



Nationalisation and Restructuring Baoshang Bank (2019-2020)



Table 5: Summary of Chinese banks supported by the authorities from 2019 to 2020⁶²

| No | Bank (established) | Date of intervention | Region | Branches | Employees (estimated) | Total Assets (CNY billion) (estimated % of banking industry) |
|----|--|-------------------------|-------------------------------------|---------------------------|--------------------------|---|
| 1 | Baoshang Bank ^{63, 64} (Dec 1998) | May 2019 | Inner Mongolia | 18 (291 sub- branches) | 8,000 | 431.6 / \$62.2 billion (2016) (0.2%) |
| 2 | Hengfeng Bank ^{63, 64} (Oct 1987) | Dec 2019 | Yantai city, Shangdong | 18 (306 sub- branches) | 10,700 | 1,028.8 / \$147.7 billion (2019) (0.3%) |
| 3 | Harbin Bank ^{64, 65} (Jul 1997) | Nov 2019 | Harbin, Heilongjiang Province | 17 (282 sub- branches) | 7,000 | 623.4 / \$94 billion (June 2018) (0.3%) |
| 4 | Bank of Jinzhou ⁶⁵ (22 Jan 1997) | Mar 2020, Jul 2019 | Liaoning province | 15 | 6,000 | 748.4 / \$113 billion (June 2018) (0.3%) |
| 5 | Bank of Gansu ⁶⁵ (19 Nov 2011) | Apr 2020 | Lanzhou city, Gansu | 12 (190 sub- branches) | 4,200 | 335.1 / \$48 billion (2019) (0.1%) |
| | | | | | | 3,167.3 / \$464.9 billion (1.2%) |

⁶² Non-exhaustive list of banks

⁶³ Baoshang and Hengfeng are part of 12 national joint-stock commercial banks in China

⁶⁴ Linked to Tomorrow Group, a conglomerate involved in banking, insurance, real estate, and other businesses

⁶⁵ Harbin, Jinzhou and Gansu were listed on the Hong Kong Stock Exchange (HKEX) in March 2014, December 2015 and January 2018 respectively

Background and context

On 24 May 2019, China's financial regulators, the People's Bank of China (PBOC) and the China Banking and Insurance Regulatory Commission (CBIRC), jointly announced that they would take over the management of Baoshang Bank (Baoshang) for a period of one year citing the severity of its credit risk.

This was China's first government takeover of a bank since 1998 and it took place against the backdrop of rising defaults, growing debt burdens and a slowing economy. As at end 2016, Baoshang had an asset size of CNY432 billion (\$62.2 billion). At the time of the takeover, it had about 4.73 million customers, including 4.67 million individuals and 63,600 corporate clients. Baoshang had not published any annual reports since 2016. It was also reported that 18 small Chinese banks had yet to release financial results in 2018, signalling a potential build-up of non-performing loans (NPL) in the Chinese banking system.

Financial markets were concerned that Baoshang's troubles reflected wider problems among the smaller

regional banks across China, which had expanded aggressively and were highly dependent on interbank funding. Shortly after Baoshang's takeover by the Chinese authorities, these small banks faced issues securing borrowing, as fears permeated the interbank market. The interbank borrowing rate for smaller banks spiked from its normal level of about 3.5% to as high as 15% in June 2019, triggering severe liquidity tensions in the Chinese interbank market.

Matters were further complicated by virtue of the 89% owner of Baoshang, Tomorrow Holdings. In early 2017, Xiao Jianhua – the billionaire founder of Tomorrow Holdings – was taken into police custody in mainland China from Hong Kong. His involvement in Baoshang inevitably raised the question as to whether the regulators would seek to break up his sprawling business empire. It was reported that the Tomorrow Group had illegally borrowed CNY156 billion (\$22.3 billion) from Baoshang in the form of 347 loans through 209 shell companies from 2005 to 2019 and these had subsequently become delinquent.

Resolution of Baoshang – Timeline of Key Events

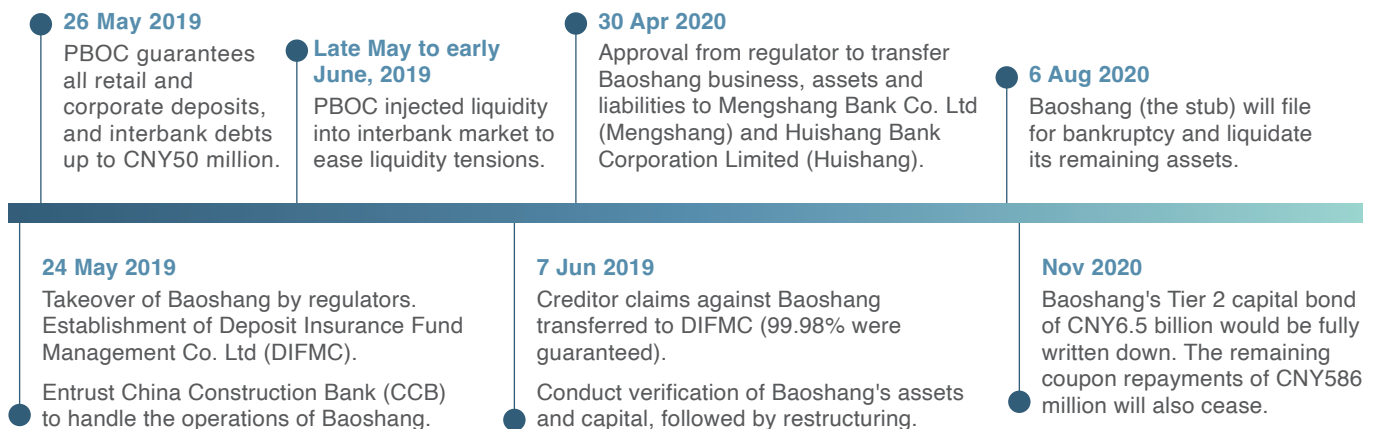
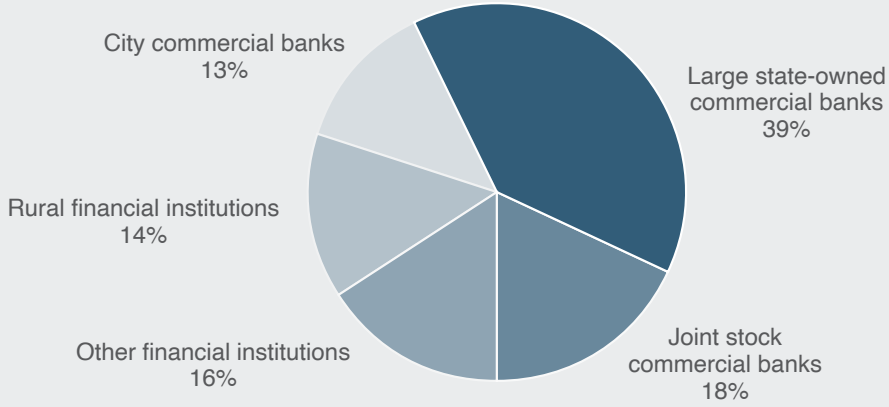
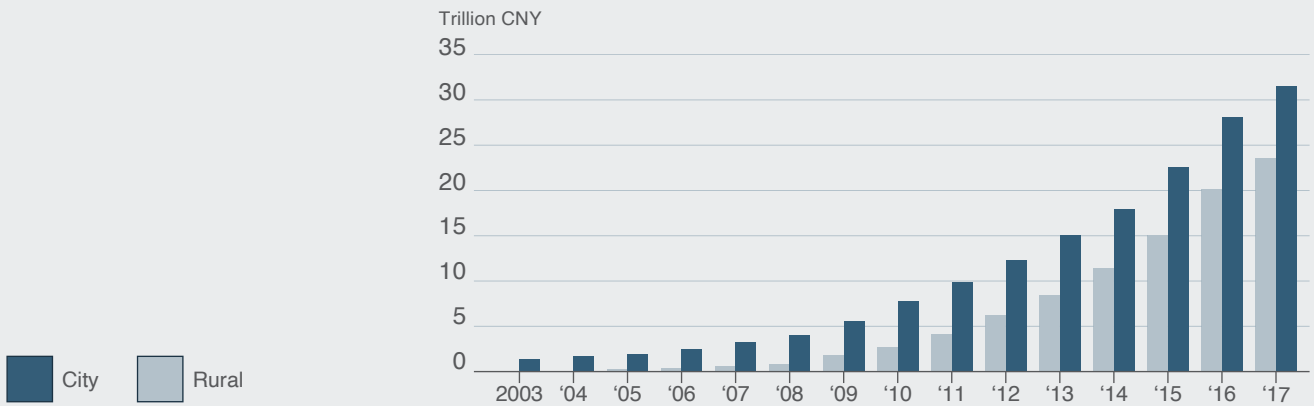


Diagram 4: Overview and salient features of the Chinese banking system

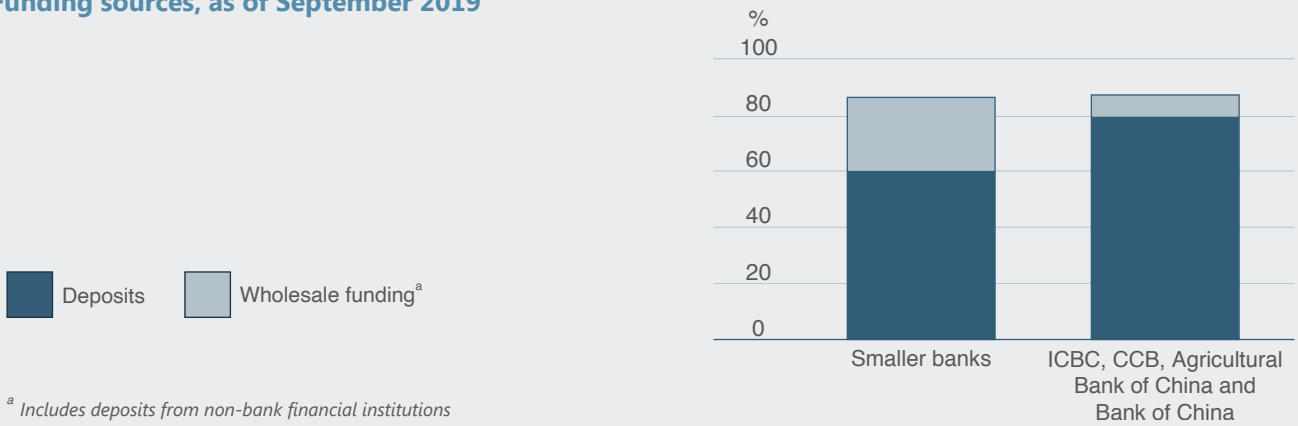
China: Share of banking sector assets as at 31 December 2021



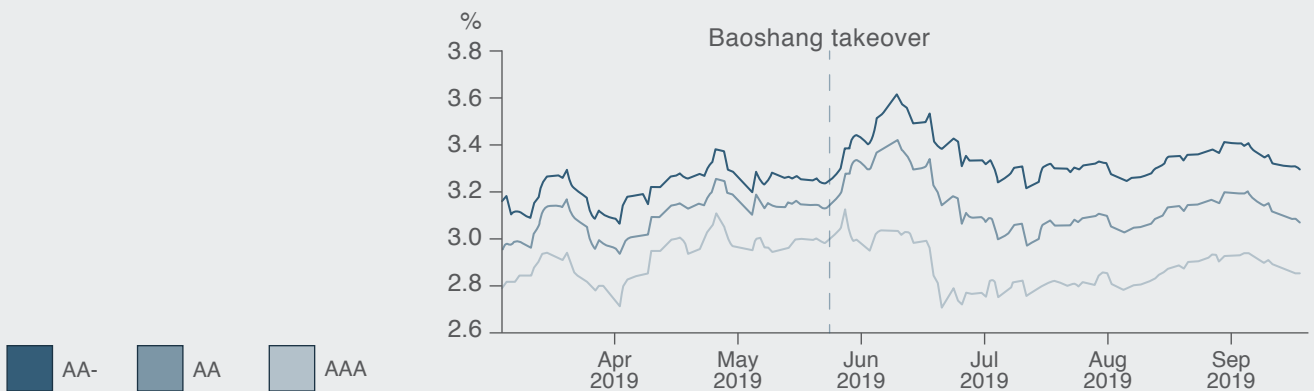
Total assets of smaller Chinese commercial banks by category



Funding sources, as of September 2019



Yields on Chinese bank debt by credit rating



Sources: PBOC, CBIRC, Wind, The Wall Street Journal

Resolution actions

Stabilisation measures taken to alleviate market fears of a sudden takeover

On the same day of the Baoshang takeover, in order to protect depositors' savings, PBOC set up the DIFMC⁶⁶ to manage a CNY100 billion (\$14.5 billion) fund.

On 26 May 2019, PBOC issued an official statement that it would guarantee all retail deposits, corporate deposits and interbank debts of up to CNY50 million (\$7.2 million) in Baoshang. For debts above that threshold, there would be guarantees to corporate creditors at least 80% of their deposits, and to other financial institutional creditors at least 70%.

CCB was appointed to assume the daily operations of Baoshang to protect the interests of customers and depositors. PBOC also announced that it would offer timely and sufficient funds to ensure that the payment services of Baoshang operated smoothly.

In response to the liquidity tensions, PBOC took steps to support small banks by injecting more money into the system, and extended its medium-term lending facility to institutions at a rate of 3.30%. To further reassure investors, the PBOC

stated that it was not planning to undertake any other bank takeovers. In addition, it would use various monetary policy tools to stabilise the money market and boost liquidity of the banking system. Financial markets reacted positively to the steps taken by the PBOC, and interbank market interest rates then stabilised, indicating that the concerns around the takeover had abated.

By 7 June 2019, Baoshang's creditors had transferred all their claims to the DIFMC fund. The transfer marked the end of the first phase of the takeover. 99.98% of Baoshang's corporate creditors had their claims fully guaranteed. The remainder – as well as some large interbank creditors – had an average of 90% of their claims guaranteed. The regulators disclosed that not all creditors were fully guaranteed, to avoid the perception that they were encouraging FIs to invest in illegal high-interest products without conducting robust risk assessments. This moral hazard could lead to a systemic crisis. In November 2019, PBOC proceeded to restructure Baoshang after being close to completing asset and capital verification work.

Business Transfer and Sale of Baoshang

On 30 April 2020, Baoshang received regulatory approval for the transfer of its business, assets and liabilities to Mengshang (a new province-level FI) and Huishang.

Mengshang assumed the business, assets and liabilities of the head office and various branches of Baoshang in North China's Inner Mongolia autonomous region, while Huishang took over branches outside Inner Mongolia.

Mengshang – with a registered capital of about CNY20 billion (\$2.8 billion) – would serve as the 'New Baoshang'. Its shareholding structure comprises Inner Mongolia's finance

department and state-owned enterprises (50.16%), DIFMC (29.84%), Huishang (15%), and CCB's subsidiary, Jianxin Finance Asset Investment Co. Ltd (5%).

Anhui-province's Huishang⁶⁷ was one of Baoshang's biggest creditors prior to the latter's takeover by the government, and is reported to have sustained CNY3 billion (\$425 million) in losses via interbank loans. The DIFMC provided CNY34.4 billion (\$5.0 billion) to Huishang to cover losses from buying part of Baoshang's good assets. In August 2020, it was reported that DIFMC had injected another CNY8.9 billion (\$1.3 billion) into Huishang and became its second largest shareholder.

Liquidation of Baoshang's Stub

Subsequently, in August 2020, it was reported that Baoshang would file for bankruptcy and liquidate its remaining assets in a final step to clean up the mess. The equity of Baoshang's original shareholders and unprotected creditors would be liquidated in accordance with the law. Authorities had stated that they would also hold relevant persons to account for Baoshang's troubles.

According to the official disclosure by PBOC, the government-led restructuring of Baoshang covered repayment of 90% of debts to large creditors. Since the takeover of Baoshang, PBOC has provided CNY23.5 billion (\$3.38 billion) of

liquidity support through a standing lending facility. Without the injection of public funds, the average repayment rate for creditors would be less than 60%.

In November 2020, Baoshang stated that it would write-down the full principal amount of a CNY6.5 billion (\$984 million) Tier 2 capital bond (Bond) and not make remaining coupon payments of CNY585.6 million (\$89 million). This was in accordance with clauses in the Bond's prospectus, and followed a notice by the PBOC and CBIRC confirming that Baoshang had experienced a "non-viability trigger event".

⁶⁶ PBOC established the deposit insurance fund in 2015 and has since collected insurance premiums from depository FIs. Depositors could receive up to CNY500,000 (\$70,800) each in compensation if a bank were to fail

⁶⁷ Huishang Bank's asset size was CNY1.13 trillion (\$162 billion) in 2019, equivalent to market share of 0.4% of China's banking system

Key takeaways

Resolution strategies need to fit within the broader context and state of play of financial systems in specific jurisdictions. In China's case, these considerations include the market structure (e.g. size, concentration, type of players, geographical dispersion), stage of development, sectoral interconnectedness between banks and insurers, role of government in the financial sector, political economy and other regulatory as well as institutional factors.

The resolution of Baoshang relied on funding and operational support from central and provincial governments, as well as the Deposit Insurance Fund Management Corporation. A large state-owned bank was also drafted into the overall restructuring scheme.

The authorities in China also sought to avoid moral hazard in executing the resolution strategy for Baoshang. The PBOC chose a measured response to impose haircuts on corporate and interbank depositors while retail and small deposits were fully protected. Baoshang's Tier 2 bond worth a principal sum of CNY6.5 billion (\$984 million), would also be fully written down together with the ceasing of related coupon payments. This loss-sharing mechanism was an attempt to break the long-existing implicit government guarantee of full repayment, which had fuelled risk-taking by FIs. Such actions were also in line with regulators' heightened scrutiny of the risk management of regional banks.

Commercial banks and deposit-taking institutions in China will begin to use deposit insurance labels starting from November 28 (2020) ... this is a break from past practice, where it was widely assumed the authorities would step in to save collapsing financial firms

Central Banking Publications

While the group of recent bank failures and restructurings in China including Baoshang Bank, involved small, regional banks (collectively holding just 1.2% of total assets of the banking industry), authorities nonetheless acted decisively to preserve financial stability and market confidence. Swift and close collaboration between regulatory bodies were imperative in crisis management. Clear communications on the progress of resolution, including successive press conferences on areas such as reasons for takeover, status of follow up actions, and the liquidity position of troubled banks – all served to alleviate market anxiety. These actions were crucial to address prospective contagion risk, amid growing investor concerns on the collective indebtedness of small banks.

China's experience also highlights issues relating to corporate governance. In July 2020, the CBIRC published a list of 38 shareholders required to divest from banks and insurance companies. These shareholders had used banks to finance companies they own leading to concentration risk for the lenders, including the case of Baoshang Bank linked to Tomorrow Group.

Another separate development in China was a spate of bank runs in rural banks. These were triggered by social media rumours in end-2019 and from July to August 2020.

