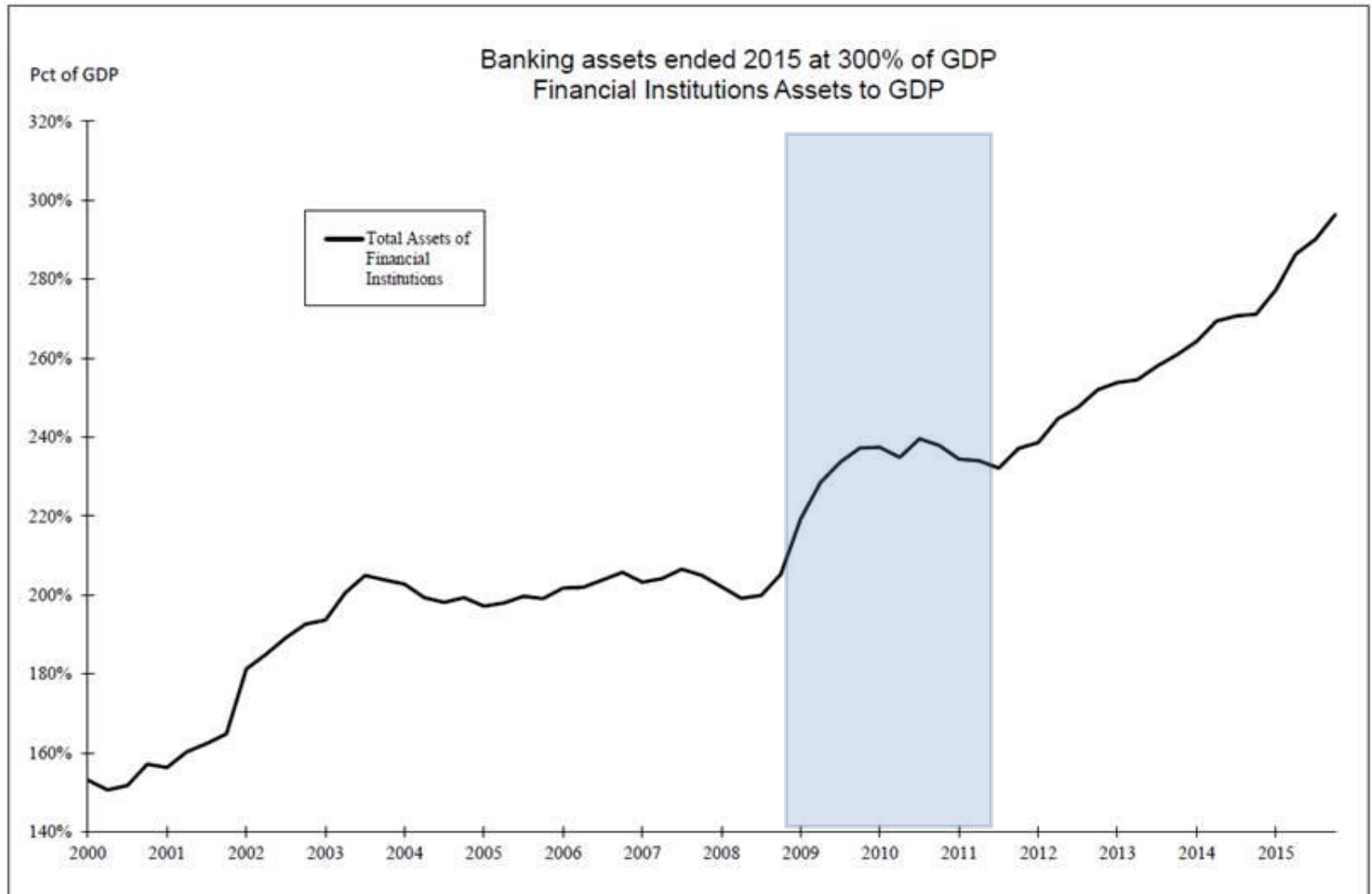


# The Fragility of Chinese Banks

Christian Broda  
Duquesne

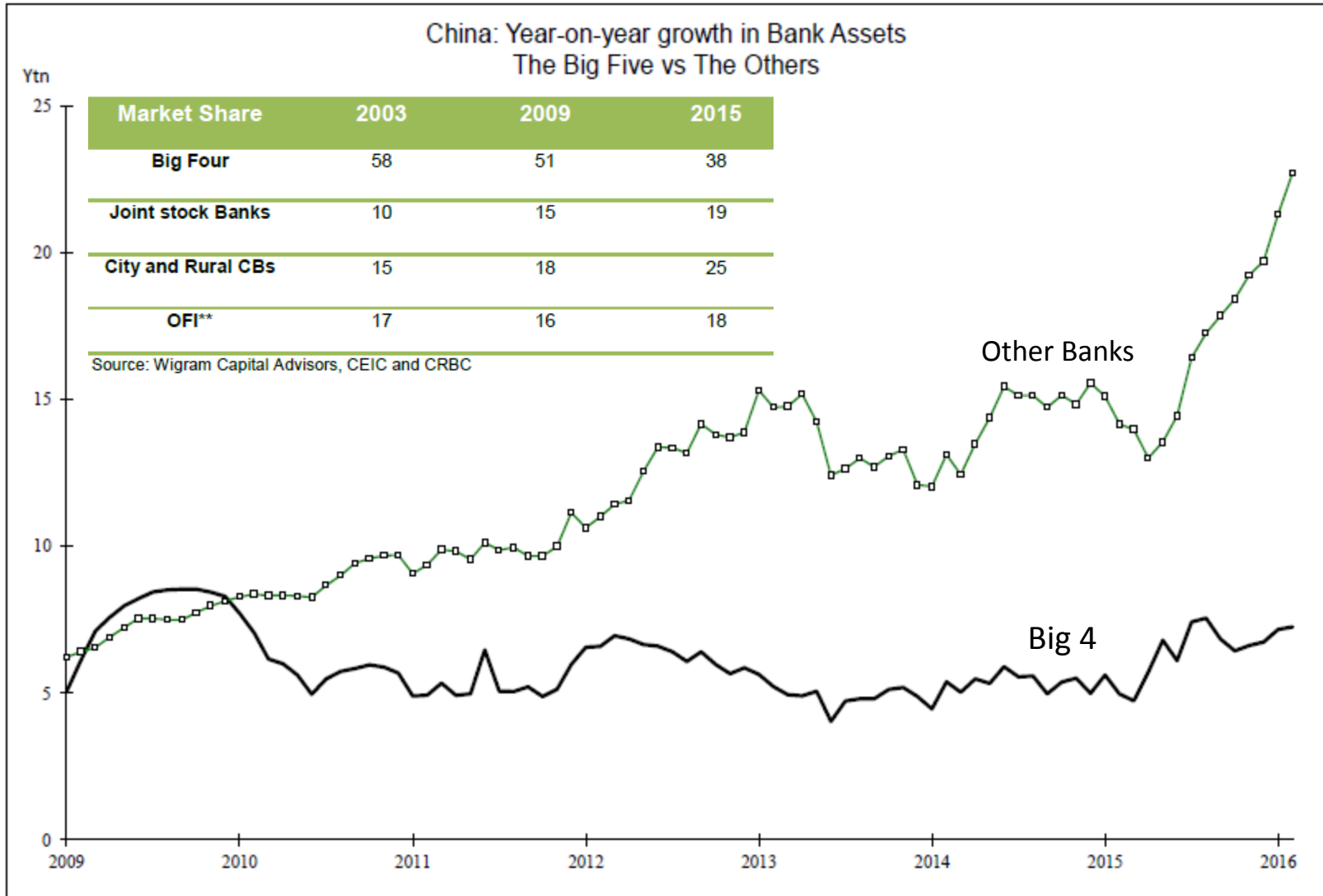
May 2016

# Chinese Bank assets as a % of GDP (“on B/S”)

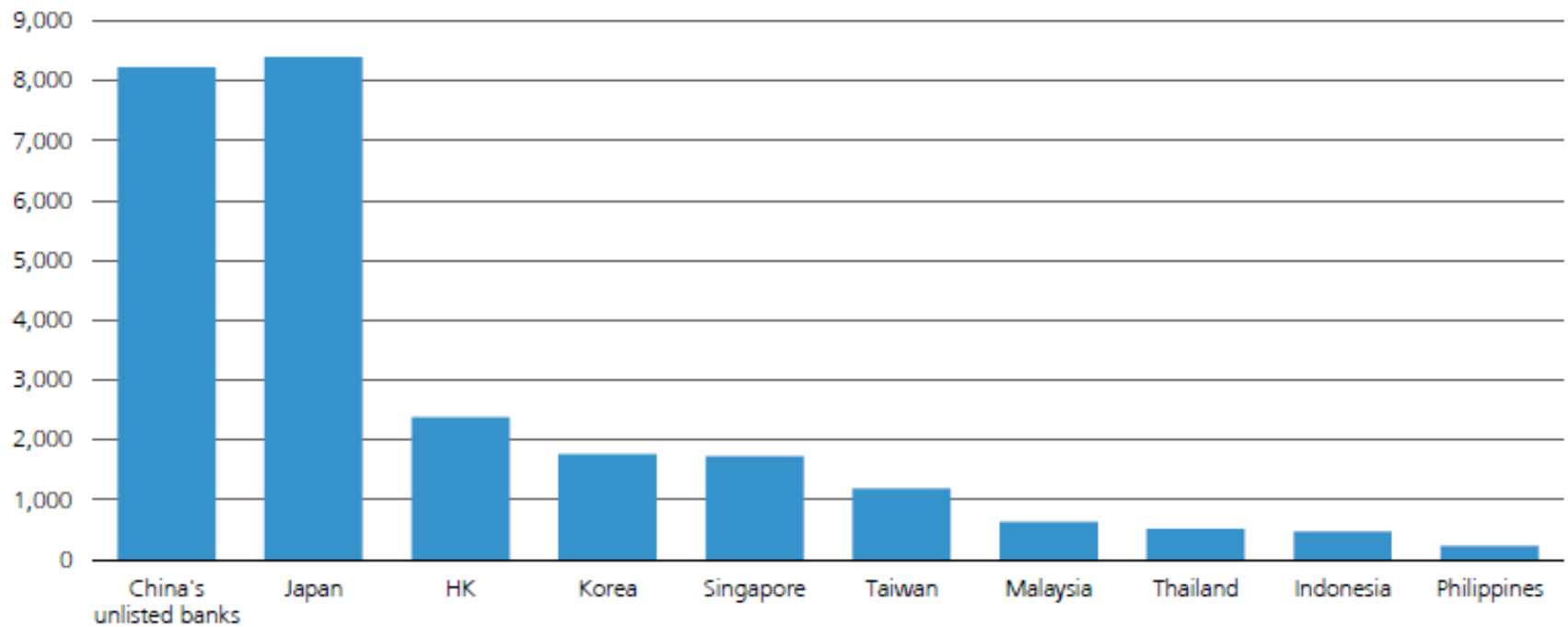


# Type of Banks:

## De-centralization meant growth of provincial banks



# Weaker Regulation of unlisted Banks (in current Dollars)

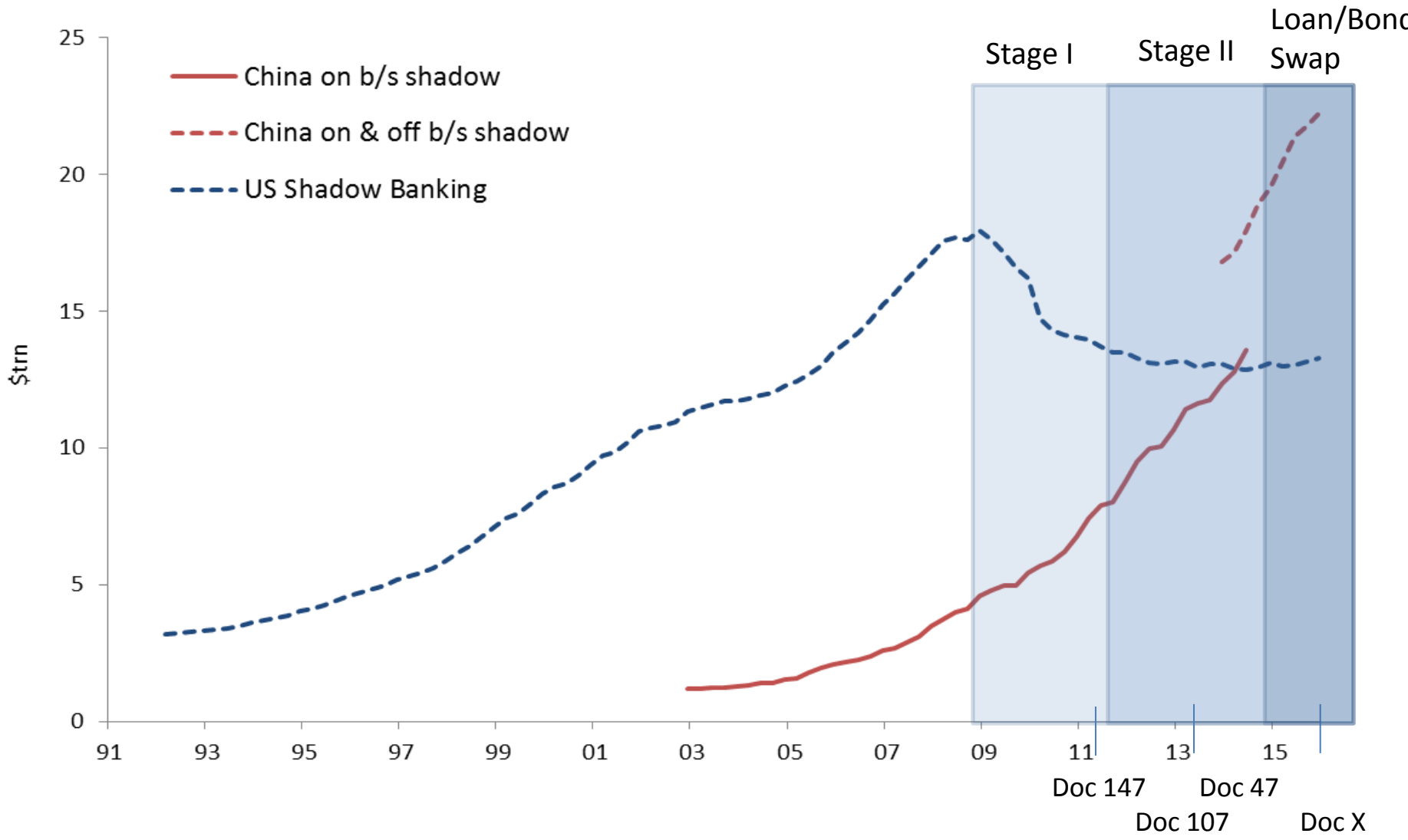


Source: UBS research

Note: The China unlisted bank numbers exclude the assets of China's three policy banks



# Type of Assets: Shadow Lending growth from “Market Discipline”, Capital Arbitrage, Limiting regulation



Source: Pozsar et al (2012), Bedford (2015, 2016), Wigram Consulting (2012-2015)

We have substantially increased our investments in trust beneficiary rights and directional asset management plans due to the following reasons.

Firstly, we are able to reach more customers with financing needs through trust companies and securities companies. Secondly, the returns of investments in trust beneficiary rights and directional asset management plans are also generally higher than other investment products on the market. As of June 30, 2013, the weighted averages of the agreed return on trust beneficiary rights and on directional asset management plans were 6.98% and 6.06%, respectively, which were higher than the weighted averages of the agreed return on government bonds and bonds issued by policy banks as of the same date, which were 3.23% and 4.00%, respectively. In addition, most of our investments in bank guaranteed trust beneficiary rights or directional asset management plans have a risk weighting of 25% in calculating the risk weighted assets under the Capital Administrative Measures, which contribute to a more efficient use of our capital.

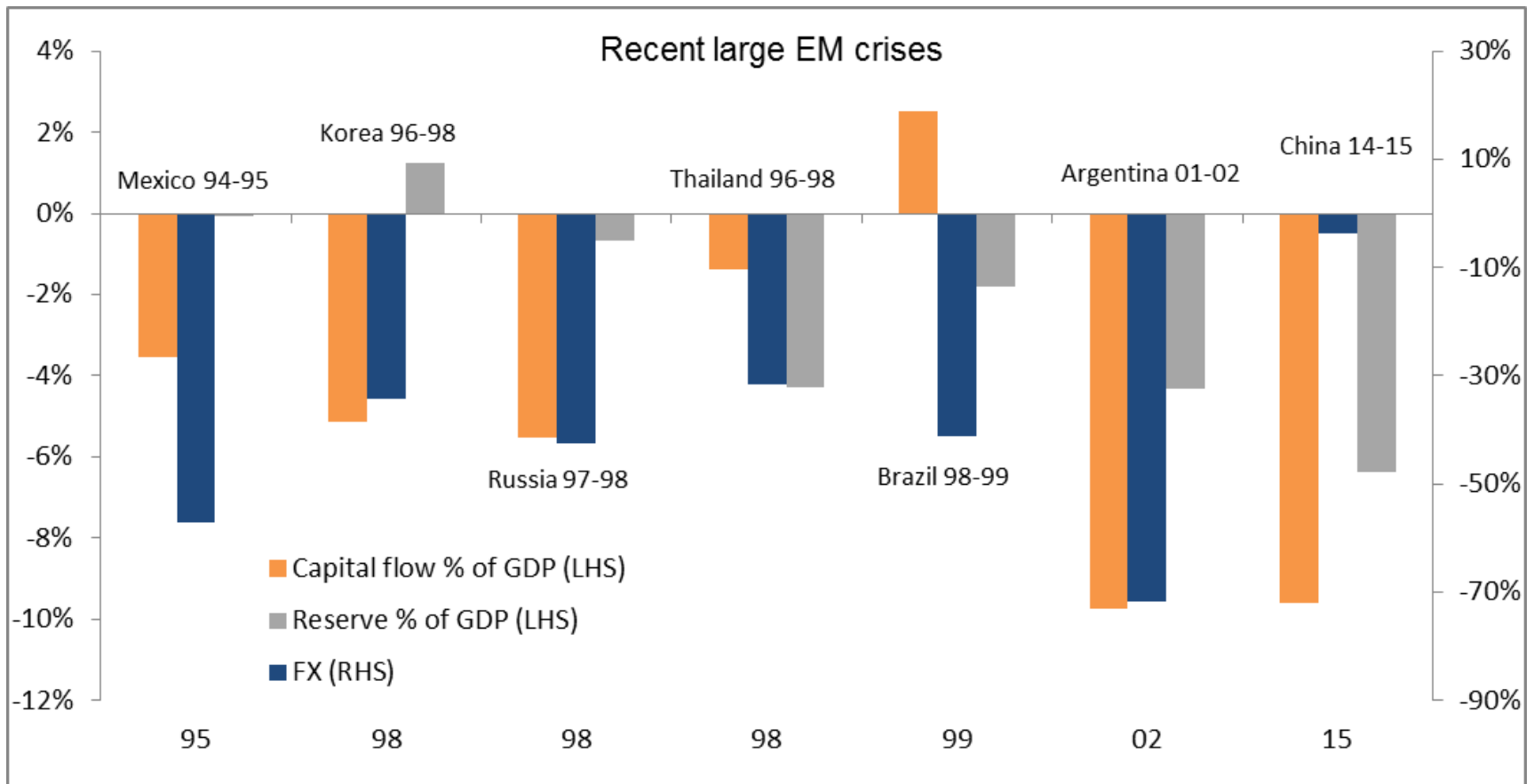
(source: Bank of Chongqing prospectus, page 135)

Capital  
arbitrage  
and credit  
risk of  
shadow  
lending

	Stated CT1 CAR	Impact of normalizing risk weighting from 25% to 100% on TBRs on CT1 CAR (bps)	Impact of applying loan provisioning (2.5%) to TBRs on CT1 CAR (bps)	Revised CT1 CAR
Evergrowing Bank	8.71%	-318	-156	4.54%
Bohai Bank	8.64%	-315	-174	4.38%
Guangfa Bank	8.12%	-87	-40	6.90%
Zheshang Bank	8.62%	-111	-46	7.10%
Chongqing Sanxia Bank	8.74%	-173	-63	6.50%
Xiamen Intl Bank	8.17%	-234	-497	4.97%
Jinzhou Bank	8.64%	-208	-101	5.79%
Bank of Zhengzhou	8.66%	-183	-81	6.20%

Source: Banks' financial information and UBS

# One of the largest capital flights in recent history



Source: Duquesne, Haver.





# Conclusions

1. The speed, extent and type of credit growth are concerning.
2. Risks concentrated in shadow loans (capital arbitrage), smaller provincial banks (with poor supervision or unlisted), and overcapacity sectors (with a strong SOE presence).
3. Growing signs of industrial and banking stress.