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People's Republic of China: National Fund for Development of Credit Guarantees for Private Enterprises

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National Fund for Development of Credit Guarantees for Private Enterprises (NCG)

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Contents:

Views on the Necessity of Utilizing Foreign Capital to Establish Credit Guarantees for Private Enterprises

(Ye Fujing)

The financing problems of private enterprises have always been a critical issue which restrains the economic development in China. Given the predominance of indirect financing among private enterprises at present, establishing credit guarantee system has remarkable significance. This article first examines the importance of credit guarantee system for private enterprise financing, then goes on to analyze the problems in the current credit guarantee system. Finally, it argues that it's necessary to absorb foreign capital to set up credit guarantee funds for private enterprises.

I. Review of Economic Theories on Guarantee

The traditional economic theories presuppose perfect market competition in which manufacturers and consumers know everything about each other, so there was no such a concept as guarantee. The genuine guarantee theory came into being with the arising of information economic theory. In 1970, George Arthur Akerlof, an American economist, explained in his research on second-hand automobile market the outcome resulting from information asymmetry, as well as some mechanisms to cope with this problem, in which the role of guarantee was discussed for the first time. After that, more progress has been steadily made in exploring the theory of credit guarantee.

The well-known economist Joseph Stieglitz particularly analyzed the function of the third-party guarantee in his research on credit ration. Their theories prove that the lender can encourage more application for investment through adjusting the requirement for guarantee and the loan interest rate. The western economists following them further illustrate why credit guarantee is widely used in financing by drawing on moral hazard and adverse selection theory.

Other researchers gave more attention to other functions of guarantee, such as signal transmission and financial agent. For example, researcher Yuk-Shee Chan and George Kanatas considered that when the lender holds different information from the borrower, the guarantee system can help the lender better evaluate the expected returns, thus becoming an additional and indirect signal generator. However, when the two parties produce divergent evaluation of the financing project due to the difference in beliefs, the guarantee system can promote striking the agreement. Donald D. Hester believes that when rationing credit, the bank also attaches great importance to non-price terms of the loan in addition to market interest rate, the relationship with the lender being one of such factors. Therefore, if the lender can come into good terms with the bank and can assure it of its faithfulness to the contract, it probably would get more loans from the bank. And the guarantee system can indeed serve this function.

These researches reveal in theory that guarantee industry may be a double edged sword for economic development. On the one hand, guarantee system can increase enterprise credit, strengthening the bond between enterprise and bank and supporting the growth of the enterprise. On the other hand, owing to the presence of moral haphazard and adverse selection, the guarantee system would intensify the moral haphazard of both the lender and the borrower resulting from information asymmetry. These two aspects can both find reflections in the growth of guarantee industry in China, but obviously the positive effects are far greater.

II. Analysis of the Importance of Guarantee System in Private Enterprise Financing in China

(I) Direct financing is not a solution to the critical issue of private enterprises by far. According to world experiences, direct financing is premised on using numerous financial innovation tools and comparatively mature capital market supervision, but these two premises are not ready yet in China. In the recent decade, the structure of capital market has been severely twisted, due to the restriction of special economic and social environment in China. Stock spot and bond issue has almost become the only investment vehicle in capital market. To prevent financial risks, the stock market inevitably set conditions for admittance. Besides, the pioneer board and SME board are not full-fledged. And the private enterprises, of small size, cannot afford the cost of listing or meet the requirement for public offering. For these weaknesses, it's almost impossible for private enterprise to rely on the stock market as a major financing channel. Compared with developed countries, the stock market in China still needs more improvement. If the SMEs opt for direct financing in the stock market, it will involve higher financial risks and would be difficult to raise the capital as expected. Meanwhile, the state major projects bond and the local enterprise bond currently issued in the bond market are fixed bonds and long-term bond, and mainly go to the investment in macro capital intensive projects. These bonds are more or less pushed by the government and are inaccessible to general private enterprises, thereby being inapplicable to SMEs financing.

(II) It is difficult for SMEs to obtain capital through indirect financing due to their own inadequacy and the defects of our banking system. For one thing, a majority of private enterprises (especially SMEs) do not possess the land management right, nor the ownership and right of use to the factory buildings, so they are not qualified to use the land or factory buildings as effective mortgage. In addition, their accounting information and credit record are incomplete and the financing haphazard of SMEs is evidently higher than that of larger enterprises, which are all obstacles for SMEs to get support through indirect financing. For the other, there are some institutional defects in our banking system. According to statistics, the State owns most of the shares of commercial banks. The situation is not only embodied in intensive industry monopoly and network monopoly, but also in the concentration of financial assets and financial businesses on deposit market and loan market, which are mainly operated by the four giant state-owned commercial banks. The state-owned banks lay more stress on state-owned enterprises in their operation, especially on the large and medium state-owned enterprises, so as to secure their development and reduce financial haphazard. Furthermore, most of the foreign banks are located in the east of China. In view of the incomplete credit system of local enterprises, these foreign banks preferentially target the enterprises invested by their own country. For instance, over 90% of business covered by branches of small- and medium sized Korean banks are for Korean enterprises; however, the local small- and medium sized banks, especially the private banks, have lagged far behind and are not able to provide sufficient credit support to SMEs.

(III) Establishing guarantee system can effectively cope with the financing problems of our private enterprises under current circumstances. In theory, the guarantee industry can be a double-edged sword when it comes to increasing financing efficiency. But under current circumstances, the positive effects of guarantee industry for private enterprise financing could be far larger. As mentioned above, SMEs' financing problems can't be explained by the prevalence of "bad money drives out good money" among SMEs, but result from the deficiencies in China's banking system and overall credit system. Therefore, when there's great need for information, the guarantee system can more serve as a signal than misleading the lender. In practice, the guarantee system can enable the capital owners to grant loan with confidence and security and to achieve their normal economic purposes as a lender. Meanwhile, the enterprises or individuals can build an independent credit resource to make up for their enterprise credit, without reducing their right of disposing to the mortgage. It can be seen that the SMEs' credit guarantee system can obviously increase the credit, that is, the guarantee agencies can provide SMEs with financing guarantee several times or even dozens of times higher than the guarantee capital through effective control of risks. The credit leverage made possible by professional guarantee system can play as financing agent to achieve a maximum result with limited guarantee capital. Since it's hard to improve the enterprise credit system within a short term, increasing credit through guarantee system can be adopted as a better way to tackle the private enterprise financing problems.

III. Private Enterprise Credit Guarantee System in China: Present Situation and Weaknesses

The recent years have witnessed rapid growth of private enterprise credit guarantee system in China. According to incomplete statistics, there are over 4,000 guarantee agencies in China. A comprehensive guarantee system has come into being and provides vigorous credit support to SMEs, with policy guarantee enterprises in a dominant position (accounting for about 90%), supplemented by guarantee agencies self-organized by SMEs and other commercial guarantee agencies (accounting for about 5% respectively). For example, the commercial guarantee agencies in Anhui Province have provided financing guarantee amounting to RMB 59.4 billion to 16, 000 SMEs. However, many weaknesses can still be found in current private enterprise guarantee system, because it was set up only more than a decade ago and our credit system is not yet adequate, which can be illustrated in the following aspects.

(I) The guarantee market and guarantee industry cannot satisfy the SMEs in practice, despite of their rapid growth. At present, credit deficiency is a prevalent problem among SMEs. Most SMEs are composed of many complicated economic components, and modern enterprise system is not really in place. The private enterprise owners are of low quality and are liable to decision mistakes. Despite SMEs' insistent crying for guarantee, the unstandarized management, small assets, few equity capital, and lack of competitiveness add to the risk of providing guarantee for them and pose higher challenge to the guarantee industry. Moreover, the market admittance system in guarantee industry remains to be improved and industry supervision is inadequate to some extent, resulting in easy access and the flooding of all sorts of social capitals into the guarantee market. Though guarantee agencies have mushroomed, they cannot really meet the needs of SMEs, and their operating performance is also unsatisfactory.

(II) There are apparent system deficiencies. Firstly, there are structural system deficiencies. The guarantee capital offered by the government constitutes too large a share while the percentage of private guarantee capital (including mutual guarantee and commercial guarantee) is far too low. Presently, the policy guarantee agencies account for 90% in overall guarantee system, while even in those countries where government provides considerable capitals as America, Japan and Germany, the percentage of guarantee capital offered by the government is no more than 10% of the total of loans for SMEs. Secondly, there are operational system deficiencies. The capital replenishment mechanism and risk diversification mechanism are not yet set up. Due to the dominant position of policy guarantee agencies, the guarantee capital are mainly financial capitals and assets transference from local governments at all levels, limited in quantity and lacking added capital. Besides, it's difficult for these agencies to run as enterprises on the basis of market mechanism, so there is barely any risk diversification mechanism and the only way they resort to avoid risk is to charge higher guarantee fees. As a consequence, the advantage of guarantee industry to increase the credit cannot be brought into play. Thirdly, there are functional system deficiencies. The structural and operational deficiencies in guarantee system would turn into functional system deficiencies in the end. On the one hand, it resulted in a heavier financial burden on the government, involved it in higher risks and impaired its capability of managing market risks. Meanwhile, the market's managing and diversification of risks have been weakened and the establishment of market order, market environment and infrastructure was ignored, which aggravated moral haphazard and adverse selection in credit guarantee, and eventually affect the performance of SMEs' guarantee system, as well as its sustainable development.

(III) The limited role of credit guarantee leverage inhibits the vigor of private capital investment into the credit guarantee industry. Compared with the average ratio of credit guarantee leverage in developed countries (about 10), the power generated by our SMEs' credit guarantee agencies is generally far too little. According to a survey of 16 outstanding guarantee agencies in Hangzhou and Ningbo of Zhejiang Province, where SMEs' credit guarantee industries are more prosperous than other areas, the average ratio is 3.62 in 2003, with Zhongcai Guarantee CO., LTD registering the best performance (13) and Xiacheng Guarantee CO., LTD the least satisfactory (1.64). The low leverage ratio would lead to decreasing return rate on guarantee capital provided by the guarantee agencies; even reduce it to a level lower than average return rate on social capital. Besides, it increases the cost of private enterprise financing, thereby cutting down the financing efficiency.

The low leverage ratio can be explained from several aspects as follows. Firstly, there's a lack of incentive mechanism in policy guarantee agencies and the capitals are not used effectively. Secondly, due to the deficiencies of internal control and management, the guarantee agencies are not capable of high credit leverage. Finally, the enterprise credit system hasn't been completed yet, and in practice, the credit guarantee agencies determine guarantee limit largely by the value of counter-guarantee assets provided by the enterprise, which virtually weaken the capability of increasing credit for SMEs.

(IV) In absence of explicit rules and regulations, nor sound internal control mechanism, the credit guarantee agencies are even faced with credit crisis between two fires. For one thing, to some extent, limited channels, limited size and low quality of guarantee capital has reduced the credit grading, thereby affecting the leverage effect of guarantee. For the other, there's no such standard systems in a great number of guarantee agencies, as the separation of evaluation, verification, and subrogation and recovery, performance supervision, mortgage deposit, subrogation and debt recovery and so on. For guarantee industry, these factors severely damaged its credit when examined both by financing enterprises and by banks, and get it stuck in credit crisis between two fires.

(V)The management philosophy deficiencies further endanger the guarantee agencies themselves and relevant sectors. To begin with, some guarantee agencies are poorly run, with limited business expansion and high rate of idle capital. The phenomenon is more conspicuous in policy guarantee agencies, which are less market-oriented. In addition, the increase of guarantee agencies aggravates competition. To obtain business, some agencies opt for low price competition without taking risks into careful consideration, resulting in high risks and low return of guarantee. The practice not only threatens the long-term development of the agency, but also disrupts the orderly competition of the whole industry. Finally, some guarantee agencies, unable to obtain suitable guarantee business or get approval of the bank, inject their capital in government bond, real estate, and even the stock market, or provide direct loan to the enterprise, thus becoming a "capital dealer". Their approach is a severe departure from the proper business of guarantee agency, which further endangers themselves and relevant sectors, and reduces the credit of guarantee industry as a whole.

(VI) Relevant legislation lags behind the development of guarantee industry and industry supervision remains to be enhanced. It hasn't been long since the guarantee industry came into being, so it has been trying to find the way in operation, management and supervision. In absence of higher legislations, the duty of supervising is not clear-cut among the supervision institutions and only covers a limited range. For the whole industry, there's no explicit admittance and withdraw mechanism, or rules and regulations concerning guarantee procedures, charge standard, supervision and management etc. It leads to many problems that restrict the growth of guarantee industry in China, such as multiple supervisions, gap in supervision and so on.

(VII) The government intervention in credit guarantee sometimes affects the decision-making on projects. SMEs' Credit guarantee is closely related to government policy, as well as market environment. In this sense, even the guarantee agency funded by government should adopt enterprise system and operate on the basis of market regulations. Especially, when it comes to the selection of guarantee project, rigid evaluation needs to be conducted to ensure that the enterprises under guarantee are able to repay the loan. Otherwise, the guarantee agencies have to take the obligation of subrogation. Excessive sticky projects would reduce the return rate of credit guarantee, and add to operational risks. Moreover, some profitable projects which should have got the loan would be curbed as a result, impeding the invigoration of SMEs. However, the policy guarantee agencies currently have complicated relations with local governments, which results in government intervention in some guarantee projects as regards the guarantee project selection. The practice tends to bring negative effects, such as decision mistakes, repaying the loan by guarantee agencies, which would be harmful to the survival and growth of guarantee agencies.

It can be seen from the discussion above that a major problem in the guarantee system in China is its failure to provide accurate signal to the borrower. What makes it worse is improper government intervention as well as the lack of restraint of laws and regulations. These greatly increase the moral haphazard of guarantee agencies in some cases and reduce the operational efficiency of guarantee agencies as a whole.

IV. Analysis on the Necessity of Absorbing Foreign Capitals to Establish Private Enterprises Guarantee Fund

Given the inadequacy of all three kinds of guarantee agencies at present, policy, mutual and commercial, the recent years have witnessed the rapid growth of guarantee fund as a form of guarantee which is more in line with the current economic development in China. Guarantee funds have been established in most parts of China by far, chiefly financed by governments and supplemented by SMEs' mutual funds, which play a crucial role in the growth of credit guarantee industry for private enterprises.

Compared with policy and mutual guarantee agencies, the advantages of guarantee funds are not hard to see. Above all, fund is one of the most flexible ways of financing among all sorts of financing patterns. The open-end fund can raise and absorb new capitals at any time with business growth as required, so as to enlarge the operation of fund. Accordingly, the lack of capital replenishment mechanism in policy guarantee agencies can be handled to a large degree through the working of guarantee funds. Besides, representing a flexible operation pattern, fund can either be managed by fundraisers themselves, or entrust it to professional fund managers or experts. What's worth mentioning is that the contract fund can spare both parties the burden to bear heavy taxes. Finally, the guarantee fund, by means of equity participation, can effectively coordinate the vigor of three kinds of guarantee agencies, which is more in agreement with the economic development in China at present.

However, some disadvantages remain to be solved in the guarantee fund financed by private enterprises' mutual funds and local government. Firstly, the fund size is limited. Both the local government and private enterprises can afford large capital injection. Although the establishment of guarantee fund can enhance the credit leverage to a certain degree, the limited fund size put a restraint on the leverage effect of credit guarantee fund. Secondly, the guarantee fund is not run effectively. The credit guarantee fund is specially established to satisfy the need for capital by private enterprises. The need itself makes it more risky than general funds, which entails fund personnel with higher quality. So far, the fund personnel from local government and fiancial organization are way far from this requirement. Thirdly, as a major facilitator for guarantee fund, the government may intervene too much in the use of fund, which could add to the moral haphazard and adverse selection in guarantee industry and impair the vigor it pumps to economic development.

Given this situation, using foreign capital to establish private enterprises guarantee fund could be effective for SMEs to get out of the distress of financing. The solution appears more important when the growth of SEMs is bottleneck after the explosion of world financial crisis. The advantages of this approach can be examined from eight aspects as follows.

(I) The approach is in line with China's strategic target to coordinate domestic development with world economy. Compared with the personnel in financial organizations and local government in China, the international financial organizations, especially the World Bank, the IFC and ADB are more capable of financial management and operation. Moreover, these organizations lay more stress on social and public purposes, remarkably distinctive from those financial capitals obsessively pursuing profits. Therefore, with higher credit rating, the private enterprises guarantee fund financed by foreign capitals would become a newer and steadier investment channel for the huge deposit of residents and enterprises in China, offering a solution to the saving-investment imbalance and echoing the strategic target of coordinating domestic development with world economy.

(II) The approach will optimize the use of foreign capital, improving the quality and level of foreign capital utilization. In the past, China's strategy on utilization of foreign capital put more emphasis on quantity, whereas ignored quality. While boosting the economic development in China, the foreign investment over-concentrated on export-oriented industry through processing trade, which not only added to the risk in export sectors, but also subdued domestic demand to certain extent. However, most of our private enterprise are internal-oriented and take up a vital position in our future development strategy. Therefore, using foreign capital to build private enterprises guarantee fund constitutes a strategy of enlarging domestic demand by means of international resources, and will advance the quality and level of foreign capital utilization in China.

(III) The approach is helpful to healthy development of private enterprises in China. As discussed above, remaining in the primary stage of growth, the support provided by credit guarantee to private enterprises is limited. On the one hand, the foreign capitals, especially those from multi-lateral international financial organizations, are able to furnish larger amount of financial support to China's private enterprises. On the other hand, their capability of credit evaluation and capital management could provide better leverage to private enterprises, whose effect will be stronger than policy guarantee agencies and mutual guarantee agencies. So we can say that the approach is significant to the healthy development of China's private enterprises.

(IV) The approach will enhance the competitiveness of China's credit guarantee industry as a whole. Currently, market mechanism has not been set up in guarantee industry, with government intervention to a certain extent and the many deficiencies in capital replenishment mechanism. All these factors have negative effects on the competitiveness of guarantee industry at large. Nevertheless, with an earlier start and more experiences, the foreign guarantee fund has higher degree of development and regulation, compared with their counterpart in China. The principal-agent theory also indicates that reducing moral haphazard and adverse selection still relies heavily on the restraints of rational systems. The international financial organizations have made more progress in system construction than the guarantee agencies in China. So the introduction of foreign capital into the development of guarantee industry in China virtually could promote the construction of market mechanism in policy guarantee agencies, through competition and demonstration, eliminate government intervention and help to transform the capital replenishment mechanism from government injection to market financing. Moreover, the introduction of personnel working in foreign guarantee fund, with substantial experience in fund management, will facilitate improving personnel quality in China.

(V) The approach will promote the standardization and legal administration of guarantee industry supervision in China. Using foreign capital to establish guarantee fund has virtually posed a greater challenge to guarantee industry supervision. It also will help introduce some management patterns in foreign guarantee industry that could meet the reality of China. So the approach will play a vigorous role in the standardization and legal administration of guarantee industry supervision.

(VI) The approach will also boost financial innovation. The overall ability of financial innovation in China is still left behind developed countries. Introducing foreign capital into the establishment of private enterprises guarantee fund is not only a new mode of financial innovation, but also will advance the financial innovation process in China and raise the quality of financial industry as a whole, by drawing on some sophisticated patterns of capital management, supervision and fund management practiced in developed countries.

(VII) The approach will alleviate financial burdens. One of the reasons why it's hard for policy guarantee agencies to exert their function is the restraint of government financial budget. The local governments, especially in western areas where there's an urgent need for development, couldn't afford to provide an abundance of capital to the guarantee industry. Being quasi-public in nature, the private enterprises guarantee fund financed by foreign capital, with loans and grants from international financial organizations and foreign governments in particular, won't be reluctant to conduct credit guarantee programs in underdeveloped west, in spite of the poor economic conditions there, which is significant in lifting government financial burdens, especially in the underdeveloped areas.

(VIII) The foreign capital will help increase credit rating of China's guarantee agencies through certain patterns such as cooperation with local guarantee companies. Currently, one of the prevalent disadvantages of China's guarantee industry is low credit rating, with private guarantee agencies in particular. The introduction of high rating international capital can help raise the credit of domestic guarantee agencies of all kinds, through patterns as establishing re-guarantee fund, which will effectively promote the growth of business conducted by domestic guarantee agencies.

Using foreign capitals to establish private enterprises guarantee fund is highly necessary, and is practical and feasible as well. It can be illustrated in the following four aspects.

(I)There are essential differences between the foreign capital used to establish private enterprises guarantee fund and those speculative financial capitals. With the rapid growth of China's economy, the position and role of private enterprises becomes increasingly notable in national economy. The international capital, with multi-lateral financial organization in particular (such as ADB, IFC etc.) has demonstrated great attention to china's private enterprises, as well as strong willingness to make investment. ADB has specially allocated loans and equity investment for China's private enterprises and the investments of IFC in China focus on financing for private enterprises through equity participation with a certain ceiling. The first investment made by ADB into private enterprise in China has gone to the largest private credit guarantee agency, so as to fulfill "commercial and public purposes", that is, to support the growth of China's private enterprises in addition to making profits, through the leverage effect exerted in providing credit guarantee service to private enterprises. It can be seen that these multi-lateral international financial organizations attach more importance to social and public benefits besides commercial concerns, which is essentially different from speculative financial capital. Their operation is practical and feasible, which lays a concrete foundation for using foreign capital to establish private enterprises credit guarantee fund.

(II) Using foreign capital to build private enterprise credit guarantee fund is in line with the foreign capital utilization target set by government policy. Featured by strong emphasis on social and public benefits, the private enterprise credit guarantee fund are projects that are quasi-public in nature, which will assume the role of government policy guidance, financial haphazard diversification and maintaining and promoting the construction of social credit. It will play a crucial part in boosting the guarantee industry for private enterprise financing, improving competitiveness of domestic guarantee enterprises, promoting interest rate market-oriented reform, diversifying bank risks, optimizing financing environment for private enterprises and so on. Therefore, the introduction of foreign capital into this sector is completely in accordance with the State's strategic guideline of "converting from quantity-oriented to quality-oriented in utilization of foreign capitals". So that the policy support from administrative authorities concerned would be easy to come by.

(III) The entry of foreign capital into credit guarantee fund for private enterprises will not involve higher financial risks. As discussed above, the foreign capitals that are introduced into this sector at present come chiefly from international financial organizations as the World Bank, or the grants and loans from foreign governments. With strong emphasis on social and public benefit, these capitals are essentially different from speculative international fluid capital. There's little possibility of large-scale capital withdraw or speculation, so it won't involve higher financial risks. The participation of these foreign capitals virtually facilitates introduction of more sophisticated pattern of management and operation, and gives vigor to the improvement of operation and supervision in China's financial industry.

(IV) Using foreign capital to build credit guarantee fund can also be a very workable approach in practice. The majority of the capital used to establish private enterprise credit guarantee fund are from international financial organization, and loans and grants from foreign governments. Meanwhile, the fund will absorb investment from enterprises and venture capital institutions home and abroad. The approach will give to full play the support of foreign capital to China's private enterprises, and generate long-term effect, through the leverage function of financing guarantee fund, without increasing financial burden of the government. As to the organization of the guarantee fund, good international experiences will be adopted to implement enterprise system in fund management as practiced universally in the world. It will introduce advanced management philosophy, experiences, technology and specialized talents from foreign countries, and operate with market orientation and legal person management. The guarantee fund will deliver services in various business patterns, such as direct guarantee, joint guarantee, re-guarantee, credit rating, investment, in-service training, consultation etc. It will promote the resource integration of commercial guarantee agencies in China and increase their credit rating. Besides, it will improve the quality of guarantee personnel, encourage standard guarantee practice and reduce the risk for guarantee industry as a whole. Currently, some international financial organizations have demonstrated obvious interest in this sector. Besides, with the increasing opening-up of China's financial industry since its entry into WTO, China has developed many experiences in cooperating with such organizations and keeps on good terms with them. Therefore, it's justifiable to say that the prospects discussed above are highly workable in practice.

Research on the Establishment and Operation of Guarantee Funds for Foreign -funded Private Enterprises

(Zhang Haifeng)

July, 2009

I. 1 BACKGROUND

A. 1.1 Status of Private Enterprises

The market economy has developed in China for 30 years, which promotes the rapid increase of small and medium-sized enterprises (SMEs). At present, the number of SMEs registered in industry and commerce administration is over 10 million, accounting for 99% of total enterprises registered. The SMEs create 70% of state gross output value, 40% of tax, 60% of export and provide 75% of job opportunities for society. The statistics indicate that the SMEs, which contribute 70% of GDP increase in China, just obtain 30% of financial resources and around 10% of loans and the average development costs of SMEs is less than 1% of sales. Therefore, the problems of financing, guarantee and credit guarantee are rather serious with respect to SMEs. To solve this problem thoroughly, Chinese government officially started the construction of SMEs credit guarantee system with the tenet of supporting the development of SMEs in June 1999.

On August 24, 2000, the General Office of the State Council issued the *Circular of the General Office of the State Council Transmitting Opinions of State Economic and Trade Commission on Policies of Encouraging and Promoting the Development of SMEs* (Guobanfa [2000] No.59), in which State Council decided to accelerate the establishment of credit guarantee system and required the governments of all levels and relevant departments shall accelerate the credit guarantee system of state, province and region (city) to serve the SMEs, mainly focusing on the SEMs of Technology Type, to create financing conditions for the SMEs. After that, State Council issued a series of guiding documents including *Several Opinions on Strengthening the Administration of Credit of Small and Medium -sized Enterprises, Opinions on Strengthening the Quality Work of Small and Medium -sized Enterprises, Interim Measures for Risk Administration of SMEs Credit Guarantee Institutions and Guiding Opinions on Establishing SMEs Credit Guarantee System Pilot Projects etc.* Meanwhile, the progress of legislation of Law of the People's Republic of China on Promotion of Small and Medium-sized Enterprises is also obviously speeding up. The perfection of relevant laws and regulations will be helpful to safeguard the legal rights and interests of SMEs, support the establishment and development of SMEs and greatly improve the external environment of SMEs, which can fully exert the role of SMEs in relieving the employment pressure, raising the vigor of innovation and stimulating private investment etc, and also will lay a solid foundation for the healthy development of credit guarantee market.

At first, from the static perspective, private enterprises have already played a major role in Chinese economic development and they are pillars in some fields and backbones in some industries. From the dynamic perspective, the development of private becomes more and more important in many aspects including fortune creation and job opportunities. During 30 years since reform and opening-up, private enterprises provided abundant job opportunities. Therefore, the private enterprises make great contribution to employment increase, tax creation, fortune provision as well as social stability and will make more contribution continuely. With the development of private enterprises, their percentage will be higher and Chinese economy will actually be private economy in the future because the percentage of state-owned economy will be quite low and in some fields, the majority of enterprises will be private ones. The private economy will be the mainstay of Chinese economy with the percentage of two thirds.

Next, in the aspect of policy: the *Circular on Issues Concerning Reserves Pre-tax Deductions of Credit Guarantee Institutions for Small and Medium-sized Enterprise jointly released by China's Ministry of Finance and the State Administration of Taxation* (Caishui [2007] No. 27) specifies that: in terms of credit guarantee institutions for SMEs, Ⅰ.credit guarantee institutions for SMEs can calculate guarantee compensation reserves at the rate of less than 1% of the balance of the guaranteed liability at the end of the current year; such reserves are allowed to be deducted prior to enterprise income tax . Ⅱ.The SMEs guarantee institutions can calculate the undue liability reserves at the rate of 50% of guarantee fee income at the current year; the undue liability reserves shall adopt the balance calculation according to annual guarantee fee income and the reserves drawn from the exceeding 50% of annual guarantee fee income shall be transferred to the income of the current period.Ⅲ.the actual commutation of the SMEs guarantee institutions shall offset the guarantee compensation reserves deducted before tax and the general risk preparation drawn from after-tax profit in turn and the shortfall shall be deducted from enterprise income tax according to actual situations; This policy came into force on January 1, 2007.

The rapid development of private enterprises and relevant supporting policies made by Chinese government create a sound market environment for the development of guarantee fund companies.

B. 1.2 Evolution of Establishing Private Guarantee Funds Utilizing Foreign Capital

Private enterprises have gradually become an important component of our economy but the financing difficulty forms the bottleneck of their further development. Hence, National Development and Reform Commission (NDRC) has begun to research on how to utilize foreign capital to promote the development of private enterprises since 2003, which won the support from leaders of State Council. Sponsored by Asian Development Bank (ADB), the NDRC organized the research on the subject of establishing guarantee funds for private enterprises. Its scheme of establishment has been ratified by State Council.

II. 2 ORIENTATION AND DESTINATION MARKET OF GUARANTEE FUNDS

A. 2.1 Orientation of Guarantee Funds

The private guarantee funds established by utilizing foreign capital will be run in corporate system and serve domestic private enterprises with businesses of financing and contract performance etc.

The development plan of guarantee fund companies is to expand and deepen guarantee businesses, control or buy shares of small-sum loan institutions in a proper degree and finally become financing holding companies specializing in guarantee businesses within a few years. On the basis of sustainable development, we will try to make them become the leader and No.1 brand of Chinese guarantee Industry.

B. 2.2 Business Scope

C. 2.1.1 Guarantee Business

Main businesses: provide guarantee services for private enterprises which are qualified to obtain direct financing in capital market, including issue of bonds, trust plan guarantee; other innovative financial products.

Guarantee retailing businesses including: enterprise financing guarantee, bond guarantee, construction performance, asset preservation, account receivable discounted, pledge financing, entrusted loans, investment and financing consultancy, mortgage/re-mortgage loan guarantee, house decoration loan guarantee etc;

Financing guarantee businesses for private enterprises: enterprise current fund loan guarantee, enterprise notes discounted guarantee, acceptance bill issue guarantee, export tax rebate pledge loan guarantee, import and export financing guarantee, property right (equity, intellectual property right, operational right etc) pledge loan guarantee, equipment lease financing guarantee, enterprise establishment/acquisition bridge loan guarantee, project investment loan guarantee, policy supporting project loan guarantee, factoring business (account receivable discounted guarantee, credit insurance) etc;

Economic contract performance guarantee businesses: construction contract performance guarantee, construction bidding performance guarantee, technical transfer contract performance guarantee, trade contract performance guarantee, enterprise property right transfer transaction security guarantee, contract liquidation deposit/advance payment/quality deposit guarantee, agency fee/commission guarantee, product quality guarantee, property preservation guarantee etc.

D. 2.1.1 Re-guarantee Business

Re-guarantee business provides re-guarantee service for superior guarantee institutions chosen from the guarantee investment fund companies after credit rating selection ,including re-guarantee of guarantee institutions credit and re-guarantee of guaranteed project.

Guarantee investment fund companies share and bear the guarantee risk of credit guarantee institutions according to the percentage agreed in contract and seek cooperation with insurance companies which will provide insurance for re-guaranteed percentage of guarantee investment fund companies.

E. 2.3 Destination Market

F. 2.3.1 Destination Industries

（1）Energy conservation EMC project financing or performance guarantee;

（2）Financing or performance guarantee of new-type agricultural products industrialization

（3）Financing or performance guarantee of export-oriented whole-set equipment industrialization or spare parts enterprises.

G. 2.3.2 Clients

（1）The company has moved into the steady operation period with steady cash flow , positive net cash flow and the annual increase rate of its sales income is more than 10%;

（2）The base amount of guarantee is more than RMB 20 million Yuan.

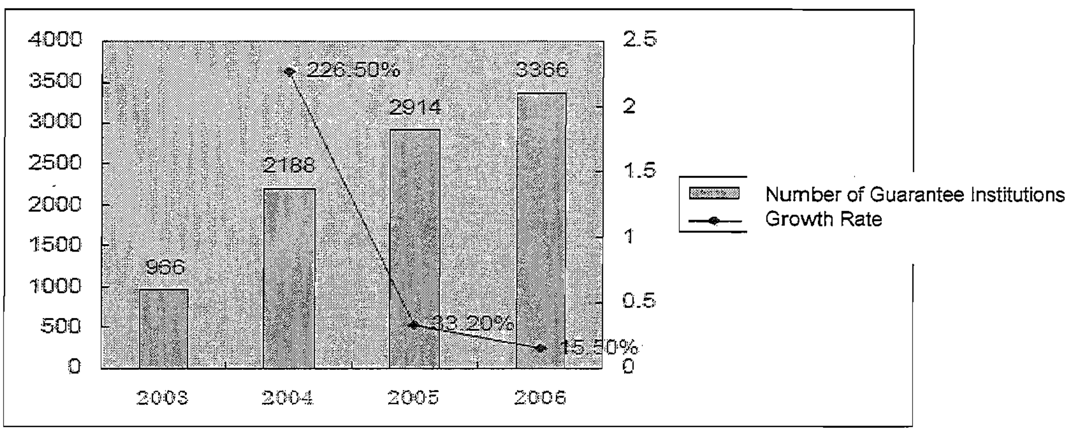
H. 3 Market and Competitiveness Analysis

I. 3.1 Current Status Analysis of Chinese Guarantee Industry

J. 3.1.1 Development of Guarantee Institutions

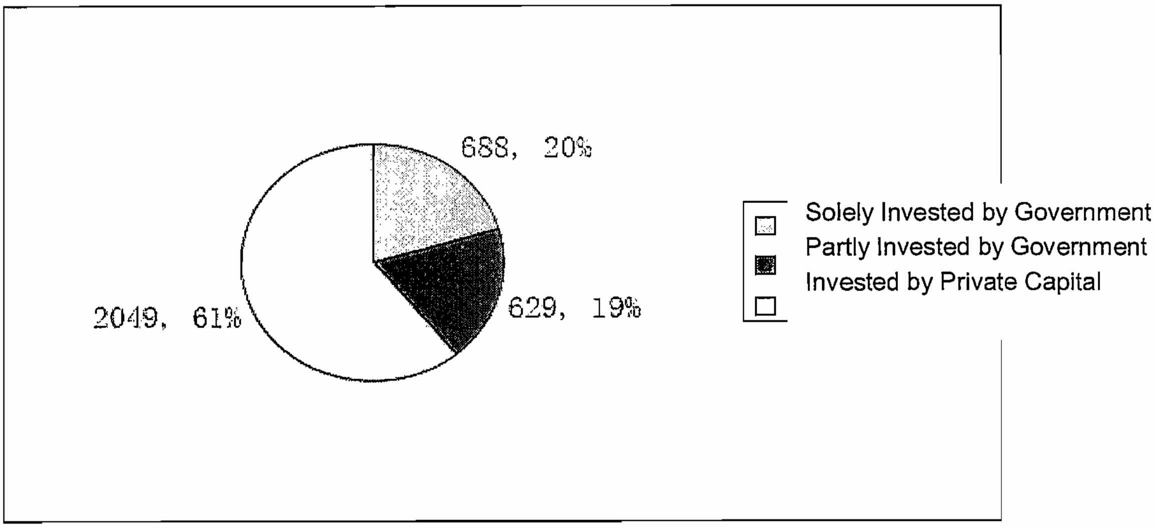
The guarantee industry has developed very fast in China. In 2003, the number of guarantee institutions was 966 and at the end of 2007 this number became 3729 with year-on-year rise of 15.5%; in 2003, the number of guaranteed enterprises was merely 48,000 and at the end of 2007 this number hit 736,000 with year-on-year rise of 94.2%.

Fig.: 2003-2006 Change of Guarantee Institutions'



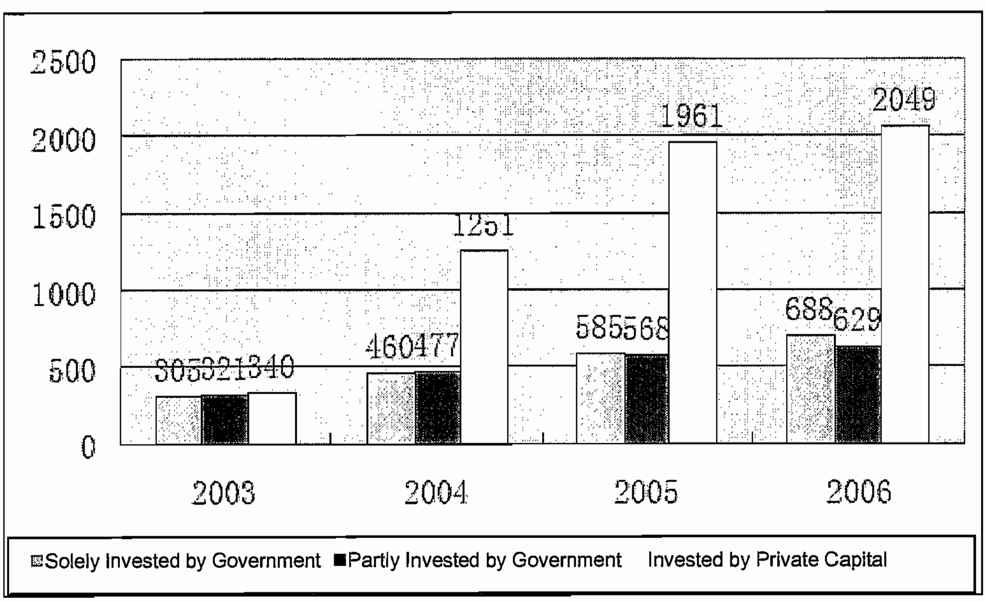
In 2006, among 3366 guarantee institutions nationwide, 688 were solely invested by government, accounting for 20%; 629 were partly invested by government, accounting for 19%; 2049 were invested by private capital, accounting for 61%.

2006 Government and Private Capital Contribution Structure in Guarantee Institutions Nationwide



As early as in 2003, 305 guarantee institutions nationwide were solely invested by government, accounting for 31.6% of total; 321 were partly invested by government, accounting for 33.2%; merely 340 were invested by private capital, accounting for 35.2%

2003-2006 Change of Government and Private Capital Contribution Structure in Guarantee Institutions Nationwide



From the above, we can see that the guarantee enterprises invested by private capital developed very fast and have grown to be the most important power of guarantee industry in China.

K. 3.1.2 Problems in the Development of Guarantee Industry

1、Small scale and weak guarantee capability

The guarantee industry developed very fast in China but its scale is comparatively small on the whole and total strength of guarantee institutions is still weak, which are major problems of the industry. Registered capital of about 95% guarantee institutions is below 100 million Yuan and that of 50% guarantee institutions is below 10 million Yuan. We carried out a preliminary investigation on guarantee institutions in Wuhan and Yangzhou, the situation thereof is conspicuous.

There are 14 guarantee companies altogether in Wuhan. Their total capital fund is around RMB 200 million Yuan and each company just owns RMB 14 million Yuan on average. The number of employees is comparatively small and total staff of 14 companies is 564 with each 40 persons on average. And the sum of guarantee of each company is less than RMB 1 million Yuan on average. In terms of single guarantee, the guarantee from RMB 100,000 Yuan to 1 million Yuan accounts for 50% in the 14 guarantee companies with obvious feature of short-term flow of small guarantee.

There are 16 guarantee companies altogether in Yangzhou, including 2 directly under municipal government, 1 in Guanglin District, 1 in Hanjiang District, 1 in Development Zone, 2 in Baoying, 1 in Yizheng, 3 in Jiangdu and 5 in Gaoyou. 15 companies serve general private industrial and commercial enterprises and small rural enterprises, individual businessman as well as personal consumption loans and 1 for building enterprises. According to the survey, total registered capital of 16 guarantee companies is RMB 632 million Yuan and by the end of June this year their paid-up capital is RMB 510 million Yuan; accumulative guarantee RMB 2,522 million Yuan; current guarantee balance RMB 712 million Yuan; newly-increased guarantee this year RMB 484 million Yuan.

2、 Single profit-making mode and limited profit-making capability

The research shows that most of relevant government departments, financial institutions, guarantee companies and private enterprises hold the opinion that the guarantee industry is an industry with high risk, low income and small profit margin.

At present, the income of most guarantee enterprises is mainly from guarantee fees and investment benefits with the former in the leading position. The charge of guarantee companies is generally 1%-3%, which can just offset the business expenses, and the percentage of industrial loss is comparatively large. The reason for this phenomenon is that in addition to the non-profit making tenet of some policy guarantee institutions, private guarantee institutions shall use a rather large part of their income for due liability reserves and risk reserves, which result in that the security of their financial policies is far more important than profitability in the process of actual operation. The internal financing space of guarantee industry is comparatively small and personnel expansion and training as well as new business extension lack powerful capital support, which make the independent development capability of enterprises restricted to certain degree.

3、The banks still hold inappropriate opinions to guarantee companies and fail to handle their relations with guarantee companies properly.

At first, some commercial banks are worried about the cooperation with guarantee companies. Many guarantee institutions are in rather small scale with scattered capital contribution and some guarantee mutual funds are merely several million Yuan, which makes it difficult to win the trust of banks. Next, most banks are not willing to bear risks and it is hard for banks and guarantee companies to form the mechanism of sharing risks and profits. Third, the magnification rate is inadequate. According to relevant provisions, banks can provide loans for guaranteed enterprises based on the proportion of 1:5 to 1:10, but in actual operation only a few guarantee companies are able to reach such magnification rate and most guarantee institutions cooperate with banks by 1:1, that is, banks require the guarantee company to deposit funds of equal value as guarantee before issuing each loan, which has greatly restricted the development of guarantee industry with any doubt.

4、Improper orientation of re-guarantee business

Providing financing guarantee for private enterprises has comparatively large compensation risks and according to international practices, the percentage by which guarantee institutions bear liabilities is 70%-80% and the rest shall be borne by cooperative banks. In case commercial banks fail to do so, we may consider establishing state (government) re-guarantee institutions with the purpose of risk compensation. The re-guarantee funds can be 20-30% of current guaranteed balance of guarantee institutions.

5、Weak internal mechanism and risk prevention of guarantee institutions

Mainly includes: inadequate department balance mechanism, re-study mechanism and business innovation capability; deficient risk sharing mechanism and automatic analysis technology; obvious business concentration with certain structure risks. In addition, the risks control to guarantee institutions by state is not perfect yet.

L. 3.2 Guarantee Market Analysis for Private Enterprises

M. 3.2.1 Current Status Analysis of Private Enterprises Financing Structure

At present, our private enterprises account for 98.5% of total enterprises, 70% of total employees and 50% of total assets; create 50% of GDP with their final products and services; provide 75% of urban job opportunities. The financing difficulties seriously restrict the further development of private enterprises. According to the survey conducted by IFC, the majority of development funds of private enterprises come from their own internal reserves and only less than 20% of accumulative loans and equity are obtained by private enterprises. Over 70% of domestic loans go to large and medium-sized enterprises and the percentage private enterprises account is extremely low.

In 2007, IFC of World Bank conducted a typical survey to the capital source structure of private enterprises in three cities of Sichuan Province. The results are as follows:

Capital Source Structure of Private Enterprises in Three Cities of Sichuan Province

	Internal reserves	Banks	Relatives	Commercial credit	Others	Venture Investment Fund	Equity	Financing lease
Fixed asset investment								
Small enterprises	83.3	6.0	6.2	1.6	0.4	0.4		
Medium enterprises	77.7	9.7	2.2	3.7	2.5		3.0	
Average	82.2	6.63	5.94	2.06	0.93	0.9	1.0	0.57
Current fund								
	Internal reserves	Banks	Relatives	Commercial credit	Others	Non-formal financing		

Small enterprises	80.4	7.2	5.7	3.1	1.4	0.2
Medium enterprises	70.9	17.7	2.1	4.3	2.2	0.9
Average	78.1	9.65	5.07	3.25	1.57	0.85

Data source: IFC/CPDF. The samples are 601 private enterprises in Chengdu, Mianyang and Leshan produced by the means of excess random sample including 461 private enterprises and 132 medium-sized enterprises. In terms of industry, there are 234 in manufacture, 79 in services, 44 in commerce, 26 in building and 26 in others. Closing date of survey: Dec 31, 2007

The questionnaire made by Shanghai Branch of the People's Bank of China on 300 private enterprises of Zhejiang and Fujian under its jurisdiction indicates: by the end of September 2007, ① bank loans have accounted for 58% of external financing source of enterprises and the larger the scale of enterprise is, the higher the percentage of its bank loans will be; ② around 11% of enterprises have had internal financing and around 8% have used private loans. In small enterprises with asset scale less than RMB 5 million Yuan, employee contribution and private loans account for 16%; ③ 40% of short-term funds come from suppliers or commercial credit of joint venture or cooperation partners; ④ enterprise capital funds are mainly from internal financing and non-formal private loans, wherein internal financing accounting for 25%, private loans 14% and the rest are from internally raised funds by business owners and main founders.

The questionnaire made by Wuhan Branch of the People's Bank of China on 178 SMEs of Jiangxi, Hubei and Hunan under its jurisdiction indicates: from January 2006 to August 2007, among the net increase fund sources of state-owned and reconstructed collective ownership SMEs: ① all kinds of loans account for 48%, wherein bank loans forms 94%. In total debts of enterprises, bank loans account for 55%; ② external equity financing just accounts for 17% and compensating capital funds by profit 5%; ③ internal financing is difficult, only accounting for 2%.

In 2006, IFC conducted a survey on the financing structure of 600 private enterprises in Beijing, Chengdu, Shunde and Wenzhou. The results are as follows:

2006 Financing Structure of Private Enterprises in Beijing, Chengdu, Shunde and Wenzhou

	Internal financing	Bank loans	non-financial institutions	Others
Operating years	92.4	2.7	2.2	2.7

< 3 years	92.1	3.5	0.0	4.4
3-5 years	89.0	6.3	1.5	3.2
6-10 years	83.1	5.7	9.9	1.3
> 10 years	90.5	4.0	2.6	2.9
All companies				

On the basis of the above general data and typical surveys, we can outline the basic status of SMEs financing in China: (1) the SMEs financing channels are narrow. Their current development mainly relies on their own internal accumulation, namely, the percentage of their internal financing is too high while that of their external financing is too low. (2) bank loans are the most important external financing channel of SMEs ,but banks mainly provide current funds and fixed asset renovation funds and seldom provide long-term loans;(3) the non-formal financing such as loans from relatives, employee contribution and private loans etc plays an important role in SMEs financing, but due to the gaps of economic development level and private credit system construction among different areas, the development of non-formal financing is greatly different between Jiangzhe (Jiangsu and Zhejiang) and middle and western regions; (4) It is very common that SMEs lack long-term steady fund sources—not only the source of equity fund is rather limited but it is difficult to win the support of long-term debts; (5) the asset scale is the decisive factor on whether an enterprise is able to obtain bank loans and long-term liability funds.

N. 3.2.2 Development of Enterprise Bond Market

Because the credit system had not perfect yet, in 2007, enterprise bond market won further development through innovation and the issue scale continued to expand.

By the end of 2007, 101.5 billion Yuan enterprise bonds had been issued and annual amount of enterprise bonds broke through 100 billion Yuan for the first time..

From 1987 to 2005, our country issued enterprise bonds of 328.8 billion Yuan accumulatively and the speed of issue showed an upward trend. This January, NDRC approved the bond issue of 43 enterprises altogether with total scale of enterprise bond issue 60.8 billion Yuan. The issue of these bonds had ended by October of 2007.

It is expected that the enterprise bond issue market in 2007 will continue to expand in its scale. At first, the second installment of enterprise bond issue in 2007 will be close to RMB 100 billion Yuan, wherein, around RMB 60 billion Yuan is assigned to large state-owned enterprises such as China Merchants Group and China Nuclear Power Group etc and the rest to local enterprises.

These bonds of nearly RMB 100 billion Yuan will mainly be issued in 2007. The following table shows the actual issue scale of enterprise bonds from 2000 to 2007.

Table: Actual Issue Scale of Enterprise Bonds from 2000 to 2007

Year	Scale(hundred million)	Number of enterprises
2000	77	5
2001	147	6
2002	325	12
2003	358	15
2004	322	15
2005	654	30
2006	1015	45
2007	1709.35	81
Total	4607.35	209

O. 4 Business Models of Companies

The means of profit-making of companies mainly include

(1) Guarantee business adopts two means: fixed expenses and interest margin income distribution.

Fixed expenses charge 2% of guaranteed amount as service fees annually and the actual guarantee yield reaches 4-5%. Meanwhile, companies require guarantee enterprises or persons to provide sufficient counter-guarantee assets so as to avoid risks;

Floating benefits: exchange guarantee fees for part of equity, namely, guarantee investment business with expected return over 10%.

(2) Obtain loans directly through controlling or buying shares of small-sum loan companies or entrust banks for loans with yield over 10%;

(3) Funds management business: bank deposit or bonds purchase with yield 4-5%;

(4) Consultancy agency business: guarantee fund companies obtain benefits by providing financing and management inquiry for private enterprises and conduct investment bank businesses in a proper time.

P. 5 Marketing Strategy

Based on market analysis or competitiveness analysis, Chinese guarantee industry is in the stage of seller's market. The strategy of guarantee fund companies is to be prepared for danger in times of peace and work with industrial cooperators to develop credit guarantee customers with highest value and provide right guarantee service products for social needs.

Q. 5.1 Measures of Customer Development

Customer development and information collection are the basic work of guarantee and investment business and customer resources will become the precious treasure of guarantee fund companies. Guarantee fund companies plan to adopt the following methods to establish and perfect the channels of customer sources.

(1) establish broad connections with bank credit departments and seek customers through their recommendations;

(2) connect with government departments of all levels and seek customers through them;

(3) connect with chambers of commerce and trade associations and seek customers through them;

(4) conduct the membership management of enterprise credit guarantee to foster core customers;

(5) Publicize widely in society, conduct market survey and carry out customer registration to seek potential customers.

R. 5.2 Marketing Strategy

Guarantee fund companies adopt the integrated marketing strategy with brand operation as its core and the marketing plan will be based on the following operating principles:

(1) Guarantee fund companies will give considerations to conducting guarantee and investment businesses independently or with other institutions;

(2) Conduct personal credit guarantee mainly by themselves and take it as a breakthrough of expanding the operating scale of guarantee fund companies, and under the preconditions of ensuring quality and strictly preventing risks strive, expand guarantee businesses and pursue the operating scale of guarantee businesses;

(3) Conduct SMEs financing and economic contract performance

businesses and especially combine enterprise financing guarantee with guarantee investment; stick to the principle that "guarantee is just a tool while investment is the real purpose" ,proactively look for investment projects which conform to their strategy such as small and medium-sized hi-tech enterprises etc and provide financing guarantee for enterprises with guarantee and investment tools and transfer it to direct investment in a proper time. While guarantee businesses emphasize the scale of operation, investment businesses shall focus on investment benefits;

(4) If necessary, seek cooperation with other guarantee institutions for cross and mutual guarantee and united guarantee ,seek re-guarantee support of state SMEs credit guarantee system and utilize other innovative devices to share risks and reduce losses;

(5) Because investment businesses need coordination with relevant investment institutions, seek cooperation between banks or other financial institutions with clients for all loan guarantee businesses ;

(6) Establish e-commerce network and conduct guarantee business publicity, guarantee business register, online business acceptance, guarantee market survey and credit rating etc through website;

(7) Conduct wide publicity by news media and other forms to support the strategy of promoting guarantee business and guarantee investment.

As an important part of market, guarantee funds shall establish strategic cooperation relations with financial institutions to carry out the financing tasks of enterprises and individuals with credit effectively; meanwhile, guarantee funds shall form tactic cooperation with counterparts to share their guarantee risks.

S. 5.3 Establish Strategic Cooperation Partnership

T. 5.3.1 Government and Policy Institutions

Conduct hi-tech guarantee relating to high and new technology industrialization and business of government departments and state industrial departments (e.g. NDRC).

Conduct financing guarantee for industry supported by state funds, which mainly includes industrialization of new-type energy conservation and environmentally friendly projects;

Conduct industrialization financing guarantee for businesses supported by state policy such as agriculture;

Conduct financing performance guarantee for export-oriented whole-set equipment industrialization.

U. 5.3.2 Cooperative Banks and Derivative Businesses

Guarantee companies can reach strategic cooperation agreement with ADB and other banks and on this basis, further participate in services of non-financial businesses in which some cooperative banks can't participate pursuant to current provisions and form strategic alliance of mutual complementation of relative advantages and businesses with cooperative banks. Their derivative businesses mainly include:

(1) guarantee of bank and enterprise transaction performance

(2) guarantee of bank credit card

(3) guarantee of bank notes discount business

(4) guarantee of bank L/C business

(5) disposal business of bank pledge assets

V. 5.3.3 Security Companies and Derivative Businesses

Guarantee companies can reach strategic cooperation agreement with several large integrated security companies and provide broad business cooperation for security companies and customers. The contents are as follows:

(1) stock and bond financing guarantee business

(2) issue, allotment of shares and bridging loan guarantee business

(3) personal guarantee business of security company executives

(4) listing financing guarantee

W. 6 Risks of Companies

X. 6.1 Operational Risks

Credit guarantee and guarantee investment businesses that guarantee fund companies engage in have certain degree of operational risks.

Y. 6.1.1 Credit risks of Guarantee Services

Credit risks of guarantee businesses are brought in by guarantee or liability. Generally speaking, the following are main factors which may cause operational risks of guarantee businesses:

(1) purpose of funds, repayment source and its feasibility;

(2) credit degree of borrower and binding force of contract terms;

(3) amount, quality and liquidity of counter-guarantee assets;

(4) concentration degree of guarantee businesses;

Z. 6.1.2 Investment Risks of Guaranteed Investment

Although guaranteed investment businesses try to lower investment risks by guarantee devices, the selection and management of investment project is the decisive factor for investment risks. The risks of guaranteed investment project are mainly caused by the following factors:

(1) feasibility and assessment of projects;

(2) design of guaranteed investment scheme;

(3) management of project;

(4) concentration degree of investment;

(5) investment withdrawal methods and policy risks

AA. 6.2 Market Risk Analysis

The course of marketization in China was very fast during the past 30 years since reform and opening-up. Whether it is means of production or daily necessities, China has completed the transition from the sellers' market where demand exceeds supply to the buys' market where supply exceeds demand. Finance is the most lagging field in reform and opening-up. China's entry into WTO has made the capacity of our guarantee market much bigger but also raised market risks. Only when we recognize the market risks can we make relevant measures to effectively prevent and control market risks.

1. 6.2.1 Market Capacity Risks

Chinese guarantee market is huge but valid demand for guarantee is relatively small. So-called valid demand for guarantee refers to the guarantee application with adequate performance ability. In traditional guarantee market field, the cases of guarantee joint liability incurred by overdue enterprise loans are rather common. The living condition of commercial guarantee is to find out the guarantee with valid demand. In this situation, the target market space of guarantee will become much smaller.

In terms of personal guarantee market, that China lacks the institutions of personal credit data collection and evaluation is the main reason for inadequate valid demand for guarantee.

Relatively speaking, because the valid demand for performance guarantee is higher, risk is comparatively lower for guarantee fund companies.

As for inadequate valid demand for guarantee in guarantee market, guarantee fund companies may strengthen classification control of target market customers. Just like the operation and management of banks, guarantee fund companies can bring in ABC classification managing method, continuously seek some customers with good credit and provide long term follow-up services for them. In this way, they can capture the market commanding point with status and scale advantage of guarantee industry forerunners.

2. 6.2.2 Competition Risks

In the long run, Chinese guarantee market will definitely produce the competition brought by the course of marketization. Future competition is mainly from the following aspects:

(1) the lowered threshold for the establishment of guarantee institutions will cause too many guarantee institutions and inadequate demand;

(2) competition of guarantee institutions in service quality and price;

(3) appearance of cross-region guarantee monopoly institutions;

(4) the potential financing holding group will enter the guarantee industry.

3. 6.3 Policy Risks

The policy risk of our guarantee market at first lies in whether commercial guarantee has the policy reversibility. Definitely, unless the marketization reform has the reversibility in China, the policy risk of canceling commercial guarantee will appear.

4. 6.3.1 Market Risks under Macro-economic Environment

Guarantee industry will definitely be influenced by macro-economic environment, especially financial environment. The factors of macro-economic environment influencing guarantee market mainly include:

(1) tight monetary supply;

(2) currency deflation;

(3) economic cycle;

(4) financial crisis.

For steady operation, guarantee fund companies shall keep its capital adequacy ratio and sufficient risk reserves to cope with market risks caused by any change of macro-economic environment.

5. 6.4 Measures of Risk Prevention

The guarantee industry is just in a transitional period from planning economic system to market economic system in China. Under the co-existence of opportunities and challenges, how to effectively prevent risks and how to coordinate the relation between policy and commerciality by their reputation, economic strength and professional skills and exert their bridge function for fund accommodation and commodity circulation are the main tasks of guarantee fund companies' operation. Guarantee fund companies can adopt the following measures to prevent risks:

(1) The biggest risk of credit guarantee is the credit risk of vouchee. Therefore, we shall conduct thorough and detailed investigation on enterprises which apply for guarantee, evaluate transparency and controllability, analyze the change of their financial structure and calculate and predict their profitability. Risk control shall stick to the principle of comprehensiveness and doing what is possible and adopt the method of follow-up management and timely control. Meanwhile, China is establishing the credit assessment mechanism, which also provides favorable guarantee for risk prevention;

(2) Guarantee fund companies shall take bank, enterprise and guarantee institution into consider in a comprehensive way and form a guarantee consultancy institution composed by three parties to conduct various consultancy services such as law, accounting and taxation etc, and form a effective mechanism supporting the superior and the stronger; establish risk transfer and united guarantee mechanism; obtain the support of state guarantee system of all levels and win re-guarantee and united guarantee cooperation. In case of occurrence of commutation, guarantee fund companies can obtain certain compensation and thus lower guarantee risks greatly. In addition, united guarantee is also an effective method to transfer risks.

(3) Guarantee fund companies shall develop a set of scientific and sound credit risk assessment index system by utilizing modern electronic information technology and execute it effectively.

(4) Guarantee fund companies shall fully take advantage of complementarity of guarantee and investment and strengthen the

investment decision-making through guarantee devices to reduce the cost of investment and financing and effectively prevent investment risks; complement guarantee commutation loss with investment benefits, enlarge asset scale of companies and increase the guarantee capability rapidly to be strong supporters of guarantee industry.

(5) Guarantee fund companies shall strengthen the verification of projects, conduct strict and scientific research and evaluation on the feasibility of projects to be guaranteed or invested and operate strictly in accord with the system and regulations made by companies so as to control risks to greatest extent.

(6) In the aspect of financial management, guarantee fund companies shall draw guarantee compensation reserves and investment risk reserves etc according to annual operational plan in a appropriate proportion to safeguard the regular operation of companies.

(7) Conducting guarantee derivative businesses by means of guarantee investment can explore the channel of obtaining additional benefits; meanwhile, it is an effective method to proactively implement process supervision and strictly control risks.

(8) Guarantee fund companies shall introduce the advanced risk control system and regulations of international banks including systems of decision-making, assessment and internal supervision etc. and finally establish a sound, transparent and top-down management system.

III. 7 CORPORATE MANAGEMENT

Guarantee fund companies shall conduct internal management completely according to legal person governance structure in shareholding system. The shareholders' meeting is the top authority of guarantee fund companies. The board of directors and the supervisory committee shall be elected by shareholders' meeting. The chairman of the board shall appoint or dismiss the daily management institution, which is responsible for day-to-day affairs under the effective supervision of the supervisory committee.

A. 7.1 Shareholders' Meeting

B. 7.1.1 Authorities of Shareholders' Meeting

According to the articles of association of the guarantee fund company, shareholders' meeting is the top authority of the company and shall exercise the following powers:

(1) to decide upon the operation policies and investment plans of the company;

(2) to elect and replace directors and decide on matters relating to remuneration to directors;

(3) to elect and replace the supervisors filled by the representatives of shareholders and decide on the payment to supervisors;

(4) to examine and approve the reports by the board of directors;

(5) to examine and approve the reports by the supervisory committee;

(6) to examine and approve the annual financial and budget plan and financial accounting plan of the company;

(7) to examine and approve the plans for company's profit distribution and losses recovery;

(8) to pass resolutions on the increase or decrease of registered capital;

(9) pass resolutions on the issue of bonds;

(10) to pass resolutions on issues such as merger, division, dissolution and liquidation of the company;

(11) to revise the articles of association of the company;

(12) to examine the proposal raised by shareholders who represent over 5% of total issued shares of the company with voting rights;

(13) to examine other matters which shall be decided by shareholders' meeting according to laws, rules and articles of association of the company

Shareholders' meeting shall be convened at least once a year and may convene the interim shareholders' meeting according to legal procedures prescribed by articles of association to exercise the said powers.

C. 7.2 Managing Institutions of the Company

D. 7.2 Board of Directors

The board of directors of the guarantee fund company shall be elected by shareholders' meeting.

E. 7.2.2 Supervisory committee

The supervisory committee of the guarantee fund company shall b e elected by shareholders' meeting and shall be composed of CPAs, lawyers and employees' representatives.

The supervisory committee shall exercise the following powers according to articles of association:

(1) to check up on the financial affairs of the company;

(2) to supervise the acts violating law and regulation or the articles of association of directors, general manager and other senior executives in performing their duties;

(3) to request directors or manager to remedy their acts whenever such acts harm the interests of the company and if necessary, report to shareholders' meeting or relevant government department;

(4) to propose the convening of an interim shareholders' meeting;

(5) to check up the operational risks of the company.

When exercising its powers, the supervisory committee may employ the law office and the accountant office etc for professional support and the costs incurred by this shall be borne by the company.

F. 7.2.3 Consultants' Committee

For the purpose of turning the guarantee fund company into a learning organization of experts adapting to the times of knowledge-based economy, the company shall establish the consultants' committee composed of distinguished experts and scholars in industrial and academic fields, which provides the guiding consultancy for major operational decision-making of the company.

G. 7.2.4 Guarantee Assessment Committee/ Investment Decision-making Committee

There is guarantee assessment committee/ investment decision-making committee under the board of directors, which is responsible for the board. The committee is composed of directors and professionals employed by the board and the chairman shall be assumed by the director or professional appointed by the board. The committee shall abide by the principles of being scientific, precise and practical and make a decision upon all guarantee/investment projects submitted according to the approval power of decision-making system. When handling the specific work, the committee can employ relevant experts to participate in the work if necessary.

H. 7.2.5 Daily Management Institutions of the Company

The guarantee fund company shall adopt the system of general manager responsibility under the leadership of the board and meanwhile, especially emphasize the supervision and prevention function of risk control in operation of guarantee businesses. The organizing structure of the company refers to Chart 1 (see next page)

From the chart of organizing structure, we can see that the managing institutions of the company are mainly divided into four major parts: operations (Guarantee Ⅰ, Ⅱ, Ⅲ for enterprise, individual and performance business respectively), management, development and logistics. They all adopt the system of general manager responsibility. Only auditing department, funds department and office of the board are directly under the board, that is, the incentive mechanism of those managers who are in charge of risk control and funds is not connected with the development of businesses and the board will manage funds and control operation risk.

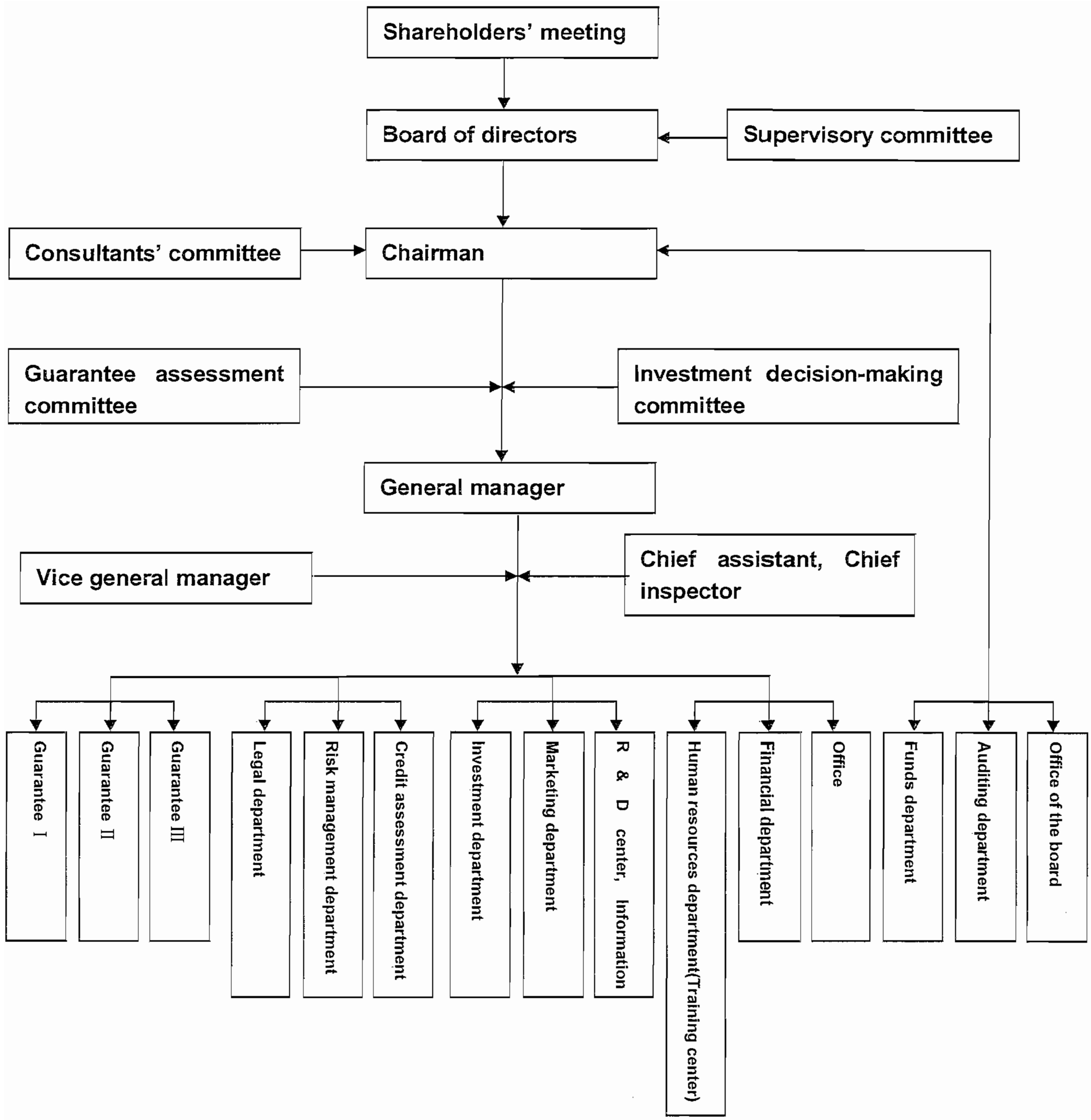


Chart 1 Organizing Structure of the Guarantee Fund Company

IV. 8 COMMERCIAL PLAN

With the purpose of developing the company to be the leader and No.1 brand of Chinese guarantee industry, the company make the future five-

year commercial plan quantificationally based on the principle of conservative forecast and prudent fiscal management. Meanwhile, the company conducts elaborate financial forecast on its future five-year commercial plan.

A. 8.1 Commercial Plan of the Company

The future five-year commercial plan of the company can be divided into three parts including operating plan, funds plan and costs plan. On the basis of quantitative analysis, the chapter shall conduct the comprehensive economic benefit forecast on the future five-year commercial plan.

B. 8.1.1 Operating Plan

Chinese guarantee market has grown out of nothing and developed very fast since being officially launched in 1999. The growth trend of guarantee business of the company is predicted as follows:

Table 1 Growth Trend of Guarantee Business

Unit: RMB hundred million Yuan

Indicator	First year	Second year	Third year	Fourth year	Fifth year
Operating funds	70	70	100	120	150
Guarantee capacity	700	700	1000	1200	1500
Planned guarantee scale	200	400	700	840	1050
Yearly increase rate					

Notes: Suppose the guarantee magnification is 10 times on average;

Suppose the 70% of the operating funds is used for guarantee business;

According to the growth trend of businesses, the company predicts that at the end of the fifth year, its operating funds will reach RMB 10-20 billion Yuan; the guarantee capacity, RMB 150 billion Yuan; planned guarantee scale, over RMB 100 billion Yuan. From the perspective of business scale, the guarantee fund company will become a large quasi-financial enterprise in five to ten years.

The future five-year operating plan of the company is as follows:

Table 2 Future Five-year Operating Plan

Unit: RMB ten thousand Yuan

Indicator	First year	Second year	Third year	Fourth year	Fifth year
I Operating funds	700,000	800,000	1,000,000	1,200,000	1,500,000
Guarantee capacity	7,000,000	8,000,000	10,000,000	12,000,000	15,000,000
Planned guarantee scale	200	400	700	840	1050
Fixed benefit investments	70,000	80,000	100,000	120,000	150,000
Equity direct investments	140,000	160,000	200,000	240,000	300,000
Income					
Income of guarantee fees					
Income of fixed benefit investments					
Income of equity direct investments					
Total income					

Notes:

(1) Suppose the guarantee magnification is 10 times on average;

(2)Suppose the operating funds of the company are distributed according to the proportion of 7:1:2;

(3) Yearly guarantee charge rate is 2.0% on average;

(4) Yearly yield of fixed benefit investments is calculated by 4.5%;

(5) Yearly yield of equity direct investment is calculated by 10%.

C. 8.1.2 Funds Plan

Due to the nature of guarantee industry, it is impossible that the company expands its business by means of loans. In order to meet the need of guarantee deposit increase, the company can only resort to share stock expansion. **Therefore, the fund demand and use are mainly used for**

rapid increase of major business and enhancing the risk-resistant ability.

Table 3 Future Five-year Funds Plan

Unit: RMB ten thousand Yuan

Indicator	**First year**	**Second year**	**Third year**	**Fourth year**	**Fifth year**
Ⅰ **Funds sources**					
Total share stocks					
Capital funds					
Equity of owners					
Long-term liability					
Ⅱ **Funds use**					
Guarantee deposit					
Funds for fiscal management					
Operating funds					
Long-term investment					
Short-term investment					

D. 8.1.3 Costs and Expenses Plan

The costs and expenses of the companies shall be limited to around 10% of income, which will fully display the feature of focusing on efficiency.

Table 4 Future Five-year Costs and Expenses Plan

Unit: RMB ten thousand Yuan

Indicator	**First year**	**Second year**	**Third year**	**Fourth year**	**Fifth year**
Salary and benefits					
Office expenses					

Equipment depreciation	E				
Social insurance					
Fees of lawyer and accountant					
Marketing expenses					
R&D expenses					
Others					
Total					

E. **8.2 Financial Forecast**

F. **8.3 Investment and Share Increase and Listing**

V. 9 CONCLUSIONS

VI. THE BUSINESS MODE AND MAJOR BUSINESS OF GUARANTEE FUND COMPANIES ARE THE PRECONDITIONS FOR THEM TO BECOME THE LEADERS AND NO.1 BRAND OF CHINESE GUARANTEE INDUSTRY.

The necessary condition of realizing their commercial plan is whether guarantee fund companies own sufficient capital funds to conduct guarantee and guarantee investment businesses. Due to the nature of guarantee funds, they can increase the operational funds only by share capital expansion so as to meet the funds need from major businesses. Therefore, the realization of commercial plan of guarantee funds companies depends largely on investment and stakes increase and implementation of listing plan.

That guarantee fund companies seek the goal to list domestically is to meet the need of developing themselves into large quasi-financial companies at first. Domestic listing will be conducive to their business scale as well as their professional development and business expansion in other areas of the country, which will extend the operation and management of guarantee fund companies to professional and local branches and expand the service scope of guarantee fund companies to most provinces of China and main credit guarantee fields with the scale of multiplier expansion.

Domestic listing also helps the companies to enter the field of guarantee asset/pledge asset securitization and thus repeat their successful commercial mode in a higher level.

Just like all financial enterprises, the fundamental guarantee of whether guarantee fund companies can continue their operations lies in risk control. The commercial plan of guarantee fund companies makes risk control penetrate into each link of operational activities such as market, management, fiancé and investment etc. The commercial plan puts forward relevant measures for major aspects which may produce operational risks. The key to protect the interests of all investors including the promoters lies in whether the companies can effectively execute the measures of risk control and risk management. From the angle of investors, the analysis of the commercial plan of guarantee fund companies shows that although this kind of investment has certain risks, the investment benefits are obvious and the degree of investment benefits relies on the operational team. The nature of shareholding system of guarantee fund companies and the goal of domestic listing can congregate an operational team with profound professional knowledge and rich operating experience and the advanced knowledge structure and rich professional experience of senior managers are the core of the operating team.

A Study of the Operation Mode of the Private Enterprise Guarantee Fund

(The Third Draft, Dai Xu)

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Content

Guarantee agencies, which manage and share risks, are indispensable operation subjects in the market economy. They gain interest by sharing risks and improve profits by managing risks. The stage of economic development, economic management system and financial market environment in a country have great influence on the function orientation and operation mode of the guarantee agencies in that country. To establish a national guarantee fund for private enterprises in China, we should give full consideration to its significance for improving the financing environment of private enterprises and promoting economic development. In terms of operation mode, we should give attention to both policy support and policy orientation, but should stick to market operation in actual operation.

I. Comparative study of operating modes of guarantee agencies

Guarantee agencies may fall into two categories with respect to whether they take profit making as their major goals: one category is policy guarantee agencies and the other commercial guarantee agencies. These two categories have big differences in their operation modes. A comparative study may be of help to the design of the operating mode of the Private Enterprise Guarantee Fund in China.

(i) Operating mode of policy guarantee agencies

Policy guarantee agencies with government involvement have been existing for many years in various places of the world, for which there have been many experiences of successful operation. For example, the Tokyo Small and Medium-Scale Enterprise Credit Guarantee Association of local nature was established in Japan in 1937, and the Japanese Small and Medium-Scale Enterprise Credit Insurance Bank and the National Federation for Small and Medium-Scale Enterprise Credit Guarantee Associations of national nature were established in 1958; the United States, Germany and Canada started to construct the small and medium-scale enterprise credit guarantee system in 1953, 1954 and 1961 respectively; Taiwan and Hong Kong of China also started to implement small and medium-size enterprise credit guarantee in 1974 and 1998 respectively. At present, there are some guarantee agencies with government background and policy tendency in various places of China, which generally are affiliated with relevant government departments, for example, financial department and technological department etc., or subsidiaries of state-funded companies. These guarantee agencies generally provide guarantee for some small and medium-scale enterprises following government policies for industry support.

Non-financial guarantee or insurance that each country provids for export enterprises also have very strong policy color. But as they do not belong to financing guarantee, they are not included into the scope of study of this project.

Providing financing guarantee support in terms of policy to small and medium-scale enterprises is an effective tool for the government to promote the development of the real economy. For example, from the second half of 2008, because of the aggravation of the financial crisis caused by the sub-prime crisis, which exerted impact on the real economy, some countries have, to cope with the sliding of the real economy, stepped up efforts in support for financing of small and medium-scale enterprises. One of the measures is to step up efforts in providing policy guarantee for financing of small and medium-scale enterprises and provide convenience for their financing.

Comparing and analyzing these guarantee agencies of policy nature, we can find many similarities in terms of operating mode, which are reflected in the following characteristics:

1. Establishment of government-led policy guarantee agencies

The government establishes policy guarantee agencies mainly for realizing the government will and policy objectives, supporting the development of small and medium-scale enterprises or enterprises of specific industries, and promoting economic growth. Generally speaking, small and medium-scale enterprises are the most active components in the economy of each country, and are main channels for employment. But compared with large-scale enterprises, it is generally difficult for small and medium-scale enterprises to finance because of their own relatively small scale and relatively poor risk-resistance ability. It is very difficult to solve this problem by relying on market forces. Commercial guarantee agencies either do not provide guarantee for such enterprises to control risk or collect high guarantee fees, which increases the burden to small and medium-scale enterprises. Therefore, government support is required in this respect. As a result, policy guarantee agencies supporting financing of such enterprises come into being. These guarantee agencies organized or led by the government promote the healthy development of small and medium-scale enterprises so as to serve the implementation of government industrial policies.

The government organizes or leads policy guarantee agencies mainly because credit guarantee has the attribute of "public products" on the whole, and its external effect is obvious. Therefore, the private sector generally is unwilling to be involved or is only involved in a limited manner in providing guarantee to some small and medium-scale enterprises or enterprises of industries needing support. The government is needed to make up this gap so as to better promote economic development. The establishment of government-led guarantee agencies is mainly reflected in government capital contribution or funding for establishing policy guarantee agencies and promoting the normal operation of these guarantee agencies through continuous preferential policies, which is a major difference of policy guarantee agency from commercial guarantee agencies.

2. The government limits the guarantee objects of policy guarantee agencies

Policy guarantee agencies are generally established or funded by the government; therefore, they must serve the government will, including the selection of guarantee objects, which are mainly small and medium-scale enterprises that have potentiality for development but cannot acquire loan through normal channels. Generally, the government stipulates the guarantee objects of policy guarantee agencies, which are not so specific as to guaranteeing a certain enterprise, but is mainly reflected in stipulation of the scale and nature of guarantee objects, or the industry type of the guarantee objects, or the key guarantee objects etc.

For example, the "Small Business Act" of the United States authorizes the small business administration to provide guarantee to loans acquired by small enterprises that cannot acquire loans of reasonable conditions from ordinary channels; in the "Small and Medium Enterprise Law", a basic law for policies for small and medium-scale enterprises in Japan, which was amended in 1999, the guarantee objects supported by the government are "vibrant independent small and medium entrepreneurs", that is, to assist small and medium enterprises with good prospect for development.

Policy guarantee agencies overseas, besides providing guarantee mainly for small and medium-scale enterprises, sometimes take some special groups as guarantee objects, for example, women, the disabled, demobilized soldiers, ethnic minorities and enterprises established in poverty-stricken areas. The credit guarantee fund in Taiwan China provides guarantees for students in senior middle schools and above to apply for loans to pay their tuitions, internship fees, books and accommodation charges. Meanwhile, policy guarantee agencies generally clearly stipulate not to provide guarantee for speculating activities. For example, the guarantee plan of the United States clearly stipulates that loan plan of any kind may not be used for the purpose of speculating, particularly not for the real estate business with speculation as its purpose, may not be used for re-lending, may not be used in selling goods on a commissioned basis or multi-level marketing or any non-profit making activities not related with enterprises.

3. Policy guarantee agencies may not take profit making as its main operation objective

The government establishes or funds policy guarantee agencies, not for engaging in guarantee business and pursuing profits. Its operation objective is to provide guarantee for objects that the government wishes to support, and the social benefits of the guarantee business these agencies carry out far outweigh their economic benefits. Therefore, on one hand, policy guarantee agencies do not charge guarantee fees according to the market level, but collect some guarantee fees as a token; on the other hand, the guarantee objects of policy guarantee agencies are objects for which commercial guarantee agencies are unwilling to provide guarantee, and have relatively bigger risk of debt settlement. As a result, many policy guarantee agencies do not make profit or make little profit.

Due to this fact, the government generally will provide part of the guarantee fund for policy guarantee agencies or is jointly liable for such guarantee agencies. Meanwhile, the government will establish a financial compensation system or establish corresponding risk compensation fund for policy guarantee agencies. Also, it will give preferential treatment in terms of taxation etc., so that policy guarantee agencies can develop healthily and continue operation.

Though policy guarantee agencies do not aim at profit making, yet they implement fairly strict risk control mechanism. For example, the US Small Business Administration assumes responsibility for policy guarantee. It has strict admittance conditions to its guarantee objects and requires that the guaranteed objects provide counter guarantee measures. Meanwhile, the Small Business Administration carries out strict project review. A review committee organized by experts in various aspects such as investment, financing, accounting, law and project management to carry out evaluation on the guaranteed projects in terms of economy, technology and capital, and then give comprehensive opinions to decide whether the guarantee project is feasible.

(ii) Operating mode of commercial guarantee agencies

Generally, in some countries, policy guarantee agencies coexist with commercial guarantee agencies. Commercial guarantee agencies are set up by market subjects independently and take profit making as their main operation objective. In their operation activities, basically, there is not support and compensation mechanism of national or local fiscal authorities. Due to the pressure of survival and profit making, their operating mode differs greatly from that of policy guarantee agencies. The operating mode of commercial guarantee agencies generally has the following characteristics:

1. Independently selecting guarantee objects according to their risk and profit conditions

Commercial guarantee agencies do not have the operation requirement on supporting certain kinds of enterprises. But as they have the operation objective and pressure of profit making, when they select their guarantee objects, they will make a comprehensive evaluation of the risk and profit conditions of providing guarantee to their guarantee objects, and then decide whether to provide guarantee or not on this basis. Meanwhile, to better control risks, commercial guarantee agencies will select industries and fields which they know well and are good at to carry out guarantee business, and generally require that the guaranteed organizations to provide some counter guarantee measures.

The amount of commercial guarantee agencies in China is not small. But as their capital fund and asset scale are small generally, their credit rating is not high and their guarantee agility is limited, they are basically unable to take initiative to select those guarantee objects with low risks. For example, they cannot provide guarantee for financing of large enterprises or public offering bonds, but can only provide guarantee for financing of some small enterprises. As such guarantee objects have limited assets for mortgage, their risk of debt settlement is big, and some of them should be guaranteed by policy guarantee agencies, it is difficult for domestic commercial guarantee agencies to carry out guarantee business, and there are not many successful cases.

2. The commercialization and marketization degree of guarantee business operation is high

Commercial guarantee agencies take profit making as their major operation objective, and the commercialization and marketization degree of their guarantee business operation is high. Generally speaking, commercial guarantee agencies will carry out comprehensive evaluation and review of their guarantee objects, and implement strict review standards for their guarantee objects and complicated guarantee business examination and approval process. The pricing of guarantee fees is also more market-oriented. Guarantee fees will be determined on the basis of risk evaluation of guarantee objects, mainly considering the credit upgrading measures such as credit status and counter guarantee measures as well as the scale and term of guaranteed debt, etc.

3. Carrying out strict risk control measures

Commercial guarantee agencies are agencies operating risks, and require a sound risk control system, which is the basis for their survival in the market.

Firstly, the regulatory authorities and the creditors guaranteed will pay close attention to critical indexes such as magnifying power of guarantee and guarantee balance of guarantee agencies. If the above indexes exceed the recognized warning line in the industry, guarantee agencies may not be able to continue to provide guarantee or their power for continuing guarantee will be inadequate, which limit the impulse of guarantee agencies to keep expanding in order to seek profits, so that it is guaranteed that guarantee agencies have adequate solvency to cope with possible compensation.

Secondly, commercial guarantee agencies will carry out strict examination of guarantee objects, require their guarantee objects to provide counter guarantee measures, and prevent and control possible guarantee risks before an event takes place; after providing guarantee, they will continue to supervise the production and operation status of their guarantee objects, pay attention to their continuing solvency, reduce the possible risk of contract breach by guarantee objects, and reduce the loss ratio through various measures after a guarantee object breach contract.

Lastly, commercial guarantee agencies can also disperse some risks by applying for re-guarantee with re-guarantee agencies.

II. Factors that the operating mode of the Private Enterprise Guarantee Fund needs to pay attention to

The Private Enterprise Guarantee Fund takes private enterprises as its main guarantee objects and therefore should pay close attention to some characteristics of private enterprises, so that the operating method and operating strategies of the Private Enterprise Guarantee Fund are more pertinent, and the Fund can improve the financing environment of domestic private enterprises under the prerequisite of controlling its own risks.

(i) Characteristics of private enterprises that need to be considered as guarantee objects

1. Private enterprises mainly engage in competitive industries

There are few private enterprises distributed in monopoly industries and public industries in China. Private enterprises are mainly distributed in competitive industries. These industries generally have fierce competition and the industry profits tend to be averaged; meanwhile, the impact of economic fluctuation and policy factors on these industries is big, and their periodicity is very obvious. These factors make the operation and development of private enterprises not very stable, their ability to resist various risks is weak, and their operation conditions are much subject to the impact of economic fluctuation. Compared with state-owned enterprises, the contract breach rate of their debts is higher.

2. The assets that private enterprises use in mortgage are generally small

The asset scale of domestic private enterprises is generally not big and the assets that they can use in mortgage are small, which makes it difficult for them to provide counter guarantee measures to guarantee agencies. When guarantee objects have difficulty in repaying debt, there are few measures that a guarantee agency can adopt to control risk and make up losses.

3. The corporate governance structure of private enterprises is generally not sound enough

Private enterprises are generally created and developed by a certain family or individual, so they have strong family color. In particular, some non-listed private enterprises do not have very sound corporate governance structure generally. The core figure plays a decisive role in the development of private enterprises. If the core figure has an accident or his/her decision has a major error, the enterprise may have operation difficulties, and may even be unable to continue operation, so as to affect the repayment of debt.

4. It is generally difficult for private enterprises to finance

It is generally difficult for private enterprises to finance, which limits their development. Also their fund chain is liable to break, and their liquidity is inadequate; as a result, for a certain due debt, it is difficult for them to repay it through re-financing.

(ii) Factors that should be noted for the operating mode of the Private Enterprise Guarantee Fund

As the guarantee objects of the Private Enterprise Guarantee Fund have the above characteristics, the following factors should be noted for its operating mode:

1. Try to get government support in various aspects

To establish a guarantee agency with private enterprises as its major guarantee objects when the circumstances that the financing environment for private enterprises are not good, reflects policy feature and is a support for private enterprises. So the Private Enterprise Guarantee Fund should win government support in various aspects. For example, in time of establishment, support should be given to the operation scope and field of the guarantee fund; in the course of operation, preferential arrangement should made for the income tax of the Fund, and special support should be given to the external debt financing of the Fund. In all, the Private Enterprise Guarantee Fund can have stable and continuous operation and better serve improvement of the financing environment of private enterprises only when it has adequate support from the government.

2. Sticking to the principle of market-oriented operation

The Private Enterprise Guarantee Fund should stick to the principle of market-oriented operation. The Private Enterprise Guarantee Fund is absolutely not a "charity organization" for private enterprises, not a "straw to grasp at" for private enterprises, either. For private enterprises that do not have sound operation and management, and whose products lack competitiveness, if they do not meet guarantee conditions, guarantee should not be provided to them. The principle of market-oriented operation is reflected in the selection of guarantee objects, e.g. private enterprises with good qualifications, large scale and good prospect for development should be selected as guarantee objects; they should also be reflected in the collection of guarantee fees, which should correspond to the guarantee risk assumed; in addition, the principle should also be reflected in risk control of guarantee objects, including strict review of guarantee objects, design of effective risk control measures and continuous tracking and supervision over guarantee objects.

3. Carrying out diversified operation while focusing on guarantee business

Objectively speaking, the social effect of guarantee business is very strong. Compared with the risks it assumes, the interests gained by a guarantee agency are limited. Meanwhile, it has to perform some guarantee responsibilities after a guaranteed object breaches contract, which makes it difficult for a guarantee agency to maintain its normal operation and become bigger and stronger by only relying on the guarantee income collected. Therefore, guarantee agencies, while focusing on guarantee business, should also carry out investment, management consulting and relevant training service and, with the income of these businesses, provide a compensation mechanism to maintain the normal operation and expand the scale of the guarantee agency and improve its operation level.

4. Establishing a sound risk control system

Domestic private enterprises have relatively big operation risk, but their contribution to the economic development and full employment is very great. For the guarantee fund mainly engaged in private enterprise guarantee, it is very important to control risk, which is related to whether it can continue to develop healthily. Through several years' development, many excellent private enterprises have emerged in China. Through the careful selection among them by the Private Enterprise Guarantee Fund, the risk of providing guarantee for some enterprises is small. Meanwhile, counter guarantee measures should be taken, as well as continuous supervision after guarantee. In all, the Private Enterprise Guarantee Fund, which fixes private enterprises as its guarantee objects, should establish a sound risk control system to manage well risk control and implement risk control in each aspect of the guarantee business.

III. The Private Enterprise Guarantee Fund adopts the mode of corporate closed-end fund

As to what kind of organizational form that the Private Enterprise Guarantee Fund should adopt, on one hand, the opinions and orientation of the Fund sponsor should be listened to; on the other hand, related domestic laws and taxation environment should be considered. For the Private Enterprise Guarantee Fund, consideration can be given to mainly two organizational forms. One form is to establish a limited liabilities company or joint stock company and of course the form of joint stock company is better for the guarantee agency to expand its scale and become stronger; the other form is to establish a corporate or contractual fund, and from the perspective of stable operation and continuous guarantee, corporate closed-end fund is more appropriate. After comprehensive consideration, we think that the mode of corporate closed-end fund should be adopted for the Private Enterprise Guarantee Fund.

(i) Adopting the mode of corporate closed-end fund

1. The private placement mode will be adopted for the Fund

As far as fund raising is concerned, private placement or public offering may be adopted. Domestic securities investment funds are typical public offering. Public offering is more suitable for operating very mature funds with good liquidity. Private placement is issued mainly for specific institutions, for example, domestic trust products and industrial investment funds etc. Private placement is more convenient, for which communication is easier. For the Private Enterprise Guarantee Fund, on the basis of full communication with domestic and overseas financial institutions, it is more appropriate to adopt the private placement method.

2. The corporate mode is adopted for the Fund

Corporate funds are independent legal persons and may be allowed to integrate fund from banks through normal paths and within a scope permitted to solve short-term fund deficiency and improve the risk resistance ability of the funds, or expand the fund scale and strengthen the development stamina of the Funds. Under ordinary circumstances, contractual funds are not allowed to directly acquire loans or call loans. Besides, compared with contractual funds, corporate funds have obvious advantages in governance structure, internal control, investment decision making, and dealing with the rights and obligations among various parties.

3. The closed-end mode will be adopted for the Fund

To enable the Private Enterprise Guarantee Fund to operate at a relatively stable scale in the first few years, the mode of closed-end fund will be adopted. The Fund will be closed after its establishment is announced, no new investor will be accepted within a certain period, and the sponsors cannot redeem it. Only in this way can the Fund be guaranteed to have continuous guarantee ability and the stability of external investment can be maintained. To provide liquidity to the sponsor, transfer may be arranged at the property exchange. When conditions are ripe in the future, exchange of fund shares at stock exchanges established according to law may be applied for, and the sponsors or the investors may carry out exchange and transfer in the secondary market.

(ii) Several problems for establishing a corporate closed-end fund

1. The problem of sponsor

(1) Adopting the mode of corporate closed-end fund will be conducive to segregating the risk of the guarantee fund from the risk of the sponsors

For the sponsors, the mode of corporate closed-end fund can segregate the operation risk of the Fund. A corporate fund is a joint stock company established according to the Company Law and formed by raising funds in the form of issuing stocks. According to Article 3 of the Company Law, "the shareholders shall be responsible for the company to the extent of the capital contributions they have paid." According to this provision, the risk of the sponsor is limited and can be forecast. Its greatest loss is that the capital used to subscribe the shares of the Fund cannot be taken back. In this way, the risk of the guarantee fund can be well segregated from the sponsors and more investment of the sponsors may be acquired.

(2) State policy banks, financial institutions and investment companies may act as the primary sponsor

State policy banks, financial institutions and investment companies may act as the primary sponsor. Though the China Development Bank has been transformed to commercial banks, yet it still keeps some functions of a policy bank. Therefore, it is very appropriate to be the primary sponsor of the Private Enterprise Guarantee Fund. Meanwhile, the China Development Bank has the conditions and ability to contribute capital to establish the Private Enterprise Guarantee Fund. In recent years, the China Development Bank has participated in the initiation and management of several funds such as the Sino-Swiss Fund, the Sino-Belgium Fund and the Bohai Fund, and has rich experience in fund establishment and management as well as guarantee business.

(3) Attracting overseas financial institutions to be sponsors

While the China Development Bank being selected as the primary sponsor, several overseas financial institutions may be selected as sponsors, which not only reflects the characteristic of using foreign capital, but also improves the strength of the Private Enterprise Guarantee Fund. In fact, the huge guarantee market of China has great attraction to foreign capital. Many foreign-funded institutions such as International Finance Corporation and Temasek have applied for establishing commercial guarantee agencies in China, while some private guarantee funds in China have shares of overseas financial institutions. Therefore, it is very feasible for the China Development Bank and overseas financial institutions to jointly establish the Private Enterprise Guarantee Fund.

(4) Attracting other commercial banks or large-scale state-owned enterprises and private enterprises to be sponsors

There is no legal barrier for domestic commercial banks to participate in the sponsorship and establishment of a guarantee fund in policy. Meanwhile, participating in shares of a guarantee fund can help increase the profit sources and space of domestic commercial banks, and can effectively integrate financial resources and improve competitiveness. This is also a direction for the development of the financial industry in China. The regulatory authorities in China are gradually loosing control over the business of financial institutions. In August 2007, the CBRC promulgated the "Measures for Implementing Administrative Licensing Matters of Non-banking Financial Institutions" to expand the business scope of commercial banks; in December 2006, the General Office of the State Council transmitted the "Opinions on Strengthening the Construction of the Small and Medium Enterprise Credit Guarantee System" by the Development and Reform Commission, the Ministry of Finance, the People's Bank of China, the General Administration of Taxation and the China Banking Regulatory Commission, requiring related departments and local governments at all levels to attach great importance to the establishment of the small and medium enterprise credit guarantee system and adopt effective measures to promote the continuous and healthy development of small and medium enterprise credit guarantee agencies. These policies clearly show that the State's support for the reasonable business extension of commercial banks and strengthening the guarantee work of small and medium enterprises.

Leaders of the CBRC have once expressed in their internal meeting that establishing guarantee funds is an effective path for improving enterprise financing environment and dispersing bank risks, and they will support guarantee funds with substantial strength to be established and carry out business, and they will hold an open attitude to commercial banks' participation in establishing guarantee funds.

After the impact of the world financial crisis on the economy of our country in 2008, the State has stepped up efforts in supporting small and medium-scale enterprises and encourages banks to provide financing arrangement for small and medium-scale enterprises. In China, the majority of small and medium-scale enterprises are private enterprises. Therefore, against this backdrop, commercial banks participate in the establishment of the Private Enterprise Guarantee Fund is in fact a response to the state policy and will be conducive to improving the financing environment of small and medium-scale enterprises.

Large-scale state-owned enterprises have strengthened their layout in the financial field in recent years. The State-owned Assets Supervision and Administration Commission also support this practice. As a quasi-financial institution, a national guarantee agency has large potentiality for fund share appreciation in the future. To infiltrate into some industries or enterprises with a guarantee fund is attractive to these state-owned enterprises. Also, the participation of large-scale state-owned enterprises in the Private Enterprise Guarantee Fund also reflects support for private enterprises, which is of certain political significance. State-owned enterprises will compete and develop together with private enterprises in some fields. Therefore, we may consider attracting large-scale state-owned enterprises with sufficient funds to participate in the establishment of the Private Enterprise Guarantee Fund.

2. The issue of fund scale

The recommended scale of the Private Enterprise Guarantee Fund at its establishment will be RMB 7 billion. The sponsors will subscribe for fund shares pro ratio. After the establishment, it is recommended to increase the capital to RMB 15 billion to RMB 20 billion in the fifth year according to the needs of actual development of the Fund business. The fund will strive to get the AA level corporate credit rating rated by the rating company upon establishment, and start to rise to AA+ level from the fifth year. From then on, the Fund will continue to develop and expand, and strive to rise to the AAA level after about 7 years and maintain this rating level.

Determining the above scale and follow-up arrangement is mainly based on the following reasons:

Firstly, it is determined by the nature of the guarantee fund business. A guarantee fund operates credit and its primary business is to provide guarantee and re-guarantee. If the Fund scale is small, it will not get good corporate rating so that the role of credit enhancement of the guarantee fund is very limited, and the significance for its development of business is not big; on the other hand, affected by the guarantee multiplying power, it will not be able to continue to increase guarantee business or provide guarantee for larger loans.

Secondly, it is determined by the current situation of the domestic guarantee market. At present, the capital fund of domestic guarantee companies is generally of small scale, their credit rating is not high, and the guarantee ability is limited. To help the Private Enterprise Guarantee Fund to acquire important status in the guarantee market and maintain a high credit level, a scale of at least RMB 10 billion is required.

IV. The primary business of the Private Enterprise Guarantee Fund is direct guarantee business and re-guarantee business

The primary business of the Private Enterprise Guarantee Fund is guarantee business, but it should also operate non-guarantee business related with its guarantee business, so that the Fund can maintain healthy development.

(i) The guarantee business carried out by the Private Enterprise Guarantee Fund

There are three kinds of business modes that can be selected by the Private Enterprise Guarantee Fund in the guarantee field: the first kind is the business operation mode directly providing guarantee to private enterprises; the second is the business operation mode of carrying out equity investment with guarantee companies, which may be private guarantee companies or guarantee companies that mainly provide guarantee to private enterprises; the third kind is the business operation mode of cooperating with the guarantee companies mentioned in the second kind to provide re-guarantee.

1. The business mode of mainly carrying out equity investment with guarantee companies is not recommended

(1) Limited fund cannot enhance the guarantee ability of the guarantee company to a large extent

Objectively, as the scale of domestic guarantee companies is not big at present, it is difficult for them to develop their primary guarantee business, their risk resistance ability is bad, and corporate governance structure is not sound. If the limited several billion fund of the Private Enterprise Guarantee Fund is scattered to several or even over ten guarantee companies of this kind, the guarantee ability of these guarantee companies will not be increased to a large extent, instead, the ability of the Private Enterprise Guarantee Fund to provide guarantee will be decreased to a large extent.

(2) The income of equity investment in guarantee companies is not optimistic

The investment of the Private Enterprise Guarantee Fund in guarantee companies is not strategic investment, as it does not need to realize resource advantage integration or combination of the strong through investment, nor does it have the mission to improve the corporate governance structure of the invested enterprises and improve management level through strategic investment. The investment of the Private Enterprise Guarantee Fund in guarantee companies is mainly financial investment, aiming at acquiring capital return and valuing direct and short-term interest. However, at present, domestic guarantee companies generally do not have high net return on capital. Some have high yield, but it mainly comes from income of non-guarantee business, with big risk and also very unstable. Therefore, the income of equity investment in guarantee companies will not be very optimistic.

(3) Equity withdrawal from guarantee companies is very difficult

There are several thousand guarantee companies in China. The admittance threshold is very low. Basically, there is no guarantee “license fee”. It is not easy to find an appropriate assignee, let alone the difficulty of selling at premium. Meanwhile, it is very difficult for small guarantee companies in China to be listed through IPO due to their industry characteristics and income conditions, which makes it very difficult to realize the method often used for equity withdrawal.

2. It is recommended to take direct provision of guarantee to private enterprises as the primary business and the re-guarantee business may be carried out

The Private Enterprise Guarantee Fund may directly provide guarantee to private enterprises and may also carry out re-guarantee business. In the beginning of establishment, it may mainly engage in providing direct guarantee, supplemented with the re-guarantee business. With the continuous improvement of the guarantee business level and guarantee ability of the Fund, the proportion of the re-guarantee business will be gradually increased.

(1) Providing guarantee to private enterprises directly

The biggest problem for domestic guarantee companies is their small scale. For private enterprises with larger scale, these small guarantee companies cannot provide guarantee. Therefore, the Private Enterprise Guarantee Fund should give play to its advantage of strong guarantee strength and high ability of business management to subdivide the guarantee market and carry out staggered competition with existing guarantee companies, and mainly provide guarantee to guarantee objects for which the present guarantee companies are unable to guarantee.

In the early period when it carries out business, the business should be focused on the Pearl River Delta and the Yangtze River Delta on the southeast coast. The private enterprises in these developed regions have larger scale and stronger ability of risk resistance. After the Private Enterprise Guarantee Fund accumulated experience and strength, it can expand to other regions.

To control guarantee risks, it is recommended that the guarantee term should be under three years, and the longest should better not exceed five years. Generally speaking, it is relatively accurate to forecast the economic trend and development of a guarantee object within three to five years. It is difficult to see the trend and development in over five years. Meanwhile, to control risks, the guarantee objects should be required to provide counter guarantee measures.

(2) Re-guarantee business

At present, there is a large number of guarantee companies in China, but they are generally confronted with problems such as small amount of fund, weak strength and poor ability of risk resistance. It may be said that the construction of the re-guarantee system in China far lags behind the development of guarantee companies in China. This is mainly because the access threshold for guarantee companies is low and the threshold required by re-guarantee companies is higher. The initial scale of the Private Enterprise Guarantee Fund may reach RMB 7 billion, and has the full strength for developing re-guarantee.

Generally, re-guarantee business has strong policy color. It can share and disperse risk for guarantee agencies, expand the magnifying power of the whole guarantee industry, and improve the public creditability of guarantee companies. The Private Enterprise Guarantee Fund carrying out re-guarantee business will not only help develop the re-guarantee market in China but also bring substantial benefits to the Fund.

From guarantee projects that guarantee companies agree to undertake, the Private Enterprise Guarantee Fund can select some good projects to provide re-guarantee. Under this business mode, a large amount of fundamental work has been completed by the guarantee companies, and the Private Enterprise Guarantee Fund only has to carry out due diligence and examination of some excellent guarantee projects. In this way, a large amount of labor can be saved for the Private Enterprise Guarantee Fund. Meanwhile, the guarantee projects that guarantee companies agree to undertake have undergone the selection and due diligence review of the guarantee companies. On this basis, the Private Enterprise Guarantee Fund provides re-guarantee for guarantee projects with better qualifications among these projects, that is, selecting the best from the good. In this way, guarantee risk can be well controlled. Of course, this requires guarantee companies to carry out strict review of their guarantee projects, and guarantee companies should provide relevant information of the guarantee projects to the Private Enterprise Guarantee Fund, to prevent information asymmetry; also guarantee companies should recommend truly good projects to the Private Enterprise Guarantee Fund to avoid ethical risk before re-guarantee.

Therefore, the Private Enterprise Guarantee Fund should choose to cooperate with guarantee companies with good credit standing, strong strength, sound internal governance structure, sound risk control and rich experience in guarantee business. Meanwhile, it should announce detailed and strict conditions and standards for re-guarantee projects to these guarantee companies. For the re-guarantee projects recommended by guarantee companies, the Private Enterprise Guarantee Fund should carry out strict review and provide re-guarantee to those projects meeting conditions, and then enter agreement with the guarantee companies on the collection of re-guarantee fees and re-guarantee compensation etc.

(ii) Non-guarantee business carried out by the Private Enterprise Guarantee Fund

As above mentioned, because the income of the guarantee business cannot give shareholders stable return, maintain the normal operation of the guarantee fund or make the Fund larger and stronger, the Private Enterprise Guarantee Fund should carry out some non-guarantee business besides the guarantee business.

1. Assets operation and investment business

Assets operation is mainly operation and management of various pledges acquired by the Fund from the guaranteed parties. Investment is mainly external investment of self-owned fund. To maintain the liquidity of the assets owned by the Fund itself to cope with various compensation demands after providing guarantee, 70% of the capital owned by the Fund itself may be used in fixed income investment, mainly including bank deposit,T-bonds, financial bonds, and bond buyback etc. and the remaining 30% can be used in equity investment, mainly including stock trading in the secondary market, as well as equity investment with growing enterprises and enterprises to be listed. Such investments can not only increase the income of the Fund and provide support to the guarantee business and provide stable return to shareholders but also keep expanding the strength of the Fund.

2. Consulting and training business derived from the guarantee business

Such business mainly refers to providing consulting on guarantee, investment and management as well as related training service, credit information management and training of guarantee personnel etc. If possible, the Fund may also develop credit rating of guarantee agencies etc.

V. The Private Enterprise Guarantee Fund can acquire stable business income

The profits of the Private Enterprise Guarantee Fund mainly come from four major blocks: the first block is the business income from providing direct guarantee and re-guarantee service; the second block is the capital appreciation income from assets operation and direct investment; the third block is income of capital fund used in investment with fixed income; the fourth block is service income acquired from relevant services such as consulting and training.

(i) Income of guarantee business

Guarantee business can bring stable income to the Fund. Estimated at RMB 7 billion, the scale of the Fund upon its establishment, assuming that the magnifying power is five times in line with the principle of prudence, the guarantee balance of the Fund may reach RMB 35 billion. Also, it is assumed that the Fund keeps increasing at a scale of RMB 15-20 billion every year on average. If the guarantee fees are collected at one time, and the amount is 2% of the guarantee scale, then the income of the Fund from the guarantee business is about RMB 300-400 million every year.

(ii) Income from direct investment

To realize the self "hemopoiesis" function and self-compensation mechanism of guarantee agencies, with reference to international experiences, it is assumed that 30% of the Private Enterprise Guarantee Fund (about RMB 2.1 billion) may be used to carry out investment business such as investment in the securities market and direct investment. Estimation is carried out according to the historical performance of the US direct investment funds publicized by the US National Venture Capital Association and the Thomson Financial Survey.

Table 1: Historical performance of the US direct investment funds Unit: %

Fund type	Average income of one year	Average income of three years	Average income of ten years	Average income of ten years
Total direct investment funds	**31.3**	**16.3**	**9.2**	**13.3**
Small direct investment funds	11.5	7.8	7.9	25.4
Medium direct investment funds	33.8	10.0	10.9	16.5
Large direct investment funds	18.2	16.0	10.2	12.7
Super direct investment funds	35.7	17.8	8.8	11.4
Mezzanine fund	12.2	4.8	6.4	8.9

Source of data: Thomson Financial/ US National Venture Capital Association

Data explanation: the data covers 1,841 direct investment funds and the total amount of capital reached USD 657 billion. The data of yields are yields of limited partners after deducting the management fees and bonus for the manager (the two items account for about 5%). The capital amounts of small, medium, large and super direct investment funds are: less than USD 250 million, USD 250-500 million, USD 500 million to USD 1 billion and above USD 1 billion.

If the average long-term compound yield in ten years, that is, 9.2% (this yield can be easily realized under domestic conditions at present), is used as the basis for estimation, RMB 2.1 billion can have a yield of RMB 193.2 million every year.

(iii) Income of fixed income investments

70% of the Private Enterprise Guarantee Fund (about RMB 4.9 billion) may be invested in fixed income varieties with high level of safety and liquidity, including bank deposit, national debts, financial bonds, central bank bills and enterprise bonds with higher level. If the average income of these varieties is assumed to be 4.5%, the investments of fixed income varieties may acquire an income of RMB 220.5 million every year.

(iv) Service income from consulting and training

The Private Enterprise Guarantee Fund will make full use of the advantage of having foreign-funded shareholders to introduce and draw on overseas advanced experience in guarantee business, for example, project selection evaluation and risk control etc., and vigorously carry out relevant consulting and training service. A conservative estimation is that a service income of RMB 50 million without risk may be acquired.

The above four kinds of income may earn a profit of RMB 763.7-863.7 million for the Fund. If the financial lever effect of the debt of the Fund is considered, the annual profit of the Fund will be higher than this level. Considering factors such as income tax, the net asset yield will be maintained at around 8%, basically reaching the average social profit level, which can enable the Fund to continue its operation.

VI. The organizational structure and management mode of the Private Enterprise Guarantee Fund

(i) The organizational structure of the Private Enterprise Guarantee Fund

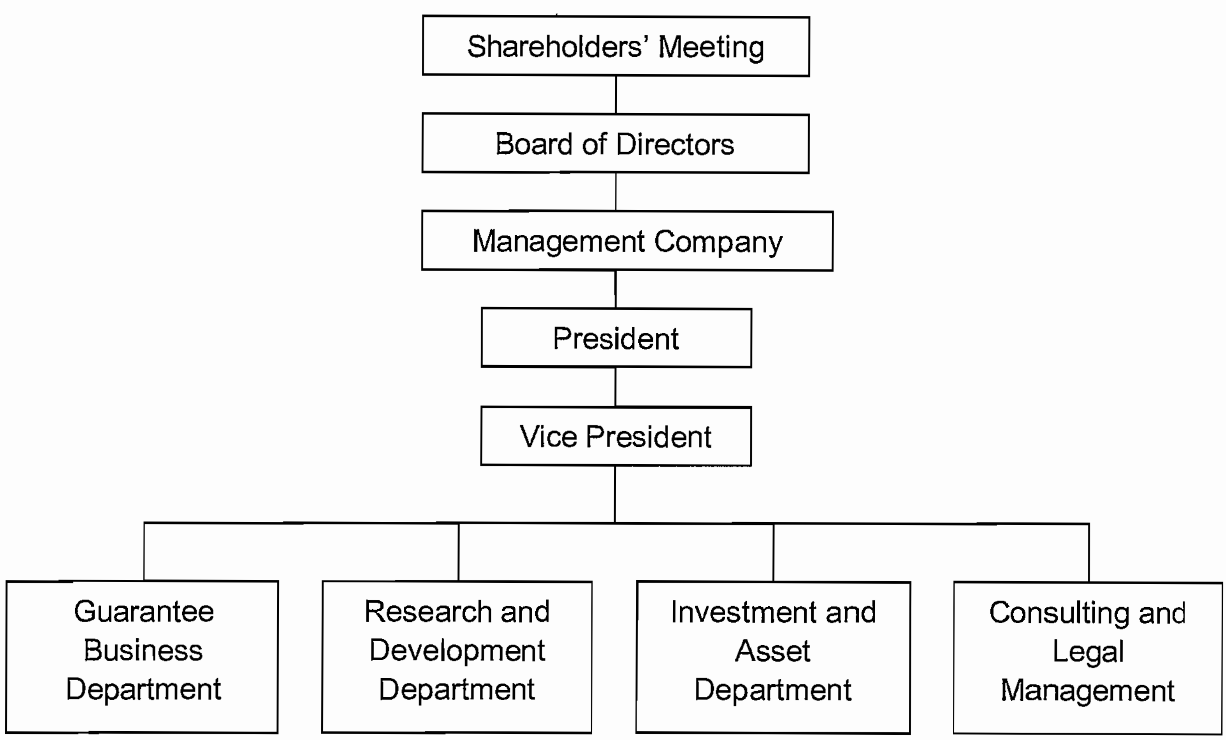
The Private Enterprise Guarantee Fund will set up the Shareholders' General Meeting and the Board of Directors, and seven committees will be set up under the Board of Directors, corporate management, remuneration and performance, auditing and legal affairs etc., responsible for the making and supervision of policies of various major aspects of the operation and management of the Fund, and directly responsible to the Board of Directors.

Meanwhile, a management company that conducts business will be set up, which is the operation and management organization of the Fund, responsible for the daily operation and management of the Fund. The management company will be organized by one president and several executive presidents and other senior management.

The management company will set up four major business centers, the guarantee business department, research and development department, the investment and assets department and the consulting and legal management department, specifically responsible for the management and marketing of the primary business of the Fund.

The functional departments of the management company will include the office, the human resource department, the planning and financial department and the auditing office etc. The actual arrangement will be prepared by the president, to be deliberated and approved by the Board of Directors.

Chart 1: Chart of the Organizational Structure



(ii) Governance structure of the Private Enterprise Guarantee Fund

According to the provisions of related laws, regulations and regulatory documents issued in China, the governance structure of the Private Enterprise Guarantee Fund will be:

The Shareholders' Meeting is the highest organ of power of the Fund. The power exercised by the Shareholders' Meeting is mainly on major matters of the Fund, mainly including deciding on the operation guidelines and investment plan for the Fund, deliberating and approving the reports of the Board of Directors, deliberating and approving the Fund's annual financial budget plans and settlement plans etc.

The Board of Directors is responsible to the Shareholders' Meeting, responsible for summoning sessions of the Shareholders' Meeting, reporting work to the Shareholders' Meeting, execute the resolutions of the Shareholders' Meeting, deciding on the operation plans and investment plans of the Fund, formulating the annual financial budget plans and settlement plans of the Fund, and deciding on the setup of the internal management structure of the management company, supervising the operation of the management company and responsible for appointing the president of the management company, among others.

The Management Company, according to board resolutions, carries out the fund business and the daily operation and management of the Fund.

The President is responsible for the daily operation activities of the company and carries out board resolutions.

(iii) The risk control system of the Private Enterprise Guarantee Fund

A risk management department will be specially set up. A risk control system on the front desk, middle desk and back desk will be established in the course of carrying out guarantee business, forming a risk management procedure of "prevention before an event, control in the course of an event, and evaluation after an event". To effectively control risk, not only will the guarantee business be operated according to the strictest guarantee conditions and risk management requirements but also strict process supervision will be exercised on the projects under guarantee, so as to give warning to the deterioration of the ability of the guarantee objects to perform their contract.

In the risk management of the Fund, the three-element management method will be adopted as a major method: firstly, the operation conditions of the Fund shall be good, and the risk exposure shall be stable and controllable; secondly, risk management and growth of the fund business shall be coordinated, and the risk management policy shall follow the short-term, mid-term and long-term development planning; thirdly, increase risk adjusted return through risk management. To ensure the effective implementation of the risk management process, where necessary, the organizational structure of the Fund may be re-designed and adjusted to make it adapt to the implementation of strategies, business development, risk control and critical operation indexes. Specifically, the risk management of the guarantee business will be realized mainly through the monitoring and management of four stages, evaluation of the guaranteed objects, regular evaluation of the risk of guaranteed business, claim management and recovery management.

Feasibility Analysis On China Development Bank（CDB） as Sponsor and Investor of Private Enterprise Guarantee Fund

(Liang Huijiang)

Contents

I. Brief Introduction of China Development Bank (CDB)

China Development Bank (CDB) was established in March 1994, under the direct leadership of the State Council. As a policy bank, the Bank vigorously implements the State's macro-economic policies and has assumed an active role in raising and channeling social funds to alleviate the bottleneck restraints and strengthen the weaker links in the development of economy and society. The Bank is dedicated to promoting the market construction and the planning prioritization through financing, and supports the development of such areas as the State's infrastructures, basic industries, pillar industries and high and innovative technologies, as well as key national projects. Since 1998, in response to the State's policies of increasing domestic demand and stimulating the economic growth by investment, CDB has extended its supports from major national projects to urban infrastructure projects. By the means of financing promoting the market construction and the planning prioritization, the Bank has reaped commercial benefits in the process of building up urban public infrastructures, and has gradually expanded its investment from tier-one cities to tier-two cities and counties. This approach has effectively transformed the mode of economic growth from the single stimulation of major projects to the overall stimulation of urbanization. Consequently, the impact of the State's policy of stimulating the economic growth by investment has been multiplied with resounding effects, and CDB has become one of the top banks leading China's medium-term and long-term investment and financing areas. Since 2003, with the rich experience in infrastructure-related lending, CDB has helped to lift the bottlenecks in China's society as well as to improve the living standards of people. The Bank has taken on a more important role in areas that are closely related with people's life, including, the issue of agriculture, countryside and farmers, the construction of a new countryside, small and medium-sized enterprises, the housing problem of low-income families, energy conservation and environment protection, education, medical treatment and public health. In 2008, faced with the complicated situation configured by the spreading of the international financial crisis, the unprecedented domestic natural disaster, the domestic economic slowdown, as well as its own commercialization transition, the Bank, by taking a scientific outlook on development and adhering to the State's guidelines and policies, met the challenge vigorously and re-demonstrated the stabilizing function of medium-term and long-term investment and financing for a smooth economic cycle.

For 15 years, as a governmental development financial institution, CDB has stuck to the principle of advancing with the times. The Bank has integrated its advantages in financing with the government's advantages in organizing, and has undertaken the State's development priorities by a market-oriented approach. Aiming to build up a system momentum to promote China's economic development and to achieve success in both project development and system construction, the Bank has developed a development banking pattern with its own characteristics. While executing the State's development strategy and priorities with a market-oriented approach, CDB strives to lead in growth, innovation, and market performance and to enhance core competitiveness.

As specified on the National Conference on Financial Work in Jan. 2007, CDB would undertake a reform as a pioneer among the three policy banks, carry out an overall commercialized operation in the light of the requirements on establishing a modern financial enterprise system, follow an operational mode of independent operation, assumption of risks and sole responsibility for its own profits and losses, and mainly deal with medium-term and long-term businesses. In Feb. 2008, the reform initiative of CDB was approved by the State Council. On Dec 16, 2008, the former China Development Bank became China Development Bank Corporation, which marked the beginning of a new phase of the Bank's reform.

By the end of 2008, the Bank's asset balance had amounted to RMB 3,821.2 billion, out of which the outstanding loans had been RMB 2,898.6 billion. The asset quality and the profitability had outshined most of its peer banks. The Bank's non-performing loan ratio had been 0.96%. The total profit had been RMB 27.9 billion, yielding an average return on assets (ROA) of 0.62% and an average return on equity (ROE) of 5.97%. The ratio of allowance for loan impaired losses to identified impaired loans had been 210.12%, and the capital adequacy ratio had been 11.31%.

Currently, the Bank has 34 branches and 2 representative offices across China, with over 6,000 employees, among whom 91.9% hold bachelor's degrees and above. The Bank has trained numerous professionals specialized in different industry sectors, together with many engineers, financiers, lawyers and experts in other fields. Indicators such as the amount of per capita assets and per capita profit show CDB in a leading position among peers, both in China and abroad.

II. CDB's Advantages as a Sponsor and Investor of the Guarantee Fund

The Bank has the following advantages to assume the roles of a sponsor and investor of the Private Enterprise Guarantee Fund.

(I) Promoting the Private Enterprise Guarantee Fund is in line with CDB's business development strategy.

Since 2003, the Bank has vigorously implemented the State's industry policies and has strengthened its supports to lift the social bottlenecks and improve the livelihood of people. The Bank has taken on itself the social responsibilities as a financial enterprise to promote scientific development, social harmony, economic prosperity and social wellbeing. It has provided financial supports to the areas closely connected with people' life, including small and medium-sized enterprises, the issue of agriculture, countryside and farmers, the construction of a new socialist countryside, the housing construction of low-income families, education and healthcare. The Bank attaches great attention to private enterprises' financing problems, and has provided financing services for private enterprises in credit loans, bond underwriting, financial consultation, the guarantee system construction, etc. As of the end of 2008, the Bank's had offered accumulated loans of RMB 91 billion to SMEs, accumulatively supported 1,010,000 SMEs, individual businesses and farmers, and created 2.04 million new jobs, and the outstanding loans had accounted for RMB 55.6 billion, which has given huge impetus to the sustainable and healthy development of SMEs. In 2008, despite of the financial environment featured by credit scale tightening, the Bank continued to provide preferential credit loan policies for SMEs, with an increase of nearly 1 fold in credit loan programs compared with the previous year. In the same year, the Bank once again won the honorary title of 'advanced unit in providing financial services for small enterprises' granted by China Banking Regulatory Commission. There's every reason to say that promoting the establishment of the Private Enterprise Credit Guarantee Fund fits the Bank's development strategy of providing vigorous financing supports for SMEs, and the fund will diversify the services for the financing of private SMEs.

(II) CDB has successful experiences in fund promotion, investment, operation and management.

The Sino-Swiss Partnership Fund is the first fund that CDB has participated in. In 1998, on behalf of the State, CDB participated in the launching and establishment of the Sino-Swiss Partnership Fund by investment, and from then on CDB has become the first domestic banking financial institution to directly invest in sector funds. In 2004, the Bank invested in another two funds, i.e. the ASEAN China Investment Fund and the China-Belgium Direct Equity Investment Fund. From 2006 to 2008, the Bank had participated in the establishment of several other funds, among which, the China-Africa Development Fund established in 2007 enjoyed many firsts. Never before had the establishment of a fund been announced by the Chairman of the State and had its opening been unveiled by the officials of the State Council. This fund has also been the largest private equity fund in China and the first equity investment fund dedicated to the investment in Africa by far. The China-Africa Development Fund was established upon the formal approval of the State

Council, and its eventual size accounted for USD 5 billion, out of which the initial USD one billion was invested by CDB. In 2008, the Bank undertook new investment in four funds—New Development Startup Investment Joint-stock Enterprise (the initial investment amounting to RMB 1.5 billion), China Citic Bank Yuanjing Collective Investment Trust (CIT) Program for Infrastructure (totaling RMB 1.23 billion), Kaitou Startup Investment Enterprise (totaling USD 202 million) and Kaixin Venture Capital CO., LTD. (totaling RMB 900 million).

By the end of 2008, CDB had invested in 11 funds, including the China-Africa Development Fund, the China-Italy Mandarin Fund, the ASEAN China Investment Fund, etc., and 5 fund management enterprises. The total investment had amounted to RMB 69.52 billion, with the committed investment accounting for RMB 12.78 billion and the actual investment reaching RMB 10.47 billion.

Currently, the industry funds that CDB have initiated or invested are mainly divided into three categories. First and foremost are the funds that implement the State's strategic intents, have important significance in economy and diplomacy, and embody bi-lateral or multi-lateral cooperation forms, such as the China-Africa Development Fund, the Sino-Swiss Partnership Fund, the ASEAN China Investment Fund, the China-Belgium Direct Equity Investment Fund, the China-Italy Mandarin Fund, China-Israel Huayi Startup Investment Fund, etc. Then there are macro industry funds that support the development of domestic regional economy or industries, such as the Bohai Industrial Development Fund. The last category includes funds which promote the growth of SMEs by adopting a market-oriented approach, such as Kaitou Startup Investment Enterprise and Kaixin Venture Capital CO., LTD.

The Bank's investments in the different categories have accomplished the planned strategic goal and have brought into play the important functions of the funds. The fruitful results are displayed in the following three aspects. First of all, the investments have promoted the economic exchange and diplomatic cooperation between China and the fund partner countries. The operation of the funds has embodied the cooperative intentions between the governments, increased mutual trust, facilitated the cooperation between enterprises of the two countries, upgraded the level of bi-lateral economic cooperation and promoted diplomatic relations. Secondly, mutual understanding has been deepened between the financial organizations of the two sides concerned, which has put forward bi-lateral or multi-lateral economic and trade cooperation. Finally, the investments have stimulated the growth of the domestic related industries. With specific investment policy guidance, the CDB funds do not aim for large-scale enterprises, but the leading enterprises in the related industries (including sub-sectors), which are also the industries encouraged by the State's policies, such as new energy, energy conservation and environment protection, as well as new materials. Through rigor selections, the CDB funds have invested in the enterprises that are supported by the State's industry policies and possess core competitiveness, which has promoted the adjustment and upgrading of the national industrial structure.

The funds that CDB has invested are all operating effectively, and have yielded good profits. The projects in the payback period bear fruitful results, and those in the initial phase keep good growth momentum as well and have achieved good returns. Therefore, years of rich experience in fund operation and management will enable CDB as a sponsor to effectively manage and operate the Private Enterprise Credit Guarantee Fund.

(III) CDB leads in fund business and capital market with good enterprise image, and has established good partnership with governments, other financial organizations and large enterprises.

1. CDB is well-recognized in the fund business field.

As one of the earliest financial institutions that were approved by the State to participate in the launching and establishment of fund business, the Bank has set up good enterprise brand and are well-accepted at home and abroad, through the nearly a-decade participation in the industrial investment fund business and good operation, which has paved the way for the Bank's continuous expansion in the investment fund business.

2. CDB has developed good partnership with local governments at all levels.

Ever since August 1998 when the first financial cooperation agreement was drawn up between CDB and Anhui Provincial Government, the Bank, by proactively drawing on the support of state credit, has expanded from the initial financial cooperation agreement to the credit cooperation agreement featured by organizational credit supported by governments and the public. The Bank has followed the principle of 'focusing on government priorities, giving support to the most needed, prioritizing planning, increasing credit, and promoting with financing'. It has emphasized on platform improvement and risk control, and put major efforts in market construction and credit construction. Ultimately, a new pattern of development financial cooperation agreement has been established through exploration, focusing on 'macro capital upon commitment, rolling planning, capital platform, and financing stimulation'. Giving a full play to the local government's advantage in organization and its own advantage in financing promotion, CDB has helped the governments at all levels through financing in their concerns on infrastructures, basic industries and pillar industries, as well as people's livelihood. The Bank has built good partnership with the governments while contributing to the local economic and social development.

3. As a bond issuer, a bond underwriter, a bond market maker and a bond investor, CDB has established an excellent enterprise image in the

bond capital market as well as good partnership with numerous financial organizations, while promoting the growth of the domestic bond market in a comprehensive way.

The Bank assumes four roles in the bond market.

Firstly, the Bank mainly raises funds through the issuance of debt securities, and ranks the second issuer in the domestic bond market after the Treasury Department. Continuously updated issuing mechanisms and diversified product innovations have made CDB, a leading bond bank in China, a major contributor in the development of domestic bond market. As of the end of 2008, the Bank had issued RMB denominated debt securities amounting to RMB 4.36 trillion, out of which the bond outstanding totals RMB 2.71 trillion, accounting for one quarter of the outstanding in the inter-bank bond market (excluding the Central Bank Bill).

Secondly, CDB has been very successful in the bond underwriting business. The Bank is the only banking organization which is qualified to underwrite corporate bond, short-term financing bills and medium-term notes. During 2002-2008, CDB had ranked the premier bond underwriter with 41 bonds underwritten, the largest volume in the market.

Thirdly, CDB supports the market growth by market-making business. The Bank continues its leading position by developing the market-making business in RMB bonds, interest rate swap and RMB foreign exchange, which has contributed to the progress of the market infrastructures such as the issuing system, transaction system and settlement system of the bond market.

Fourthly, CDB has greatly invigorated the bond market as an investor managing thousands of billions of transaction assets. In years of business cooperation, the Bank has formed good cooperation and mutual trust with such institutions as commercial banks, insurance companies, securities companies and fund management companies.

4. CDB has developed close partnership with large state-owned enterprises.

The Bank's main lending targets are the State's infrastructure and basic and pillar industries, including many State and regional crucial projects for economic and social development, such as the Three Gorges Power Plant, the State Strategic Oil Reserve Base, the South-to North Water Conversion Project, the West-to-East Power Transmission Project, the West-to-East Natural Gas Transmission Project, the Jing-jiu Railway and the Qingzang Railway. CDB's loan shares have remained about 40% of the long-term loans for basic construction granted by state-owned banks. Approximately 80% of credit funds for the State's key projects and 1/3 of supplementary loans for treasury-bond projects are provided by the Bank. During the contribution to the State's key projects, the Bank has established good partnership with many large state-owned enterprises, such as China Petroleum & Chemical Corporation, China National Petroleum, China Shenhua, China Telecom, China Mobile and Guangdong Nuclear Power Group.

To sum up, with the leading position and the good enterprise image in the bond business and the capital market, as well as the good partnership with governments, financial organizations and large enterprises, CDB as a sponsor of the Private Enterprise Guarantee Fund will attract potential investors and facilitate the fundraising initiation.

(IV) CDB's experiences and advantages in managing private enterprise projects will be valuable for the operation and management of the Private Enterprise Guarantee Fund.

In recent years, guided by the concept of 'preventing and controlling risks by mechanism construction', the Bank has established a comprehensive risk management mechanism, including authorization, review and approval, management, evaluation, assessment, incentive, audit, accountability and exemption, which has been proved to be very effective in practice. The Bank has developed a successful operation model for SMEs' lending projects, covering program development, evaluation, loan extending, post-lending management and risk control. It has made much progress in alleviating SMEs' financial problems with the 'finance socialization' mechanism, and has established a business model on the basis of municipality-county cooperation, supported by continuous improvement in administrative systems and guaranteed by risk prevention and control. The risk diversification and compensation mechanism has run effectively through socialization, keeping bad loan ratio below 1%. Furthermore, CDB has established good partnership with local governments at all levels and a variety of financial organizations. These advantages will greatly enhance its initiatives in the selection, evaluation, risk supervision and current management of fund projects.

(V) CDB has the legal qualification for a fund sponsor.

According to the CDB reform embodiment approved by the State Council, the Bank consists of an investment company and a securities company. The *Letter of China Banking Regulatory Commission on Approving Matters Concerning Establishing Equity Investment Fund Corporation by China Development Bank Corporation* (Order No.195 [2009] of China Banking Regulatory Commission) issued in June 2009 officially approved that, the Bank injects RMB 35 billion to establish Guoyin Financial CO., LTD, which would hold the equity investment business transferred by CDB, exclusive of banking financial institutions equities. As a result, CDB has the legal qualification for launching the Private Enterprise Credit Guarantee Fund, compared with other commercial banks.

(VI) CDB launching the Private Enterprise Guarantee Fund benefits the business complementation between CDB and the Guarantee Fund as well as the realization of a 'win-win' situation.

Through the lending business for SMEs in recent years, the Bank has developed a comprehensive set of management mechanisms, and has accumulated stable and high-quality customer groups as well as experiences in providing financing services to SMEs. These advantages can be shared with the Guarantee Fund, so as to promote its safe operation and rapid growth. Meanwhile, focusing on providing guarantee and re-guarantee services for SMEs' financing, the Guarantee Fund can cooperate with CDB in SMEs lending business, so as to promote the development of CDB's SMEs lending business. Therefore, the Bank launching the Guarantee Fund will facilitate the complementation of advantages and boost the mutual development of both parties concerned.

III. Pending Questions for CDB as a Sponsor of the Guarantee Fund

Despite of the above advantages, there remain some pending questions for CDB, a corporation in its transitional phase of reform, to become a sponsor of the Private Enterprise Guarantee Fund.

(I) Investment business development strategy

The development strategy for future investment business remains unknown, as Guoyin Financial is still under preparation, and the Board of Directors and a management system are not in place.

(II) Investment business decision-making procedures

As the supreme administrative body of Guoyin Financial, the Board of Directors has the final say in investment business. Before the establishment of the Board, the personnel arrangements and the decision-making procedures of the Board are unknown, and much remains to be seen as to its influence on the investment decision to launch the Private Enterprise Credit Guarantee Fund.

(III) Financial pressures after reform

After the commercialization reform of CDB, the shareholders expect for higher returns, which put the business operation of CDB under huge financial pressures. According to the *Measures for the Management of Capital Adequacy Ratio of Commercial Banks* promulgated by China Banking Regulatory Commission, all the investment in Guoyin Financial by CDB will offset its capital, so the business pressure would be inevitably transmitted to Guoyin Financial. If the future Credit Guarantee Fund couldn't yield high returns, the amount of capital launched or invested by Guoyin Financial might be affected accordingly.

Suggestions on Promoters and Investors of Guarantee Funds for Private Enterprises

China Center for Business Cooperation & Coordination

Chen Xin

A. Ⅰ. Adjustments to the Framework Scheme of Guarantee Funds for Private Enterprises

The selection of promoters and investors of guarantee funds for private enterprises is restricted and influenced by various factors. In addition to the guidance of state policy and market value, the requirements of funds in their nature and features are key issues to be consider. Therefore, the scheme of fund establishment is the basis for our selection of fund promoters and investors.

In the previous period, experts put forward the framework scheme of establishing guarantee funds for private enterprises by utilizing foreign capital and it elaborates the nature, features and functional orientation of the funds. As the situations have changed since then and in order to consider more of the operability of fund establishment, we suggest making necessary adjustments to the scheme:

Key points of the previous framework scheme		Adjustment suggestions
Nature of funds	The guarantee fund is defined to be a closed-end corporate fund utilizing foreign capital in an innovative way and is established through private placement. It is a quasi-public product directed and supported by policy capitals, exercising market-based operation, assuming the guiding function of state industrial policy, sharing bank risks and improving the financing environment of private enterprises.	The guarantee fund is a closed-end corporate fund encouraged and supported by the government, initiated by state policy-oriented financial institutions, utilizing foreign investment in an innovative way and established through private placement. It will focuse on credit guarantee business, exercising market-based operation, making management decisions and undertaking risks independently.
Objectives of the fund	The objectives of guarantee funds are to utilize foreign investment innovatively, to bring in new ideas, latest management concepts, up-to-date technologies and talents, to raise the credit ratings and management level of guarantee institutions through capital lever, to provide the channels of risk transfer and sharing and strengthen the financing guarantee capability of guarantee institutions; meanwhile, guarantee funds shall provide guarantee service for the direct financing of private enterprises, and in this way	The objectives of guarantee funds are to bring in foreign capitals, new ideas, latest management concepts, up-to-date technologies, tools and talents, to boost the regulation, upgrading, integration and development of the credit guarantee industry through the link and lever of capitals while at the same time seek to grow in a sustainable way.

	realizing the seamless combination of policy goal and business goal, improving the financing environment of private enterprises through multi-channels and promoting their healthy development.	
Functions of the government	1. Provide relevant policy support Make relevant laws and regulations to permit utilizing foreign capitals to establish guarantee funds for private enterprises; provide relevant policy support concerning various aspects such as utilizing foreign capitals, government capital contribution, fund establishment, industry entrance, tax preference, the establishment of compensation mechanism, strengthening the cooperation between banks and guarantee institutions, the construction of exterior credit environment and financial reform etc. 2. Provide the policy capital guidance for guarantee funds Entrust policy making financial institutions to make the capital contribution on behalf of the government and exercise the duty of government as a contributor. 3. Provide indirect support by policy capital for guarantee funds For example, to permit the policy financial institutions to provide loans without interest or with low interest to guarantee funds and to permit the state and local policy capital to buy shares of guarantee funds etc. 4. Exercise the rights of contributors in the establishment and operation of funds through the contributor's representative. 5. Establish the risk prevention and compensation mechanism of guarantee funds Government risk prevention: Policy risk, foreign capital entrance risk, financial risk, foreign loan risk and supervision risk etc. Compensation mechanism includes: The government compensates the guarantee funds directly through the financial budget each year and a floating compensation quota may be adopted whose compensation quantum will float according to the guarantee business volume in the	1. Provide relevant policy support 2. Establish the risk compensation mechanism to guarantee funds 3. Make the share repurchase undertaking to international institutional investors such as Asian Developmnt Bank (AeDB), IFC etc. For example, promise to repurchase the fund shares held by the above investors within 5 to 8 years according to their net assets at the time. 4. Nominate representatives to join the fund consultation institution and provide consultation services for the funds. 5. Make the supervision according to law

	previous year; relevant laws should be issued stipulating clearly that the guarantee funds shall draw the risk reserves and the due responsibility reserves etc from their guarantee fees to a certain percentage each year. 6. Supervise the guarantee funds To publish relevant laws stipulating clearly the contents and means of supervision to regulate the supervision behavior. Supervise the guarantee funds to establish the modern legal person governance mechanism and enhance the efficiency of fund operation and internal control. Establish the credit evaluation standards of guarantee funds and conduct the regular credit rating of guarantee funds. Supervise the appraisal of guarantee items and strengthen the guarantee market admission. Supervise guarantee funds to establish the risk sharing and prevention mechanism. Supervise dynamically the operation of guarantee funds and ensure the operation efficiency. Strengthen the financial supervision and performance assessment of guarantee funds. Strengthen the annual auditing of guarantee funds.	

The core contents of the above adjustments are:

1. The guarantee funds for private enterprises shall focus on the credit guarantee industry and seek to develop in a sustainable way in the process of boosting the development of guarantee industry by conducting the business of guarantee, re-guarantee and direct equity investment etc. Their investment business shall focus on the equity investment of credit guarantee industry, namely, the industrial investment funds of credit guarantee industry.

2. We do not advise the use of the “quasi-public product” definition, but highlight exercising the market-based operation, making management decisions and undertaking risks independently.

3. It should be clarified that the funds shall be encouraged and supported by the government. But the means of support will not necessarily be capital contribution and we shall focus on the policy support. The risk compensation in the operation of the funds and the repurchase undertaking of foreign shares shall also become the goal of the funds.

4. It is clearly expressed that the funds shall be established by state policy financial institutions.

B.

C. Ⅱ. Qualifications of Fund Promoters and Investors

The fund promoter refers to the institutions which establish the funds and who bear the legal responsibilities to the originality, accuracy and comprehensiveness of the contents of their prospectuses. It plays an important role in the establishment of the funds.

As the current scheme suggests, the guarantee funds for private enterprises adopt the form of corporate fund. The corporate fund is a legal person type of fund. The means of its establishment is to set up the venture capital company of joint-stock system or limited liability system through registration. The company doesn't have the management team but is entrusted to the management company to run. The investors become the shareholders by capital contribution and the major issues and investment decision-making shall be subject to the shareholders' meeting and the board of directors, in which the investors enjoy the right to know and the right to participate at a high degree.

Compared with the forms of partnership and trust fund, the weakness of the corporate fund lies in the unavoidable problem of double taxation and the decision-making efficiency of major issues in the fund operation is not high. But its advantages are:

1. The investors shall just hold the limited liability limited to their contribution;

2. The fund under corporate system can constitute an independent enterprise legal person and the enterprise can collect fund through obtaining a loan from a bank;

3. Compared with the partnership, the corporate system has a longer history and enjoys a sound legal environment in many countries, and its management and operation system is well

structured and well regulated, thereby reducing the operational risk effectively.

The earliest law issued in our country for the investment fund is the Law of the People's Republic of china on Securities Investment Funds promulgated in 2003. In November, 2005, ten ministries and commissions including the National Development and Reform Commission (NDRC) jointly promulgated the Interim Measures for the Administration of Venture Capital Enterprises. The Measures for the Administration of Industrial Funds which has been slow to issue will probably be replaced by the Administrative Measures on Private Equity Funds being discussed.

The mature operational pattern of securities investment funds provides references for the establishment of guarantee funds for private enterprises. According to the Interim Measures for the Administration of Securities Investment Funds, their main promoters are securities firms, trust and investment companies and fund management companies established in accordance with relevant state provisions and the number of promoters shall be two at least. The fund promoters have to meet the following conditions: the main promoters are securities firms, trust and investment companies and fund management companies established in accordance with relevant state provisions; the promoter must own adequate capital and the paid-up capital of each promoter shall not be less than RMB 300 million Yuan; the main sponsors shall have experiences in securities investment and a record of consecutive profits for over three years; the promoters shall have sound organizational structures and management systems with good financial status and standardized acts of operations.

According to the Interim Measures for the Administration of Securities Investment Funds, the fund investors refer to natural persons and legal persons holding fund units or fund shares, namely, the holders of fund. The fund investors are the real owners of the fund and they enjoy the right to know, the right to vote and the right to benefit. The purpose of funds in all investment activities is to increase the income of investors and all risk management aims at the protection of investors' interests. Hence, investors are the center of all activities of funds. Rights of fund investors include the right to obtain fund benefits, the right to transfer fund units and the decision-making right of certain degree to fund operation. For different types of fund, the ways investors influence the investment decision-making are different. In corporate funds, the investors exercise their rights for major decision-making of fund companies through the board of directors of fund companies elected by shareholders' meeting while in contract funds the investors can make resolutions to major issues of the funds only by holding beneficiaries' meetings but can't directly influence the daily decision-making of funds.

According to relevant provisions of the Interim Measures for the Administration of Securities Investment Funds, the fund investors in our country enjoy the following rights:

① to attend or to entrust a representative to attend the fund investors' meeting;

② to obtain fund benefits;

③ to oversee the fund management and obtain information on the status of the fund business and finances;

④ to bid, redeem or transfer fund units;

⑤ to obtain the residual assets of the fund after settlements; and

⑥ other rights provided for in the fund deed.

The fund investors' meeting may make resolutions on the following major issues and submit them to CSRC for approval: revision of the fund deed; termination of the fund ahead of time; change of the fund administrator; change of the fund trustee.

Fund investors shall fulfill the following obligations:

As fund investors enjoy the rights, they shall bear these obligations:

① to abide by the fund deed;

② to pay the amount subscribed to the fund and the prescribed fees;

③ to bear limited liabilities for the losses or termination of the fund; and

④ not to engage in any activity detrimental to the interests of the fund and other fund investors.

Integrating the suggestions for the framework scheme of guarantee funds for private enterprises, the qualifications of fund promoters (excluding government, government department or institution) shall have the limits in the following aspects:

1. the paid-up capital or net assets;

2. the operational performance or financial status in recent years (we may require three years);

3. a record of legal operations

4. the experience of engaging in guarantee business, asset management, finance and capital operation etc.

5. the number of professionals and their experience for guarantee business, asset management, finance and capital operation etc.

6. the requirements or limits of non-guarantee businesses the promoters intend to engage in. For example, according to the provisions of Securities Law, the operation of securities industry shall be separated from banks, trust and insurance. Hence, to observe this provision, banks, trust institutions and insurance institutions can't act as its promoter if the guarantee fund intends to engage in securities investment unless otherwise specified by the state.

Moreover, for the qualifications of promoters, we shall make different standards for foreign and Chinese promoters and the requirements for foreign promoters shall be higher than those for Chinese promoters.

D. Ⅲ.Responsibilities of Fund Promoters

According to the Interim Measures for the Administration of Securities Investment Funds and relevant provisions of CSRC, the responsibilities of fund promoters include:

1. to make relevant legal documents and lodge an application of fund establishment to the competent authority and prepare for fund establishment;

① The fund promoters shall study and analyze the state economy, financial policy, market status and people's investment mentality and on this basis make a plan for the fund to be established including setting its main investment direction, type, term as well as scale of fund etc.

② The fund promoters shall sign the fund deed with the fund administrator and the fund trustee on behalf of the fund holders, stipulating the rights and obligations of parties. Meanwhile, the fund promoters shall also prepare other documents required by relevant department such as the prospectus etc.

③ to fix the scheme of issue and select the sales institution.

④ to lodge an application of fund establishment to the competent authority and submit relevant documents required by it.

⑤ to make an announcement once the application is approved.

2、 2. to subscribe to or hold a certain amount of fund units;

The fund promoters shall subscribe to a certain amount of fund units at the time of fund-raising and keep a certain percentage during the term of the fund, thus integrating the interests of fund promotes and fund holders and making the fund promoters take safeguarding the legal rights and interests of investors as their guidelines of behavior and not to engage in any activity detrimental to the interests of investors so as to protect the interests of investors.

3. In case the fund can't be established, the fund promoters must bear expenses for the fund-raising and the raised fund with additional calculation of bank current deposit interest must be refunded to fund subscribers within prescribed time.

E. Ⅳ.Differences between Fund Promoters and Common Investors

The parties in fund relations refer to the main bodies in fund relations, namely, the people who join the fund, enjoy their rights and assume their obligations. The main bodies of fund relations spread in fund investment including fund promoter, fund administrator, fund trustee and fund holder (investor).

For contract fund, the legal relation of fund investment belongs to trust legal relation, in which fund holders are both client and beneficiary. Fund administrator and fund custodian are joint trustees while the legal status of fund promoter has not been agreed on.

For most securities investment funds in our country, fund promoters refer to the people who are in charge of the work of fund establishment and enjoy rights and assume obligations in fund establishment. The work of fund establishment includes: draft relevant legal documents and handle procedures of establishment; handle the matters of fund and security issue, raise fund and establish securities investment fund; the matters of employment of fund administrator and fund trustee. Scholars have had arguments on whether the fund promoter is a main body of fund relations. One opinion is that taking the fund promoter as a party of fund deed is inconsistent with any legal principles. The reason is that as the designer and organizer of securities investment fund, the fund promoter's behaviors as well as rights and obligations happen before the fund establishment; after that, the fund promoter will exit from the operation of fund and not enjoy the rights and assume relevant obligations as a party of fund deed any longer[1]. Another opinion is that the fund promoter is the main body of fund legal relations but for the stage of establishment[2].

After fund establishment, the status of fund promoter is changed and (1)will become simply fund holder or fund beneficiary through fund purchase, (2)will become fund administrator and hold fund

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[1] Refer to Cao Xinzhai, Song Jie, Thoughts on Perfecting Contract Structure of Securities Investment Funds in China, Hubei Social Science, 2003, □5:64□

[2] Refer to Zhang Lei, On the Legal Status of Securities Investment Funds, Journal of North China University of Technology (Social Science Edition), 2003, 3, (4:61)

units at the same time, playing the roles of client, trustee and beneficiary, (3) because the Law of the People's Republic of China on Securities Investment Fund promulgated in 2003 does not stipulate that the promoter shall hold a certain percentage of fund units, it is also possible for the promoter to just become the fund company without holding any fund shares, (4) or will exit from the market completely, four possibilities altogether. These possibilities will affect directly the main body relations of investment fund as well as the protection of investors.

From the above, we can see that the fund promoter exits in the stage of fund operation on the surface, but except the fourth possibility, the fund promoter still influences the fund operation by transition of its role. As a matter of fact, the fourth possibility does not exist because the fund investment is a commercial behavior with making profit as the goal and the fund promoter is rational so that if it just assumes the refund responsibility of principal and interests of fund raised it will not establish the fund. In other three situations, the rights and obligations of fund promoters are inherited by other main bodies in the stage of operation and as a result, fund promoters have three kinds of adscription: one is fund investor, the second is administrator and the third is investor as well as administrator. This orientation lies in two considerations: (1) protect the enthusiasm of fund promoters and ensure the successful establishment of the fund. (2) protect the interests of fund investors. The latter is far more important the former. Based on the consideration of protecting the interests of fund investors, the author thinks the adscription of fund promoters shall be the joint client of investors.

F. Ⅴ. Selection of Fund Promoters and Investors of Guarantee Funds for Private Enterprises

1. Special requirements for promoters and investors of guarantee funds for private enterprises

According to the foresaid adjustment suggestions concerning the framework scheme of guarantee funds for private enterprises, the main fund promoter shall meet the following conditions:

- It is a state policy financial institution;

- It has rich experience in the fund establishment and management;
- It is expected to have profound understanding to credit guarantee business and credit guarantee industry.

After confirming the state policy institution as the main promoter, we shall select 2 to 3 foreign financial institutions as the joint promoters of guarantee funds for private enterprises in order to display its vital feature of utilizing foreign capital in an innovative way.

Moreover, guarantee funds for private enterprises shall welcome local government to participate in the establishment of funds through capital contribution.

As for the investors of guarantee funds for private enterprises, we shall prescribe the qualifications of investors, for instance, over 10 years' experience in industry or commerce, or over 5 years' experience in finance etc. In addition, we shall also consider the following requirement:

- The fund shall include the investors representing local finance;
- shall include the commercial bank investors;
- Foreign investors shall include international risk management institutions as well as international financial institutions;
- shall include the representatives of private enterprises;
- Regional distribution of domestic investors shall be as reasonable as possible and shall take the needs of fund business development into consideration;
- shall set up minimum amount of investment, for instance, RMB 50 million Yuan.

2. Selection of promoters and investors of guarantee funds for private enterprises

(1) Fund Promoters

According to the foresaid requirements concerning fund promoters of guarantee funds for private enterprises, China Development Bank (CDB) before reconstruction is an ideal candidate for the main promoter.

In recent years, CDB has participated in the establishment and management of funds such as Sino-Swiss Partnership Fund, China-Belgium Fund, Bohai Industrial Investment Fund etc. It also has rich experience in the business of guarantee and re-guarantee and supports the guarantee industry by providing soft loans for local guarantee companies, which benefits many small and medium-sized enterprises (SMEs).

Because CDB has been reconstructed from policy-oriented bank to commercial bank and the investment company which is able to assume the function of investment has not been established yet, there is certain system obstacle for CDB acting as the main domestic promoter of guarantee funds for private enterprises at present.

The Export-Import Bank of China (China Eximbank) is another ideal choice for the main promoter.

As a state-policy-oriented bank directly under State Council, the main responsibilities of China Eximbank are to execute state industrial policy, foreign economic and trade policy, financial policy and foreign policy and provide policy financial support for enlarging the import and export of our mechanical and electrical products, whole-set equipment and high-tech products, pushing the enterprises with comparative advantages to contract projects and invest overseas and promoting foreign relations development and international economic and trade cooperation. In recent years, China Eximbank developed a series of trade financing and L/G credit products to strengthen its support to SMEs. In May, 2007, China Eximbank, CDB and Intesa Sanpaolo jointly established Mandarin Capital Partners with the scale nearly 330 million Euros to assist the SMEs in both China and Italy with their cross-border economic cooperation. At present, this fund is running well and has successfully invested in the project of Zoomlion's acquisition of CIFA which involved 511 million Euros.

As for foreign promoters, both ADB and IFC are ideal choices.

Moreover, according to the trial scheme of funds, we may invite the government departments of Beijing, Sichuan, Guangdong and Zhejiang to participate in the establishment of funds.

(2) Fund Investors

According to the suggestions previously given by experts concerning investors of guarantee funds for private enterprises, the investors of funds may include:

① promoters / leading investors: domestic policy banks, financial institutions or non-bank institution appointed by government;

② foreign loans financing: foreign government concessional loan or grants;

③ foreign investors: multi-lateral financial institutions such as ADB, World Bank/ IFC; foreign non-government investors such as private equity and bond funds, insurance companies, re-insurance companies, banks, pension fund and hedge fund etc;

④ domestic investors: state policy banks such as CDB, domestic commercial banks associations; local government or institutions; domestic enterprises with investment desire (large state-owned or private enterprises) and other domestic investment institutions (trust companies, credit guarantee companies and insurance companies etc.)

The said capital sources are all potential investors of guarantee funds for private enterprises. In order to promote to establish the new-type cooperative relation between banks and guarantee institutions, we suggest inviting investment companies of main domestic commercial banks to act as the investors of guarantee funds for private enterprises. In a sense, the cooperation from banks is the key to the success of funds.

Research on Legal Issues of the Establishment of a Fund for Development of Credit Guarantees for Private SMEs by Utilizing Foreign capital Under the New Situation

(By Han Jian)

Based on the work done in previous periods, the establishment of a fund for development of credit guarantees for private SMEs by utilizing foreign capital means absorbing foreign capital to set up a closed-end corporate fund via private placement, whose nature will be set as quasi-public goods. Its purposes include attracting foreign capital, introducing advanced international concepts, management, technologies and talents, standardizing the guarantee behaviors by offering means of risk transfer and dispersion and utilizing capital leverage, enhancing the guarantee ability, improving the financing environment and promoting the healthy development of private enterprises.

This article will discuss laws and regulations that might be relevant to all the processes of establishing the fund for development of credit guarantees for private SMEs by utilizing foreign capital (hereinafter referred to as "Guarantee Fund"), including its initiation, establishment and trusteeship, under the new situation on the basis of identifying its nature: a corporate style, closed-end and private equity fund.

I. Initiation of the Guarantee Fund

The purposes of establishing the Guarantee Fund are to enhance credit ratings of China's guarantee agencies, increase information communication between credit guarantee market participants and regulators, promote the establishment of credit system for Chinese private SMEs, and push forward financial reform and the improvement of investment and financing service system for SMEs as well. In addition, the establishment of the Guarantee Fund is to attract foreign capitals and professional management institutions to enter China, guiding domestic capitals by offering financing services for private SMEs. While improving the financing environment for private SMEs, we also need to establish the credit system for private SMEs gradually and complete the mutual trust mechanism between financial institutions and private SMEs to effectively guard against and defuse financial risks for banks. By introducing overseas credit risk management technologies, advanced international credit rating methods, and enterprise credit management training techniques, we also endeavor to promote domestic credit guarantee institutions' optimization and resource integration, comprehensively improve the overall quality and guarantee size of China's credit guarantee industry, succeed in having the credit guarantee industry practice and financial risk prevention specialized and internationalized, and promote the healthy development of the whole credit guarantee industry.

China's current regulations relating to the fund industry include: the *Securities Investment Fund Law* (effective since June 1, 2004), the *Interim Measures on the Administration of Venture Capital Enterprises* (effective since March 1, 2006) and the *Interim Measures on the Administration of Industry Investment Funds* (2006). None of the three regulations cover the specifications of the nature, functions and businesses of the Guarantee Fund, therefore they fail to offer a clear, specific and feasible blueprint for the establishment and operation. As a result, it cannot be directly based on the above-mentioned regulations to establish the Guarantee Fund.

The Guarantee Fund is different from the existing securities investment funds in terms of establishment purposes and operation models. The Guarantee Fund should be classified as one of product and system innovations, so that no current laws, regulations and regulatory documents are available to offer a specific, clear and sufficient basis for its establishment and operation. In view of the importance of the Guarantee Fund in practice, it should be issued a separate law (inclusive of the promulgation of administrative rules or regulations, as well as other supporting regulatory documents) to regulate its nature, establishment, fund raising, participation of foreign capitals, management and custody of fund assets, fund investment operation as well as income distribution when conditions are at the time of maturity. In the current stage, we can refer to the regulations in the *Interim Measures on the Administration of Industry Investment Funds* (Overseas investors can serve as a sponsor of a fund and participate in the establishment of the fund or the fund management company). In accordance with the above regulations, we should report to appropriate authorities and gain access to special examination and approval.

II. Establishment Forms of the Guarantee Fund

Based on the current legal regime, existing guarantee funds are initiated via private placement, structured as a limited liability or joint-stock company, and operated in a closed way.

(A) Initiating method: private placement

The so-called private equity funds refer to the funds whose capital sources are from specific investors in a non-public manner, which has the following features: (1) Non-openness: That is, their fund raising is not from the public via issuing a notice, etc. Instead, they raise funds from specific investor in private; (2) Placement: That is, the number of their investors should be limited, and fund stakes should be sold to specific investors at the same time and at same price; (3) Being closed: That is, they have definite issue volume and duration periods, in which fund stakeholders should not be allowed to opt out stakes whilst allowed to transfer stakes; (4) Non-public: Fund shares cannot be traded on the stock exchanges; and (5) Large investment amount: Usually the minimum investment amount for each investor is rather large, having a higher limit.

The amended *Company Law* (effective since January 1, 2006) and the amended *Securities Law* (effective since January 1, 2006) ensure that the Guarantee Fund can be initiated in private placement. To be specific, the *Company Law* mainly offers a legal basis for the establishment and operation of corporate private equity funds; and the *Securities Law* for the exit channels of private equity funds. The *Company Law* stipulates that a limited liability company can have less than 50 shareholders, significantly reducing the standards of establishing a limited liability company or joint stock company. The law also loosens the requirements such as the proportions of industrial property rights and non-patent technology funding. Meanwhile, it stipulates how to collect enough registered capital by installments as well as lifts the general restriction that companies are not allowed to make offshore investments. The *Securities Law* loosens the listed companies' capital requirements without making a compulsory requirement on profitability.

(B) Organizational form: corporate type

Concept and feature of a corporate fund are as follows: In general, investors first contribute capital to form a corporate fund with independent legal entity, thereby becoming the stakeholders and shareholders of the fund and accordingly enjoying the shareholder rights, and then establish a board of directors, which will entrust the fund assets to the fund management company. Besides, the fund custodian will be responsible for leaving the fund assets in custody. In the course of the operation, the corporate fund's board of directors will play a larger role in supervising the investment and operation of its management fund. In comparison with a contract fund, the corporate fund can better protect investors' interest.

The prospective clients of the Guarantee Fund are credit guarantee companies and banks, while private SMEs and guarantee institutions will be ultimate beneficiaries of this guarantee fund. In accordance with Article VII of the *Guarantee Law of People's Republic of China* (effective since October 1, 1995): "Legal persons, other organizations or citizens that have the capacity to pay off debts can act as guarantors." After it adopts "Guarantee Company" as its organizational form, the Guarantee Fund can be ensured with independent civil rights and civil capacities. With its independent legal personality and independent property, the fund can provide guarantee companies and banks with guarantee and re-guarantee services in its own name. Furthermore, it can bear guarantee duties and other civil responsibilities in its own name. Meanwhile, according to relevant provisions in the *General Rules on Loans*, company legal persons, institutional legal persons, other economic organizations, privately or individually-owned businesses, and natural persons with the PRC nationality and full civil conduct ability may become a "borrower" only after they get approved by the industrial and commercial administrative organs (or the competent authorities) and finish registration processes. A corporate fund can be qualified as a legal person, thereby having independent property and the ability to bear civil liability independently. When they use funds in good conditions, carry out successful operations, and still need to increase the company size and add assets, they can borrow money from banks to broaden financing channels. They can also fully strive for and utilize preferential loans both at home and abroad.

After several revisions, the *Company Law* provides basic protection for the development of corporate funds. Implemented on June 1, 2004, the *Law of the People's Republic of China on Funds for Investment in Securities* provides in Article 102 that "Regulations governing the establishment of a securities investment company to engage in securities investment and other related activities by raising capital through public offering of shares shall separately be formulated by the State Council." This leaves a room not only for the possible establishment of corporate funds but also for their development in the future. The enactment of the *Trust Law* (effective since October 1, 2001) makes a basic specification for corporate funds. Of most importance, the law establishes the principle of independence of the fund assets, making corporate funds different from other fund companies. In real practice, China's industry investment funds represented by Zibo Township Fund, Nanshan Fund and Peninsula Fund have already been established in the mode of a corporate fund, creating a precedent and accumulating experience for the introduction of the corporate fund.

Therefore, corporate funds confront no legal obstacles.

If the Guarantee Fund adopts the corporate organizational form, it will be conducive to the formation of scientific corporate governance structure and modern enterprise system, as well as the establishment of a sound organizational structure and decision-making process. As the company's shareholders, corporate fund investors have the right to examine and approve the company's major policy decisions, and to express their views. The Guarantee Fund's sponsors and shareholders, and other funding parties are mainly government organizations and large institutional investors. The corporate fund belongs to corporate funds, thereby entitling the aforementioned investors with the right to rationally and effectively monitor how to use huge amounts of money, how to carry out guarantee businesses, and how to conduct investments, etc. Meanwhile, it will help attract and facilitate foreign capital and management inputs to the fund.

A fund company should be based on the *Company Law* to establish a sound organizational structure, and set up the general meeting of shareholders (Shareholders Meeting) and the board of supervisors, thereby forming an effective corporate governance structure. The fund company's highest authority is the general meeting of shareholders (Shareholders Meeting), which is made up of holders of the fund's stakes and whose standing body is the fund's board of directors. The fund company should establish internal control system, risk management system, internal authorization system and other management regulations in accordance with the needs of operation and management. Also, it should build various business units and branches in a rational way.

When the Guarantee Fund is established, it is required to sign *Sponsors Agreement* and provide articles of incorporation.

(C) Operation Model of the Guarantee Fund: Closed

A closed-end fund is a fund with a fixed number of shares outstanding. Its holders of equity interests cannot redeem shares within its duration period. The main characteristics of a closed-end fund are as follows: (1) Equity-based: That is, a closed-end fund carries out a series of principles of protecting the fixed equities similar to a joint stock company; (2) Debt-based: That is, a series of principles that a closed-end fund carries out are similar to those for a corporate bond; and (3) being supervisory: That is, in terms of public offering, the securities market has a more stringent monitoring mechanism on a closed-end fund.

Based on the Guarantee Fund's capital requirements and operational characteristics (especially in the early stage), sponsors should in advance clarify fund raising scale, duration period and follow-on fund raisings and other items, thus covering the fund's expected return, investment period and exit mechanisms, etc. in its basic provisions.

Due to the fact that its assets are stable and the fund itself is easy to get financed, a closed-end fund can take loans from banks; meanwhile, due to the fact that the increase or decrease of its assets is similar to those of other companies, its assets are in a stable state. It needs stable and sustained assets as its capital support and credibility to carry out relevant businesses. Therefore, the operation model of a closed-end fund is appropriate.

III. Eligibility of Fund Sponsors

The Guarantee Fund's sponsors refer to the main body of investors who initiate the establishment of the fund and play an important role during the establishment course. The majority of overseas funds' sponsors are competitive financial institutions. The number of overseas funds' sponsors can be a single one or more.

The confirmation of qualified sponsors of the Guarantee Fund is constrained and impacted by various factors, including the own nature and feature of the Guarantee Fund, the requirements of guarantee businesses, and the requirements of other businesses the fund is going to conduct. We believe that the qualifications of the Guarantee Fund's sponsors need to be within specific limits in the following aspects: (1) The sponsors' paid-up capital or net assets; (2) Results of operations or financial conditions of the sponsors in recent years (say three years); (3) Record of legitimate operation of the sponsors; (4) Experience of the sponsors in conducting guarantee business, asset management, finance, capital operation and other businesses; (5) The number and experience of professionals in the sponsors' companies who conduct guarantee business, asset management, finance, capital operation and other businesses; (6) Requirements or restrictions for other businesses excluding guarantee business that the sponsors are going to conduct.

Main responsibilities of the fund sponsors include:

1. Conclude a sponsor agreement: The agreement shall agree on such items as the fund's name, ownership, fund raising scale, duration period, restrictions on stake percent that sponsors subscribe, time and amount limitations on stakes the sponsors hold, and so on.

2. Draw up articles of association: Such items as the establishment of the company's organizational structure, powers of organizational structure, rights and obligations of shareholders (holders of fund shares), follow-on fund raisings and extended duration period, financial and accounting system, income distribution, and the fund's termination and liquidation should be stipulated in the articles of association.

3. Compile the fund's prospectus: To help investors understand the specific circumstances of the fund and determine whether to subscribe shares or not, the prospectus should contain explanations on important issues relating to the fund.

4. Determine fund managers and fund clients; sign a commission agreement and a bailment agreement respectively.

5. Employ qualified accounting firms, law firms and other intermediary agencies or personnel; sign service agreements with them.

6. Subscribe a certain number of fund shares.

7. Undertake fund raising process-related duties. For instance, having investors familiarize the contents of the fund's prospectus and sign a subscription L/C (letter of commitment) during the fund raising process.

8. Hire a statutory capital verification agency to complete capital verification and apply for registration from the industrial and commercial administration department and report to the administration organ for the record, with committed capital by investors in place.

9. If the fund cannot be established, fund sponsors have to bear the fund raising costs. They shall pay back fund subscribers with raised capital plus interest on the bank account with a specified timeframe.

(A) Qualifications of the Chinese major sponsors

1. According to a study we did some time ago, China Development Bank Corp. (CDB) is supposed to act as the major sponsor on behalf of the People's Republic of China.

China Development Bank was officially launched in December 2008, as the bank transformed itself into a joint stock company. Nevertheless, according to the relevant provisions in the *Commercial Bank Law* (amended on December 27, 2003) and the *Securities Law* (which was amended on October 2005 and has come into force since January 1, 2006), a more stringent system of divided operation and divided management was still applicable to China's financial industry, and commercial banks can only engage in traditional banking businesses, namely, deposit, loan, and exchange businesses.

According to the provisions in the *Securities Law* (Article 6[3]) and the *Commercial Bank Law* (Article 43[4] and Article 74[5]), CDB shall not conduct investment in the Guarantee Fund, nor shall it serve as one of the sponsors. Nevertheless, the State Council in principle agreed that commercial banks could invest insurance companies, and allowed three or four commercial banks as pilot banks in December 2007. In early 2008, the State Council approved *the Circular on the Investment in the Equity Interests of Commercial Banks by Insurance Institutions (Circular 160)* that was jointly filed by the China Banking Regulatory Commission and China Insurance Regulatory Commission. This circular agreed in principle that banks could buy the equity of insurance companies. Subsequently, the two regulatory authorities jointly announced the signing of the *Memorandum of Understanding Concerning Strengthening In-depth Cooperation and Cross-industry Cooperation between Banks and Insurance Companies by China Banking Regulatory Commission and China Insurance Regulatory Commission* on January 22: Under the premise of the risk isolation and abiding by relevant provisions, commercial banks and insurance companies will implement mutual investments in trial in accordance with market rules based on equality and mutual benefit. The signing of this MoC indicates the appearance of a turning point for the finance industry to carry out mixed operations.

In fact, the CDB participated in initiating several funds as one of their sponsors, including the Sino-Swiss Partnership Fund (1998) and the Sino-Swiss Venture Capital Fund Management Co., Ltd. (2003), China – ASEAN

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[3] Securities business shall be engaged in and administered as a business separate from the banking business, trust business and insurance business. Securities companies shall be established separately from banks, trust companies and insurance companies, unless it is otherwise prescribed by the state.

[4] No commercial banks shall undertake the businesses of trust and investment and securities dealing business, nor shall they invest in the non-self-use real property or non-bank financial institutions and enterprises, unless it is otherwise prescribed by the state.

[5] In case a commercial bank has any one of the following circumstances, the banking regulatory organ of the State Council shall order it to correct, and confiscate the illegal gains if any, or impose a fine of one time up to five times the illegal gains if the illegal gains are more than RMB 500,000; if there are no illegal gains or the illegal gains are less than RMB 500,000, a fine of RMB 500,000 up to RMB 2 million shall be imposed; if the circumstances are especially serious or the bank fails to correct within a prescribed time limit, the banking regulatory organ of the State Council may order it to straighten out by stopping business operation or revoke its permit for operation; in case it constitutes a crime, it shall be subject to criminal liabilities: (7) Engaging in trust & investment or securities dealing business, investing to non-self-use realty or non-bank financial institutions and enterprises in violation of state provisions.

SME Investment Fund (2004), China-Belgium Direct Equity Investment Fund (2004), China-Africa Development Fund (2007), the Bohai Industry Investment Fund (2006), and China-Italy Mandarin Fund (2007). It is also learned that recently the People's Bank of China has approved the establishment of a state-owned finance company, which in effect is a wholly owned subsidiary of the CDB specializing in investment business. Therefore, in terms of sponsor qualifications, the CDB should be no legal obstacles.

2. In a recent study, the Export-Import Bank of China (China Eximbank) is also proposed to be one of major sponsors on behalf of the People's Republic of China.

Fully owned by the Chinese government and under the direct leadership of the State Council, China EXIM Bank is a government policy bank. Meanwhile, the Bank is a major on-lending bank of foreign government loans. Its business scope covers the provision of "other business approved or entrusted". Given the special nature and practical significance of the Guarantee Fund, China EXIM Bank can act as one of its major sponsors after the policy bank finish approval procedure.

(B) Issue of overseas investors as sponsors

China's regulations for overseas investors include: the *Catalogue for the Guidance of Overseas Investment Industries* (amended in 2007), the *Provisions on Guiding Overseas Investment Direction* (2002), and the *Administration of Foreign-funded Venture Capital Investment Enterprises* (effective as of March 1, 2003), wherein, Article 4 of the *Provisions on Guiding Overseas Investment Direction* provides, "Overseas investment projects shall be classified into four categories: encouraged, permitted, restricted and prohibited projects. Overseas investment projects belonging to encouraged, restricted and prohibited categories are listed in the *Catalogue for the Guidance of Overseas Investment Industries*. Those permitted overseas investment projects which do not belong to the above three categories are not to be listed in the *Catalogue for the Guidance of Overseas Investment Industries*." Guarantee fund is one of those permitted overseas investment projects that do not belong to encouraged, restricted and prohibited categories.

Therefore, the establishment of a guarantee fund by utilizing foreign capitals should belong to one of permitted categories of foreign investment. Nevertheless, given the special nature of the Guarantee Fund, it is required that such specific issues relating to the establishment of the Guarantee Fund as credit requirements for overseas investors, capital contribution method, and capital contribution ratio should be covered in a specific provision. Only by doing so can we ensure the specific basis for the operation of the establishment of the Guarantee Fund by utilizing foreign capital.

In 2006, People's Bank of China, CSRC, SAFE jointly issued the *Measures for the Administration of Securities Investments within the Territory of China by Qualified Overseas Institutional Investors*. The QFII system permits QFIIs to transfer a certain amount of overseas exchange funds into China and be exchanged for local currency and then invest the local securities market through a special investment account, which is under strict supervision and management, and finally remit various capital gains including dividends and bid-ask spreads upon approval. According to the Measures, in light of approved investment quotas, QFIIs may invest in A shares, bonds, warrants, securities investment funds listed in China's stock exchange market and other financial instruments approved by the CSRC and participate in issuances of new shares and convertible bonds, SPO (Seasoned Public Offering), and the subscription for allotted shares. Provisions such as the amount of registered capital, financial status, operation period of QFIIs are all covered in the Measures so as to protect the stability and healthy development of the domestic securities market. When establishing the Guarantee Fund by utilizing foreign capital, relevant parties can use the Measures as a reference.

(C) Provisions for the sponsors

As for the sponsors of the Guarantee Fund, the requirements for the sponsors shall refer to the *Interim Measures for the Administration of Securities Investment Fund Management Companies* (promulgated by the Securities Commission under the State Council on November 14, 1997)[6]. In addition,

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[6] **Article 7:** The following terms shall be met for an application for the establishment of a fund: (1) its main sponsors are securities firms, trust and investment companies and fund management companies established in accordance with relevant state provisions; (2) the actual capital of each sponsor shall not be less than RMB 300 million, and the main sponsors shall have experiences in securities investment and a record of consecutive profits for over three years. However, the fund management companies are excluded; (3) the sponsors, fund trustees and fund administrators shall have sound organizational institutions and management system with good financial status and standardized acts of operations; (4) the fund trustees and fund administrators shall have a site for business operations, facilities for security and precaution and other business-related facilities commensurate with requirements; and (5) other terms prescribed by CSSCC.

Article 10: The existence of a closed-end fund shall not be less than five years and the minimum amount raised shall not be less than RMB 200 million.

Article 11: Expansion of fund raising and extension of a closed-end fund shall have the following qualifications and be subject to the examination and approval of CSSCC: (1) annual rate of returns is regulatory bodies shall set different standards on overseas and domestic sponsors. Requirements for overseas sponsors shall be more stringent than domestic counterparts.

IV. Capital Source of the Guarantee Fund

(A) Funding source in light of the current design paradigm

According to the research we did some time ago, capital source of the Guarantee fund include: 1. International capital: ADB, IFC and other international financial institutions; as well as overseas enterprises, institutional investors and individuals; 2. Domestic funds: central fiscal funds; local fiscal funds; investments from banks, domestic enterprises and institutional investors.

(B) Legal nature of raised funds

The raised funds here refer to the capital that sponsors or other fund investors use as capital contribution of the fund. After the Guarantee Fund is established, sponsors or other fund investors will bear risks and enjoy profit distribution based on the scale of capital contribution. The legal nature of the raised funds for the Guarantee Fund is as follows: 1. Capital contributors are the fund's shareholders (holders of fund shares); 2. After the fund is established in accordance with law, the raised funds will become the fund's

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higher than the average rate of returns nationwide; (2) the fund trustee and the fund administrator have committed no major acts in violation of laws and regulations in the past three years; (3) the fund holders' meeting and the fund trustee's agreement on the expansion of fund raising or extension; and (4) other qualifications prescribed by CSSCC.

Article 13: The duration of fund raising of a closed-end fund shall be three months, which is to be calculated from the date of approval of the said fund. A closed-end fund can only be established when the fund raised within three months from the date of approval of the said fund exceeds 80% of the approved scale of the said fund. An open fund can only be established when the net sales within three months from the date of approval of the said fund exceed RMB 200 million. A closed-end fund shall not be established when the fund raised is less than 80% of the approved scale of the said fund on expiry of the duration of fund raising of the said fund. An open fund shall not be established when the net sales within three months from the date of approval of the said fund are less than RMB 200 million. The fund sponsors must bear expenses for the fund raising and the fund raised with additional calculation of bank current deposit interest must be refunded to fund subscribers within 30 days.

assets, and capital contributors are not permitted to redeem; 3. The fund or other fund managers entrusted by the fund will manage and run the raised funds in accordance with relevant laws, regulations, regulatory documents and commission management agreements, etc.; 4. The raised funds do not guarantee the principal and the profit.

(C) Legal analysis of the Fund's capital composition

1. ADB, IFC and other international financial institutions; as well as overseas enterprises, and individuals

Overseas enterprises, institutional investors and individual investors can serve as sponsors or holders of shares of the Guarantee Fund, but they have to meet the qualifications of fund sponsors, investor qualifications and foreign investment quotas in light of China's laws and administrative regulations.

2. Domestic social capitals

1) Domestic investors serving as the Guarantee Fund's sponsors or stakeholders should also meet the requirements of qualified sponsors and investor statuses we described in the previous paragraphs in this article.

2) Central and local fiscal funds

As a corporate fund, the Guarantee Fund will implement market-oriented operation and enterprise management, make its own management decisions and take full responsibility for its own profits and losses. Therefore, it is not appropriate for central and local fiscal funds to directly allocate into the Fund's assets as financial allocations. Instead, they should follow the relevant provisions of the state-owned assets management: State-owned asset management departments that are eligible sponsors or investors of the Guarantee Fund will represent the state capital contributors to invest part of central or local fiscal funds in the Fund; these state-owned asset management departments will hold fund shares and exercise shareholder rights in accordance with law as well as bear responsibility to protect and increase the value of state-owned assets. Only in this way can it be in line with the corporate organizational form and meet market-oriented operational needs.

V. Business Scope of the Guarantee Fund

Capacity for civil conduct described in this item mainly refers to the business scope of foreign-funded guarantee funds, namely, apart from guarantee business foreign guarantee funds provide for Chinese private SMEs and re-guarantee business they provide for Chinese guarantee institutions, whether they can engage in other businesses, in particular those businesses relating to relevant advisory business and investment business.

(A) Advisory and related training businesses

The Guarantee Fund is planned to cover business scopes such as offering advisory and related training services for guarantee companies, private enterprises and banks.

According to the *Catalogue for the Guidance of Overseas Investment Industries* (amended in 2007), in addition to social surveys which are prohibited categories of foreign investment projects, legal advice and market research belong to restricted categories, and other advisory businesses are encouraged or permitted foreign investment projects. Therefore, the Guarantee Fund can engage in other advisory businesses excluding advisory businesses listed in prohibited categories. Nevertheless, it needs to pass through approval procedures in accordance with relevant provisions for approving restricted categories of foreign investment projects before it conducts restricted advisory services such as legal advice and market research, etc. In addition, as for advisory businesses that need the approvals from relevant administrative authorities in light of the current laws, regulations and regulatory documents and advisory businesses that can only be done with relevant business qualifications, they shall also comply with the abovementioned stipulations. Notably, if the Guarantee Fund is going to engage in securities investment advisory business, it should report to the CSRC for approval.

At present, the *Catalogue for the Guidance of Overseas Investment Industries* has not included "training" services separately in encouraged, restricted or prohibited categories of foreign investment projects. In this regard, we think that training business the foreign guarantee funds are going to engage in can be part of advisory business, which can be deemed as a special business model in advisory business.

Therefore, as for advisory business the Guarantee Fund is going to engage in, the main problem at present is to confirm the specific types of advisory services. Then, it needs to fulfill approval procedures in accordance with relevant laws, regulations and regulatory documents before it commences to start relevant advisory business.

(B) Investment businesses

The investment businesses described in this section includes direct investment (equity investment), securities investment and other investments.

1. Direct investment

According to the *Interim Provisions for Investment in the Territory of China by Foreign-funded Enterprises*, which was promulgated on July 25, 2000 jointly by the former Ministry of Foreign Trade and Economic Cooperation and the State Administration for Industry and Commerce, Sino-foreign joint ventures, Sino-foreign cooperative enterprises and foreign-funded enterprises that are legally established in the territory of China taking the form of limited liability company, may use their own names to set up enterprises in China or buy shares of other investors. Therefore, guarantee funds or guarantee companies can directly conduct equity investments in the territory of China in accordance with relevant provisions.

According to the *Provisions on the Establishment of Investment Companies by Foreign Investors*, which was amended by the Ministry of Commerce of the People's Republic of China on November 17, 2004, foreign investors are permitted to, in accordance with the relevant laws and regulations of China on foreign investments as well as the present Provisions, establish investment companies in China. The term "investment company" as mentioned in the present Provisions refers to a company established by a foreign investor in the form of either wholly-owned enterprise or Sino-foreign joint venture to engage in direct investments. Nevertheless, the investment company shall not directly engage in production activities.

According to the *Provisions of Administration of Foreign-funded Venture Capital Investment Enterprises*, effective as of March 1, 2003, a foreign enterprise established within the territory of China by foreign investors, or by foreign investors together with companies, enterprises or other economic organizations registered and established under Chinese law ("the Chinese Investors"), can conduct venture capital investment business in accordance with these Provisions.

Based on the above laws and regulations, we believe that there are no legal obstacles under the premise of complying with the *Catalogue for the Guidance of Overseas Investment Industries* for foreign-funded enterprises to engage in direct investment in China.

Therefore, with regard to the Guarantee Fund's right to conduct direct investment, we shall formulate a separate law, regulation or regulatory document by using the above stipulations as references and then promulgate it after going through relevant authorization or approval procedures by administrative authorities.

2. Securities investment:

According to the provisions in the China's *Securities Law*, the *Securities Investment Fund Law* as well as other securities laws, regulations and regulatory documents, institutions engaging in self-operated securities business on domestic securities market shall be subject to the approvals from the CSRC and other competent authorities according to law. Of institutional investors, only securities companies and securities investment fund management companies are eligible for engaging in self-operated securities business. For foreign institutions, the *Measures for the Administration of*

Securities Investments in China by Qualified Foreign Institutional Investors (effective as of September 1, 2006) provides that a QFII may, within the approved investment quota, invest in stocks, bonds, warrants, securities investment funds and other financial instruments approved by the CSRC, participate in issuances of new shares and convertible bonds, SPO (Seasoned Public Offering), and the subscription for allotted shares, and open up and use its securities account. Nevertheless, a QFII shall, in making any domestic stock investment, comply with the limits on proportion of shares stipulated by the CSRC and other relevant provisions of the state.

In accordance with the *Measures for Strategic Investment by Foreign Investors upon Listed Companies*, effective as of February 1, 2006, foreign investors will acquire A-shares of the listed company having finished reform of non-tradable shares and of the new listed companies by means of long-and-mid-term strategic investment of merger and acquisition with certain scale. In Article 3, it provides that "Investors may undertake strategic investment in accordance with the Measures after the approval of the Ministry of Commerce."

Therefore, if the Guarantee Fund intends to engage in self-operated securities business and conduct securities investment, it should be specially approved by the CSRC and other relevant administrative departments since securities investment by the Guarantee Fund is prohibited in the current legal environment within China.

3. Investments in other fields

If the Guarantee Fund is going to engage in other investments, it should be consistent with the stipulations provided in the *Catalogue for the Guidance of Overseas Investment Industries* and other relevant laws and regulations whose promulgations are aimed at normalizing investment acts of foreign investors when they engage in investment within China's territory.

4. Preferential tax policies for the Guarantee Fund's investments

On February 15, 2007, the Ministry of Finance and the State Administration of Taxation jointly published the *Notice Clarifying Issues Relating to Income Tax Concessions for Venture Capital Enterprises*. Pursuant to the notice, any venture capital enterprise investing in a non-listed small and medium-sized high-tech enterprise for a period of over two years (24 months) in the form of equity rights holding may have 70% of its investment amount in the small and medium-sized high-tech enterprise deducted from its taxable income.

Pursuant to the *New Enterprise Income Tax Law* effective as of 2008, the deductible tax will be 17.5% of the investment amount (25% as uniform tax). Pursuant to the *Notice on Questions Relevant to the Enterprise Income Tax of*

Joint Stock Companies, which was published on June 21, 2000, if the shareholders of a venture capital company are enterprises, it is entitled to tax exemptions, so as to avoid duel taxation.

(C) Credit rating of guarantee institutions

The so-called credit rating of guarantee institutions, namely, the assessment of credit of guarantee institutions and make relevant ratings, means that credit rating agencies comprehensively assess operation status, social credit status, and credit capacity of guarantee institutions, based on the collected information relevant to guarantee institutions. When doing assessment, credit rating agencies should adopt the following factors as standards: Relevant provisions of administrative departments and financial institutions as well as classified management information of guarantee institutions and other external factors.

Pursuant to the *Guiding Opinions of the People's Bank of China for the Management of Credit Rating* (No. 95 [2006] of the People's Bank of China), People's Bank of China), relevant guiding opinions are applicable to the management and guidance of the People's Bank of China to the credit rating businesses regarding financial products, borrowing enterprises and guarantee agencies by the credit rating agencies in the inter-bank bond market and the credit market. Credit rating agencies should employ professional assessors with considerable experience in fields of finance, accounting, securities, investment and evaluation. Credit rating agencies should file relevant material to the People's Bank of China and formulate appropriate credit rating work system and internal management system.

Guarantee funds are by nature quasi-public goods guided and supported by policy-based finance and operated according to market rules, thus having dual natures: market-oriented and quasi-public goods. In accordance with the abovementioned provisions, guarantee funds can provide credit rating services for credible guarantee agencies if certain conditions permit. Foreign guarantee funds should independently carry out credit ratings to ensure the fairness, consistency and completeness of ratings in strict accordance with rating methods and procedures known to the public, accordingly any unit or individual shall not affect credit rating results. Notably, pursuant to the *Guiding Opinions of the People's Bank of China for the Management of Credit Rating*, if there exists benefit relationship between credit rating agencies and assessors with a subject to be evaluated, they should ask for avoiding the assessment case. Therefore, a foreign guarantee institution shall not rate a guarantee institution if the latter is one of its guarantee targets.

VI. Laws, Regulations and Regulatory Documents Relevant to the Operation of the Guarantee Fund

1. Laws, regulations and regulatory documents in contract field

The establishment and operation of the Guarantee Fund are both subject to the regulation of the *Law of Contract*, from the signing of *Sponsors Agreement* in initiation stage to the formulation of *Prospectus* and *Subscription Commitment* in fund raising stage, and to the signing of *Trust Management Agreement* and *Bailment Agreement*, etc. in fund assets' management and custody stage. In the guarantee business processes, it is necessary to sign a large number of *Guarantee Contracts* in order to clarify the rights and obligations between the Guarantee Fund and warrantees.

In addition, a foreign guarantee fund will involve the signing of *Loan Agreement*, *Grant Agreement* and other contractual documents to fully utilize domestic and foreign preferential loans and grants, regulating the general approval, usage and repayment of loans as well as how to use the grants.

2. Laws, regulations and regulatory documents in guarantee field

The object and mission of the establishment of the Guarantee Fund are to provide guarantee services for the financings of private enterprises, so guarantee business shall be its most basic and important business. As the company's legal person, the Guarantee Fund must comply with the *Guarantee Law*, the *Procedures for the Administration of Guarantees Overseas by Institutions in the Territory of China* and the *Detailed Rules for the Implementation of the Procedures for the Administration of Guarantees Overseas by Institutions in the Territory of China*, as well as other relevant laws, regulations and regulatory documents.

VII. Supervision and Administration of the Guarantee Fund

Since the Guarantee Fund is an intermediary providing credit enhancement method for guarantee institutions and providing services for enterprises, the operations of the Guarantee Fund would directly impose a certain impact on the financing and operation of certain enterprises in the market economy. It is the running of a sound market economy that determines the requirements of the standardization of the Guarantee Fund's own operations, the accuracy and fairness of services it provides. If there are irregular operations, it will not only adversely affect its own operations but also directly affect its clients. Therefore, the standardization of operations is essential to the Guarantee Fund.

With regard to the supervision and administration of the Guarantee Fund, we can refer to Chapter VI: **Supervision and Administration**[7] in the *Measures for the Administration of Securities Investments in China by Qualified Foreign Institutional Investors* as reference.

On February 3, 2009, the General Office of the State Council promulgated the *Notice on Further Specifying the Supervisory Functions for Financing Guarantee Business* (No. 7 [2009] of the General Office of the State Council). The Notice states that an inter-ministerial regulatory joint meeting (the "Joint Meeting") regarding a financial guarantee business will be established by the

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[7] Article 30 Where, under any of the following circumstances, a QFII shall, within 5 workdays as of the occurrence, report to the CSRC and the SAFE for record:
(1) the alteration of trustees;
(2) the alteration of legal representatives;
(3) the alteration of the controlling shareholders;
(4) adjustment of the registered capital;
(5) being involved in any important litigations and other grave events;
(6) being imposed upon a great penalty overseas; or
(7) other circumstances as specified by the CSRC and the SAFE.
Article 31 Where, under any of the following circumstances, a QFII shall re-apply for a Securities Investment License:
(1) the alteration of business name;
(2) being acquired by or merged with other institution(s); or
(3) other circumstances as specified by the CSRC and the SAFE.
During the period of re-applying for a Securities Investment License, a QFII may continue its securities transaction, except that it shall be suspended by the CSRC according to the principle of prudent supervision.
Article 32 Where, under any of the following circumstances, a QFII shall surrender its securities investment license and foreign exchange certificate respectively to the CSRC and the SAFE.
(1) where the applicant has not applied to the SAFE for an investment quota within 1 year after obtaining a securities investment license;
(2) where the institution is dismissed, has entered the bankruptcy procedure or has been taken over by the administrator;
(3) where the QFII intends to re-apply for a license;
(4) where the QFII has committed any serious illegal act, and other circumstances as determined by the CSRC and the SAFE.
Article 33 Where there exists any serious violation of laws or regulations with respect to the securities accounts managed by a QFII, the CSRC shall restrict its transaction under relevant securities accounts or take other measures according to law; the SAFE may restrict its remittance of capital or take other measures according to law.
Article 34 Where a trustee has seriously violated any law or regulation, the CSRC and the SAFE shall jointly make a decision to cancel its qualification as a trustee.
Article 35 Where a QFII, trustee, or securities company violates the present Measures, the CSRC and the SAFE shall impose corresponding administrative penalties upon it according to law.

State Council. The Joint Meeting will be headed by the China Banking Regulatory Commission (the "CBRC"). The duties of the Joint Meeting will include, among others, formulating regulatory policies for the financial guarantee business, coordinating with the relevant departments and local regulatory organs, and specifying the corresponding supervisory functions of local governments at the same time. The State Council also demands that the Joint Meeting shall accelerate to improve relevant systems and policies, and formulate national regulations dealing with the requirements on establishment and the businesses of financial guarantee companies. After the Joint Meeting finishes the abovementioned task, it shall report to the State Council in time for approval. The Joint Meeting also shall facilitate to formulate policy measures relevant to promoting the healthy development of the financial guarantee business and easing the difficulty of SMEs financing, and do research on establishing a self-regulatory organization for the financial guarantee business. The Notice has taken a crucial step for the standardization of the financial guarantee business.

Given the Guarantee Fund as a corporate fund, its supervision and administration can also refer to regulatory documents applicable to guarantee companies. To further guard against risks, it is suggested that a regulatory body designated by the State Council shall organize competent institutions to utilize all the existing provisions and do relevant research work to formulate the management rules for guarantee companies and to integrate and improve such contents as guarantee companies' market access, personnel and organization, operating principles, management requirements, business scope, regulatory requirements and responsibilities of illegal operations, so as to provide an institutional basis for the standardization of the operations of guarantee companies. It is also suggested that the requirements for the industry's access standard, operation and exit rules shall be unified and that such items as registered capital, personnel, premises and approval shall meet the requirement for a competent guarantee company, thereby achieving the standardization of a guarantee company in its establishment stage by reasonably controlling the industry's access threshold.[8]

VIII. Exit Methods of the Guarantee Fund

In addition, the Guarantee Fund's exit mechanism, including but not limited to, bond financing, the overall transfer, listing of fund companies, also must comply with the Securities Law and other relevant regulations.

[8] Refer to China Merchants Bank President Ma Weihua's proposal put forward during this year's two sessions: On Strengthening the supervision and administration of Domestic Guarantee Companies and Rating Companies.