in* THE ANATOMY OF CORPORATE LAW: A COMPARATIVE AND FUNCTIONAL APPROACH 49, 50–51 (Reinier Kraakman et al. eds., 2017) (for a brief comparison between the one-tier and two-tier board).

[51] Zhonghua renmin gongheguo gongsi fa (中华人民共和国公司法) [Company Law of The People's Republic of China] (promulgated by the Standing Comm. Nat'l People's Cong., Dec. 28, 2013, effective Mar. 1, 2014) [hereinafter Company Law], art. 99, www.fdi.gov.cn/1800000121_39_4814_0_7.html (China).

[52] *Id.* arts. 109, 118.

[53] *Id.* arts. 50, 114.

[54] *Id.* art. 118.

reminiscent of the supervisory boards in Germany.[55] Second, unlike the two-tier board model in Germany, however, the one in China resembles the Japanese or Taiwanese model, under which the board of supervisors does not appoint members of the board of directors. Instead, it is the shareholders' meeting that appoints the supervisors.[56] Third, while maintaining the board of supervisors, China also introduces independent directors and specific board sub-committees, which resembles the best practices implemented in the United States[57] and the United Kingdom.[58]

Below, I introduce each major corporate organ inside Chinese commercial banks.

1. Shareholders' Meeting

The shareholders' meeting is the governing body of a Chinese company.[59] It consists of all shareholders, with each share possessing one vote.[60] The shareholders' meeting possesses a number of powers similar to their equivalents in other jurisdictions.[61] The most important power is to elect and dismiss directors and non-employee supervisors.[62] Companies may adopt the cumulative voting system for the election.[63] However, if a listed company

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[55] *See generally* Klaus J. Hopt, *The German Law of and Experience with the Supervisory Board* (Eur. Corp. Governance Inst., Working Paper No. 305, 2016), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=2722702 (introducing the laws and practice of supervisory boards in Germany).

[56] Company Law, *supra* note 51, art. 106.

[57] *See, e.g.*, NYSE, NYSE LISTED COMPANY MANUAL SECTION 303A CORP. GOVERNANCE STANDARDS FREQUENTLY ASKED QUESTIONS 1–2 (2010), https://www.nyse.com/publicdocs/nyse/regulation/nyse/final_faq_nyse_listed_company_manual_section_303a_updated_1_4_10.pdf.

[58] *See, e.g.*, FIN. REP. COUNCIL, THE UK CORPORATE GOVERNANCE CODE 4–5 (2018), https://www.frc.org.uk/getattachment/88bd8c45-50ea-4841-95b0-d2f4f48069a2/2018-UK-Corporate-Governance-Code-FINAL.PDF.

[59] Company Law, *supra* note 51, art. 99.

[60] *Id.* art. 103.

[61] These powers include the power to approve a bank's operation guidelines and investment plans, the reports of the board of directors and the board of supervisors, the annual financial budget plans and final accounts, the profit distribution plans and loss recovery plans, the merger, spin-off, dissolution or liquidation, and the modification to the articles of association, among others. *Id.* arts. 37(1), 99.

[62] *Id.* arts. 37(2), 99.

[63] *Id.* art. 105.

has a controlling shareholder that controls 30% or more of the company's shares, cumulative voting becomes mandatory.[64]

2. *Board of Directors*

As in other jurisdictions, the board of directors in China has the primary responsibility of operating and managing the Chinese commercial banks.[65] Their powers include deciding the operational and investment plans of the company; formulating the annual financial budget plans, final accounts, profit distribution plans, loss recovery plans, and plans for merger, spin-off, or dissolution of the company; deciding on the establishment of internal management bodies; and formulating fundamental management systems.[66] Among them, one of the most crucial powers of the board of directors is to supervise senior management. It possesses the power to appoint and dismiss senior management, to determine their executive compensation,[67] and to conduct overall supervision.[68]

Banks elect their board members according to the following procedures. First, the board's nomination committee and shareholders, individually or jointly holding 3% or more of the voting shares, can nominate candidates to the board of directors.[69] Second, the board of directors, after deliberation, submits the list of candidates to the shareholders' meeting for an election.[70] Third, the shareholders' meeting elects the board members on an individual

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[64] Shangshi gongsi zhili zhun ce (上市公司治理准则) [Code of Corporate Governance for Listed Companies in China] (promulgated by China Securities Regulatory Comm'n and State Economic and Trade Comm'n, Dec. 12, 2013, effective Mar. 1, 2014).

[65] Shangye yinhang gongsi zhili zhiyin (商业银行公司治理指引) [Guidance on Corporate Governance of Commercial Banks], (promulgated by China Banking Regulatory Comm'n on Printing and Distributing the Guidelines for the Admin. of Commercial Banks, July 19, 2013, effective July 19, 2013) [hereinafter Guidance on Corp. Governance of Com. Banks], http://www.gov.cn/gongbao/content/2013/content_2509243.htm.

[66] Company Law, *supra* note 51, arts. 46, 108. For commercial banks, the board of directors also decides the operational and developmental strategies, the risk tolerance level, risk management, and internal control policies, as well as the capital plans and capital management. It also regularly evaluates and improves the corporate governance, takes charge of information disclosure, protects the interests of depositors and other stakeholders, and establishes mechanisms to address conflicts of interest between the banks and shareholders (particularly for major shareholders). Guidance on Corp. Governance of Com. Banks, *supra* note 65, art. 19.

[67] Company Law, *supra* note 51, arts. 46(9), 108

[68] Guidance on Corp. Governance of Com. Banks, *supra* note 65, art. 19(6).

[69] *Id.* art. 45(1).

[70] *Id.* art. 45(2).

basis.[71] Finally, the elected directors must pass the CBRC's review.[72] The term of each elected director is three years.[73]

A Chinese commercial bank typically has three categories of board members: executive, non-executive, and independent directors. Executive directors are directors who also assume other senior management positions in the commercial bank.[74] Non-executive directors are directors who do not assume other management positions.[75] Independent directors refer to non-executive directors who do not have any relationship with the commercial bank or its major shareholders[76] that may affect his or her independent and objective judgment.[77] Together, the directors elect the chairperson and vice chairperson of the board of directors on a majority basis.[78] The elected chairperson cannot be the CEO of the commercial bank.[79]

For listed companies, at least one-third of board members must be independent directors.[80] They can be nominated by either the board's

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[71] *Id.* art. 45(5).

[72] *Id.* art. 47(1).

[73] *Id.* art. 47(2).

[74] *Id.* art. 21.

[75] *Id.*

[76] Major shareholder refers to any shareholder holding five percent or more shares of the bank and has significant impact on bank decisions. *Id.* art. 9(2).

[77] *Id.* art. 21. According to the Guiding Opinions issued by the Chinese Securities Regulatory Commission ("CSRC"), the following persons cannot serve independent directors:

1. Employees of the company and its affiliates, as well as the direct relatives of these employees (such as the spouse, parents, children of the employees) and people having major social relationship with these employees (such as the sibling, parents–in–law, children–in–law, spouses of the siblings, siblings of the spouse, etc., of the employees);
2. Natural person shareholders who hold 1% or more of the company's shares or are one of the top ten shareholders of the company, as well as their direct relatives;
3. Employees of the entity shareholders which hold 5 percent or more of the company's shares or are one of the top five shareholders of the company, as well as their direct relatives;
4. People who satisfied any of the above three conditions in the recent year;
5. People who provided services in finance, law, advice, etc. to the company or its affiliate;
6. Other people provided in the corporate charter;
7. Other people determined by the CSRC.

Guanyu zai shangshi gongsi jianli duli dongshi zhidu de zhidao yijian (关于在上市公司建立独立董事制度的指导意见) [Guiding Opinions on the Establishment of Independent Director System in Listed Companies] (promulgated by China Securities Regulatory Commission, Aug. 16, 2001), art. 3, 2001 Zhengjianfa 102.

[78] Guidance on Corp. Governance of Com. Banks, *supra* note 65 at art. 25.

[79] *Id.*

[80] Guiding Opinions on the Establishment of Independent Director System in Listed Companies, *supra* note 77, art. 1(3). Typically, Chinese commercial banks appoint university professors, retired government officials, or private professionals such as lawyers, accountants, or investment bankers to serve as independent

nomination committee or shareholders individually or jointly holding 1% or more of the voting shares.[81] Each independent director cannot serve for more than six years.[82] In addition, he or she cannot serve as an independent director simultaneously in more than two commercial banks.[83] Independent directors should focus particularly on interested transactions, profit distribution plans, employment and dismissal of senior management, matters which could cause material losses to the bank, matters which could harm the legitimate interest of depositors, minority shareholders, and other stakeholders, and the employment of external auditors.[84] They must work on their director duties for at least fifteen business days in the commercial bank every year.[85]

Chinese commercial banks further establish a number of sub-committees under the board of directors, including for strategy, audit, risk management, interested transaction review, nomination, and compensation.[86] Among them, the chairpersons of the audit, interested transaction review, nomination, and compensation committees must be independent directors.[87] For listed companies, the majority members of audit, nomination, and compensation committees must be independent directors.[88] The chairpersons of audit, interested transaction review, and risk management committees must work for at least twenty-five business days in the commercial bank every year.[89]

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directors. These independent directors do not necessarily hold party titles; some of them are even non-Chinese professionals.

[81] Guidance on Corp. Governance of Com. Banks, *supra* note 65, art. 46(1).

[82] In general, this term restriction is considered a good practice because it can prevent independent directors from being captured by the management and thus ensures the independence of independent directors. Guidance on Corp. Governance of Com. Banks, *supra* note 65, art. 47. For a related discussion in the U.S. context, see generally Yaron Nili, *The "New Insiders": Rethinking Independent Directors' Tenure*, 68 HASTINGS L.J. 97 (2016) (discussing whether a tenure restriction is necessary for ensuring the independence of independent directors in the United States).

[83] In general, this part-time restriction is considered a good practice because it can prevent independent directors from being distracted by overwhelming works and thus ensures the devotion of independent directors to the bank. Guidance on Corp. Governance of Com. Banks, *supra* note *65,* art. 50. For a related discussion in the U.S. context, see generally Jeremy C. Kress, *Board to Death: How Busy Directors Could Cause the Next Financial Crisis*, 59 B.C. L. REV. 87 (2018) (discussing whether to limit the outside commitments of independent directors in the United States).

[84] Guidance on Corp. Governance of Com. Banks, *supra* note 65, art. 54.

[85] *Id.* art. 55.1.

[86] *Id.* art. 22.

[87] *Id.* art. 24.3.

[88] Guiding Principles on Governance of Listed Companies, *supra* note 64, art. 52.

[89] Guidance on Corp. Governance of Com. Banks, *supra* note 65, art. 55.

3. Board of Supervisors

In China, the board of supervisors undertakes the primary responsibility of internal supervision.[90] It possesses the power to inspect financial issues, supervise and file actions against the directors and senior management, and attend meetings of the board of directors as non-voting participants.[91] They can propose to dismiss directors or senior management who violate laws, regulations, articles of association, or shareholders' resolutions,[92] but they cannot elect board members or senior management.

In a Chinese commercial bank, the board of supervisors consists of three categories of members: employee, outside, and shareholder supervisors. Employee supervisors are elected by employee representatives, while the latter two are elected by the shareholders' meeting.[93] At least one-third of supervisors must be employee supervisors.[94] For outside supervisors, similar to independent directors, they cannot possess relationships that could affect their independent judgment with regards to the commercial bank and its major shareholders.[95] The term of each supervisor is three years, but outside supervisors cannot serve for more than six years.[96] Outside and shareholder supervisors must work for at least fifteen business days in the commercial bank every year.[97]

4. Senior Management

The senior management of a Chinese commercial bank includes the CEO, vice presidents, chief financial officer ("CFO"), and the board secretary in the case of listed companies.[98] The board of directors appoints the

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90 *Id.* art. 32.

91 Company Law, *supra* note 51, arts. 53, 54, 118(1). Commercial banks also have to regularly evaluate the board of director's development strategy, to inspect the operational decision, risk management, and internal control of the bank, to supervise the appointment process of directors, to evaluate the performance of directors, supervisors, and senior management, to supervise the salary and executive compensation system of the bank, and to regularly communicate with the CBRC about the bank's situation. Guidance on Corp. Governance of Com. Banks, *supra* note 65, art. 32.

92 Company Law, *supra* note 51, arts. 53(2), 118(1).

93 Guidance on Corp. Governance of Com. Banks, *supra* note 65, art. 33.

94 Company Law, *supra* note 51, art. 117.

95 Guidance on Corp. Governance of Com. Banks, *supra* note 65, art. 33(2).

96 *Id.* art. 60.

97 *Id.* art. 62(2).

98 *Id.* art. 39; Company Law, *supra* note 51, art. 216(1).

members of senior management, subject to the CBRC's review.[99] Together, the senior managers manage the operational affairs of commercial banks in accordance with the articles of association and the board of directors' authorization.[100] They are accountable to the board of directors and subject to the board of supervisors' supervision.[101]

The CEO leads the senior management. He or she possesses the power to direct management of production and business operations, to organize the implementation of the board of directors' resolution, annual operation plans and investment plans, to propose to employ or dismiss the vice presidents or CFO, and to decide the employment or dismissal of other management.[102]

5. *The Party Committee*

In addition to the above corporate organs, almost all commercial banks have established a unique organ—that is, the party committee.[103] The party committee is representative of Chinese-style corporate governance,[104] but it can be rather mysterious for outsiders. For instance, the financial statements or official websites of Chinese commercial banks rarely mention the existence of a party committee or report the committee's members.

The existence of party committees, however, has become more visible since 2017. As part of the efforts of the Xi Administration to improve the efficiency and productivity of Chinese SOEs by extending the party's

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[99] Guidance on Corp. Governance of Com. Banks, *supra* note 65, art. 65. The CBRC scrutinizes the eligibility of the appointed senior management in accordance with the Regulation Administrating the Eligibility of Board (Council) Members and Senior Management of Banking Financial Institutions. According to this regulation, the scrutiny conducted by the CBRC resembles the fit and proper test adopted elsewhere in the world which examines the basic eligibility instead of the merits of the appointed bank managers. Therefore, in most of the cases, the CBRC will defer to the bank as long as the appointed bank managers do not meet any of the events of disqualification. Yinhang ye jinrong jigou dongsi (lishi) he gaoji guanli renyuan renzhi zege guanli banfa (银行业金融机构董事（理事）和高级管理人员任职资格管理办法) [Regulation Administrating the Eligibility of Board (Council) Members and Senior Management of Banking Financial Institutions] (promulgated by China Banking Regulatory Commission, Nov. 18, 2013, effective Dec. 18, 2013), CLI.4.213557(EN) (Lawinfochina).

[100] *Id.* art. 40.

[101] *Id.*

[102] Company Law, *supra* note 51, arts. 49, 113.

[103] According to the Company Law, companies shall provide conditions necessary to support the party activities in the company. *Id.* art. 19.

[104] *See generally* Xiao Li, *Legal and Economic Development with Sui Generis Chinese Characteristics: A Systems Theorist's Perspective*, 39 BROOK. J. INT'L L. 159, 181–99 (2014) (discussing the Chinese characteristics of corporate governance and the party-state's role therein).

representation and leadership in these SOEs,[105] in 2017, a number of Chinese SOEs, including some Chinese commercial banks, wrote the party committee into their articles of incorporation. Among the five SOCBs, four of them, namely, the Industrial and Commercial Bank of China ("ICBC"),[106] the Agricultural Bank of China ("ABC"),[107] the Bank of China ("BOC"),[108] and the Bank of Communications ("BoCom"),[109] have amended their articles of incorporation and institutionalized the party committee therein. Such practice has also started to spread to joint-stock commercial banks ("JSCBs"), the second-tier banks in China. For instance, the Board of Directors of the China Everbright Bank has similarly amended the articles of incorporation and submitted them to the shareholders' approval.[110] According to these amendments, the bank shall establish a party organization, that is, the party committee.[111] This party committee is, in general, comprised of a secretary, two deputy secretaries, and a number of party committee members.[112] It possesses a number of powers;[113] most prominently, the board of directors

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[105] *See* Hughes, *supra* note 39; *see also* Tom Mitchell, *China's Communist Party Seeks Company Control Before Reform*, FIN. TIMES (Aug. 15, 2017), https://www.ft.com/content/31407684-8101-11e7-a4ce-15b2513cb3ff.

[106] Zhongguo yinjianhui [China Banking Regulatory Commission Reply], Sept. 25, 2017, No. 308.

[107] Zhongguo yinjianhui [China Banking Regulatory Commission Reply], Nov. 8, 2017, No. 349.

[108] Zhongguo yinjianhui [China Banking Regulatory Commission Reply], Nov. 27, 2017, No. 367.

[109] Bank of Communications, Materials for the First Extraordinary Shareholders' Meeting of 2017 2–3, 6–7, 12–14, 22, Oct. 27, 2017 (unpublished shareholder information on file with author) (subject to the CBRC's approval).

[110] China Everbright Bank, Announcement related to the Amendment of the Articles of Incorporation of the China Everbright Bank 2–3, Nov. 1, 2017 (unpublished shareholder information on file with author).

[111] *See, e.g.,* INDUSTRIAL AND COMMERCIAL BANK OF CHINA LIMITED, ARTICLES OF ASSOCIATION art. 13 (Oct. 25, 2005) [hereinafter ICBC'S ARTICLES OF INCORPORATION], http://v.icbc.com.cn/userfiles/Resources/ICBCLTD/download/2017/gszc_en.pdf ("The CCP's organization is to be established in accordance with the relevant provisions of the CCP Charter and the Company Act. The Party Committee shall play the core leadership function, controlling the direction, managing the overall situation, and ensuring the implementation. The Party's working entities are to be established, equipped with an adequate number of party affairs working staff and ensured the working expense of party organizations.")

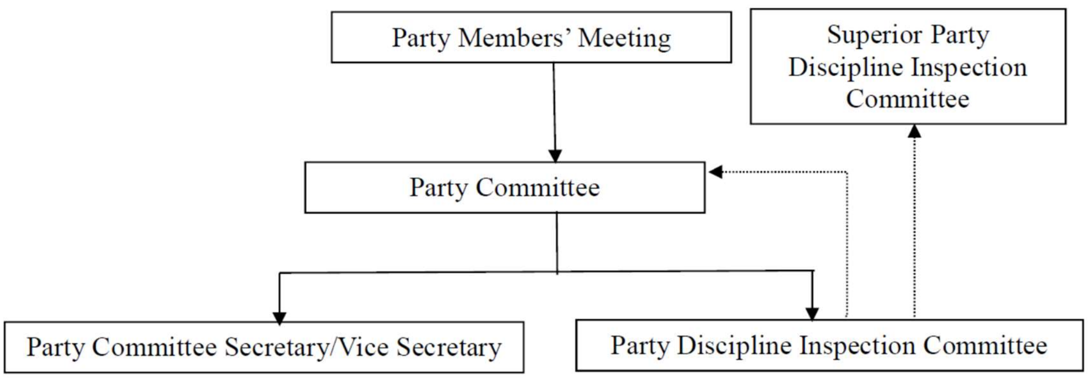
[112] *Id.* art. 52 ("This Bank establishes the CCP's ICBC Committee [hereinafter the Party Committee]. The Party Committee establishes one secretary, two deputy secretaries, and a number of party committee members. A single person assumes both the chairperson and the party committee secretary and determines a party committee deputy secretary to assist him/her in the party affairs. Party committee members who satisfy the related conditions may serve the members of the board of directors, the board of supervisors, or the senior management in accordance with legal procedures, while directors, supervisors, or senior managers who satisfy the related conditions can join the Party Committee in accordance with related rules and procedures. The discipline committee is established in accordance with rules.")

[113] *Id.* art. 53 ("The Party Committee exercises the following powers in accordance with CCP Charter and other party rules: (1) Promise to supervise the implementation and enforcement of the Party's and the State's policies in the Bank and implement the major strategic decisions of the Party center and the State Council as well as the related important working deployments of the superior party organization; (2) Strengthen the leadership and control of the appointment and employment, administer the standard, procedure, review, recommendation, and supervision, insist on the principle of party administration of cadres, combined

shall consult the party committee's opinion before deciding on the bank's major issues.[114] The emergence of these amendments shocked outsiders who were unfamiliar with the party system in Chinese companies.[115]

These amendments are, however, less earthshaking than they appear. Party committees, as mandated by the CCP Charter, existed far before Chinese SOEs amended their articles of incorporation. These amendments simply reaffirm and formalize the long-existing practice. In fact, they even fail to lay out the essential role of party committees. Below, I introduce the party committee in the context of Chinese commercial banks. Chart 2 illustrates the party system inside China's commercial banks.

Chart 2: Structure of Party Committees



Note: The solid line indicates the power to appoint the arrowed subject.
The dotted line indicates the obligation to report to the arrowed subject.

with the Board of Directors' legal power to appoint the management and the management's legal power to employ employees; (3) Study and deliberate the major issues related to the Bank's steady reform and development, major operational affairs, and employees close interests and propose suggestions. Support the shareholders' meeting, the Board of Directors, the Board of Supervisors, and the Senior Management to perform their duties. Support the Employee Representatives' Meeting to develop their works. (4) Undertake the duty to govern the party in a comprehensively strict manner. Lead the political works of the Bank's thinking, the unification works, the spirit and civilization construction, the enterprise's cultural works, and the group works of unions and Communist Youth League. Lead the construction of party style ethics and support the discipline committee members to perform the duty to monitor. (5) Strengthen the Bank's basic party organization and the team construction of party members. Sufficiently play the role of the Party sub–division's fort and party members' model. Consolidate and lead cadres and employees to devote to the Bank's reform and development. (6) Other important matters related to the duty of the Party Committee.")

[114] *Id.* art. 144.

[115] *See, e.g.*, Mitchell, *supra* note 105. Recently, the CSRC is even considering requiring all publicly listed companies, including foreign companies and foreign joint ventures, to establish party organizations. *See* Annie Wu, *China Requires All Publicly Listed Companies to Establish Communist Party Branches*, EPOCH TIMES (June 18, 2018), https://www.theepochtimes.com/china-requires-all-publicly-listed-companies-to-establish-communist-party-branches_2565214.html.

It is essentially mandatory for each Chinese commercial bank to establish a party committee, regardless of whether it amends its articles of incorporation or not. This is because, pursuant to the CCP Charter, any enterprise that contains three or more official CCP members shall establish a primary-level organization of the party, that is, the party committee.[116] The party members' meeting elects party committee members[117] for a term of three to five years.[118] After the party committee elects its secretary and deputy secretaries, it shall report the election result to its superior party organization for approval.[119] In addition to the party committee, an enterprise also establishes the party discipline inspection committee (or a single discipline inspector) to conduct discipline inspections.[120] This committee or inspector is led by both the enterprise's party committee and the superior party discipline inspection committee.[121]

The primary mission of a party committee is to supervise the implementation of the party's and the state's policies in that enterprise.[122] Specifically, the party committee undertakes the duty to advertise and execute the party's policies and resolutions; to organize party members to learn Marxism, Leninism, Maoism, and Deng Xiaoping theories; to educate, administer, supervise, and serve party members; to communicate with the ordinary people; to discover, develop, and recommend talented party members; and to supervise the party cadres and others so that they abide by the state laws and discipline.[123] In relation to the enterprise's production and operation, it assists the shareholders' meeting, the board of directors, the board of supervisors, and the CEO in exercising their powers in accordance with laws, assist the employee representatives' meeting in developing its work, and participate in the decision-making process for the enterprise's major issues.[124]

The primary mission of the party discipline inspection committee (or the discipline inspector) is to safeguard the CCP Charter and other party

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[116] XIANFA (中国共产党章程), art. 30 (2012) (China).

[117] *Id.*

[118] *Id.* art. 31.

[119] *Id.* art. 31.

[120] *Id.* art. 45.

[121] *Id*. This superior party discipline inspection committee could be at the central level or local level of the CPP, and its committee members are elected by the party member's meeting of that party organization.

[122] *Id.* art. 33.

[123] *Id.* art. 32.

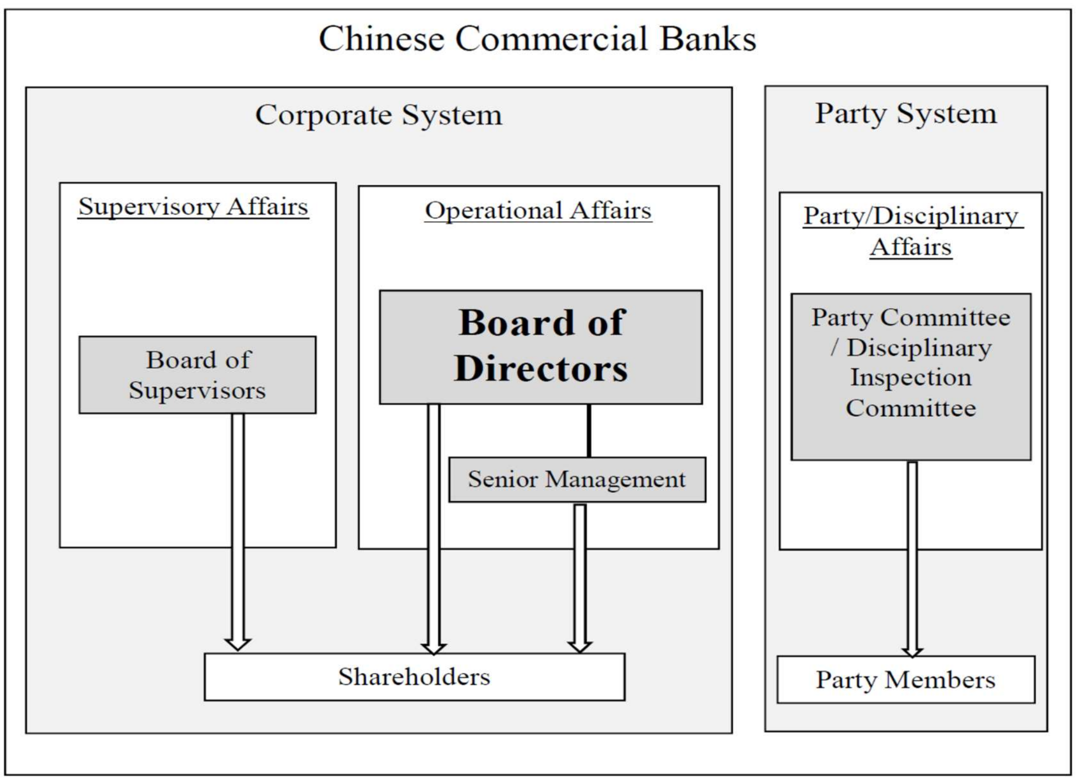
[124] *Id.* art. 33.

bylaws, to inspect the enforcement of party policies and resolutions, to assist the party committee in developing the party's spirit, and to organize and coordinate anti-corruption works.[125] To ensure the compliance of party disciplines, the party discipline inspection committee should frequently educate party members to abide by the party discipline, monitor the cadres' exercise of power, inspect and handle breaches of party charter or bylaws made by party organizations or party members, and decide the punishment against the party members, etc.[126] Its inspection, however, is subject to review from the superior discipline inspection committee.[127]

6. Summary of the Statutory Governance Systems of Chinese Commercial Banks

Chart 3 summarizes the governance system of a Chinese commercial bank as follows:

Chart 3: Corporate Governance System of Chinese Commercial Banks by Statute



[125] *Id.* art. 44.
[126] *Id.*
[127] *Id.* art. 45.

To illustrate, in law, the governance system of a Chinese commercial bank can be divided into two parts: the corporate system and the party system. The corporate system deals with corporate affairs, including operational affairs and supervisory affairs. For operational affairs, the board of directors takes the charge, supported by the senior management. For supervisory affairs, the board of supervisors takes the charge. In general, all these corporate organs are accountable to shareholders. On the other hand, since a commercial bank contains party members, it also involves party and party discipline issues and thus needs the party system to deal with those issues. The party committee and its party discipline inspection committee are responsible for party and party discipline issues.

There are three points to note about the governance system of Chinese commercial banks. First, legally speaking, the party committee does not decide on the corporate affairs of a commercial bank. Its responsibility focuses primarily on party affairs, such as party promotion, party education, and party discipline inspection. As for corporate affairs, the party committee plays mainly a consultative or supportive role. Undeniably, there may be some gray areas between corporate affairs and party affairs, especially after a number of Chinese commercial banks amended their articles of incorporation and required their boards of directors to consult the party committee's opinion before deciding on major corporate affairs.[128] That said, the party committee is at most an advisor instead of a decision maker on the corporate affairs of a commercial bank.

Second, within the corporate system, legally speaking, the board of directors undertakes the primary role. It takes charge of operational affairs, leads the senior management in implementing operational decisions, and manages the risk, capital, and internal control of commercial banks. It appoints, dismisses, and rewards senior management, thereby obtaining the power to supervise senior management. In line with the best practices proposed by the Basel Committee,[129] the board of directors plays a central role in the corporate governance of Chinese commercial banks.

Third, the role of the board of supervisors is rather weak. Although it is responsible for the supervisory affairs, it shares this task with the board of director's sub-committees, such as audits, nominations, interested transaction

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[128] *See, e.g.*, ICBC'S ARTICLES OF INCORPORATION, *supra* note 111, art. 144.

[129] *See* BASEL COMM. ON BANKING SUPERVISION, GUIDELINES: CORPORATE GOVERNANCE PRINCIPLES FOR BANKS, principle 1 (2015), https://www.bis.org/bcbs/publ/d328.pdf.

control, and others. In some sense, the board of supervisors plays merely a supplementary role to these sub-committees. The primary responsibility left to the board of supervisors is the duty to evaluate the performance of directors, supervisors, and senior management.[130] To the extent that Chinese laws are gradually shifting the power of the board of supervisors to the board of directors and highlighting the importance of independent directors and board sub-committees, the corporate governance of Chinese commercial banks is converging toward the Anglo-Saxon model.[131]

B. Governance on the Street

Unsurprisingly, the real practice implemented in Chinese commercial banks deviates from the aforementioned statutory designs. The CCP's dominant position in China's economy and society blurs the clear statutory distinction between the corporate and party system. In place of the board of directors, the party committee, which is relatively weak according to the statutory design, moves to the power center. The board of directors, which is the statutory power center, only has marginal power in real life.

Chart 4 describes the real situation in Chinese commercial banks. In practice, three main characteristics of Chinese-style bank governance stand out. First, the power center of the bank is reversed from the board of directors to the executive team, i.e. the party committee. Second, the party system captures the power center. Third, the majority shareholder of a bank does not necessarily possess the control over the bank. Behind them stands the omnipresent Chinese party-state.

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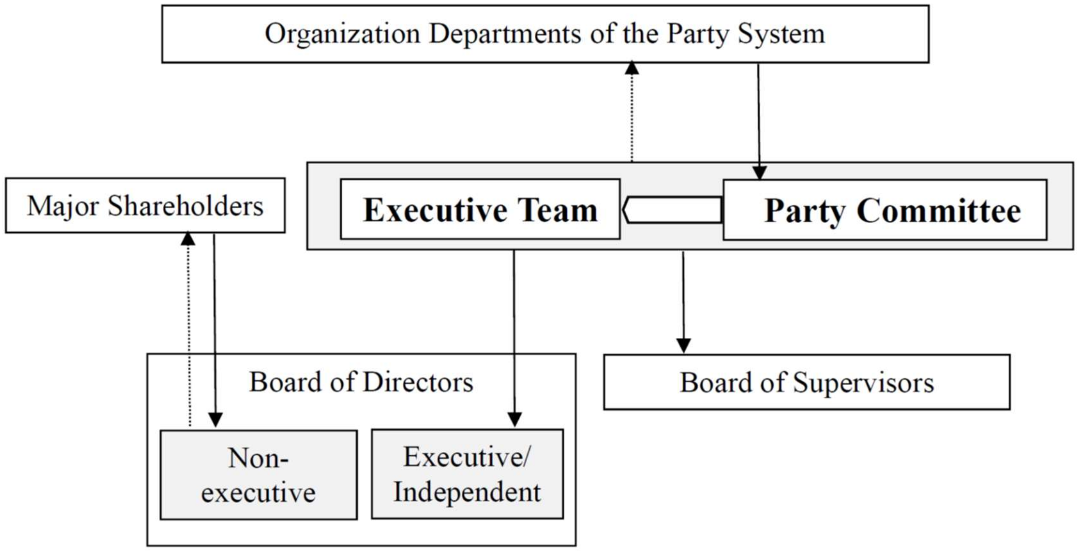
[130] Guidance on Corp. Governance of Com. Banks, *supra* note 65, art. 32.

[131] This echoes the observation of Hansmann and Kraakman. *See generally* Henry Hansmann & Reinier Kraakman, *Reflections on The End of History for Corporate Law*, *in* CONVERGENCE OF CORPORATE GOVERNANCE: PROMISE AND PROSPECTS 32 (Abdul Rasheed & Toru Yoshikawa eds., 2012) (observing that the world company laws, including that in China, is converging toward the shareholder-oriented model as practiced in the United States and the United Kingdom).

Chart 4: Real Governance Practice of Chinese Commercial Banks



Note: The solid line indicates the *de facto* power to appoint the arrowed subject.
The dotted line indicates the *de facto* obligation to report to the arrowed subject.

1. *The Reverse of the Power Center to the Party Committee*

The real power center of a company often rests with the executive team, not the board of directors. Even though the company laws of almost all jurisdictions vest the supreme operational power to the board of directors, the reality is that the board of directors largely delegates this power to the executives, in particular, the power to handle daily operational affairs. The limited number of board meetings held annually is telling. In China, listed commercial banks convene around ten board meetings annually.[132] Most directors, with the exception of the executive directors and some special non-executive directors, only work on a part-time basis.[133] In light of the limited time devoted to the bank, the board of directors, at most, decides the major operational issues. It does not manage the operation of the bank on a day-to-day basis.

Similar to other jurisdictions, the corporate organ in charge of the daily operation of a Chinese commercial bank is the executive team. In China, this

[132] Looking at the five largest Chinese Commercial Banks in 2016: ICBC convened eight board of director meetings, CCB convened seven, ABC convened fourteen, BOC convened eleven, and BoCom convened eight.

[133] The Guidance on Corporate Governance of Commercial Banks hints that independent directors of commercial banks are only expected to work for fifteen to twenty–five business days a year at the bank. *See* Guidance on Corp. Governance of Com. Banks, *supra* note 65, art. 55.

executive team generally includes the board chairperson, the supervisory board chairperson, the CEO, other executive directors, vice presidents, and other senior managers. In law, the board of directors possesses the power to design operational policies for the bank, delegate the implementation to the executive team, hear reports from the executive team on the implementation, and monitor the performance of the executive team.[134] In practice, as the board of directors can only devote limited time, it is the executive team that drafts the operational policies and plans for the board of directors' approval. It is this team that really manages and makes most of the operational decisions for the bank. The board of directors plays at most an advisory or monitoring role.

To be fair, the above practice is not exclusive to China.[135] The special practice in China, however, is that the party-state captures the executive team. In Chinese commercial banks, most members of the executive team are often simultaneously the members of the bank's party committee. The board's chairperson is often the party committee's secretary,[136] the CEO is often the party committee's deputy secretary, and the supervisory board's chairperson and other vice presidents are often party committee members.[137] For instance, take the Industrial Bank, the sixth largest commercial bank in China in 2016, the secretary of the bank's party committee was the bank's chairperson Gao Jianping,[138] while other party committee members included the CEO Tao Yiping, the chairperson of the supervisory board Jiang Yunming, and the vice presidents Chen Jinguang, Xue Hefeng, Chen Xinjian, Li Weimin, and Sun Xiongpeng.[139]

In appearance, this arrangement reduces the conflict between the party system and the corporate system. As mentioned above, sometimes the division between corporate affairs and party affairs can be ambiguous, which leads to an unclear division of works between the corporate system and the party system. By delegating both the corporate works and party works to the same

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[134] *Id.* arts. 19(1), 40, 41.

[135] It is a universal practice in other jurisdictions such as the United States. *See, e.g.*, Nicola Faith Sharpe, *Process over Structure: An Organizational Behavior Approach to Improving Corporate Boards*, 85 S.C. L. REV. 261, 269–74 (2012).

[136] An increasing number of banks have institutionalized this practice by amending their articles of incorporation which mandate that the chairperson and the party committee's secretary shall be assumed by the same person. *See*, *e.g.*, ICBC'S ARTICLES OF INCORPORATION, *supra* note 111, art. 52.

[137] *See* Howson, *supra* note 23, at 142–43; STENT, *supra* note 23, at 49.

[138] INDUSTRIAL BANK, XINGYE YINHANG GUFEN YOUXIAN GONGSI 2016 NIAN NIANDU BAOGAO (兴业银行股份有限公司 2016 年年度报告) [ANNUAL REPORT OF 2016] 91 (2017).

[139] *Id.* at 91–96.

group of people, i.e., the executive team (or the party committee), this arrangement streamlines the decision process inside commercial banks. By virtue of this arrangement, the CCP can also nominally preserve its ideology that the party must penetrate in every economic unit while avoiding jeopardizing the decisional efficiency of commercial banks.

In this context, an entity's control over the board of directors of a commercial bank does not infer control over that commercial bank *per se*. It is the control over the executive team (or the party committee) that counts.

2. The Party System's Capture of the Power Center

In most companies with concentrated ownership, whether the power center rests on the executive team or the board of directors is not a significant problem because, in either case, the control ultimately rests on the controlling shareholders. This is because the shareholders' meeting possesses the power to appoint directors, while the board of directors, in turn, possesses the power to appoint and dismiss the executive team and determine their compensation. Under this setting, a controlling shareholder naturally dominates the board of directors and thus dominates the executive team and the company. In other words, the controlling shareholder's control over the board of directors generally equates with its control over the executive team and the company.

As illustrated above, China adopts the same rule in its corporate laws as well. The practice, however, does not work as planned, thanks again to the unique party-state system in China. The crucial difference between China's system and other jurisdictions is that China *de facto* assigns the power to appoint and dismiss the executive team to the party system, not the board of directors. The Company Law indeed assigns this power to the board of directors.[140] In Chinese commercial banks, however, as illustrated above, members of the executive team wear two hats: the executive hat under the corporate system and the party committee hat under the party system. Accordingly, in addition to the Company Law, CCP's Charter also applies to the appointment, dismissal, reward, and promotion of these members. In addition, the party system often exercises the *de facto* power to appoint, dismiss, and reward the executive team, i.e., the party committee.

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[140] Company Law, *supra* note 51, art. 113.

a. The Power to Appoint

In practice, the appointment process adopted by the party system differs from the design provided in the CCP's Charter.[141] According to the CCP's Charter, all party members in the commercial bank elect the party committee members through the party members' meeting. In practice, however, the superior party system, in particular, the organizational department of the superior party system, appoints the party committee members. To illustrate in detail, for the five SOCBs, which are institutions at the central level, the Central Organization Department appoints their executives.[142] For city commercial banks ("CCBs") and rural commercial banks ("RCBs"), which are institutions at local levels, the organization departments of the local party system that the bank belongs to appoint most of their executives.[143] JSCBs, the second-tier national banks in China, are relatively tricky. For local banks (e.g., Shanghai Pudong, Industrial, Zheshang, Bohai), the appointment power rests on the organization departments of that local party system.[144] For others that are part of a central SOE business group (e.g., CITIC), the appointment power rests on the party system within that SOE.[145] In some tricky cases, in particular the Merchant Bank and China Minsheng Bank, the appointment power rests with the CBRC.[146]

To be fair, the party system does not completely ignore the appointment rules of related corporate laws. To harmonize these corporate laws with the party regime, the CCP at least "formally" complies with these laws. For instance, in the case of a CEO, when there is an open seat the selection process does not start from the board of directors or the nomination committee of the commercial bank. Instead, the party system takes charge. It selects potential candidates from its database of human resources, which extends to not only the senior managers of the bank itself, but also those from other banks or even officials of the governmental branches. Once it reaches a decision, it notifies corresponding corporate organs of the commercial bank to perform the

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[141] *See* STENT, *supra* note 23, at 47.

[142] LIU PENG (刘鹏), ZHONGGUO SHANGYE YINHANG BIANGE YU ZHUANXING: JINJI SHICHANGHUA ZHONG SHANGYE YIHANG DE ZUOYONG YU KE CHIXU FAJAN (中国商业银行变革与转型：经济市场化中商业银行的作用与可持续发展) [THE REFORM AND TRANSFORMATION OF CHINESE COMMERCIAL BANKS: THE ROLE AND SUSTAINABLE DEVELOPMENT OF COMMERCIAL BANKS IN PROCESS OF ECONOMIC MARKETIZATION] 170 (2014).

[143] *Id.*

[144] *Id.*

[145] *Id.*

[146] *Id.*

appointment process required by corporate laws, such as the nomination committee's meeting and the board of directors' meeting. Candidates "recommended" by the party system are almost always approved. In this way, the appointment process of this CEO formally complies with all the procedural requirements mandated by corporate laws. In reality, however, these corporate organs do not make the appointment decision; the party system does.

b. The Power to Dismiss

The party system also possesses the power to dismiss bank executives as needed. Dismissals can involve corruption, scandals, breach of party discipline, or simply poor management.[147] To harmonize with corporate rules, in practice the party system rarely orders a dismissal. Instead, it would have the executive resign from his or her post. In this way, the party system can refrain from formally infringing the dismissal power of the board of directors.

Since General Secretary Xi strengthened the crackdown on corruption and discipline violations in recent years, the party system has sent an increasing number of bank executives to the discipline investigation. Between August 2014 and July 2015, it put more than fifteen bank vice presidents or senior executives under the discipline investigation, including the former CEO of China Minsheng Bank, the former vice president of Huaxia Bank, the former chairperson of China Guangfa Bank, and the former chairperson of Bank of Chengdu.[148] The most high-profile case in recent years took place in November 2015, which involved the CEO of ABC, Zhang Yun. Before the conclusion of the investigation, the party had already demoted his party ranking.[149] In December, he also resigned from all his positions in ABC.

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[147] STENT, *supra* note 23, at 51.

[148] Li Yumin (李玉敏) & Zhang Jie (张杰), *Yi niannei yinhang ye chao bairen yina tan fu luoma zhihang zhang zhan bi wu cheng* (一年内银行业超百人因贪腐落马 支行长占比五成) [*More Than A Hundred of People in the Banking Industry Went Down in One Year due to Corruption, The Head of Sub-branches Took Fifty Percent of Them*], 21ST CENTURY BUS. HERALD (21 世纪经济报道), Aug. 2, 2015.

[149] Li Weiau (李微敖), *Nong hang hang zhangzhang yun jiangji ceng zao yuan fu xing zhang yanghun dang ting jubao* (農行行長張雲降級 曾遭原副行長楊琨當庭舉報) [*The CEO of ABC, Zhang Yun, Was Demoted, He Used to be Reported by the Former Vice President Yang Kun on Trial*], SOUTHERN WKLY. (南方周末), Nov. 2, 2015.

c. The Power to Reward and Promote

The party system often promotes bank executives to a higher or more glamorous position within its system as a way to reward their performance and incentivize their cooperation. This includes intra-bank promotion, inter-bank promotion—sometimes referred to as parachuting—or even bank-to-government promotion. Sometimes a party system might find an empty post which could be anywhere: in a commercial bank, a non-bank financial institution, or even a government branch. If it finds a bank executive the best candidate for that post, it could have him or her resign from his or her current bank and promote him or her to that empty post. In this case, sometimes the bank would disclose that the departure of specific top executive results from "job transfer."

Both intra-bank and inter-bank promotions are frequent in recent years. The recent change of ICBC's chairperson and CEO is illustrative of intra-bank promotions. In 2016, the former ICBC chairperson Jiang Jianqing retired from his post; since then, the Central Organization Department of the CCP conducted an on-site meeting and study in ICBC.[150] In May 2016, it decided to promote ICBC's then-CEO Yi Huiman to the post of chairperson and secretary of the party committee.[151] As this promotion left the post of CEO empty, the Central Organization Department in September 2016 decided to promote the ICBC's then-vice president Gu Shu to the post of CEO.[152] The recent change of ABC's chairperson serves a good example of an inter-bank promotion. In December 2015, ABC's former CEO Zhang Yun resigned from his post due to the accusation of corruption; after that, the Central Organization Department of the CCP decided to promote Zhao Huan, the CEO

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[150] Wan Min (万敏), *Zhong zu bu renming yihui man wei gongxing dangwei shuji jiang jiren dougshi zhang* (中组部任命易会满为工行党委书记 将接任董事长) [*The Central Organization Department Appoint Yi Huiman as the Party Committee Secretary of ICBC, Will Assume the Chairperson*], NAT'L BUS. DAILY (每日经济新闻), May 16, 2016.

[151] *Id.*

[152] Zhang Wei (张威), *Shengeng gongxing shiba nian gu shu jieren xin yiren xing zhang* (深耕工行十八年 谷澍接任新一任行长) [*Working Hard in ICBC for Eighteen Years, Gu Shu Will Become the Next CEO*], CAIJING (财经), Sept. 12, 2016.

of Everbright Bank, from a JSCB to an SOCB to fill this post.[153] Other high-profile promotions in recent years include the promotion of ABC's Chairperson Liu Shiyu to serve as CSRC's chairperson, the promotion of ICBC's vice president Zheng Wanchun to serve as China Minsheng Bank's CEO, and the promotion of BOC's vice president Zhu Hexin to serve as the deputy provincial governor of Sichuan Province.

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Without the personnel powers articulated above, the monitoring function of the board of directors, if any, is weak. The board of directors of Chinese commercial banks can still conduct audits, review the interested transaction, and supervise internal control.[154] Nevertheless, it has limited teeth to enforce these actions against bank executives. Moreover, it has to share some of these powers with the party system. For instance, the party system also controls the party discipline inspection committee in each commercial bank, which inspects the legal compliance and interested transactions of bank executives. Backed by the CCP's discipline system, the party discipline inspection committee possesses even sharper teeth to enforce the discipline inspection. Accordingly, the function of the board of directors in Chinese commercial banks is *supervisory in statute but advisory* in nature: it can supervise bank executives in certain aspects, but since it has limited tools to enforce its supervision, its supervision is more like advice to the real supervisor, i.e., the party system.

The executive team is further capable of influencing the appointment of board members. As mentioned above, the board member candidates are selected by the nomination committee and then recommended by the board of directors to the shareholders for their approval. In practice, however, the executive team captures the selection process. This is particularly the case for

[153] Li Weiau (李微敖), *Guang dayuan xing zhang zhougguo nongxing qianren bei jiangji* (光大原行长赵欢掌中国农行 前任被降级后辞职) [*The Former CEO of Everbright, Zhao Huan, Manage the ABC, The Former Resigned after Demoted*], SOUTHERN WKLY. (南方周末), Jan. 15, 2016.

[154] It is also reported that the board of directors is allowed to veto the proposals made by the executive team, i.e. the party committee. Howson, *supra* note 23, at 140–41.

the selection of independent directors.[155] After the executive team, backed by the party system, selects the directorate candidates, the board of directors and shareholders typically have no choice but to accept the nominated candidates. In the end, these board meetings and shareholders' meetings only possess nominal election power—the real power rests with the executive team and the party system behind it.[156]

The board of supervisors is equally weak or even weaker. For instance, similar to the board of directors, the executive team/party committee generally dominates the selection of supervisor candidates. This compromises the independence of the board of supervisors. In addition, except for employee supervisors, commercial banks do not have full-time executive supervisors. This limits the time and resources available to the board of supervisors for effective supervision. Furthermore, many internal audit divisions of commercial banks report directly to the CEO, while the board of supervisors can only gather necessary information by hearing reports from the executive team.[157] Within this setting, an effective system of checks and balances against the executive team are largely unavailable.

3. The Separation of Ownership from Control

Under this governance practice, shareholders play an extremely marginalized role, regardless of whether or not they are the majority, or whether or not they are governmental entities. Despite their dominant equity ownership and board seats, shareholders do not have real say over the personnel or operational decisions of their banks. Even if a shareholder is a

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[155] *See* Cheng Xiaoping (程小平), *Woguo shangye yinhang donshihui zhili cunzai wenti yu duice* (我国商业银行董事会治理存在问题与对策) [*The Problems of and Solutions for the Board Governance in China's Commercial Banks*], 30 MODERN BUS. (现代商业) 31, 32 (2013).

[156] To be sure, this approach is similar to that adopted by the U.S. executive-controlled companies for influencing the selection of independent directors. *See generally* Richard Clune et al., *The Nominating Committee Process: A Qualitative Examination of Board Independence and Formalization*, 31 CONTEMP. ACCT. RES. 748 (2014) (conducting qualitative studies on to what extent the CEOs of U.S. companies intervenes in the decision of nominating committees and to what extent are committee processes formalized); For an account of the evolution and status quo of nominating committees in the United States, see generally Michael E. Murphy, *The Nominating Process for Corporate Boards of Directors: A Decision-Making Analysis*, 5 BERKELEY BUS. L.J. 131, 144–51 (2008) (detailing the process for nominating the board members in U.S. companies).

[157] *See* LIU, *supra* note 142, at 169–70.

state agency and possesses majority shares, it is the party system behind that agency that possesses the power, not that agency itself.

The only privilege left to shareholders is the power to appoint non-executive directors who are not independent directors, also known as "shareholder directors" in China. That said, only shareholders holding 3% or more of voting shares can nominate representative directors.[158] In the majority of instances, the party system respects the right of major shareholders to nominate their directorial candidates and allows them to have those seats on the board of directors. Consequently, major shareholders may indirectly participate in the direction of the bank's major policies and share the supervisory/advisory function of the board of directors, which more or less protects the interest of shareholders.[159] Nonetheless, these shareholder directors are far away from the real power center. Most importantly, neither these shareholder directors nor major shareholders possess the real power to appoint, dismiss, or reward the executive team. Their supervision is essentially toothless.

C. Some Case Studies of the Bank Governance Practice in China

1. The Big Four and a Half

Because the SOCBs are the largest type of banks and control 37.3% of bank assets in China,[160] the CCP maintains the tightest control over these banks. Cases of the SOCBs thus best illustrate the "Huijin Model" and how the Chinese party-state intervenes in the corporate governance of Chinese commercial banks. Table 1 summarizes the ownership structure, board composition, and senior management of the five SOCBs.

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[158] Guidance on Corp. Governance of Com. Banks, *supra* note 65, art. 45(1).

[159] For instance, when deliberating the direction of the bank's major policies in the board meeting, the shareholder directors designated by major shareholders may raise dissidents or even vetoes against the proposal made by the executive team.

[160] CBRC 2016 REPORT, *supra* note 32, at 27.

Table 1: Ownership Structure, Board Composition, and Senior Management of SOCBs (2016)

Name	Major Shareholders	Board Composition	Executive Composition
ICBC	Huijin (34.99%) MOF (34.6%)	4 executive directors 5 shareholder directors (3 Huijin, 2 MOF) 5 independent directors	Board Chairperson: Internally Promoted CEO: Internally Promoted Supervisory Board Chairperson: Parachute Vice Presidents: 1 Internally promoted, 4 Parachute
CCB	Huijin (57.31%)	4 executive directors 3 shareholder directors (all Huijin) 6 independent directors	Board Chairperson: Parachute CEO: Parachute Supervisory Board Chairperson: Parachute Vice Presidents: 4 Internally promoted, 1 Parachute
ABC	Huijin (40.03%) MOF (39.21%)	3 executive directors 6 shareholder directors (all Huijin) 5 independent directors	Board Chairperson: Parachute CEO: Parachute Supervisory Board Chairperson: Parachute Vice Presidents: 1 Internally promoted, 3 Parachute
BOC	Huijin (64.63%)	4 executive directors 4 shareholder directors (all Huijin) 5 independent directors	Board Chairperson: Parachute CEO: Internally promoted Supervisory Board Chairperson: Parachute Vice Presidents: 2 internally promoted, 3 parachute
BoCom	MOF (26.53%) *HSBC (19.05%)* Social Security Fund (14.71%)	4 executive directors 8 shareholder directors (3MOF, 1 SSF, 2 *HSBC*, 1 China Tobacco, 1 Capital Airport) 6 independent directors	Board Chairperson: Parachute CEO: Parachute Supervisory Board Chairperson: Parachute Vice Presidents: 2 Internally promoted, 2 Parachute

Note: Italics indicate that the shareholder is a foreign strategic investor.

From their ownership structure and board composition, one may mistakenly perceive that the central government controls these SOCBs. As

Table 1 indicates, the central government, through either the Central Huijin or the MOF, is the controlling shareholder of all five SOCBs. In the case of Bank of Communications ("BoCom"), it also has a private block-holder HSBC, which is a foreign strategic investor that holds more than 5% ownership. The SOCBs' board composition, in general, replicates their ownership structure. As Table 1 indicates, on the board of directors of each SOCB, executive directors occupy only the minimum number of seats, while independent directors take slightly more than one-third of seats. The state controlling shareholder takes almost all of the remaining seats, leaving only two seats to foreign strategic investors in the case of BoCom.[161]

That is not the case, however. In practice, although the Central Huijin and/or the MOF is the majority shareholder and takes almost all the board seats, neither of them controls the personnel power of any of these SOCBs. Instead, the power to appoint and dismiss the executives of SOCBs rests on the CCP's central party system, the Central Organization Department.[162] For instance, when the ICBC's chairperson and CEO positions were vacant in 2016, neither the Central Huijin nor the MOF intervened in searching for replacements. Rather, the Central Organization Department conducted on-site interviews of potential candidates and reached its own decision for the new chairperson and CEO.[163] The same happened in the case of ABC as mentioned above.[164]

The SOCB's executive composition further reveals the Central Organization Department's frequent intervention in the SOCBs' personnel decisions. As Table 1 summarizes, among the five SOCBs, none of them has a majority of executives originating from internal promotions. Only the ICBC's board chairperson and CEO were both internally promoted. The executives of other SOCBs, including their board chairpersons and CEOs, mostly parachuted from other state banks or governmental agencies. Such a high rate of parachutes results from the "invisible" hand behind the scene, i.e.,

[161] This has suggested the limited role of foreign capital in the corporate governance of SOCBs. *See* Howson, *supra* note 23, at 137–39.

[162] STENT, *supra* note 23, at 42.

[163] Wan, *supra* note 150; Zhang, *supra* note 152.

[164] Li, *supra* note 153.

the Central Organization Department, which frequently rotates bankers and government officials.[165]

This party-state-operated governance practice nullifies the very purpose of incorporating the Central Huijin. By incorporating the Central Huijin to hold the state's ownership on the state's behalf, Chinese reformers envisaged a state holding company model, which was meant to create a business-oriented entity comprised of commercial professionals to sever the direct command and order imposed by the government on SOCBs.[166] The Central Huijin formally adopts this model, but it is a completely different picture in substance. Instead of consisting of business professionals, the executive team of the Central Huijin remains controlled by political elites.[167] In addition, the Central Huijin can only appoint its representatives to serve as non-executive directors of the SOCBs, which in no way transforms into real control over the SOCBs' operations.

What is left to Central Huijin is some marginal supervisory or advisory functions.[168] To the extent that it controls a significant number of seats on the SOCBs' board of directors, it possesses the venue to voice its concerns about SOCBs' operation or performance. Statistics show that Central Huijin's shareholder directors raise more dissenting opinions and vetoes than independent directors on the SOCBs' boards of directors,[169] which suggests that the Central Huijin more or less supplements the monitoring role of independent directors. That said, it can at most monitor the personal misbehavior of the executive team itself. It can do little if the mismanagement results from misdirection from the central party system.

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[165] The criteria for the Central Organization Department to appraise bank executives should include "achievement of growth and profitability goals, avoidance of risk and losses, and implementation of national and Party policy guidelines, economic and non-economic, and, of course, adherence to Party discipline." STENT, *supra* note 23, at 114.

[166] The most famous case adopting this state holding company model is Singapore's Temasek Holding.

[167] For instance, Central Huijin's current deputy chairperson Li Jiange had his career mainly in the State Council. Two vice presidents had their career in the MOF and CSRC, respectively. Only the CEO, Bai Tao, appears to be more business-oriented, who had his career mainly in the ICBC.

[168] See STENT, *supra* note 23, at 157–58, for a similar observation.

[169] *Gao Xiging: hunhe suoyouzhi shi due quoyu zichan jinxing zhiyue* (高西庆：混合所有制是对国有资产进行制约) [*Gao Xiqing: Mixed Ownership is to Restrain State–owned Asset*], SINA FIN. (新浪財經), Nov. 26, 2014.

2. *China Minsheng Bank*

The case of China Minsheng Bank ("CMB") best illustrates the omnipresence of the party system. It shows how the Chinese party-state penetrates a major Chinese commercial bank even though it does not control any significant ownership or directorship.

Unlike most large Chinese commercial banks, CMB is a privately-owned bank listed on the Shanghai Stock Exchange and Hong Kong Stock Exchange. By the end of 2016, its largest shareholder was Anbang Insurance, which held 17.84% ownership, followed by the coalition of Orient Group and Huaxia Life (5.74%), the China Oceanwide Group (4.61%), New Hope Group (4.41%), and Fosun International (2.22%).[170] All of these shareholders are private companies or institutions. Under this ownership structure, the Chinese party-state in no way controlled CMB in appearance.

CMB's board composition also seems to be dominated by private capital. As of 2016, its board of directors consisted of seventeen directors, including three executive directors, nine shareholder directors, and six independent directors.[171] The state shareholder did not appoint any representatives to the board of directors. Instead, each of the nine shareholder directors was affiliated with a private shareholder.[172] Furthermore, no single shareholder dominated the board of directors. Rather, the seats of shareholder directors were distributed equally among the major private shareholders.[173] With this composition, CMB's board of directors seemed controlled by private capital instead of the party-state.

The Chinese party-state, however, found a different way to penetrate CMB's operation and executive appointments. CMB is a national bank that falls within the jurisdiction of the central party system. In the past, the CCP's Central Financial Works Committee ("CFWC") within the central party

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[170] CMB, ZHONG GUO MINSHENG YINHANG 2016 NIAN NIANDU BAO GAO (中國民生銀行 2016 年年度報告) [ANNUAL REPORT OF 2016] 75–77 (2017).

[171] *Id.* at 86–87.

[172] *Id.* at 90–93.

[173] *Id.*

system took charge of CMB's personnel decisions.[174] After the CFWC was dissolved, the CBRC's party committee took over its main tasks.[175] Therefore, unlike other banks where the CBRC is merely a regulator that reviews and approves the elected executive candidates on an *ex-post* and fit and proper basis, the CBRC engages deeper in the appointment process on an *ex-ante* and merit basis. The CBRC sets the appointment standards at the beginning of the appointment process and asks the board of directors to abide by its standards when selecting potential candidates.[176] It further recommends the candidate it prefers to CMB's board of directors and asks CMB to appoint the CBRC's candidate. In this way, the CBRC dominates the executive appointment process of CMB.[177]

The appointment of CMB's current CEO Zheng Wanchun best illustrates the CBRC's dominance. In January 2015, after the CCP started to investigate CMB's former CEO Mao Xiaofeng for his breach of discipline, the CBRC dismissed him from his position as CMB's CEO and party committee secretary.[178] This left the post of CMB's CEO vacant. To search for the new CEO, a major shareholder, who was also a former shareholder director, publicly recommended that CMB should select candidates through public recruitment.[179] The CBRC, however, did not adopt this recommendation. Instead, it conducted its selection process secretly.[180] Since Zheng was the vice president of ICBC at that time, the CBRC also privately

174 *Zhongguo minsheng yinhang qian dangwei fu shuji linkeping; cong wu dao you* (中国民生银行前党委副书记林克平：从无到有) [*CMB's Former Party Committee Vice Secretary Lin Keping: From Nothing to Something*], QQ FIN. (騰訊財經), Jan. 11, 2016.

175 For an introduction of the CFWC, see Sebastian Heilmann, *Regulatory Innovation by Leninist Means: Communist Party Supervision in China's Financial Industry*, 181 CHINA Q. 1, 17–18 (2005).

176 Merchant Bank also does this when it selects its CEO. Li Weiau (李微敖), *Zhaoshang yinhang dongshihui de 18 zhang yizi* (招商银行董事会的 18 张椅子) [*The Eighteen Chairs of the Merchant Bank's Board of Directors*], SOUTHERN WKLY. (南方周末), June 14, 2013.

177 Ge Jia (葛佳), *Minsheng yinhang xing zhang yi zili kong xuan bannian hou gongxing fu xingzhang zhengwanchun keneng kongjiang buque* (民生银行行长一职空悬半年后，工行副行长郑万春可能空降补缺) [*Half–year After the Vacancy of China Minsheng Bank's CEO, Zheng Wanchun, the Vice President of ICBC, Might Parachute and Fill the Vacancy*], SURGING NEWS (澎湃新闻), July 30, 2015.

178 *Id.*

179 *Id.*

180 *Id.*

consulted ICBC's opinion.[181] In October 2015, ICBC announced Zheng's resignation from his post in ICBC.[182] In November 2015, CMB's board of directors approved the appointment of Zheng as its new CEO.[183]

This case illustrates how powerless private capital is in appointing the bank's CEO, despite their absolute control of the majority of the board of directors. It also represents the epitome of the Crouching-Tiger-Hidden-Dragon practice that is prevalent among Chinese commercial banks. The Dragon, the party system, hides its dominance over the Great Wall Street well, while Tigers, private capital, can only crouch.

III. EXTERNAL GOVERNANCE OF CHINESE COMMERCIAL BANKS

Corporate governance is not only about the internal governance structure of a firm; it also concerns other external governance mechanisms such as market competition, governmental regulation, or hostile takeovers.[184] In addition, empirical studies have shown that some external governance mechanisms, such as robust market competition, advanced financial development, or transparent political institutions, may control the negatives of state ownership and improve the performance of state-owned banks.[185] Accordingly, although the Chinese party-state dominates the internal

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181 *Zheng Wanchun ciren gongxing fu xing zhang xiaoxi cheng jiang danzen minsheng yinhang xing zhang* (郑万春辞任工行副行长 消息称将担任民生银行行长) [*Zheng Wanchun Resigned ICBC's Vice President, Information Says He will Assume the CEO of CMB*], SOHU BUS. (搜狐财经), Oct. 22, 2015.

182 *Id.*

183 Song Yikang (宋易康), *Gong xing yuan fu xing zhang Zhang Wanchun jian chuzen minsheng yinhang xeng zhang jiyu yu tiao zhan bingcun* (工行原副行长郑万春将出任民生银行行长 机遇与挑战并存) [*ICBC's Former Vice President Zheng Wanchun Will Assume CMB's CEO, Opportunity and Challenge Both Exist*], CHINA BUS. NEWS (一财网), Nov. 20, 2015.

184 *See generally* Mark Roe, *The Institutions of Corporate Governance, in* HANDBOOK OF NEW INSTITUTIONAL ECONOMICS 371 (Claude Menard & Mary M. Shirley eds., 2005) (theorizing the institutions that can facilitate the corporate governance of firms, including internal and external institutions).

185 *See generally, e.g.*, Tobias Korner & Isabel Schnabel, *Public Ownership of Banks and Economic Growth: The Impact of Country Heterogeneity*, 19 ECON. TRANSITION 407 (2011) (finding that government ownership of banks is harmful to a country's financial and economic development only if a country has low financial development and low institutional quality); Svetlana Andrianova et al., *Government Ownership of Banks, Institutions and Economic Growth*, 79 ECONOMIA 449 (2012) (finding that government ownership of banks is actually positively correlated with the long-run growth rate of a country); Marcia Million Cornett et al., *The Impact of State Ownership on Performance Differences in Privately-owned versus State-owned Banks: An International Comparison*, 19 J. FIN. INTERMEDIATION 74 (2010) (studying the Asian Financial Crisis and finding that state-owned banks closed the gap with private banks in terms of cash flow returns, core capital, and nonperforming loans in the post-crisis period of 2001–2004).

governance of Chinese commercial banks, as long as China maintains other robust external governance institutions, it does not necessarily follow that these Chinese banks will perform poorly.[186] In this section, I explore the status of external governance on the Great Wall Street.

A. Growing Yet Distorted Market Competition

Market competition, specifically competition in the product market and the capital market, may incentivize corporate management to improve operational efficiency.

1. Oligopolistic Product Market

As of 2016, there were 4,399 banking institutions in China, including 5 SOCBs, 12 JSCBs, 134 CCBs, 1,114 RCBs, 8 private banks, 39 foreign banks, and 1 postal saving bank.[187] Undoubtedly, the degree of competition in China's banking market has increased significantly in the past four decades.

A closer examination of the composition of this market, however, still reveals the oligopoly of China's banking market. As of 2016, the 5 SOCBs still held over 37% of bank assets in China and dominated China's banking market.[188] Such an oligopoly, however, does not seem unbreakable. As Chart 5 indicates, the market share of SOCBs declined significantly from 55% in 2006 to 37% in 2015. In contrast, JSCBs grew by 51%, CCBs doubled in size, and RCBs grew 7.6 times larger.[189] If this trend continues, competition in China's banking sector might become more robust in the future.[190]

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[186] *See generally* Donald C. Clarke, *Law Without Order in Chinese Corporate Governance Institutions*, 30 NW. J. INT'L L. & BUS. 131 (2010) (illustrating the general corporate governance environment in China).

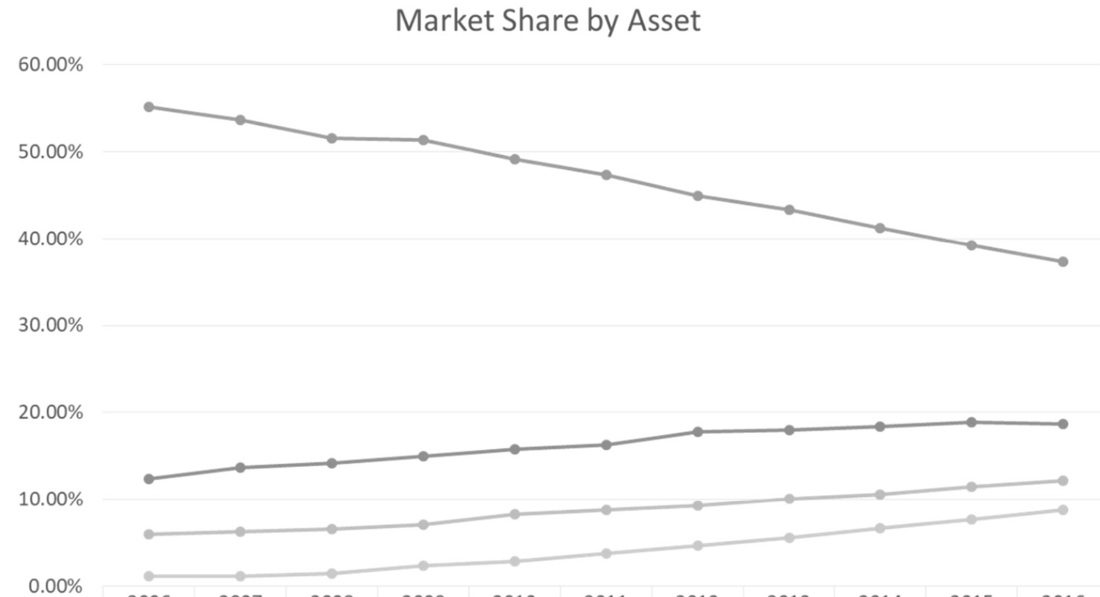
[187] CBRC 2016 REPORT, *supra* note 32, at 26–27.

[188] *Id.* at 27.

[189] *See id.* at 184.

[190] *See generally* BING XU ET AL., BANCO DE ESPANA, MEASURING COMPETITION IN CHINA: A COMPARISON OF NEW VERSUS CONVENTIONAL APPROACHES APPLIED TO LOAN MARKETS (2014) (analyzing the enhanced competition in China's bank lending market).

Chart 5: Market Share of Different Types of Banks (2006-2016)[191]



	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
SOCBs	55.15%	53.66%	51.58%	51.31%	49.20%	47.34%	44.93%	43.34%	41.21%	39.21%	37.28%
JSCBs	12.39%	13.69%	14.13%	14.99%	15.74%	16.31%	17.78%	17.95%	18.41%	18.83%	18.72%
CCBs	5.93%	6.29%	6.51%	7.09%	8.24%	8.79%	9.24%	10.04%	10.52%	11.48%	12.16%
RCBs	1.15%	1.15%	1.48%	2.34%	2.87%	3.70%	4.63%	5.56%	6.62%	7.62%	8.73%

That said, one should not overlook the fact that the CCP's party system dominates most Chinese commercial banks. Accordingly, in a more general sense, all Chinese banks are affiliates of each other to some extent. Except for some privately-operated and foreign banks, they share the same controller—the CCP. Under this CCP umbrella, they might still compete with each other based on market principles in ordinary times; however, if needed, the CCP can also easily coordinate their behaviors. The recent collusion between twenty-nine banks in Zhejiang to agree on a ceiling deposit rate in 2016 suggests that the CCP can intervene to inhibit market competition.[192]

[191] *See* CBRC 2016 REPORT, *supra* note 32, at 184.

[192] In September 2016, up to 29 banks in Zhejiang entered into a "self-discipline agreement on deposit rate pricing," in which they agreed on a set of ceiling rates for different types of deposits. Some market observers suspected that such "self-discipline agreement" was, in fact, the result of the regulators' implicit mandate. Bao Hui (包慧), *Zhejiang 29 jia yinhang dingli cunkuan lilu gongshou tongmeng shangfu zuigao bu chao 40%* (浙江 29 家银行订立存款利率攻守同盟 上浮最高不超 40%)[*29 Banks in Zhejiang Agreed on an Alliance in Deposit Rate, The Upper Limits Will not Float above 40%*], 21ST CENTURY BUS. HERALD (21 世纪经济报道), Sept. 14, 2016.

In addition, the undersupply of banking services in China also distorts the market competition. As of 2016, the number of commercial bank branches per 100,000 adults was only 8.8 in China.[193] This was not only significantly lower than that of other advanced countries such as Japan (34.1), United States (30.1), South Korea (16.3), or Germany (13.5)[194] but also significantly lower than that of major emerging countries such as Russia (30.1), Brazil (20.4), or India (14.1).[195] This suggests that despite the huge size of banks, banking service remains under-supplied in China. In other words, there is a supplier's market under which banking service suppliers like Chinese commercial banks possess more bargaining power and dominate the supply-demand relationship. In this case, the restraint that product market and market consumers can impose on bank executives, if any, is limited.

2. Restricted Capital Market

Competition in China's capital market is generally limited. Specifically, China still maintains the prior approval requirement governing any IPOs on China's stock exchanges,[196] which significantly restricts the access of Chinese commercial banks to the capital market in the following ways.

First, the timeline for the Chinese Securities Regulatory Commission ("CSRC") to approve the listing application of Chinese commercial banks is highly ambiguous. As of 2017, there were twenty-five commercial banks listed on China's stock exchanges. In 2016, the CSRC approved the listing of eight commercial banks, and it approved another one in 2017. This listing wave, however, was after a long wait. Taking the Bank of Jiangsu as an example, the Bank of Jiangsu declared its intention to hold an IPO on the Shanghai Stock Exchange in 2007. In 2010, after series of back and forth, the CSRC finally accepted its application and sent the application for deliberation. After that, however, the CSRC was silent for five years. On July 1, 2015, the

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[193] *Commercial Bank Branches (Per 100,000 adults)*, WORLD BANK OPEN DATA, http://data.worldbank.org/indicator/FB.CBK.BRCH.P5?contextual=default&locations=CN--US-JP-DE-KR-IN-FR-RU-BR (last visited Jan. 24, 2018).

[194] *Id.*

[195] *Id.*

[196] ZHENGQUAN FA (证券法) [LAW ON SECURITIES] (promulgated by the Standing Comm. Nat'l People's Cong., Oct. 27, 2005, effective Jan. 1, 2006), art. 10, CLI.1.60599(EN) (Lawinfochina).

CSRC finally announced that it had approved the application.[197] On July 4, 2015, however, fearing that new IPOs might aggravate the collapsing stock market in China,[198] the Shanghai Stock Exchange and Shenzhen Stock Exchange both announced that they would suspend all ongoing IPOs.[199] This moved the Bank of Jiangsu back to the CSRC's listing waitlist. Only in November 2015 did the CSRC again announce that Bank of Jiangsu passed its listing approval and bring it back to the IPO process again.[200] In August 2016, after a long wait of six years, the Bank of Jiangsu finally accomplished its IPO in the Shanghai Stock Exchange. This case reflects the lengthy and uncertain IPO process in China's stock market, which constitutes an entry restriction that precludes fair competition for capital between banks.[201]

Second, even if it approves the IPO application, the CSRC intervenes in the terms and conditions of IPOs, including the IPO volume. In the case of the Bank of Jiangsu, it initially planned to issue around 2.6 billion shares and raise around RMB 16 billion but, in the end, it only issued 1.15 billion shares

[197] Tang Qiang (唐强), *Liu jia gongsi IPO guo hui san zhi yingzi gu cangshen jiangsu yinhang* (六家公司 IPO 过会 三只影子股藏身江苏银行) [*Six Companies Pass the IPO Approval, Three Shadow Shareholders Hide Behind the Bank of Jiangsu*], NAT'L BUS. DAILY (每经网), July 2, 2015.

[198] The fear was that new IPOs might attract some of the investment funds in China's stock market, which might, in turn, result in the withdrawal of investment from the already-listed Chinese public companies and lead to sale pressure of these stocks. This would render the stock price of China's stock market continue going down.

[199] Chen Yang (陈扬), *Jiangsu yinhang shangshi zai yu bianliang ji bu ziben jin jihua geqian* (江苏银行上市再遇变量 急补资本金计划搁浅) [*The Listing of Bank of Jiangsu Face Changes Again, Its Plan to Replenish Capital Suspended*], BEIJING NEWS (新京报), July 13, 2015.

[200] Zhao Shiyong (赵士勇), *Jiangsu yinhang IPO erguofa shen hui shi ge ba nian cheng shanghang shangshi qihang* (江苏银行 IPO 二过发审会 时隔八年城商行上市起航) [*The IPO of Bank of Jiangsu Pass the Review for the Second Time, The Listing of City Commercial Banks Sail After Eight Years*], CHINA TIMES (华夏时报), Nov. 19, 2015.

[201] That was why many city commercial banks turned to list in Hong Kong in the 2010s. Examples included Bank of Chongqing, Bank of Huishang, Bank of Harbin, Bank of Shengjing, Bank of Jinzhou, Bank of Qingdao, Bank of Zhengzhou. *See* Cui Qibin (崔启斌) & Zou Chenghui (邹晨辉), *Cheng shanghang zaixin "qi A zhuan H" chao zhengzhou yinhang ni zai gang shangshi* (城商行再现"弃 A 转 H"潮 郑州银行拟在港上市) [*A Trend of "Abandoning A and Shifting to H" Reemerges among City Commercial Banks; Bank of Zhengzhou Planned to List in Hong Kong*], BEIJING BUS. DAILY (北京商报), Oct. 13, 2015.

and raised RMB 7.24 billion.[202] Similar situations also happened with other commercial banks listed in 2016: Wuxi Rural Commercial Bank initially planned to issue 550 million shares but ultimately only issued 190 million shares.[203] Jiangyin Rural Commercial Bank initially planned to issue 400 million shares but ended up only issuing 210 million shares.[204] Changsho Rural Commercial Bank initially planned to issue 350 million shares but, in the end, only issued 220 million shares.[205] CSRC reduced their issuance volume out of the concern that large-scale IPOs might divert investment and crash the stock market price in China. Such intervention, however, limits the fundraising of Chinese commercial banks. It also distorts the stock market in China and limits the corporate governance function of capital markets.

In addition to the above, the Chinese party-state also intervenes in the capital market by manipulating stock prices. In the stock market collapse of July 2015, the Chinese party-state, through the China Securities Finance Company as well as a large number of securities firms,[206] injected a huge amount of funds to keep the stock market from collapsing. A large proportion of the injected funds flowed to the banking stocks. As of September 2015, China Securities Finance Company had purchased stocks of fourteen listed banks, including 2.99% of the stock of Shanghai Pudong Bank, China Minsheng Bank, Everbright Bank, Huaxia Bank, BoCom, Ping An Bank, Industrial Bank, and Bank of Beijing.[207] Central Huijin also increased its shareholding in the SOCBs.[208] It was estimated that China Finance Company and Central Huijin invested around RMB 357 billion in purchasing stock of listed banks and insurance companies.[209] While these market support

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[202] Jan Xing (占昕), *Qi jia defang yinhang miji shangshi duoshu yinhang mu zi jihua dafu soshui* (七家地方银行密集上市 多数银行募资计划大幅缩水) [*Seven Local Banks Intensively List, The Financing Plan of Most Banks Shrinks Significantly*], INVESTOR CHINA (投资者报), Oct. 9, 2016.

[203] *Id.*

[204] *Id.*

[205] *Id.*

[206] Dai Ruifen (戴瑞芬), *Li Keqiang dongyuan 21 juanshangjiu A gu* (李克強下令 動員 21 券商救 A 股) [*Li Keqiang Orders: Mobilizing Twenty-one Securities Firms to Save the A-Stock*], ECON. DAILY (經濟日報), July 5, 2016.

[207] *Zheng jin yu huijin chizi shu qian yi mai ru shisi jian yinhang he xian qi* (证金与汇金斥资数千亿买入十四家银行和险企) [*Securities Finance and Central Huijin Spend Hundreds of Billions to Purchase Fourteen Banks and Insurance Companies*], 21ST CENTURY BUS. HERALD (21 世纪经济报道), Nov. 4, 2015.

[208] *Id.*

[209] *Id.*

measures might be necessary for preventing financial crisis in China, they distorted the fair competition in the stock market. Specifically, they discouraged listed banks from being concerned with their business performance, which created moral hazards in China's stock market.

B. Paternalistic Regulatory Environment

The relationship between banking regulations and bank governance can be a double-edged sword. On the one side, banking regulations and bank governance complement each other.[210] On the other side, banking regulation can also pose unique issues that plague bank governance.[211]

The banking regulatory system in China has been gradually converging toward international best practices standards. For instance, China has adopted most of the best practices recommended by the Basel III Principles.[212] These risk-based standards, to some extent, provide a safeguard to Chinese commercial banks against the request from the Chinese party-state. For example, when asked by the Chinese party-state to cooperate with a state policy, they might be able to refuse it by justifying that the policy mandate

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[210] Peter O. Mulbert, *Corporate Governance of Banks after the Financial Crisis – Theory, Evidence, Reforms* 25–26 (Eur. Corp. Governance Inst., Working Paper No. 130, 2010), https://ecgi.global/sites/default/files/working_papers/documents/SSRN-id1448118.pdf. *See also* Renee Adams & Hamid Mehran, *Is Corporate Governance Different for Bank Holding Companies*, 9 ECON. POL'Y REV. 123 (2003); Dirk Heremans, *Corporate Governance Issues for Banks: A Financial Stability Perspective* 8 (Ctr. For Econ. Stud. Working Paper, 2007), https://papers.ssrn.com/sol3/papers.cfm?abstract_id=1024693; Dirk Heremans & Katrien Bosquet, *The Future of Law and Finance after the Financial Crisis: New Perspectives on Regulation and Corporate Governance for Banks*, 2011 U. ILL. L. REV. 1551, 1568 (2011).

[211] For instance, deposit insurance mechanism creates the well-known moral hazard problems, under which depositors have little incentive to monitor banks. Ross Levine, *The Corporate Governance of Banks: A Concise Discussion of Concepts and Evidence* 10–11 (World Bank Policy Research, Working Paper No. 3404, 2004) (summarizing three characteristics of banks, including that banks are opaque and heavily regulated and widely involve government ownership); Jonathan R. Macey & Maureen O'Hara, *The Corporate Governance of Banks*, 9 ECON. POL'Y REV. 91, 97 (2003). Capital adequacy requirement also provides incentives for shareholders to undertake excessive risks because higher capital requirement causes shareholders to ask for higher investment premium. This induces the management to take riskier business strategy to satisfy the needs of shareholders. Luc Laeven & Ross Levine, *Bank Governance, Regulation, and Risk Taking*, 93 J. FIN. ECON. 259, 260 (2009); MULBERT, *supra* note 210 at 16–19.

[212] *See generally* BASEL COMM. ON BANKING SUPERVISION, REGULATORY CONSISTENCY ASSESSMENT PROGRAMME (RCAP): ASSESSMENT OF BASEL III REGULATIONS – CHINA (2013), https://www.bis.org/bcbs/implementation/l2_cn.pdf (assessing the capital regulatory regime in China to be "Compliant"); BASEL COMM. ON BANKING SUPERVISION, REGULATORY CONSISTENCY ASSESSMENT PROGRAMME (RCAP): ASSESSMENT OF BASEL III LCR REGULATIONS – CHINA (2017), https://www.bis.org/bcbs/publ/d411.pdf (assessing the liquidity coverage ratio regulation in China to be "Compliant").

entails excessive risks that may render the bank failing the risk threshold.[213] Hence, even if the party system dominates Chinese banks, the potential for it to over-intervene in the operation of banks may be mitigated.

Chinese banking regulators, however, also maintain a number of special regulations dictating specific governance practices or operational standards for banks, which aggravate the problems underlying the party-dominated governance system. Below are some examples.

1. Agreed Loan Scale

The Peoples Bank of China ("PBOC") maintained the so-called "agreed loan scale," a loan quota system, to control the aggregate loan scale in China.[214] Under this system, each Chinese commercial bank is required to report its agreed annual scale of loans at the beginning of a year. The PBOC would, based on the amount and growth of a bank's loan, determine whether to approve the ceiling loan scale.[215] After the approval, each bank must lend in accordance with this limit every year: its annual loans cannot exceed the limit, and they cannot be significantly lower than the limit as well.[216] This is a product of the planned economy, but the PBOC also uses this measure to prevent excessive expansion in loans and thereby control inflation.

Although the agreed loan scale facilitates the PBOC's monetary control, it compromises the market competition of the banking sector and the operational freedom of individual banks. Furthermore, the agreed loan scale causes scarcity in credit resources in China. In practice, many commercial banks extended a large number of loans at the beginning of the year, but when their loan scale approaches the ceiling limit, they refrain from lending near the year end, especially when lending to small and micro enterprises

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[213] For a related discussion, see generally Wei Liu, *Basel III and Bank Regulation in China*, 7 J. LEGAL TECH. RISK MGMT. 1 (2014) (introducing how China responded to the Basel III and incorporated it into its domestic laws).

[214] Lide Shangyu (李德尚玉), *Jie kai heyi daikuan shenmi miansha* (揭开合意贷款神秘面纱) [*Piercing the Mysterious Veil of Agreed Loan*], CHINA BUS. NEWS (第一财经日报), Sept. 9, 2014.

[215] *Id.*

[216] *Id.*

("SMEs").[217] This causes seasonal financing difficulties for borrowers, escalates the credit cost, and aggravates the financial constraint in China.[218]

2. *Restrictions on Executive Compensation*

In recent years, the CCP also intervened in the compensation of bank executives, which significantly impacted the labor market in China's banking sector. In 2014, as part of the plan to reform Chinese SOEs, the CCP decided to restrict the compensation of SOE executives.[219] It implemented this restriction in 2015.[220] The restriction directly applies to the chairperson of the board of directors, CEO, the chairperson of the board of supervisors, and other vice presidents of the enterprises administered by the central government, including the five SOCBs.[221] Specifically, it limits the compensation of these executives to no more than eight times of the average employees' salary.[222] According to the CCP, this restriction is responsive to the public's perception that the state overpays SOE executives.[223]

The restriction significantly reduced the compensation of bank executives. As Chart 6 indicates, in 2015, the chairpersons' compensation in most listed Chinese commercial banks dropped significantly. The drop was, in particular, prominent in the SOCBs because the CCP's compensation

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[217] Liu Zhendong (刘振冬), *Yinhang panhuo cunliang ying jiechu "heyi daikuan" shufu* (银行盘活存量应解除"合意贷款"束缚) [*To Mobilize the Stock, Banks Should be Free From the Constraint of "Agreed Loan"*], ECON. INFO. DAILY (经济参考报), July 8, 2015.

[218] *Id.*

[219] CCP, Zhongyang guanli qiye fuze ren xinchou zhidu giage fang an (中央管理企業負責人薪酬制度改革方案) [Reform Scheme on Executive Compensation of the Central State-Owned Enterprises] (promulgated by the Central Politburo of Communist Party of China, Aug. 29, 2014, effective Jan. 1, 2015).

[220] Lin Chenyi (林宸誼), *72 Jia yangqi dongzuo kongjian xin baiwan* (72 家央企董座 恐減薪百萬) [*The Compensation of the Chairpersons of 72 Central SOEs Might Reduce for RMB 1 Million*], ECON. DAILY (經濟日報), Nov. 24, 2014.

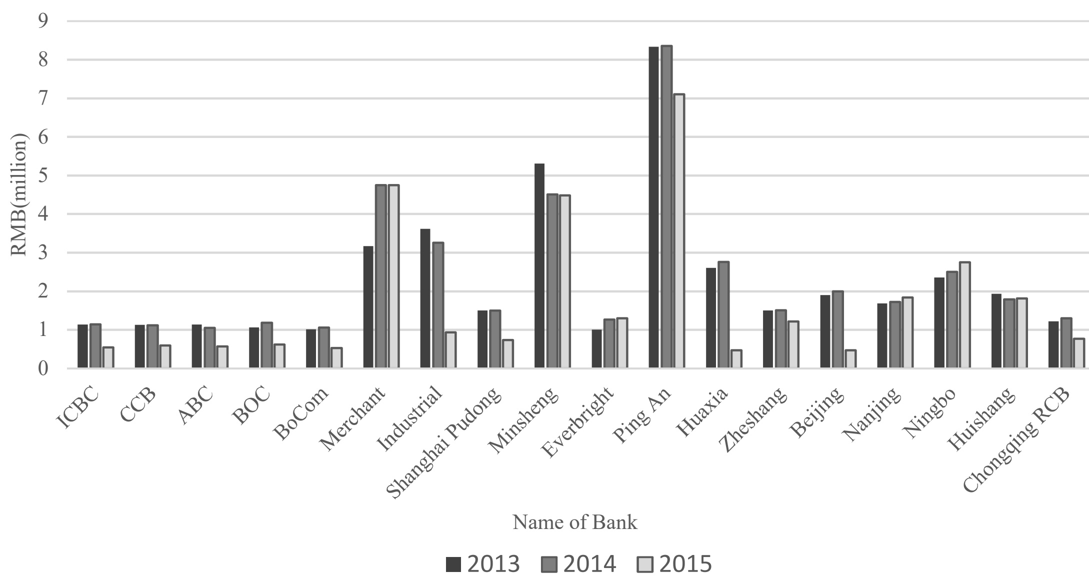
[221] Guan Jin (闫瑾), "*Ruoshi" yinhang jiang xinliao buliang zichan tunshi jixiao jiangjin*, ("弱势"银行降薪了 不良资产吞噬绩效奖金) [*"Weak" Banks Reduce the Salary, NPLs Swallow the Performance Bonus*], CHINA ECON. NET (中国经济网), Aug. 31, 2015.

[222] Lin, *supra* note 220.

[223] Ma Rohu (马若虎), *Guoqi xinchou gaige, buzhi yujiang xin* (国企薪酬改革，不止于降薪) [*SOEs Compensation Reform is not Limited to Compensation Reduction*], XINHUA NET (新华网), Sept. 15, 2015.

restriction directly applies to them.[224] The reduction of executive compensation led to a wave of resignations among bank executives in 2015. In 2015, around fifty bank executives resigned from their posts; many of them instead turned to internet finance companies, financial department of well-known enterprises, or private banks,[225] which led to a shortage of vice presidents in many banks.[226] In the future, traditional banks will have a harder time competing for top talent in the market.

Chart 6: Chairperson Compensation of Listed Banks (2013-2015)[227]



C. *Hostile Takeover*

Hostile takeovers, or the potential for hostile takeovers, are also a crucial tool to control the agency cost of corporate managers. Nevertheless,

[224] It is estimated that the compensation of the SOCBs' top executives dropped 50% in 2015. Wang Jie (王洁), *Shangshi gongsi gao guan qianwan nianxin jueji, yinhang gao guan jiangfu jin 50%* (上市公司高管千万年薪绝迹 银行高管降幅近 50%) [*No More Top Executives of Listed Companies Earn RMB Tens of Millions, The Drop in Bank Executives Approach 50 Percent*], MORNING POST (晨报), Sept. 18, 2016.

[225] Cheng Weimiao (程维妙), *Zhongduo yinhang fuxing zhang zhiwei, chuantong yinhang ying rencai juezhu shidai* (众多银行副行长职位告急 传统银行迎人才角逐时代) [*Many Banks are Seeking the Post of Vice Presidents, Traditional Banks Are Facing Competition for Talents*], BEIJING BUS. TODAY (北京商报), June 20, 2016.

[226] *Id.*

[227] Sourced from the 2015 annual reports of each identified bank.

they are unsurprisingly absent in China's banking sector for the following reasons.

First, most Chinese commercial banks have a controlling shareholder, which makes hostile takeovers less likely to succeed. To be sure, many of these controlling shareholders do not hold majority shares,[228] which makes them susceptible to potential hostile takeovers. Unfortunately, since these controlling shareholders are mostly public entities, would-be market acquirers dare not even attempt a takeover.

Second, any change of shareholders who hold 5% or more of the total amount of shares must obtain the CBRC's approval,[229] which further reduces the success rate of hostile takeovers. The case of CMB is illustrative. Before 2013, the ownership structure of CMB was nearly equally distributed among the major private shareholders, with no clear dominant shareholder.[230] This structure presented an opportunity to outside acquirers. Anbang Insurance made its move in 2014. Its shareholding of CMB increased from very minimal in 2013 to 13.62% by 2014[231] and 17.77% by 2015,[232] which made it the single largest shareholder of CMB. By CMB's board re-election in 2017, however, the CBRC had not approved the eligibility of Anbang Insurance for serving as CMB's major shareholder,[233] rendering Anbang Insurance unable to obtain real control over the CMB. In the 2017 board re-election, Anbang Insurance only secured one seat on CMB's board of directors subject to the CBRC's review of his eligibility.[234]

Finally, under the party-dominated system, even if an acquirer successfully acquires the majority shares of a commercial bank, the party

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228 *See* Annex 1.

229 Commercial Bank Law, *supra* note 44, art. 24(5).

230 *See* CHINA MERCHANTS BANK, 2013 ANNUAL REPORT 58–60 (2014).

231 CHINA MERCHANTS BANK, 2014 ANNUAL REPORT 101 (2015).

232 CHINA MERCHANTS BANK, 2015 ANNUAL REPORT 93 (2016).

233 Zhou Pengfeng (周鹏锋), *Anbang "tunbing" minsheng yinhang sannian: guodong ji dongshi zige rengwei huopi* (安邦"屯兵"民生银行三年：股东及董事资格仍未获批) [*Anbang Have "Stationed" at CMB for Three Years, Its Shareholder and Director Eligibility Remains Unapproved*], SHANGHAI SEC. NEWS (上海证券报), June 15, 2017.

234 CHINA MERCHANTS BANK, 2017 ANNUAL REPORT 98 (2018). In February 2018, the Chinese Insurance Regulatory Commission arrested Xiaohui Wu, the chairman of Anbang Group, and indicted him of fundraising fraud and embezzlement. The CIRC further seized the control of Anbang Insurance. Tom Hancock et al., *China Seizes Anbang in Latest Move to Curb Dealmakers*, FIN. TIMES (Feb. 23, 2018), https://www.ft.com/content/5d548e98-183e-11e8-9e9c-25c814761640. After that, the only shareholder director also resigned from the board of CMB.

system can prevent them from obtaining operational control by limiting their personnel power over the bank executives. As illustrated above, in China's banking sector there is an issue of separation between ownership and control. Majority shares do not necessarily bring control over the executive team due to the influence of the party system. Hostile takeovers thus become "a flower in the mirror and the moon in the water"—that is, an illusion in China's banking sector.

IV. THE AGENCY PROBLEMS OF THE CROUCHING-TIGER-HIDDEN-DRAGON MODEL

The Chinese party-state appears to be satisfied with the Crouching-Tiger-Hidden-Dragon model. It repeatedly claims that the party's leadership is necessary for developing China's economy,[235] and the Crouching-Tiger-Hidden-Dragon model facilitates party leadership in the banking sector. This heightens party-state intervention in the corporate decisions of Chinese commercial banks. While the CCP repeatedly alleges that such heightened party-state intervention can promote the overall social welfare in China, in this section I offer a critical assessment of this Crouching-Tiger-Hidden-Dragon model from an agency theory perspective. I identify a number of agency problems underlying the Crouching-Tiger-Hidden-Dragon model that might discount the CCP's alleged optimism. These agency problems have actually worsened in recent years.

A. The Heightened Party-State Intervention

The most obvious impact of the Crouching-Tiger-Hidden-Dragon model is the increasing focus of Chinese commercial banks on party-state interest rather than the bank's own best interests. Under this model, the Chinese party-state determines the appointment, removal, reward, and promotion of bank executives. Bank executives, thus, owe their accountability mainly to the CCP instead of the bank's financial investors. Therefore, their operational decisions are less business-oriented and more party-interest-

[235] *See, e.g.*, PEOPLE'S CONGRESS, DI SHIER JIE QUANGUO RENMIN DAIBIAO DAHUI DI SI CI HUIYI GUANYU GUOMIN JINGJI H SHEHUI FAZHAN DI SHISAN GE WU NIAN GUIHUA GANGYAO DE JUEYI (第十二届全国人民代表大会第四次会议关于国民经济和社会发展第十三个五年规划纲要的决议) [DECISION REGARDING THE OUTLINE OF THE THIRTEENTH FIVE–YEAR PLAN ON NATIONAL ECONOMY AND SOCIAL DEVELOPMENT], Chapter 2 (2016); THE STANDING COMMITTEE OF PEOPLE'S CONGRESS, QUANGUO RENMIN DAIBIAO DAHUI CHANGWU WEIYUANHUI GONGZUO BAOGAO (全国人民代表大会常务委员会工作报告) [WORKING REPORT], para. 4(3) (2016).

oriented,[236] which compromises the operational efficiency of Chinese commercial banks.[237]

To be fair, the CCP does not intervene in the operational decision of Chinese commercial banks on a frequent basis. For instance, despite its control over the executive personnel of Chinese commercial banks, the CCP does not dictate each and every loan extended by each bank. In most cases, the CCP only directs Chinese banks to support a specific industry, while leaving the banks free to determine which specific firm to lend to in that designated industry.[238] That said, once in a while when there are policy needs, the CCP does ask Chinese commercial banks to support its policies. Fearing that non-cooperation will jeopardize their future career in the party system, bank executives tend to obey or, at least, not to depart significantly from the party's direction.[239] In this way, the Chinese party-state obtains an easy access to the funds of Chinese commercial banks, which would be less available if bank executives were more business-oriented.

Consider the example of the 2015 stock market collapse in China. To prevent further collapse, the Chinese government designated the China Securities Finance Company to support China's stock markets by buying in the blue-chip stocks in the Chinese stock market, which required an unprecedented amount of funds.[240] In less than two weeks, however, China Securities Finance Company managed to raise RMB 1.3 trillion from seventeen Chinese banks.[241] This situation exemplifies the philosophy of the Chinese party-state: although it does not need to exercise its dominance over Chinese commercial banks each and every day, maintaining this dominance is useful in case of emergencies.

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[236] *See* HE WEI PING, BANKING REGULATION IN CHINA: THE ROLE OF PUBLIC AND PRIVATE SECTORS 151 (2014) (arguing that "in China, private interest in banking regulation ultimately equates to the interest of the government").

[237] *Id.*

[238] MCGREGOR, *supra* note 20, at 68–69 (stating that "with the need to be profitable and compete globally, top executives of state enterprise these days have a relative freedom to run their businesses").

[239] *Id.*

[240] Wu Hongyuran (吴红毓然), *Zhengjin Gongsi huo yinhang shuxie 1.22 wanyi shengqing guimo kan bi 4 wanyi* (證金公司獲銀行輸血 1.22 萬億 申請規模堪比 4 萬億) [*The Securities Finance Co. Received the Banks' Injection of RMB 1.22 Trillion, The Scale of Application can be Compared with the RMB 4 Trillion*], CAIXIN NET (财新网), July 18, 2015.

[241] *Id.*

In the eyes of the Chinese party-state, lessened operational efficiency of Chinese banks might not be much of a problem compared with the overall public welfare. In China, commercial banks should concern not only their own business development but also the advancement of the state's policies. Article 34 of China's Commercial Banks Law stipulates, "[c]ommercial banks shall conduct their business of lending in accordance with the needs of the national economic and social development and under the guidance of the industrial policies of the State."[242] In accordance with this provision, Chinese banks undertake the duty to carry out state policies, including monetary policies, industrial policies, infrastructure projects, employment, and social support, among others.[243] In performing these policy mandates, Chinese banks inevitably accrue below-expectation profits and sometimes incur additional risks. This is, however, a necessary tradeoff. Maximizing the public welfare requires a balance between the banks' own operational interests and the public interests; bank executives might be better at pursuing banks' interests, but the party-state is better at safeguarding public interests. To balance banks' interests, the party-state is willing to leave some maneuvering room for bank executives and refrain from intervening in banks' operational decisions on a daily basis, but when there are policy needs, bank executives need to cooperate with the party-state.

B. The Agency Problems in China's Banking Sector

Whether this policy-oriented model of bank governance better serves the public welfare is not the focus of this paper. Theoretically, it is possible that such model, when exercised properly, can fix the market failures caused by the purely business-oriented model of bank governance. In the real world, however, such optimal scenarios projected by the party-state can be compromised by a number of inherent agency problems. Moreover, we have witnessed these problems in China's banking sector in recent years.

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[242] Commercial Banks Law, *supra* note 44, art. 34.

[243] For instance, in an opinion issued by the PBOC, Chinese Banking Regulatory Commission ("CBRC") and other departments in February 2016, the central government explicitly encouraged banks to lower the down payment ratio for alternative fuel vehicles and used vehicles, and to support industries such as iron and steel, nonferrous metals, building materials, shipbuilding, and coal. Guanyu jinrong zhichi gongye wen zhengzhang diao jiegou zeng xiaoyi de ruogan yijian (关于金融支持工业稳增长调结构增效益的若干意见) [Several Opinions on Leveraging Financial Services to Support the Industrial Sector to Stabilize Growth, Adjust Structure and Raise Efficiency] (promulgated by People's Bank of China, St. Dev. & Reform Comm. & Ministry of Indus. & Info., Feb. 14, 2016, effective Feb., 14, 2016), para. 2, CLI.4.264232(EN) (Lawinfochina).

1. *Agency Problem I: The Misalignment Between Public Welfare and the Party-State's Interest*

The first suboptimal scenario rests on the party-state's failure to pursue the public welfare. The Chinese party-state for a long time has claimed that it safeguards the public welfare on behalf of Chinese citizens.[244] This is not always the case. It can fail either because it misjudges the situation or because political concerns rather than policy concerns unduly affect its decisions. The result of such occasional failure could be disastrous.[245]

The party-state might design a wrong policy simply due to misjudgment. For instance, the stimulus plan in 2009 that injected RMB 4 trillion to support China's economy was very controversial. As a result of the Global Financial Crisis in 2008, China's economy appeared to be cooling down. To prevent an economic slowdown, the Chinese government infused RMB 4 trillion (around US $586 billion) into the economy as a stimulus.[246] Of this amount, RMB 1.6 trillion (or US $233 billion) came from bank loans.[247] To perform this mandate, Chinese banks expanded their loans at a stunning pace: in 2009, their total new lending reached US $1.4 trillion, almost 30% of China's GDP.[248] This stimulus package, however, created a huge bubble in the market because there was not a high demand for money in China.[249] Most stimulus funds flowed to infrastructure, which made up 38% of the stimulus plan and half of total medium and long-term lending in 2009.[250] This was particularly the case for Chinese local governments: to perform the mandate, they had no choice but to borrow huge amounts of money from Chinese banks to invest in local infrastructure or housing with barely any expected return. This eventually evolved into the local debt crises, resulting in a RMB 3.2 trillion debt

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[244] *See* XIANFA, pmbl. (2012) (providing that "The CCP . . . represents the development need of China's advanced productivity, the forward direction of China's advanced culture, and the fundamental interests of China's most general citizens. . . .").

[245] For similar observations, see STENT, *supra* note 23, at 154.

[246] *Supporting China's Infrastructure Stimulus Under the INFRA Platform*, WORLD BANK: INFRA UPDATE, June 2010, at 1, http://siteresources.worldbank.org/INTSDNET/Resources/5944695-1247775731647/INFRA_China_Newsletter.pdf.

[247] *Id.* at 1.

[248] *Id.* at 1–2.

[249] For a discussion, see generally LANG XIANPING (郎咸平) & SUN JIN (孫晉), ZHONGGUO JINGJI DAOLE ZUI WEIXIAN DE BIANYUAN (中國經濟到了最危險的邊緣) [CHINA'S ECONOMY HAS APPROACHED THE MOST DANGEROUS EDGE] 40–63 (2012) (summarizing the data related to the real estate market in China and arguing the presence of a bubble therein).

[250] *Supporting China's Infrastructure Stimulus Under the INFRA Platform*, *supra* note 248, at 1–2.

replacement program in 2015.[251] Moreover, many local investments made under the stimulus plan turned out to be simply a social waste.[252] This illustrates that the party-state, even in good faith, can at times fail to achieve social welfare through their use of Chinese banks, and such failure can be disastrous and wasteful.

The party-state might also design a wrong policy because political interests taint the decision process. After all, the party-state's interest is not solely the pursuit of public policies; it also contains complicated politics within the CCP. For instance, as part of the party system, Chinese commercial banks must obey the power structure and rank within the CCP, which

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[251] Traditionally, local governments in China were responsible for most of the infrastructure investment, public service, and social spending, which accounted for around 85% of China's public spending. Their funding, however, was severely constrained due to their limited authority in tax collection. Accordingly, for long period of time, they relied on bank loans to fund local development: it was estimated that banks supplied 62% of local governments' funding. In 2009, to perform the central government's stimulus plan, in which local governments were responsible for US $410 billion of finance, their borrowings from banks rose by 70% in one year, most of which went to sectors unable to generate adequate cash flow for repayment. This practice created a huge amount of non-repayable local debts. *See* Leo F. Goodstadt, *The Local Government Crisis 2007–2014: When China's Financial Management Faltered* 1–3 (H.K. Inst. for Monetary Res., Working Paper No. 27, 2014), http://www.hkimr.org/uploads/publication/399/wp-no-27_2014-final-.pdf.

The problem of rapid fiscal expansion without rational constraint finally came to a head. In June 2013, local governments owed RMB 10.88 trillion debt, in which bank loans accounted for RMB 5.53 trillion, which was more than half of the debts due. As this huge amount of local debt was about to become due, the lack of fiscal discipline of local governments appeared unsustainable in 2015. This forced the central government to launch a series of debt-replacement programs to rescue local governments. In March 2015, the MOF approved the replacement of RMB 1 trillion local debt. In June 2015, it approved another RMB 1 trillion. In August 2015, it approved another RMB 1.2 trillion. In 2015 and 2016, it is estimated that local governments completed the replacement of RMB 8.1 trillion of local debts. By replacing their debts and postponing the due date, local governments could finally take a breath. *Id.*

Despite this bitter experience, local governments continue using the local government financing vehicles ("LGFVs") to raise debts for supporting local development. As of August 2016, these LGFVs had issued RMB 1.2 trillion of corporate bonds for the year 2016, exceeding the scale of 2015, while banks were again the major investors. Highly-leveraged local governments have become a potential threat to China's banking system. For an introduction to how LGFVs function in China, see generally Liao Fan, *Quenching Thirst with Poison? Local Government Financing Vehicles – Past, Present, and Future, in* REGULATING THE VISIBLE HAND, *supra* note 21, at 69 (examining the origin, development, operational models, and challenges of the local government financing vehicles in China). *See also* Shaun Breslin, *Financial Transitions in the PRC: Banking on the State?*, 35 THIRD WORLD Q. 996 (2014) (discussing the complicated relationship between local governments, land, the banking system, and other key economic sectors in China). For a discussion of the gaming between local governments and the CBRC, see HE WEI PING, *supra* note 236, at 136–38.

[252] For instance, according to the investigation of the National Development and Reform Commission ("NDRC"), by May 2016, the "new towns" or "new districts" developed by local governments had the capacity to accommodate at least 3.4 billion residents, while the entire Chinese population was "merely" 1.3 billion. Cai Minzi (蔡敏姿), *Lu chong chengzhen hua maochu renkou dakeng* (陸衝城鎮化冒出人口大坑) [*Mainland China Rush for Urbanization and Big Holes of Population Pop Out*], ECON. DAILY NEWS (經濟日報), July 15, 2016.

compromises not only the business interests of banks but also the pursuit of social welfare. SOCBs' loans to SOEs provide a good example. One might expect that SOCBs, as the major funders of SOEs, could discipline SOEs' business decisions and promote SOEs' operational efficiency, like the main bank system in Japan.[253] The reality, however, is the opposite. Under the CCP's party system, SOEs' top leaders often possess more senior party ranks than SOCBs' top leaders.[254] Accordingly, although SOCBs seem to possess leverage in their business relationship with SOEs, they are in fact the subordinate according to the political relationship.[255] Hence, instead of improving SOEs' operational efficiency, the Crouching-Tiger-Hidden-Dragon model actually compromises SOCBs' own operational efficiencies.[256] Bank funds thus largely flow to the less productive SOEs, resulting in the financial constraint of private sectors. It is estimated that private sectors contributed to two-thirds of China's GDP but only accounted for one-third of bank loans in China.[257] Such inefficient allocation of funds not only prevents private sectors from growing but also channels bank funds to SOEs which are less productive and thus riskier. This also creates a substantial risk for the safety and soundness of China's banking sector.

2. *Agency Problem II: The Misalignment Between the Party-State's Interest and Bank Executives' Interest*

Even if the government is right in its design of policies to benefit the public, banks do not necessarily implement them correctly and efficiently. Chinese banks do not always obey the party-state's policy mandate. Instead, they may have their own interests that are incompatible with the policy goals, while the party-state, constrained by the informational asymmetry, may fail to detect or punish the resulting deviation by the banks.[258]

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253 For an introduction to the main bank system, see generally, Paul Sheard, *The Main Bank System and Corporate Monitoring and Control in Japan*, 11 J. ECON. BEHAVIOR & ORG. 399 (1989) (introducing the main bank system in Japan and how it shapes Japan's corporate governance practice); Takeo Hoshi et al., *The Role of Banks in Reducing the Costs of Financial Distress in Japan*, 27 J. FIN. ECON. 67 (1990) (introducing how the main bank system in Japan functioned to rescue the enterprises at the verge of insolvency).

254 WALTER & HOWIE, *supra* note 24, at 166–71.

255 For a discussion of the credit subsidy provided by SOCBs to SOEs, see XIANPING (郎咸平) & JIN (孫晉), *supra* note 249, at 119.

256 *See* DAVID SHAMBAUGH, CHINA GOES GLOBAL: THE PARTIAL POWER 160 (2013).

257 NICHOLAS R. LARDY, MARKETS OVER MAO: THE RISE OF PRIVATE BUSINESSES IN CHINA 99–112 (2014).

258 For similar observations, see STENT, *supra* note 23, at 154.

The financial constraint of private sectors as mentioned above is illustrative of this point. To address the financial constraint of SMEs in China, the Chinese government has imposed a specific obligation on Chinese banks to extend loans to SMEs since 2011. The obligation has evolved from the "two no less than" obligation in 2011[259] to the "three no less than" obligation in 2015.[260] Despite these explicit policies, Chinese SMEs, which are generally more productive than SOEs, still face difficulties in obtaining financing. Only 46.2% of SMEs were able to obtain loans from banks in 2014.[261] This is mainly because, in the eyes of Chinese banks, SME loans are simply too risky. The cash flows of SMEs are fairly unstable, their financial records are less than complete, they are unable to issue adequate collateral to secure their loans, and they are private businesses which lack an implicit guarantee from the government.[262] Since banks only accrue fixed interest revenue from SMEs loans, which might not be adequate to cover their potential losses, it is rational, from the banks' perspective, for banks to refrain from engaging in SME loans.[263] Instead, banks prefer to lend their money to the government or SOEs even though the public sector is less productive.[264]

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[259] The two obligations are: first, each bank's annual growth rate of SMEs loans shall not be less than its annual growth rate of all loans, and second, each bank's annual increased amount of SMEs loans shall not be less than its previous year's increase amount. Zhongguo yinjainhui guanyu zhichi shangye yinhang jinyibu gaijin xiaoxing weixing qiye jinrong fuwu de buchong tongzhi (中国银监会关于支持商业银行进一步改进小型微型企业金融服务的补充通知) [Supplementary Notice of the Chinese Banking Regulatory Comm'n on Supporting Commercial Banks to Further Improve Financial Services for Small and Micro Enterprises] (promulgated by Chinese Banking Regulatory Comm'n, Oct. 24, 2011, effective Oct. 24, 2011), para. 1(1), CLI.4.160143(EN) (Lawinfochina).

[260] The three obligations are: first, each bank's annual growth rate of SMEs loans shall not be less than its annual growth rate of all loans; second, each bank's number of SME customers shall not be less than previous year's customer number, and third, the approval rate of SMEs application shall not be less than previous year's approval rate. Zhongguo yinjianhui guanyu 2015 nian xiao wei qiye jinrong fuwu gongzuo de zhidao yijian (中国银监会关于 2015 年小微企业金融服务工作的指导意见) [Guiding Opinions In Respect of Financial Service Works for Small and Micro Enterprises in 2015] (promulgated by Chinese Banking Regulatory Comm'n, Mar. 3, 2015, effective Mar. 3, 2015), para. 1, CLI.4.244746(EN) (LawinfoChina).

[261] XINAN CAIJING DAXUE (西南财经大学) [SOUTHWESTERN UNIVERSITY OF FINANCE AND ECONOMICS], ZHONGGUO XIAO WEI QIYE FAZHAN BAOGAO 2014 (JIANYAO BAN) (中国小微企业发展报告 2014 (簡要版)) [THE 2014 REPORT ON THE DEVELOPMENT OF CHINA'S SMALL AND MICRO ENTERPRISES (SUMMARY)] 6–7 (2015).

[262] YIFU LIN (林毅夫), JIEDU ZHONGGUO JINGJI (解读中国经济) [DEMYSTIFYING THE CHINESE ECONOMY] 199–200 (2012).

[263] *Id.* at 199–207 (for a discussion of the SMEs loan problem in China).

[264] STENT, *supra* note 23, at 61.

The financial constraint of SMEs has become even more prominent as China's economy has slowed down. Despite the "three no less than" obligations, particularly the duty that the SME loan growth shall be no less than the gross loan growth, many Chinese commercial banks shrank their SME lending business in recent years. As shown in Chart 7, while SOCBs, RCBs, and foreign banks steadily increased their SME loan ratio throughout 2015 to 2017, JSCBs and CCBs did not follow the CBRC's mandate. Instead, we witness a consistent downward trend of the SME ratio in the case of JSCBs in 2016 and 2017, and we also started to observe a similar tendency in the case of CCBs in 2017. The financial constraint of SMEs in China illustrates that the Chinese party-state cannot always direct Chinese banks to implement its policy even though China is an authoritarian regime. After all, some policy mandates could be challenging, and a party-state-dominated banking system does not always possess the required capability or efficiency for implementing these challenging tasks.

Chart 7: SME Loan Ratio of Chinese Commercial Banks by Type (2015-2017)[265]

	SOCBs	JSCBs	CCBs	RCBs	FBs
2015	14.27%	23.07%	42.95%	52.25%	15.73%
2016	14.39%	20.02%	45.06%	52.94%	17.34%
2017	14.70%	19.03%	44.97%	53.14%	18.23%

[265] Based on the SME loan data and the aggregate loan data reported in CBRC's websites. *See, e.g.*, CBRC, 2017 Nian shangye yinhang zhuyao zhibaio fen jigou lei qingkuang biao (2017 年银行业金融机构用于小微企业的贷款情况表) [The Table of the SME Loans Made by Banking Financial Institutions in 2017], Feb. 9, 2018; CBRC, 2017 Nian yinhang ye jinrong jigou yong yu xiao wei qiye de daikuan qingkuang biao (2017 年商业银行主要指标分机构类情况表) [The Table of the Key Indicators of Commercial Banks by Entity in 2017], Feb. 9, 2018.

3. *Agency Problem III: The Misalignment Between Banks' Interest and Bank Executives' Interest*

Finally, within the business ambit left by the Chinese party-state to banks, bank executives of Chinese commercial banks still incur the agency problem typically seen in ordinary firms, that is, the failure to pursue the business interests of banks. The Crouching-Tiger-Hidden-Dragon model not only fails to serve the monitoring function but somehow exacerbates the problem.

A crucial impact of the Crouching-Tiger-Hidden-Dragon model is the reduced role of private capital and the lack of diversity in executive composition among Chinese commercial banks. Since the Chinese party-state dominates the appointment, dismissal, reward, and promotion of bank executives, it would prefer to select executive candidates from the party system. This results in little diversity in the executive composition of Chinese banks.[266] As Annex 2 exhibits, among the top thirty-five Chinese commercial banks in 2016, only three banks have a board chairperson whose career is unaffiliated with the party system,[267] and only one bank has such a CEO. In addition, only eight banks have at least one top executive whose career is unaffiliated with the party system, and only four banks have at least two such top executives. This summary, on one hand, shows that despite the introduction of private capital, the Chinese party-state tightly controls the executive members of major Chinese commercial banks. On the other hand, it also suggests low diversity among Chinese bank executives.

The reduced role of the private capital and the lack of diversity in executive composition tends to reinforce group thinking among bank executives in China. Absent having someone with a more business-oriented background, experience, and mindset, it would be more challenging for Chinese banks to engage in new businesses, innovate new products, or adapt to new environments.[268] The revenue structure of Chinese banks is telling. Chinese banks currently remain heavily reliant on traditional loan businesses to support their revenue. In 2017, 77.3% of their gross revenue came from

[266] For more literature raising similar concerns, see STENT, *supra* note 23, at 109–10.

[267] This refers to a career which is mainly in the private sector, that is, entities other than the government agencies or state-controlled entities.

[268] Stent also observed that Chinese banks typically share a culture which features "the fear of trying something different," which might account for "the failure of the banks to change their organizational structure to a more modern model." STENT, *supra* note 23, at 121.

interest revenue.[269] Fee businesses—which collect commission fees by providing services such as bank cards, asset management, clearing and settling, investment banking, and guarantees—remained marginal in Chinese banks' business structure, which represented only 22.7% of the gross revenue of Chinese commercial banks.[270] The poor performance of Chinese banks in business innovation and business diversity has much to do with the homogenous executive composition caused by the party-state's dominance.[271]

The lack of business diversity among Chinese commercial banks has become a serious problem. Due to the interest rate liberalization[272] and the monetary easing policies[273] that have been implemented since 2015, the interest revenue of Chinese banks faces serious challenges. In 2016 and 2017, the average net interest rate margin decreased significantly from 2.54% at the

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[269] CHINESE BANKING REGULATORY COMM'N, SHANGYE YINHANG ZHUYAO JIANGGUAN ZHIBIAO QINGKUANG BIAO (FAREN) (2017) (商业银行主要监管指标情况表(法人) (2017 年)) [THE TABLE OF MAJOR REGULATORY INDICATORS OF COMMERCIAL BANKS (LEGAL PERSONS) (2017)] (2018).

[270] *Id.*

[271] In a separate paper, I conduct empirical studies and exhibit that Chinese commercial banks whose executive composition is more party-state-oriented are associated with lower fee revenue ratio. *See generally* Yueh-Ping Yang, *Does the Proud Dragon Need to Repent? A Survey of the Chinese Party-State's Performance in China's Banking Sector* (The 12th Annual Conference on Empirical Legal Studies, Ithaca, Oct. 13–14, 2017) (empirically studying the association between executive composition and the bank's performance among major Chinese commercial banks).

[272] On October 23, 2015, the PBOC decided to cancel the deposit rate control over commercial banks and rural cooperative financial institutions, which thereby achieving full interest rate liberalization in China. *Zhonguo renmin yinghang jueding xiatiao jinrong jigou renminbi daikuan he cunkuan jinzhun lilu* (中国人民银行决定下调金融机构人民币贷款和存款基准利率) [*PBOC Decides to Reduce the Benchmark Deposit and Lending Rates and Lower the Deposit Reserve Rate*], WWW.GOV.CN (May 10, 2015), http://www.gov.cn/xinwen/2015-05/10/content_2859799.htm.

[273] Since late 2014, the slowdown of China's economy forced the PBOC to adopt monetary easing measures to stimulate the economy, which resulted in six rounds of reduction in the benchmark interest rates within one year. In November 2014, the PBOC reduced the 1–year benchmark lending rate and the 1–year benchmark deposit rate to 5.6% and 2.75%, respectively, which narrowed the interest rate margin to 2.85%. *Zhongguo renming yinhang jueding xiatiao jinrong jigou renminbi daikuan he cunkuan jizhun lilu bing kuoda cunkuan lilu fudong qujian* (中国人民银行决定下调金融机构人民币贷款和存款基准利率并扩大存款利率浮动区间) [*PBOC Decides to Reduce the Benchmark Deposit and Lending Rates, Lower the Deposit Reserve Rate, and Expand the Floating Range for Deposit Rate*], WWW.GOV.CN (Nov. 21, 2014), http://www.gov.cn/xinwen/2014-11/21/content_2782052.htm. In October 2015, after six rounds of adjustment, the PBOC again reduced these rates to 4.35% and 1.5%. *zhonguo renmin yinghang jueding xiatiao jinrong jigou renminbi daikuan he cunkuan jinzhun lilu* (中国人民银行决定下调金融机构人民币贷款和存款基准利率) [*PBOC Decides to Reduce the Benchmark Deposit and Lending Rates and Lower the Deposit Reserve Rate*], WWW.GOV.CN (Oct. 23, 2015), http://www.gov.cn/xinwen/2015-10/23/content_2952801.htm. Although the PBOC did not further narrow the benchmark interest rate margin in the 2015 reductions, the lower lending rate reduced the overall interest revenue of Chinese banks.

beginning of 2016 to 2.10% at the end of 2017.[274] This poses significant downward pressure on the profitability of Chinese commercial banks. The return on asset of Chinese banks reduced from 1.1% in 2015 to 0.92% in 2017, and the return on equity reduced from 15% to 12.56%.[275] To address this downward pressure, Chinese banks have had to adjust their business model, particularly by engaging in more non-interest-related business, such as fee services.[276] The party-state's capture of the executive composition, however, might pose an obstacle to the business restructuring of Chinese banks.

C. Summary

The Crouching-Tiger-Hidden-Dragon model comes with special agency problems. These agency problems are associated with the current challenges faced by China's banking sector, such as rising risk exposure, misallocation of funds toward the public sector, and deteriorating profitability. The Chinese party-state might defend that they are merely matters of degree and tradeoff and that it manages to strike a fair balance. The rapid accumulation of non-performing loans ("NPLs") in China's banking sector in recent years, however, has sent an alarming signal questioning the sustainability of the Crouching-Tiger-Hidden-Dragon model.

The bank NPL ratio in China has steadily increased since 2013. In five years, the bank NPL ratio has increased from 0.95% in 2012 to 1.74% in 2017,[277] almost doubling, and there have been no signs to suggest that this upward trend will cease. The pace of NPL accumulation in these five years is also worrisome. Between 2012 and 2017, the amount of NPLs has increased

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[274] CHINESE BANKING REG. COMM'N, SHANGYE YINHANG ZHUYAO JIANGGUAN ZHIBIAO QINGKUANG BIAO (FAREN) (2015) (商业银行主要监管指标情况表(法人) (2015 年)) [THE TABLE OF MAJOR REGULATORY INDICATORS OF COMMERCIAL BANKS (LEGAL PERSONS) (2015)] (2016); CHINESE BANKING REGULATORY COMM'N, *supra* note 269.

[275] *Id.* To be fair, the profitability of Chinese commercial banks remain competitive, at least compared to the U.S. banks. The ROA of U.S. banks were 1.05%, 1.04%, and 0.97% in 2015, 2016, and 2017 respectively, while the ROE of U.S. banks were 9.33%, 9.32%, 8.62% in 2015, 2016, and 2017 respectively. *See All U.S. Banks – Return on Asset (YTD)*, BANKREGDATA, http://www.bankregdata.com/allIEmet.asp?met=ROAy&inst= (last visited Nov. 5, 2018); *All U.S. Banks – Return on Equity (YTD)*, BANKREGDATA, http://www.bankregdata.com/allIEmet.asp?met=ROEy (last visited Nov. 5, 2018).

[276] Liu Zexian (刘泽先) & Yue Pinyu (岳品瑜), *Zhongjian yewu tisu, yinhnag heshi baituo licha yilai* (中间业务提速 银行何时摆脱利差依赖) [*Intermediary Business Accelerates, When Can Banks Get Rid of the Reliance on Net Interest Margin*], BEIJING BUS. DAILY (北京商报), Sept. 7, 2015.

[277] CHINESE BANKING REGULATORY COMM'N, *supra* note 269.

from RMB 0.49 trillion to 1.71 trillion, more than tripling.[278] The rapid accumulation of NPLs has posed a threat to China's banking sector. Since 2016, the CCP and the State Council have started to experiment with a number of ways to reduce bank NPLs, such as NPL securitization[279] and debt-equity swap.[280] These measures, however, can only alleviate the symptoms by reducing the amount of NPLs on banks' balance sheet. To cure the disease and reduce the accumulation of NPLs, the Chinese party-state needs to tackle the fundamental cause: the party-state-dominated bank governance practice in China.

V. CONCLUSION

China's banking sector has become too big to be ignored, yet contemporary literature lacks a coherent account of bank governance practices

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278 CHINESE BANKING REGULATORY COMM'N, SHANGYE YINHANG ZHUYAO JIANGGUAN ZHIBIAO QINGKUANG BIAO (FAREN) (2012) (商业银行主要监管指标情况表(法人) (2012 年)) [THE TABLE OF MAJOR REGULATORY INDICATORS OF COMMERCIAL BANKS (LEGAL PERSONS) (2012)] (2013); CHINESE BANKING REGULATORY COMM'N, *supra* note 269.

279 In early 2016, the banking regulators selected six commercial banks on a trial basis: the ICBC, CCB, ABC, BOC, BoCom, and Merchant Bank. Since the National Association of Financial Market Institutional Investors promulgated the Guidelines for Disclosing the Information of NPL-Asset-based Securities in April 2016, a number of bank-issued NPL-based securities emerged. By the end of mid-October 2016, the five trial banks, excluding BoCom, had issued eight NPL-based securities which were worth RMB 8.1 billion in total and disposed of RMB 27.6 billion NPLs. Zhou Pengfeng (周鹏峰), *Buliang zichang zhengquan hua shidian yunniang kuorong guo kaixing, minsheng yinhang youwang ruwei di er pi* (不良资产证券化试点酝酿扩容国开行、民生银行有望入围第二批) [*The Trial Points of NPL Securitization May Expand, China Development Bank and China Minsheng Bank are Expected to Enter the Second Package*], CHINA SEC. NET (中国证券网), Oct. 18, 2016.

280 In July 2016, the CCP and the State Council, in their joint decision, announced their inclination to experiment with a debt-equity swap in China. Zhonggong zhongyang, guowuyuan guanyu shenhua tou rongzi tizhi gaige de yijian (中共中央、国务院关于深化投融资体制改革的意见) [Opinions on Deepening the Reform of the Investment and Financing System] (promulgated by CCP Central Committee & State Council, July 5, 2016, effective July 5, 2016), para. 10, CLI.5.275879(EN) (Lawinfochina). In September 2016, the State Council declared its decision to implement this policy. Guowuyuan guanyu jiji wentuo jiangdi qiye ganggan lu de yijian (国务院关于积极稳妥降低企业杠杆率的意见) [Opinion on Actively and Appropriately Lowering the Leverage Ratio of Enterprises] (promulgated by State Council, Sept. 22, 2016, effective Sept. 22, 2016), paras. 14–16, CLI.2.281762(EN) (Lawinfochina). By January 2017, it is estimated that Chinese banks had agreed to RMB 400 billion of debt–equity swap with twenty-seven businesses. Ma Chuanmao (马传茂), *Wuda xing zhai zuan gu zi gongsi quanbu xuangao chengli zhai zhuan gu jiang jiasu luodi* (五大行债转股子公司全部宣告成立 债转股将加速落地) [*All the Big Five Have Declared the Incorporation of Their Debt–Equity Swap Subsidiaries, Debt–Equity Swap Will Accelerate*], SEC. TIMES (证券时报), Jan. 20, 2017.

in China. This paper analyzes how the Chinese party-state, masked by the best practices of corporate governance, shifts the power center to the executive team, captures the power center by its appointment and reward power, and separates the ownership from control, which results in a Crouching-Tiger-Hidden-Dragon model in China. It also evaluates the potential problems associated with this bank governance model, including the heightened political intervention, which may result in poor risk management, misallocation of funds, and reduced business innovation and diversity. In recent years, these problems have gradually floated to the surface. The problems might be controllable at the moment; however, to sustain China's banking sector, some changes or reforms of the bank governance in China will certainly be warranted.[281]

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[281] In separate papers, I explore how China may achieve such changes or reforms. *See generally* Yueh-Ping Yang, *The Cloud for Dragons and the Wind for Tigers: An Executive-Based Bank Governance Reform Proposal for China*, 24 STAN. J. L. BUS. & FIN. (forthcoming 2019) (proposing China to reform its bank governance by allowing private capital to appoint their representatives to the bank executive team); Yueh-Ping Yang, *Should the Proud Dragon Repent? Proposing a Relative Theory for China's State Capitalist Banking Sector and East Asian Developmental States' Experienc*e (Fourth Workshop on Comparative Business and Financial Law, New York City, Feb. 2-3, 2018) (drawing reference from the experiences of Japan, South Korea, Taiwan, and Singapore in reforming their banking sectors to argue that privatization is not the only way for China to reduce the party–state intervention in banks).

Annex 1: Major Shareholders[282] of the Top 35 Chinese Commercial Banks (2016)

No.	Name	Asset (RMB Trillion)	Major Shareholders[283]	Listing[284]
1.	ICBC	24.14	- Huijin Co. (34.99%) - MOF (34.6%)	HK+SH
2.	CCB	20.96	- Huijin Co. (57.31%)	HK+SH
3.	ABC	19.57	- Huijin Co. (40.03%) - MOF (39.21%)	HK+SH
4.	BOC	18.15	- Huijin Co. (64.63%)	HK+SH
5.	BoCom	8.40	- MOF (26.53%) - ***HSBC (19.05%)*** - Social Security Fund (14.71%)	HK+SH
6.	Industrial	6.09	- Fujian Province (18.22%) - PICC Group (14.06%) - CNTC (5.54%)	SH
7.	Merchant	5.94	- Merchant Group (29.97%) - ***Anbang Insurance*** (10.72%) - China Ocean Shipping (9%)	HK+SH
8.	CITIC	5.93	- CITIC Group (65.97%)	HK+SH
9.	Minsheng	5.90	- ***Anbang Insurance (17.84%)*** - ***Orient Group &Huaxia Life (5.74%)***	HK+SH
10.	SPD	5.86	- SH International Group (26.55%) - ***Fude Sino Life Insurance (20.68%)*** - China Mobile (18.98%)	SH
11.	Everbright	4.02	- Huijin Co. (53.22%)	HK+SH
12.	Pingan	2.95	- ***Pingan Insurance (57.94%)***	ZH
13.	Hua Xia	2.36	- Shougang Group (20.28%) - PICC (19.99%) - National Grid Yingda (18.24%)	SH
14.	Beijing	2.12	- Beijing SASAC (13.92%) - ***ING (13.64%)*** - ***Macrolink Group (8.45%)***	SH
15.	Guangfa	2.05	- China Life Insurance (43.69%) - National Grid Yinda (20%) - CITIC (20%)	N/A
16.	Shanghai	1.76	- Shanghai SASAC (23.62%) - ***Banco Santander (6.48%)***	SH
17.	Jiangsu	1.60	- Jiangsu SASAC (26.4%) - ***Huatai Securities (5.54%)***	SH
18.	Zheshang	1.35	- Zhejiang SASAC (25.04%) - ***Traveler Automobile (7.5%)*** - ***Hengdian Group (6.92%)***	HK
19.	Evergrowing	1.21	- Yantai SASAC (20.61%) - ***UOB (13.18%)*** - ***Nanshan Group (8.95%)***	N/A

[282] "Major shareholders" here refer to the top five largest shareholders which also hold 5% or more of the bank's shares.

[283] The shareholders which are shown in bold and italic refer to the private block-holders.

[284] "HK" refers to the listing in Hong Kong, "SH" refers to the listing in Shanghai, and "ZH" refers to the listing in Shenzhen.

			- ***Shanghai Zuoji (8.11%)*** - ***Fuxin Group (5.74%)***	
20.	Nanjing	1.06	- Nanjing SASAC (24.11%) - ***BNP Paribas (14.87%)***	SH
21.	Shengjing	0.91	- ***Evergrande Group (17.28%)*** - ***Great Capital Ltd. (9.96%)*** - Shenyang Hengxin (8.28%) - ***Huibao Int'l (6.9%)*** - ***Xinhu Zhongbao (5.18%)*** - ***Founder Securities (5.18%)***	HK
22.	Ningbo	0.89	- Ningbo SASAC (20%) - ***OCB (18.58%)*** - ***Youngor Group (11.64%)*** - ***Huamao Group (5.58%)***	SH
23.	Bohai	0.86	- Teda Investment (25%) - ***Standard Chartered Bank (19.99%)*** - China COSCO Shipping (13.67%) - SDIC (11.67%) - China Baowu Steel (11.67%)	N/A
24.	Chongqing RCB	0.80	- Chongqing SASAC (19.34%) - ***Loncin Holdings (6.13%)***	HK
25.	Huishang	0.75	- Anhui SASAC (23.59%) - ***SH Song Qing Ling Foundation (10.93%)*** - ***China Vanke (8%)***	HK
26.	Beijing RCB	0.72	- Beijing SASAC (34.59%) - ***Qianxi Shihao Electronic (6.34%)***	N/A
27.	Hangzhou	0.72	- Hangzhou City (24.16%) - ***Commonwealth Bank of Australia (18%)*** - ***Hongshi Group (5.73%)*** - China Life Insurance (5.55%)	SH
28.	Shanghai RCB	0.71	- Shanghai SASAC (24.49%) - ***ANZ Bank (20%)*** - China Pacific Insurance (7%)	N/A
29.	Chengdu RCB	0.67	- ***Anbang Insurance Group (35%)*** - Chengdu SASAC (21.92%)	N/A
30.	Guangzhou RCB	0.66	- Guangzhou SASAC (22.3%)	HK
31.	Tianjin	0.66	- Tianjin City (31.98%) - ***ANZ Bank (11.95%)***	HK
32.	Xiamen International	0.56	- Fujian Province (33.24%)	N/A
33.	Jinzhou	0.54	N/A	HK
34.	Harbin	0.54	- Harbin SASAC (19.65%) - ***Fubon Financial Holdings (7.03%)*** - ***Harbin Technology (6.55%)*** - ***Heilongjiang Software (6.55%)*** - ***Heilongjiang Xinyongsheng (5.82%)***	HK
35.	Guangzhou	0.44	- Guangzhou City (87.98%)	N/A

Annex 2: Executives' Party Affiliation of Top 35 Chinese Commercial Banks (2016)

No.	Bank Name	Listing	Chairperson	CEO	Top Eight Executives
1	ICBC	HK+SH	Yes	Yes	**7/8**
2	CCB	HK+SH	Yes	Yes	8/8
3	ABC	HK+SH	Yes	Yes	8/8
4	BOC	HK+SH	Yes	Yes	8/8
5	BoCom	HK+SH	Yes	Yes	8/8
6	Industrial	SH	Yes	Yes	8/8
7	Merchant	HK+SH	Yes	Yes	8/8
8	CITIC	HK+SH	Yes	Yes	8/8
9	Minsheng	HK+SH	**No**	Yes	**2/8**
10	SPD	SH	Yes	Yes	8/8
11	Everbright	HK+SH	Yes	Yes	8/8
12	Ping An	ZH	**No**	Yes	**4/8**
13	Huaxia	SH	Yes	Yes	8/8
14	Beijing	SH	Yes	Yes	**6/8**
15	Guangfa	N/A	Yes	Yes	8/8
16	Shanghai	SH	Yes	Yes	8/8
17	Jiangsu	SH	Yes	Yes	8/8
18	Zheshang	HK	Yes	Yes	8/8
19	Evergrowing	N/A	Yes	N/A	4/4
20	Nanjing	SH	Yes	Yes	**7/8**
21	Shengjing	HK	Yes	Yes	8/8
22	Ningbo	SH	Yes	Yes	8/8
23	Bohai	N/A	Yes	Yes	8/8
24	Chongqing RCB	HK	Yes	Yes	8/8
25	Huishang	HK	Yes	Yes	8/8
26	Beijing RCB	N/A	Yes	Yes	8/8
27	Hangzhou	SH	Yes	Yes	8/8
28	Shanghai RCB	N/A	Yes	Yes	8/8
29	Chengdu RCB	N/A	**No**	**No**	**3/8**
30	Guangzhou RCB	HK	Yes	Yes	8/8
31	Tianjin	HK	Yes	Yes	8/8
32	Xiamen Int'l	N/A	Yes	Yes	**7/8**
33	Jinzhou	HK	Yes	Yes	8/8
34	Harbin	HK	Yes	Yes	**7/8**
35	Guangzhou	N/A	Yes	Yes	8/8

1. In Columns of Chairperson and CEO, "No" means with no party affiliation, while "Yes" means with party affiliation
2. In Column of Top Eight Executives, the number refers to the number of top executives that are with party affiliation. Top executives here include the chairperson of the board of directors, the CEO, the chairperson of the board of supervisors, and the first five executives listed in the bank's annual report of 2016.