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Chinese Banks' Reemergence in the United States

I. INTRODUCTION

Beginning in 1991, the expansion of Chinese banking operations in the United States ceased due to heightened federal regulations.¹ This lasted until July 14, 2008, when the New York State Banking Department licensed China Merchants Bank ("CMB") to begin conducting branch operations in New York after receiving approval from the Federal Reserve Board ("FRB").² The CMB licensure is merely the beginning of a wave of expansion by Chinese banks into the United States which includes the recent FRB approvals in late 2008 for Industrial and Commercial Bank of China ("ICBC")³ and China Construction Bank ("CCB") to also establish branch operations.⁴ This is particularly significant for ICBC and CCB are two of the four main Chinese government-held commercial banks which now rank as some of the largest financial institutions in the world.⁵ Only five years ago, these same two financial institutions were considered to be "technically insol-

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¹. Press Release, N.Y. St. Banking Dept., New York Banking Department Licenses China Merchants Bank; First New Chinese Branch to Open in U.S. in 17 Years (July 14, 2008), http://www.banking.state.ny.us/pr080714.htm [hereinafter CMB press release].


They required massive capital injections and improved oversight by the Chinese government as part of a restructuring effort in order to become financially viable and comply with U.S. standards for entry.\textsuperscript{7} The FRB decision to permit entry to these banks into the United States should be viewed positively as it affirms the success of the Chinese banking system reforms and opening the door to greater interdependence with one of our largest trading partners. Despite the political resistance and potential drawbacks associated with greater investment by Chinese entities in the United States, this development does have positive implications for the U.S. economy. Part II of this note examines the 1991 legislative action that previously prevented expansion of Chinese banks.\textsuperscript{8} Part III discusses the review procedures for foreign banks seeking entry into the United States.\textsuperscript{9} Part IV lays out the reforms to the Chinese financial regulatory system that were necessary for compliance,\textsuperscript{10} and Part V addresses the implications of Chinese bank branches in the United States.\textsuperscript{11}

II. ESTABLISHMENT OF FOREIGN BANKS AND THE FOREIGN BANKING SUPERVISION ENHANCEMENT ACT OF 1991

By 1991, two Chinese banks, the Bank of China ("BOC") and the Bank of Communications, had established branches in the United States\textsuperscript{12} under the International Banking Act of 1978 ("IBA").\textsuperscript{13} The IBA provided certain safeguards for U.S. consumers such as placing minimum limits on reserve capital of foreign branches in the United States.\textsuperscript{14} It did not, however, require the

\begin{itemize}
\item\textsuperscript{6} See Silk & Malish, supra note 5, at 124-125.
\item\textsuperscript{7} See id.
\item\textsuperscript{8} See infra Part II.
\item\textsuperscript{9} See infra Part III.
\item\textsuperscript{10} See infra Part IV.
\item\textsuperscript{11} See infra Part V.
\item\textsuperscript{13} 12 U.S.C. § 3101 (2006).
FRB to analyze the banking institution’s financial stability or the regulatory strength of the home country in determining whether to grant it an operating license or permit the FRB to revoke that license once granted in many circumstances.\(^{15}\)

After some troubling banking scandals in the late 1980s, particularly one resulting from a large international bank holding company that was established in countries with lax oversight, Congress increased regulation over foreign banking operations in the United States by passing the Foreign Bank Supervision Enhancement Act of 1991 ("FBSEA").\(^{16}\) The FBSEA establishes the FRB as the gatekeeper for all foreign banking institutions seeking to begin operations in the United States.\(^{17}\) The federal approval process did not replace the state or federal licensing system.\(^{18}\) Rather, it provided safeguards in an effort to protect the financial system from fraud, money laundering, and financial instability.\(^{19}\) It was these heightened restrictions that foreclosed the expansion of branch banking operations of Chinese banks in the United States since 1991.\(^{20}\)

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15. See id. at 1 ("[IBA] did not require prior federal review of foreign bank entry into the U.S. market, nor did it permit a federal role in the termination of a state-licensed branch.").

16. For example, one of the major scandals that created the perceived need for more regulation was the collapse of Bank of Credit and Commerce International ("BCCI"), a banking entity with holding companies that were established in nations that lacked oversight, such as Luxembourg and the Cayman Islands. See, e.g., LISSA L. BROOME & JERRY W. MARKHAM, REGULATION OF BANK AND FINANCIAL SERVICE ACTIVITIES: CASES AND MATERIALS, 909-911 (3d ed. 2008) (describing the legislative response to the banking scandals of the late 1980s). See also Sen. Comm. For. Rel., 102nd Cong., The BCCI Affair (Comm. Print 1992) (written by Sens. John Kerry & Hank Brown), available at http://www.fas.org/irp/congress/1992-rpt/bcci/22legrec.htm ("[Current policy] needs to be replaced by a policy that threatens to withhold access to the U.S. market for banks doing business in any nation that does not meet minimum standards for regulation and the sharing of information with the United States.").

17. See Broome & Markham, supra note 16, at 910.

18. E.g., ICBC approval, supra note 3, at C116 n.16.

19. See Broome & Markham, supra note 16, at 909-10.

III. APPROVAL UNDER FEDERAL AND STATE REGULATIONS

Foreign banks have several ways of expanding into the U.S. market. They can establish a branch or more limited banking forms, such as an agency or representative office. Under the FBSEA, the key requirement for the operation of a foreign banking entity in the United States, besides managerial and financial adequacy, is that it must be “subject to comprehensive supervision or regulation on a consolidated basis” in its home country. There are, however, different standards and exceptions depending on the desired type of entity.

A. Representative Offices

Representative offices, as defined by 12 U.S.C. § 3101, are more limited banking forms that are prohibited from holding consumer deposits or engaging in normal banking operations. The threshold for entry by such a foreign bank is relaxed in this case. The FRB requires only that the “applicant bank is subject to a supervisory framework that is consistent with the activities of the proposed office,” as opposed to the more rigorous language for branches and agencies.

During the period from 1991 to 2007, several Chinese banks received approval under the FBSEA for the establishment...
of representative offices for the purpose of soliciting customers and acting as a U.S. liaison for banking operations in China.27

B. Branches and Agencies

The major distinction between the most limited form of entity as opposed to branches and agencies is the ability to take deposits and engage in direct lending.28 According to the approval orders, the three banks intend to "engage in . . . lending, trade finance, and other banking services," in addition to the taking of corporate deposits.29

In seeking to establish a branch, the "consolidated basis" language of the FBSEA applies. However, according to 12 U.S.C. § 3105(d)(6)(A)-(B) (2006), this requirement can be disregarded if:

A . . .

(i) The appropriate authorities in the home country of the foreign bank are actively working to establish arrangements for the consolidated supervision of such bank; and

(ii) [Other factors, such as financial and managerial adequacy, furnishing of information, etc.] are consistent with approval.

B . . . The [FRB] shall also consider whether the foreign bank has adopted and implements procedures to combat money laundering . . . [and] whether the home country of the foreign bank is developing a legal regime to address money laundering . . .

Though the FRB refused to find that CMB, ICBC, and CCB were subject to the strict regulatory standards mandated by


28. The major distinction between an agency and a branch is the ability to take deposits from U.S. citizens and residents. See 12 U.S.C. § 3101(1), (3) (2006). The entry standard for both of these entities is the same. 12 U.S.C. § 3105(d) (2006).

29. E.g., CMB approval, supra note 2, at C24.
the FBSEA, they were permitted entry under the 12 U.S.C. § 3105(d)(6)(A)-(B) exception.\textsuperscript{30}

C. State Approval

The FBSEA does not preempt state regulatory oversight and approval.\textsuperscript{31} Thus, the FRB order was contingent upon the approval by the New York State Banking Department.\textsuperscript{32} Although BOC and the Bank of Communications were established under federal charters,\textsuperscript{33} CMB, ICBC, and CCB all sought state charters to begin operations.\textsuperscript{34} New York foreign bank entry standards mimic those of § 3105, and require “comprehensive supervision or regulation on a consolidated basis.”\textsuperscript{35} While the FRB approvals indicate that federal approval is not dispositive of subsequent state approval, CMB, ICBC, and now CCB, has each received New York regulatory approval before the following FRB approval order was announced.\textsuperscript{36}

IV. CHINESE FINANCIAL SYSTEM AND REFORMS

A. The State of the Financial System Pre-2003

Chinese banks wishing to gain entry into the U.S. market faced two challenges: receiving adequate government oversight and showing financial stability. Prior to 1979, there was a single

\textsuperscript{30} See, e.g., id.

\textsuperscript{31} E.g., id. at C26 n.15.

\textsuperscript{32} Id.

\textsuperscript{33} See CMB press release, supra note 1 (stating that CMB is the first Chinese bank to receive a New York State charter).

\textsuperscript{34} Press Release, N.Y. St. Banking Dept., Governor Paterson Announces Largest Commercial Bank in China Opens Branch in New York State (Oct. 15, 2008), http://www.banking.state.ny.us/pr081015.htm (stating that CMB is the first Chinese bank to receive a New York State charter).

\textsuperscript{35} Application by a Foreign Banking Corporation for a License to Establish and Maintain a Branch or Agency in the State of New York. N.Y. St. Banking Dept., at 7, http://www.banking.state.ny.us/fcbnet1.pdf (citing New York law).

central bank in China, The People's Bank of China ("PBOC"), but restructuring that took place over the next several years resulted in the spinning off of four government-controlled institutions, including BOC, ICBC, and CCB. 37

Among the obstacles to admission into the United States was the presence of delinquent or non-performing loans ("NPLs") and the resulting inability to meet minimum capital adequacy standards. 38 NPLs rose mainly due to the practices of "policy lending," based on a government mandate of support to state-owned enterprises, and "relationship-based lending," whereby banks would lend to those organizations and individuals who had a good relationship with the bank and without regard to the potential risk of non-repayment. 39 Chinese officials acknowledged the potential pitfalls of these practices after the 1997 Asian financial crisis. 40 According to some sources, having an NPL ratio of fifteen percent or more may lead to financial instability in the broader economy. 41 By some estimates, the Chinese state-owned banks had NPL percentages approaching twenty-five percent or more. 42 Joint-stock


38. See Silk & Malish, supra note 5, at 118; also, e.g., CMB approval, supra note 2, at C26 (citing achievement of capital adequacy as a reason for approval).


41. See YU YONGDING, RESEARCH CENTER FOR INTERNATIONAL FINANCE, CHINESE ACADEMY OF SCIENCES, WHAT CAN WE LEARN FROM THE ASIAN FINANCIAL CRISIS? 14 (Aug. 2001) ("The lesson from the 1980s is that financial distress is likely to become systemic when NPLs ... reach 15 percent of total loans.").

42. See id. Estimates of NPLs abound, and were typically much higher than figures released. See, e.g., Elisabeth Rosenthal, Bank of China's Mounting Problems,
commercial banks, such as CMB, which had greater private ownership, did not suffer from such severe issues relating to NPLs. This has been attributed to less government influence and control.\textsuperscript{43}

Other problems recognized in the Chinese financial system in the late 1990s and 2000s were corruption, money laundering, and the lack of transparency that resulted from poor regulatory oversight.\textsuperscript{44} One notable example occurred in the mid 1990s, where one of BOC's executives secured a $23 million loan for his wife on insufficient collateral which was then improperly repaid through funds at BOC's New York branch. The case was subsequently settled by BOC with U.S. and Chinese regulators, giving them each $10 million in fines.\textsuperscript{45} In response to such scandals and in seeking better enforcement of the laws, China held two National Financial Work Conferences in 1997 and 2002 to reduce local government influence in making loans and increasing the government's supervision of the financial markets.\textsuperscript{46}

B. Reform and Restructuring 2003-2007

1. Supervision

The 2002 Work Conference set into motion recommendations that would result in the creation in 2003 of an independent

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\textsuperscript{44} See Rosenthal, supra note 42.


\textsuperscript{46} See Zhou speech I, supra note 39.
supervisory board, the China Banking Regulatory Commission ("CBRC"). The CBRC was given the task of both promulgating and enforcing standards and maintaining financial statistics. The duties of the CBRC were further focused with additional legislation at the end of 2003, giving it regulatory authority over "risk management, internal controls, capital adequacy, asset quality, [and] loan loss provisioning."

One of the first tasks that the CBRC undertook was to reassess the standards for the calculation of NPLs, the booking of revenue, and variable loss provisions. This was part of a broader effort to reduce the number of NPLs and increase the viability of the large state-owned banks for potential public stock offerings in hopes that it would ultimately help commercialize them. Because of the standards that were implemented, CBRC statistics show that capital adequacy has improved for the nation's commercial banks year over year.

Another key reform was the passage of anti-money laundering ("AML") regulations, enacted in 2003 and 2007. The

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47. See id.
50. See INDUSTRIAL AND COMMERCIAL BANK OF CHINA, 2004 ANNUAL REPORT 72 (2004) ("In March 2004, CBRC promulgated the 'Regulation Governing Capital Adequacy of Commercial Banks' which required all Chinese commercial banks to calculate their capital adequacy according to the regulation.").
52. See Zhou speech II, supra note 40 ("The ultimate target of reform [including public offerings] rests in the establishment of a whole set of market system of incentives and constraint.").
54. See CMB approval, supra note 2, at C25. The first anti-money laundering legislation passed after restructuring of the financial system occurred in March, 2003, with several bills from the PBOC that "put forward ... The anti-money laundering [AML] supervisory requirements for the banking institutions, and set up the basic framework for China's system of [AML] reporting and ... monitoring." Zhou Xiaochuan, Governor of the People's Bank of China, Speech to the Ministerial Joint Conference on AML: Anti-Money Laundering in China: the status quo and the prospects
enactment and enforcement of AML laws are an integral part of the §3105(d) exception. The 2003 legislation established the PBOC as the main authority for coordinating AML laws and provided for consequences to financial institutions that failed to comply with its reporting guidelines. The PBOC went on to coordinate AML efforts between twenty-three other government agencies, termed the “AML Bureau,” in examination and reporting efforts. These laws were based in part on international standards put forth by the Financial Action Task Force (“FATF”), a body established by the G-7 nations in 1989.

This legislation was revised in late 2006 to include more regulation and oversight which became effective in 2007. This involved mandated compliance with enumerated AML procedures and home-country laws for Chinese bank branches operating in foreign countries. These enactments elevated China from observer status to full membership in the FATF in 2007.
2. Bank Restructuring

The improved financial condition of these banks was also necessary in order to receive FRB approval. Financial restructuring was conducted in a series of steps, beginning with the government issuing bonds in order to provide for more bank capital after the 1997 Asian financial crisis. Then, in 1999, NPLs were purchased and transferred into government-controlled asset management companies. This method was similar to the proposed U.S. plans to free banks from illiquid securities as the 2008 financial crisis unfolded. The result was that state-owned banks were able to vastly improve their balance sheets and capital adequacy ratios reached international standards, as noted in the FRB approvals.

After achieving structural and financial improvements, the next step was to conduct initial public offerings ("IPOs"). One of the goals of this exercise was to increase the competitiveness of these financial institutions by increasing outside ownership and instilling a need for profitability in management. The potential risks of substantial continuing state control has not put a damper on investment as three of the four main state-owned banks have


63. See Problems Left Over From History, ECONOMIST, Dec. 11, 1999 (describing the use of asset management companies as being based upon those used for defaulted savings and loans in the United States during the 1980s) (LexisNexis).

64. See, e.g., David M. Herszenhorn, Administration is Seeking $700 Billion for Wall Street, N.Y. TIMES, Sept. 20, 2008, http://www.nytimes.com/2008/09/21/business/21cong.html (describing the U.S. counterpart to such a scheme, involving the purchase of illiquid mortgage assets in order to shore up the balance sheets of the leading U.S. financial banks and restore liquidity to the U.S. economy).

65. For example, ICBC was able to reduce its NPL ratio from 21.16% for fiscal year 2004 to 4.69% in fiscal year 2005. ICBC 2005 Annual Report, supra note 43, at 37.

66. CMB approval, supra note 2, at C26 ("CMB's capital is in excess of the minimum levels that would be required by the [Basel Capital] Accord and is considered equivalent to capital that would be required of a U.S. banking organization.").

67. See Zhou speech II, supra note 40.

68. See Diya Gullapalli & James T Areddy, China Bank Stocks Tempt Investors - Hot Listings Will Soon Be Easier to Buy, But Pros Warn About Sector's Substantial Risks, WALL ST. J., June 7, 2006 ("[E]ven after its IPO, [the Chinese government] will continue to own roughly 70% of Bank of China."). At the time of approval, nearly 75% of ICBC was under direct or indirect government control. See ICBC approval, supra note 3, at C114 n.3. Based upon prior evidence, simply increasing private ownership in banking institutions to a limited degree does not have a significant effect on
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raised significant amounts of capital in IPOs. With the scuttling of unrecoverable loans, large infusions of capital, supervisory bodies in place to promote greater transparency, and FRB approvals, it would appear that these banks are ready to set foot into the U.S. market.

There are several reasons for expanding into the United States, such as gaining management experience in foreign markets and increasing financial stability. These banks will also be able to cater to Chinese clients in the United States, thus assisting in government policies to encourage investment abroad. This increase in a Chinese banking presence internationally, including in the United States, correlates with the increase in foreign direct investment made by Chinese multinationals abroad in recent years.

V. IMPLICATIONS OF INCREASED CHINESE FINANCIAL PRESENCE

A. Potential Positive Results

Particularly during the financial downturn in the United States beginning in 2007, there has been a need for liquidity in the market, investment firms, and commercial banks as evidenced by corporate governance. See A Great Big Banking Gamble – China’s Banking Industry, supra note 51 (comparing China’s state-owned banks to those in Poland and the Czech Republic, where significant reforms did not occur without greater private control).


71. See Silk & Malish, supra note 5, at 112. See also Zhou Xiaochuan, Governor of the People’s Bank of China, Speech to the 11th China International Fair for Investment and Trade and the International Investment Forum: Provide Financial Support to Enterprises “Going Abroad,” (Sept. 8, 2007), http://www.pbc.gov.cn/english/ /detail.asp?col=6500&ID=145 [hereinafter Zhou speech IV] (“Qualified financial institutions will be encouraged to establish overseas operations, and explore equity investment in overseas financial institutions through merger and acquisition, in order to provide [Chinese] enterprises with convenient financial services in their overseas investment and operation.”).

recent government action.73 Permitting these Chinese banks to operate in the United States could allow greater access to the lending market and help encourage investment by Chinese companies.74 In fact, in September, 2008, the FRB invited Chinese investment in U.S. firms strapped for capital.75

Investment opportunities may also arise through direct investment by Chinese companies. The expansion of banking operations in the United States will likely give greater access to loans, not only to U.S. organizations, but also Chinese companies seeking to make further inroads into the U.S. market.76 Some comparisons have been drawn between this financial expansion and that of Japanese banks twenty years ago, when the banks followed their domestic customers into the United States.77 It would therefore be possible for these Chinese banks to make equity acquisitions in U.S. financial institutions and to facilitate Chinese companies in further expansion into the U.S. market.

Over the long term, the FRB hopes that its permitting Chinese banks to enter the United States will result in further reciprocal opening by the Chinese financial markets to greater investment by U.S. businesses.78 Since entry into the World Trade
Organization in 2001, liberalization of the financial market to foreign entities has been ongoing, but the United States is seeking further progress in areas such as securities trading.

B. Potential Drawbacks and Negating Factors

While increasing investment and liquidity in the United States could be a positive result of the re-entry of mainland Chinese banks, there is still some question as to what benefits would be experienced domestically, or if there would be any noticeable effect at all. For example, it has been observed that state-owned banks have shown preferential treatment for other Chinese companies in lending practices. During the high-profile Unocal bid made by CNOOC, a state-owned petroleum company, in 2005, ICBC was one of the potential financiers that offered what was alleged by some to be an excessively low interest rate loan in order to make the transaction possible. Although the deal ultimately failed under political pressure, the possibility of the acquisition of U.S. banks by Chinese banks and the favorable terms that the state-controlled banks can potentially offer to Chinese businesses may have the effect of reducing the business available to U.S. banks from Chinese companies already in the United States. It would also likely reduce business that would otherwise be available to U.S. banks who wish to service incoming Chinese compa-

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80. For example, there are limitations placed on foreign financial institutions in terms of the size of the equity stake they can hold in a Chinese bank, though this has been undergoing consistent liberalization. See e.g. *A Chinese Coup; Banking in China*, ECONOMIST, Jan. 7, 2006 (describing the Citigroup equity acquisition of a Chinese bank in excess of previous laws limiting a single foreign institution to 20% ownership as an exception to the rule) (LexisNexis). Additional restrictions apply to financial institutions investing in the Chinese stock market, requiring institutions to undergo a review process and then follow capital requirements and tiered investment restrictions. See Cheng Zhiyun, *More Bars and Hoops for QFII*, ECON. OBS. ONLINE, Apr. 4, 2008 (Liu Peng trans.), http://www.eeo.com.cn/ens/finance_investment/2008/04/30/98359.html.

81. See Silk & Malish, *supra* note 5, at 114 (describing terms of the Unocal acquisition offer).

82. See Clarke et al., *supra* note 21, at 2.
nies, similar to the situation of Japanese banks in the 1980s, whereby the main source of business was from the expansion of Japanese companies into the U.S. market and their need for financing.\(^8^3\)

Politics may also impede the potential of added liquidity provided by the entry of these banks. As illustrated by the Unocal acquisition offer, there has been resistance to expansion by Chinese companies into the United States because of the perceived threat of Chinese government influence over acquisitions.\(^8^4\) It was indicated that a major obstacle to approval of the ICBC and CCB requests was their continued government ownership.\(^8^5\) Sources indicated that it was only after the Chinese government was able to placate fears about politicization of bank operations that they were awarded entry.\(^8^6\)

Additionally, the business growth of the previous operating branches and the current economic environment will likely dictate that operations of these banks will be substantially hindered. Even without the current economic situation, the BOC and Bank of Communications branches that were established in New York have not thus far achieved great profitability due to tight regulation, competition, and operating costs.\(^8^7\) Also, in light of the significant losses that Chinese financial institutions have suffered during the current financial crisis, the drive to expand investment in the United States has been essentially halted for the foreseeable future.\(^8^8\)

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84. *See* Silk & Malish, *supra* note 5, at 116 ("CNOOC has taken the hardest direct beating for its $6 [b]illion bridge loan from state-owned [ICBC]."); *also* Press Release, Sen. Evan Bayh, Baye Urges Review of Chinese Bid for Unocal (July 22, 2005), http://bayh.senate.gov/news/press/release/?id=27d1fd5a-0a09-4cde-b642c4e049189f29 ("[Sen. Bayh] was troubled by reports that CNOOC was receiving subsidized financing from the Chinese government.").


86. *See id.*


C. Progress in the Chinese Financial Sector Must Still Be Made

While there has been a great amount of regulatory rigor impressed upon Chinese banks, it still remains to be seen whether or not the reforms really amount to "comprehensive supervision or regulation on a consolidated basis" as mandated by the FBSEA. The CBRC, the body created to establish standards of practice and provide supervision over the banking system, has been accused of being inept and lacking the talent to effectively police the system. Worse yet, a sizeable number of CBRC employees have been accused of wrongdoing in previous years.

Despite the public offering, the Chinese government continues to maintain a majority interest in CCB, ICBC, and BOC. The FRB's approval of the ICBC application states that half of the seventy percent share owned by the Chinese government would come under control of China's sovereign wealth fund, China Investment Corporation ("CIC"), which is itself wholly owned by the Chinese government. While the CIC purports to be an autonomous entity that is engaged in apolitical investment opportunities, it remains difficult for many to discount the potential for government influence. This majority ownership by the CIC and the Chinese government will likely remain a source of suspicion for the U.S. government.

Third, the current level of capitalization and liquidity, particularly in the state-owned banks, is predicated upon the continued ability to manage the risk of loans made. The reforms that were made in the beginning of 2003, such as liberalizing interest rates, creating a tier structure for risk, and attempting to reduce

90. See A Great Big Banking Gamble – China's Banking Industry, supra note 51 ("[The] head of the CBRC’s international department freely admits, ‘we lack people who understand commercial banking . . . it is a headache for the CBRC.’").
91. See Silk & Malish, supra note 5, at 125 ("[The] CBRC has even accused 1,228 of its own staff of being involved with $10.4 million in irregular funds in 2005.").
92. E.g., CCB approval, supra note 4, at 1 n.3.
93. See ICBC approval, supra note 3, at C114 n.3.
94. See Li, supra note 85.
95. Id.
96. See Garcia-Herrera et al., supra note 62, at 325.
the cronyism associated with awarding loans are significant steps.\textsuperscript{97}
Even with these reforms, however, the difficulty in adjusting from a command-style economy that was once essentially void of any financial services outside of basic savings, to creating the knowledge-base necessary for competent operations cannot be underestimated.\textsuperscript{98}

In an environment of explosive growth, increasing deposits, and increased market capitalization from IPOs, the danger posed by NPLs is negligible as the banks have acted to reduce the proportion of NPLs through the granting of a greater number of loans in recent years.\textsuperscript{99} If an economic downturn did occur, as is likely given the current global financial crisis, the amount of NPLs will increase.\textsuperscript{100} Compounding this problem is the issue of profitability. One legacy of central financial control, besides lending without regard to commercial risk, is the lack of experienced financial professionals to manage the financial services sector.\textsuperscript{101} This leaves the state-owned banks more dependent on interest revenues and less on fees than most modernized financial systems.\textsuperscript{102} An economic slowdown in China may leave its banks more vulnerable than comparable financial institutions in the United States and elsewhere.\textsuperscript{103} Already, there are some signs that indicate that China’s banks, under government mandate, may be required to focus their efforts more domestically on economic stimulus projects that may

\begin{thebibliography}{99}
\item \textsuperscript{97} See A Great Big Banking Gamble – China’s Banking Industry, supra note 51.
\item \textsuperscript{98} See Thomas R. Gottschang, The Asian Financial Crisis and Banking Reform in China and Vietnam, 6 (College of the Holy Cross, Dept. of Econ., Working Paper, No. 02-02, Aug. 2001), http://www.holycross.edu/departments/economics/RePEc/Gottschang_AsianBanking.pdf (describing the difficulties in transitioning from a command-style economy to a capitalist one).
\item \textsuperscript{99} See Garcia-Herrera et al., supra note 62, at 325.
\item \textsuperscript{100} See id. (stating that NPLs will increase for these institutions in a weakened economic environment since fundamental changes in loan making have not been made).
\item \textsuperscript{101} See Gottschang, supra note 98, at 6 (citing the previous command-style economy as being responsible for the lack in financial service professionals).
\item \textsuperscript{102} See id. See also Silk & Malish, supra note 5, at 124 (“China’s banks [had a return on investments] of 0.5 percent in 2005, the worst in Asia . . . Chinese banks are too dependent on loan income.”).
\item \textsuperscript{103} See A Great Big Banking Gamble – China’s Banking Industry, supra note 51 (“[Due to low profitability,] even a tiny deterioration in business conditions that either reduces margins or increases bad loans would wipe out earnings at China’s banks.”).
\end{thebibliography}
result in many of the most recent reform efforts being compromised.  

VI. CONCLUSION

The decision by the FRB to permit the operation of CMB, ICBC, and CCB in the United States is indeed a monumental, positive development. Not only does it potentially mean more investment in the United States at a time when it is needed by a country with the largest foreign exchange reserve holdings in the world, \(^1\) it is also an affirmation of the years of reform that the Chinese financial system has undergone in preparation for its emergence on the international stage.

While there are principally many positive aspects to these approvals, it has yet to be seen whether the effects will be substantive or merely symbolic. There has been sentiment for greater investment in the United States by Chinese companies and these banks may provide liquidity to such transactions at a time that it is needed. There are obstacles to such investment, however, including political resistance and the current state of the economy generally. The banks have put up a strong showing from their NPL restructuring to their IPOs, which provided private capital to supplement government ownership. However, merely passing laws without developing a culture of transparency and trust may present potential difficulties in achieving international prowess. An economic downturn in China or worldwide that exacerbates the NPL situation would also have a negative impact on the ability of these Chinese banks to conduct business. The economic turmoil that has been experienced globally as of late will provide adequate

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challenge to both expectations of success and profitability as they expand abroad.

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