China Debt Dynamics

CBRC Crackdown Has Teeth

Volume 2 | Issue 1
29 January 2018

Andrew Brown, CFA
Partner, Macro & Strategy

CBRC publicly criticizes and penalizes Shanghai Pudong Development Bank (SPDB)

The China Banking Regulatory Commission (CBRC) is serious about enforcing, and penalizing, banking infractions regarding prohibited accounting practices. There has been a flurry of regulatory announcements by the CBRC recently, with an increasing pace of financial penalties as a matter of public record. Only two days ago, on 27 January, the CBRC fined 12 banks RMB295 million (US$45 million) and punished over 40 people for their illegal use of bank funds of more than RMB3 billion. And just recently, on Friday 19 January, the **CBRC fined SPDB RMB462 million (US$72 million) for loan misclassifications** using creative (and prohibited) accounting to "warehouse" or hide a significant amount of NPLs. And they made no bones about it, using uncharacteristically strong language: "This is a well-organized fraud engineered by Pudong Bank's Chengdu branch… **It involved a massive amount of money, used hidden schemes, and had profoundly damaging implications**." As reported by Bloomberg, one of the breaches was that they funneled RMB77.5 billion (US$11.7 billion) of illegal loans through 1,493 shell companies, and that these companies in turn bought-out SPDB's original borrowers to conceal the fact that the loans were in default.

CBRC enforcement has teeth; NPL flows increasing

As we wrote in our China Debt Dynamics almost a year ago in March 2017, we believe the appointment of Mr. Guo Shuqing as the new head of the CBRC was (and is) a clear sign of the **Chinese authorities' intent on accelerating NPL resolutions**. And then we wrote again in April 2017 that Mr. Guo hadn't wasted any time with issuing "Circular 46" in which the **CBRC stepped-up its enforcement of prohibited accounting practices** that banks have been employing to understate credit exposures and/or warehouse problem loans, culminating in what we believe would be an **increased flow of NPL portfolio sales** as 2017 progressed.

Both of these things have been happening at an accelerated pace. First, the CBRC has been actively **auditing and investigating the banks, instituting penalties for non-compliance, and disclosing these as a matter of public record**. The SPDB event is the latest significant evidence of this, and it won't be the last in our view. Having said that, we should note that **we do not believe the issue to be systemically risky**, and we believe the Chinese authorities are fully in control of navigating this regulatory crack-down in an orderly fashion, as we have also written before (see "China Debt Dynamics; Why Now is the Optimal Time to Invest in NPLs"; 01 March, 2017). But to be sure, we should expect the CBRC to stay-the-course, and expect further new initiatives and announcements as they expose untoward practices and administer corrections and penalties.

Secondly, we believe this has played a part in the acceleration in NPL flows into the marketplace as banks seek solutions to clean up their balance sheets under the increased regulatory scrutiny and enforcement. As evidence, **ShoreVest's pipeline now includes 420 portfolios with an asking price (not original principal balance) in excess of US$50bn,** and is growing quickly each month. The regulatory push is surely affecting the increased flow of NPL portfolios into the marketplace.

As we have also shared previously, we at ShoreVest have long-been on top of banks' creative accounting techniques, with granular estimates at the individual bank level, and have been anticipating such moves by the CBRC. In fact, **almost two years ago, we developed a detailed predictive-sourcing database on the back of irregular accounting practices, which allows us to predict and act quickly** as a friendly solution provider to those banks most affected, through sourcing NPL portfolios that have yet to be recognized on their balance sheets.

On the back of these CBRC initiatives, there are increasingly-willing sellers of these exposures (and of NPLs overall), and we fully expect this flow to grow further in 2018. Early engagement with those banks that are most affected positions ShoreVest well to efficiently source NPL portfolios.

Our contact details:
International Finance Center
Suite 3601
5 Zhujiangxi Road
Tianhe District
Guangzhou, China

inquiries@shorevest.com