Asia Focus

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Postal Savings Reform in Northeast Asia
Part Two: China

This *Asia Focus* is the second of a two-part series highlighting postal savings programs in Japan, South Korea, and China. Part One of the series reviews the evolution of the Japanese and South Korean postal savings programs and discusses recent reform efforts and current challenges. Part Two outlines the development of China's postal savings program, focusing on issues of rural banking access and challenges to further reform.

China's postal savings program plays a critical role in the government's goal of more balanced economic development. Compared to its urban areas, China's rural areas remain relatively financially underdeveloped. As a result, many of the plans for China's postal savings program are centered on the need to improve access to credit and other banking services in rural areas. Chinese officials have publicly committed themselves to addressing these issues; the development of a commercially driven postal savings bank is just one part of the process.

Similar to China's mobilization of its postal savings system for the benefit of rural communities, Japanese and Korean policy makers have traditionally viewed postal savings programs as a means to provide basic banking services to un-banked segments of their respective populations. As in China's case, these un-banked groups resided mainly in rural and agrarian regions. Despite these similarities, the process of postal savings reform in the three economies has taken divergent paths, with China drawing the most explicit connection between postal savings services and improved rural banking access.

China's postal savings program is currently in a period of major transition, and publicly available data about the China Postal Savings Bank is relatively scarce and difficult to verify. Information in this report was obtained primarily from Chinese media sources and the website of China's banking regulator.

Historical Background

Like Japan and Korea, China began offering postal savings services near the turn of the 20th century. Initiated in 1919, the postal savings business in China has experienced both prolonged periods of suspended activity and a more recent surge in interest from regulators and government leaders. Following the founding of the People's Republic of China, the People's Bank of China (PBOC) permitted the post offices to provide postal savings services starting in 1951, but services were halted for political reasons just two years later. Postal savings services resumed in 1986 through the China Postal Savings and Remittance Bureau (CPSRB), which was part of the State Post Bureau.

As the postal savings business grew in subsequent years, officials began to consider ways to separate the various functions of the large postal system and to provide improved oversight. In the late 1990s, China's government separated postal and telecommunications businesses from each other and the PBOC raised the notion of establishing a stand-alone postal savings bank. After its founding in 2003, the China Banking Regulatory Commission (CBRC) supported the concept of a separate postal savings bank as a means to split the postal savings service from the main postal delivery service. In June 2006, following approval from the State Council, the CBRC formally endorsed the establishment of a separate China Postal Savings Bank (CPSB).

Two new government bodies were launched in January 2007 to separate the regulatory functions of the former State Post Bureau from its business activities. Historically, the State Post Bureau acted as both a player in the postal market and as its regulator. Going forward, the State Post Management Bureau will serve as the government regulator of postal services, while the China Post Group, a state-owned firm with registered capital of RMB 80 billion (US$ 11 billion), will concentrate on the business operations of postal services. This structure resembles that of Japan, where the Japan Post Holding Company serves as the umbrella organization over the Japan Post Bank.

In March 2007, the CPSB officially began operations with registered capital of RMB 20 billion (US$ 2.7 billion). It is wholly owned by the newly formed China Post Group and is regulated by the CBRC. By creating a stand-alone postal

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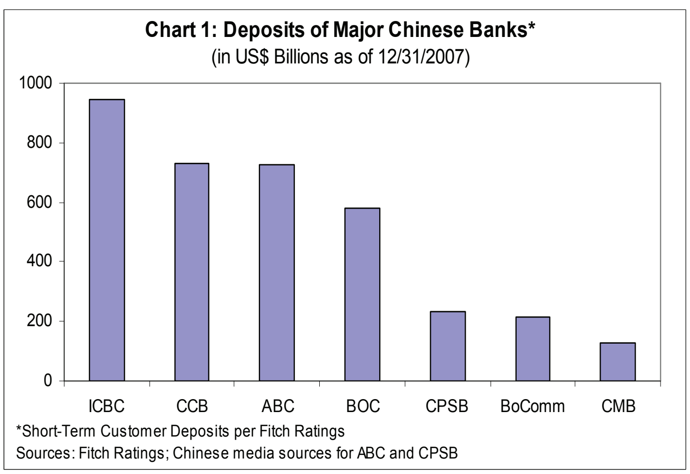
savings bank which is supervised by the country's banking regulator, Chinese authorities have avoided a common criticism of other postal savings programs—namely, that some postal savings programs enjoy special treatment with respect to financial oversight. This is currently the case for South Korea where the postal savings program remains under the purview of the Ministry of Knowledge Economy and not the Korean financial regulatory authorities.

Since the establishment of the CPSB in March 2007, the reform of the postal savings system has focused on developing sound corporate governance and internal controls for the new institution, and on setting up the bank's branch network. By February 2008, the CPSB had established 36 primary (mainly provincial level) branches. In addition, the CBRC has approved the incorporation of another 316 sub-branches and 20,089 field offices (service outlets).[i] According to media reports, some postal outlets will become wholly owned by the CPSB and will be licensed to provide a full range of banking services. Others will have restricted operations until they are able to meet regulatory requirements to control and manage risk.

Growth of Postal Savings Deposits in China

Like Japan and Korea, the Chinese postal savings system has amassed a significant deposit base. By year-end 2007, deposits with the CPSB amounted to RMB 1.7 trillion (US$ 233 billion), making the CPSB China's fifth largest bank in terms of customer deposits (see Chart 1).[ii]



Bank Acronyms: Industrial and Commercial Bank of China (ICBC); China Construction Bank (CCB); Agricultural Bank of China (ABC); Bank of China (BOC); China Postal Savings Bank (CPSB); Bank of Communications (BoComm); China Merchants Bank (CMB)

Compared with neighboring postal savings programs, the CPSB's deposit base is over five times larger than that of the Korea Post Service, but roughly one-seventh the size of the Japan Post Bank. As the CPSB begins offering and marketing new products and services, deposits are expected to increase. According to Chinese media reports, CPSB deposits have grown further to roughly RMB 1.8 trillion (US$ 247 billion) as of May 2008, and are likely to reach or exceed RMB 2.0 trillion (US$ 274 billion) at the end of 2008.[iii]

Its large deposit base notwithstanding, the former CPSRB, like its Japanese and South Korean postal savings counterparts, was not allowed to make loans. Instead, deposits were placed in the PBOC to support national investment plans. This enabled the government to mobilize rural household savings to finance national social projects. A similar practice occurred in Korea, where the Korea Post Service placed postal savings deposits in the general account of the Public Capital Management Fund that was managed by the Bank of Korea. Thus, both Chinese and Korean postal savings deposits were disbursed into large pools of government monies, with no guarantee that the funds would be re-invested in rural areas. In contrast, elected officials in Japan operated with an implicit understanding that, in return for rural support at election time, postal savings deposits would be channeled back to rural and local municipalities through the country's Fiscal Investment and Loan Program.

The State Post Bureau used interest earned by the CPSRB on deposits held with the central bank to subsidize the traditional postal business, which was not very profitable. This type of internal profit transfer is common among large postal systems with postal savings divisions, and reform of such systems raises concerns about the financial health of national postal operations. For instance, in Japan and Korea, the financial viability of mail delivery and post office management remains an ongoing concern in the wake of postal savings reforms. Likewise, in China's case, income generated from postal savings deposits was historically a significant source of revenue for the rest of the postal service. Based on one Chinese media report, in the early 2000s, approximately 42% of the annual income for the postal bureau came from the postal savings business line, and in some provinces the figure was 60-70%.[iv]

Improving Access to Banking Services in Rural Areas

Because China's early postal savings system did not offer credit services, it facilitated a transfer of money from rural areas, where capital is already scarce, to government coffers and national-level projects. In addition to financial modernization, political pressure to improve rural banking options and to close the income gap between rural and urban areas was a major driving force behind the establishment of the CPSB. In his March 2008 remarks to the Eleventh National People's Congress, Premier Wen Jiabao spoke of the need to deepen the reform of rural credit cooperatives and to actively promote the development of new types of financial institutions in rural areas, making special mention of the CPSB's role in serving rural areas and farmers. Even prior to these statements, officials from the CBRC had publicly commented that one of its goals was to encourage postal savings funds to flow back to the countryside. Indeed the CPSB appears to be working quickly to develop and launch products in support of the rural banking sector.

At the consumer level, the CPSB launched trial operations of "small loan" products in seven provinces starting in mid-2007 and as of January 2008, the bank had offered nearly RMB 87 million (US$ 12 million) of such loans.[v] "Small loan" products include loans to rural micro enterprises, farmer credit loans, and loans mutually guaranteed by groups of three to five farmer households. Although the CPSB had planned to enlarge its "small loan" business to RMB 100 billion (US$ 14 billion) within three to four years, growth has been slower than expected due to a number of obstacles, including a lack of trained banking sector professionals.[vi]

In May 2008, the CPSB began offering a specialized bankcard in Guizhou and Hunan Provinces that is tailored to the banking needs of migrant rural workers. This "tailored bankcard" service was first piloted by other banks in 2006, before the new CPSB was launched. These bankcards enable migrant rural workers to deposit cash into a bankcard account in the city where they work, then withdraw these funds from a banking institution in their hometown. Thus, "tailored bankcards" provide migrant workers with convenient options to deposit and withdraw funds in various cities, and also to remit money to their families at home. The CPSB intends to extend this service to other provinces as branches enhance IT and risk management, and as staff receive appropriate training.

Strategy and Plans for the Future

While postal privatization remains stalled in Korea and Japan Post Bank's options are constrained by its already large market share, the CPSB is steadily moving ahead with its plans to become a full-service commercial bank. In the long term, the CPSB will likely follow the path of China's other large banks by selling public shares to raise additional capital. It may also seek a foreign strategic investor at some point in the future.

The State of Rural Banking in China

In an effort to evaluate the availability of banking services across different parts of the country, the CBRC has developed a map showing the distribution of banking services across China[x]. According to official CBRC statistics, as of year-end 2006 the total number of banking institutions operating at or below the county level was 111,302, accounting for 56% of banking institutions in China. However, the data also demonstrate that banking sector resources are unevenly distributed between rural and urban areas. For example, in rural areas there were 1.26 financial institutions per 10,000 people, whereas that figure rose to 2.00 institutions per 10,000 people in urban areas (see Chart 2). And while there were over 50 banking institutions per county on average, over 30% of those were located in county-level communities as opposed to lower-level townships and villages. The average number of banking institutions per township was less than three, and 3,302 townships were considered "virtually unbanked" by the CBRC. The CBRC has concluded that competition and service quality in rural financial markets need improvement.

Chart 2: Rural vs. Urban Banking Statistics
(as of 12/31/2006)

# Institutions per 10,000 people in:	Rural areas	1.26
	Urban areas	2.00
# Institutions per:	Township	3
	County	50
Per capita loan size: (RMB)	Rural areas	5,500
	Urban areas	40,000

Source: CBRC

Although the CPSB has been in existence in some form for many years, it also resembles a *de novo* institution in that it is just beginning to become a full-service bank. It benefits from a lack of legacy nonperforming loans, which have troubled China's other large state-owned commercial banks, and its senior leaders are equipped with advice from the CBRC and lessons learned from China's financial modernization process. The CPSB also benefits from: 1) its vast network; 2) a strong base of stable, long-term savings; and 3) very localized knowledge (often down to the village level). As a result of localized knowledge, the CPSB is expected to be able to cultivate strong customer relationships, particularly in small towns with limited access to other banking services. At the same time, compared with the Agricultural Bank of China, which has historically focused on lending primarily to farmers and companies in rural areas, the CPSB may be less limited in its target client populations and product offerings. For example, the CPSB would like to pursue wealth management and intermediary business markets in the future.

In March 2008, the CPSB launched corporate services on a trial basis in its Tianjin branch. Corporate services initially will be confined to deposits and settlements, but eventually will include corporate online banking and other services. The CPSB will expand the program once it has adopted adequate measures to manage associated risks. According to Chinese media sources, the CPSB has also developed a plan to introduce ten investment products by the summer of 2008. In addition, the CPSB's Beijing branch has launched personal business loans on a trial basis and the program is scheduled to expand into nearby Zhejiang province before being launched across the country.

At the end of 2007, the CPSB reportedly signed a strategic cooperative agreement with the Sichuan branches of the China Development Bank whereby the two banks will cooperate in the offering of syndicated loans, joint loans, trust loans, trust assets and other products.[vii] The scale of their cooperation is expected to exceed RMB 6 billion (US$ 823 million). The CPSB has also started pilot sales of its first RMB wealth management products.

China Post Group, the parent company of the CPSB, was recently approved by the country's insurance regulator to set up a life insurance company, which will mainly target farmers, low-income urban residents and migrant workers in cities. The company will be named the China Post Life Insurance Company Limited and will be registered with RMB 500 million (US$ 69 million) in capital. It is expected to launch by the summer of 2009.[viii]

Challenges Going Forward

The timing of the CPSB's growth plans coincides with a challenging banking environment in China. As the CPSB expands into new business lines, it faces difficulties common not only to other commercial Chinese banks, but also to the Japan Post Bank and Korea Post Service. For example, it will need to continue enhancing its system of internal controls and implement plans to recruit and retain staff with commercial-banking experience. While addressing risk management, personnel and other issues, the CPSB must also develop strategies to compete with more established credit cooperatives and commercial banks.

The CPSB also faces an environment of increasing reserve requirements and resultant credit tightening. Chinese media sources noted in September 2007 that the CPSB would be required to adopt the same required reserve ratio (RRR) as other commercial banks starting in August 2008.[ix] As of September 2007, the PBOC allowed the CPSB to follow a RRR of 4%, well below the 12% requirement for commercial banks at that time. The PBOC reportedly planned to raise the CPSB's RRR by 200 basis points quarterly until the bank's RRR matched the standard for other commercial banks. However, the PBOC has significantly increased the standard RRR in the last year, boosting the minimum amount banks must hold against deposits as a means to manage abundant liquidity in the banking system. While the most recent increase of 100 basis points announced in June 2008 set the RRR at 17.5%, it is not clear when the CPSB will be obligated to meet this elevated requirement.

In addition, China's political leaders appear to view the CPSB as one of many tools to address rural-urban income inequality and to improve financial services in the country's rural areas. As a result, the CPSB may face pressure to make loans driven more by policy than by sound risk management practices.

Conclusion

With its extensive network of postal savings outlets across rural and urban areas, much is expected from the newly formed CPSB. China's leaders are counting on the CPSB to help improve banking services in rural areas, but the line between policy lending and commercial-based lending may become blurred. In the past, China has forged its own path along the road to financial sector modernization; the reform of its postal savings network will be no different. Regulators, bankers and other market participants likely will find a balance between development goals and commercial-banking standards as the CPSB works to improve its position among China's other major banks.

Regardless of its current transitional state, the CPSB has aggressive plans to develop new products and to enter new markets. Although many of these plans are only in pilot phases, the CPSB, as China's fifth largest bank in terms of customer deposits, will likely become an increasingly important player in China's banking sector in the future.

Table 1: Cross-Regional Comparison of Postal Savings Reform

	JAPAN	*SOUTH KOREA*	*CHINA*
Current Name	Japan Post Bank	Korea Post Service	China Postal Savings Bank
Initiation of Postal Savings	1875	1905, suspended operations in 1977, and resumed deposit taking in 1983	1919, operated briefly from 1951-53, then resumed deposit taking in 1986
Parent Company or Home Agency	Japan Post Holdings Co., Ltd. (100% government owned)	Ministry of Knowledge Economy	China Post Group (100% government owned)
Financial Data	Deposit Base: JPY 187 trillion (US$ 1.6 trillion) As of March 31, 2007	Deposit Base: KRW 40 trillion (US$ 43 billion) As of year-end 2007	Deposit Base: RMB 1.7 trillion (US$ 233 billion) As of year-end 2007
Regulatory Agency	Japanese Financial Services Agency	Ministry of Knowledge Economy	China Banking Regulatory Commission
Privatization Timeframe	Start date of October 1, 2007; full privatization by 2017	No plans have been announced yet	No specific timeline has been announced

Japan, Korea, and China: Summary Comparisons

Postal savings programs in the Northeast Asian economies of Japan, South Korea, and China have undergone varying degrees of reform based on: 1) their historical backgrounds; 2) national policy objectives; and 3) the extent of local financial sector development. Although postal savings banks across the region differ in terms of relative size and influence, their significant deposit bases and plans for further privatization are likely to increase their visibility going forward. As these banks pursue more commercial bank-like models, they will need to balance their goals for growth with appropriate risk management strategies to ensure their overall safety and soundness. The histories of the Japan Post Bank, the Korea Post Service, and the China Postal Savings Bank show that these organizations have been successful in taking advantage of changing situations and in weathering difficult times. As these postal savings programs commence commercialization and privatization, their continued ability to adapt will undoubtedly prove critical to their future success.

[i] "All outlets of China Postal Savings Bank have been approved to prepare for incorporation." CBRC website, article posted 1/11/08
[ii] "China Postal Savings Bank Unveils 36 Provincial Branches." SinoCast China Financial Watch, 1/31/08
[iii] "Deposits in China Postal Savings Bank Approach RMB 1.8 Trillion." China Industry Daily News, 6/10/08
[iv] "3 options for reforming postal savings bureau." China Business Weekly, 6/21/04
[v] "Postal Savings Bank to Spread Small Loans Nationwide." SinoCast China Financial Watch, 2/5/08
[vi] "Postal Savings Bank Accelerates Expansion in Countryside." SinoCast China Financial Watch, 5/23/08
[vii] "Sichuan Branches of CDB and China Postal Savings Bank Sign Cooperation Agreement." China Industry Daily News, 12/10/07
[viii] "China Post Group gets go-ahead to set up life insurance company." Xinhua News Agency, 6/16/08
[ix] "PBOC to Raise Reserve Ratio for Postal Savings Bank." SinoCast China Business Daily News, 9/7/07
[x] "The CBRC completed the compilation of China Banking Services distribution Map." CBRC website, article posted 6/29/07

A single US$/RMB exchange rate was used throughout this report: US$ 1 = RMB 7.29 (FRBNY rate as of 12/31/2007)

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