



INTERVIEW WITH ZHANG JIANHUA, CEO BANK OF CHINA BRAZIL

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ABOUT BANK OF CHINA

Established in 1912, shortly after the nationalist revolution, Bank of China is the oldest bank in China. It functioned as the Central Bank of China until 1949, and then became a commercial bank with a focus on foreign trade, with over 12,000 offices in China and more than 600 abroad, spread throughout 35 different countries.

CF: Could you tell us a little bit about Bank of China? How large is it? How does it compare with the other big-three banks in China?

ZJH: Bank of China was established in February 1912, making this its one hundredth anniversary year. It is the oldest bank in China. From 1912 to 1949, the Bank functioned as the central bank, the foreign exchange bank and specialized foreign trade bank, successively.

CF: Three different functions?

ZJH: At the beginning, Bank of China was the Central Bank, then the Foreign Exchange Bank, and later the Specialized Foreign Trade Bank. After 1949, it became a specialized foreign exchange and international trade bank, which means it was no longer involved in the domestic banking business. And in 1994, Bank of China was transformed into a State-owned commercial bank. In 2006, Bank of China became the first Chinese commercial bank listed in both mainland China and Hong Kong. That enabled the Bank to do business on the Shanghai and Hong Kong stock exchanges.

CF: And what's the current market cap? What is Bank of China's position in China?

ZJH: Regarding market cap, Bank of China would be ranked number three. We have four major commercial banks in China. The first one is the Industrial and Commercial Bank of China (ICBC), the second is the China Construction Bank, the third is Bank of China, and the fourth is the Agriculture Bank of China.

CF: And how many branches does Bank of China have in China, and in the world abroad?



ZJH: More than 12,000 branches. We have a very strong network, including overseas, where there are more than 600 subsidiary branches in 35 different countries.

CF: Does that mean that you are the most internationalized of the big-four?

ZJH: Absolutely. That can be explained by the fact that before 1985, Bank of China was the only one allowed to operate with international banking. That means that all companies in China, engaged in import-export activities, had to go to the Bank of China for their international business settlements.

CF: What about the other banks, do they also perform the same import and export functions as Bank of China?

ZJH: They began after 1985, which means that now we share the market, although Bank of China was the first one to operate in this area. For example, recently, ICBC applied to the Brazilian Central Bank for incorporation of its subsidiary office. So, it will spur us to do the better job here in Brazil.

AS: You said that Chinese companies turned to Bank of China for their import-export activities. And what about the Export and Import Bank of China; what is its function?

ZJH: The Export and Import Bank of China, together with the China Development Bank, and the China Agriculture Development Bank are, what we call, China's Policy Banks which business is conducted, by large, relating to social economic effects.

CF: What about the services that Bank of China provides?

ZJH: Bank Of China is one of the most globalized and diversified banks in China. It has grown in the past few decades by building on its world-renowned reputation and working with international networks. Its brand image has won worldwide recognition for its pursuit of excellence, sound management, focus on customers, and meticulous work ethic.

Our range of services includes:

- Commercial banking, including corporate banking, personal banking and financial market business;
- Investment banking, via BOC International Holdings Limited;
- Insurance services, via BOC Group Insurance Company Limited and its subordinate and associate companies;
- Fund management, via BOC Investment Management Co., Ltd.;



- Direct investment and investment management, via BOC Group Investment Limited;
- Aircraft leasing, via BOC Aviation Leasing Corporation.

CF: Do you provide both domestic and international fund management services?

ZJH: Very interesting question. According to Chinese legislation on business segregation, a commercial bank is not allowed to be engaged in fund management services. The solution is to use our owned vehicle in Hong Kong, which has a reasonably independent system that can provide this kind of service.

CF: For example, if a Brazilian company is interested in a joint venture with a Chinese company, could it be in a third country, or in China, or in Brazil? Would Bank of China be the appropriate institution for this Brazilian company to consult?

ZJH: Yes. We would provide this service through BOC International, which is registered in Hong Kong. BOC International is Bank of China Group's investment arm. For example, they would provide M&A and IPO advice, or act as a stock broker.

CF: Does BOC International, in Hong Kong, have a separate balance sheet? Because of regulations, is Bank of China trying to minimize the risk to the system?

ZJH: Yes. Some years ago, BOC International bought one of the world's major leasing companies, and its name was changed to BOC Aviation Leasing Corporation, located in Singapore.

CF: Does it also lease airplanes?

ZJH: Yes, it leases planes to many of the world's airlines. Recently, the CEO was in Brazil, in discussions with GOL and Tam. BOC Aviation Leasing Corporation is interested in providing this kind of service to Brazilian airlines.

CF: Does the aircraft leasing company also offer services to domestic companies in China?

ZJH: Yes, it does. Another thing that is important to be noticed, is that, Bank of China has been winning recognition among the financial institutions in the world.

A few of the Bank's awards are: Bank of the Year in China – 2011; the eleventh largest bank in terms of core capital, among the "Top 1000 World Banks 2011",



according to Britain's The Banker magazine; and selected as a global systematically important financial institution by the Financial Stability Board (FSB).

On November 13, 2011, Bank of China's S&P- Standard & Poor's long-term counterparty credit rating rose from A- to A. The short-term counterparty credit rating went from A-2 to A-1. The outlook for the long-term rating remains stable. This upgrade reflects Standard and Poor's positive view of Bank of China's stable operating record and competitive edge in global markets.

CF: What about Bank of China's operations in Brazil?

ZJH: Bank of China has had a representative office in Brazil since 2000. We decided to upgrade this office to the operational level and submitted an application to the Brazilian Central Bank to Incorporate Bank of China, in August 2007, which was approved in November 2008. Then, we injected capital, followed through with legal registration processes, and began operating in mid-2009.

The objective of Bank of China Brazil is to facilitate trade between companies from the two nations, focusing only on the Brazil-China market, and our customers are Chinese doing business with Brazilian counterparts, and visa-versa.

CF: What is the scope of these trade relations?

ZJH: We provide financial services, short-term working capital loans, and project financing for trade operations between Brazilian and Chinese companies. BOC is basically involved with commodities, because they represent nearly 85% of China's total imports from Brazil.

The second business sector In our focus is telecommunications, where a great number of large Chinese companies are engaged. Others are automotive and infrastructure improvement.

CF: What is it like to be engaged in the Brazilian market?

ZJH: A very good question. In real terms, we have been engaged in the Brazilian market for less than one year, since July 2011, because we needed to learn how it operates. Doing business in Brazil is different from other countries. Rules and regulations are very complicated here.

CF: Different, in general, or in the banking sector?

ZJH: I'm talking about the banking sector. There are many procedures you have to follow and they often change. So you have to be very cautious when doing business in Brazil. You need to have an understanding of the local market.



Since the moment that we got our license, we decided to move through different phases in Brazil. Phase one ran for eight months from mid-July 2009 to the first quarter of 2010, to gain an understanding of the local market and prepare ourselves. We basically spent the time building our internal business platform. For example, we made some adjustments in our IT system.

The second phase ran from April to November 2010, when we thought we could start doing some business, in small volumes, with the objective of testing whether the platform we had built was ready.

And the third phase began at the end of November 2010, when we felt we were finally ready for the market. We have actually been operating in Brazilian market since only November 2010.

CF: How have operations progressed, since then?

ZJH: Our balance sheet still is not very large, but it has doubled after one year of operation. And, most of the Bank's clients are Brazilian companies, like Vale, Petrobras, Braskem, and CSN.

CF: That is very interesting. I would think that it was the other way around. But you have a number of blue chip Brazilian client-companies.

Could we talk about the internationalization of the RMB?

ZJH: Since the world financial crisis, which started in 2008, the global currency market as been in a state of flux, the euro is in serious trouble, and international confidence in the dollar is also eroding.

In the midst of this currency turmoil, the Chinese government has been calling for international currency reform. Since late 2008, China has accelerated efforts to promote the RMB as an international currency.

The government has done this for a couple of reasons. The primary motivation, given the volume of Chinese exports and flow of FDI to the world, would be to reduce its dependence on the dollar for invoicing and settling trade, which would hurt its exports. The RMB, used as a trade settlement currency, would better protect Chinese exporters from currency risks and reduce or eliminate hedging costs. Similarly, using the RMB as an investment currency will help eliminate exchange rate risks for Chinese firms seeking to borrow money for international investment. In addition, increasing RMB use should, over time, help lower China's excessive foreign exchange reserves, which are more than three trillion RMBs.



CF: This is like a 1% depreciation of the dollar. Let's assume that would be a net loss of over 34 billion dollars in China's reserves.

ZJH: That is why the Chinese government is accelerating the use of the RMB as a settlement currency. To accomplish that, a pilot program was launched for using the RMB as a cross-border trade settlement currency, on July 6, 2009. The clearing and settlement program of cross-border trade transactions began, and involved such provinces and cities as: Shanghai, Guangzhou, Shenzhen, Zhuhai, and Dongwu. It also included places outside of China, like Hong Kong, Macau, and some East Asian countries. More than 365 Chinese enterprises were involved in trade settlements.

On June 17, 2010, the scope of this pilot program was expanded to 20 provinces and cities. Enterprises, including all import and export companies were approved for settlement of all trade transactions.

Another important step in financial reform took place on August 17, 2010, when the interbank bond market pilot program, using RMB investments for three types of offshore institutions, began, followed by the settlement of off-shore direct investments, in October 2010. With that, Chinese companies were able to trade and invest, while using the RMB as a currency.

CF: Are there clearing and settlement models to assist trade with foreign companies?

ZJH: There are two different models to be used in RMB clearing and settlement for import and export trade with foreign companies:

A clearing and settlement bank model, under which Bank of China is appointed as the RMB clearing and settlement bank in both the HK and Macau regions, was requested.

The other is what we call the correspondent clearing model, under which the Chinese domestic commercial banks are agents of the foreign commercial banks, playing the role of agent of foreign commercial banks to provide RMB settlements for cross-border transactions. This means that Bank of China, or any Chinese bank or any financial institution in mainland China, should cooperate with financial institutions abroad, and act as agents to settle and clear those types of off-shore transactions.

So far, the volume of the cross-border trade transactions settled in RMB are growing rapidly. In 2010, there were accumulated 506.3 billion yuan or Renminbi cross-border trade transactions administered by banks, representing approximately 2.5% of the total foreign trade for the corresponding period. In 2011, settlements for cross-border trade transactions totaled about RMB 2.08 trillion, 3.6 times that of 2010 and 581 times that of 2009, when the pilot program began (RMB 3.6 billion).



CF: What are the benefits of an RMB internationalization process?

ZJH: Very briefly, there are several kinds of benefits from the RMB internationalization process.

To Chinese companies:

- For exports: No Foreign Exchange (FX) risk, particularly from the expectation of RMB appreciation;
- For imports: No FX risk, when the invoicing currency appreciates and, ultimately, the financial cost of the company does not increase.

To Brazilian companies:

- Minimized FX loss: By choosing a more stable RMB as a settlement currency relative to the Dollar. FX risk could be minimized, particularly two conversions could be avoided when the third currency is used in invoicing.
- Anticipated RMB appreciation: For quite some time in the future, RMB is expected to continue appreciating. RMB asset holdings could benefit from RMB appreciation.
- More accessible FX rate:
- The mature overseas NDF market could make the FX rate closer to the tendency of the RMB exchange rate. In the Asian market – the mature overseas NDF market – non-delivery FX – you could make the FX rate closer to the tendency of RMB exchange rate.
- Attainable RMB trade financing: Trade financing in RMB could be provided by either local banks who have pre-arranged agreements or by banks on the mainland.
- Market expansion: At the time that the Chinese company chooses the RMB as the trade settlement currency, it could help the Brazilian company tap the Chinese market by also using the RMB.

Because the dollar has fluctuated a lot, over the past number of years, the Chinese companies have faced an FX fluctuation risk, but the RMB is relatively stable. So they normally prefer to choose the RMB. If Brazilian companies accept this kind of contract, they also can tap into the Chinese market by using the RMB benefit.

CF: What the latest developments in RMB internationalization?

ZJH: The latest development RMB internationalization has to do with countries involved in RMB swap agreements. In 2011, China signed the bilateral currency swap agreement with 14 countries and regions, for a total of RMB 1.29 trillion. This is



driving the development of cross-border RMB denominated business. I would like to mention those countries already involved in the RMB swap agreement. Those countries include South Korea, China, Malaysia, Russia, Indonesia, Argentina, Iceland, Singapore, New Zealand, Uzbekistan, Mongolia, Kazakhstan, Thailand, and Pakistan.

CF: In Latin America, is Argentina the only one that signed the swap agreement?

ZJH: Yes, only Argentina. Swap agreements clearly facilitate companies doing business and trade with their Chinese counterparts.

CF: How long does it take to negotiate a swap agreement?

ZJH: As I know, the Chinese Central Bank has been in discussion with the Brazilian Central Bank for nearly two years. I don't know whether you noticed, but there was a recent high level summit meeting between Brazil and China.

CF: The COSBAN?

ZJH: Exactly. The Chinese delegation, led by the Vice Premier Wang Qishan, most likely touched on this topic, and I don't know when that will be finally signed. This type of agreement would certainly facilitate trade relations between the two countries.

Therefore, both countries can reduce foreign exchange risks and costs by using their own currencies for trade, instead of the dollar.

The development of the bond trading market, in Asian currencies, should also be taken into account. That would make it easier to invest money earned through trade in the region, which could return to be invested in China.

CF: RMB internationalization is a complex subject.

ZJH: Yes, and there was another major step in the internationalization of the RMB. On December 6, 2011, China's security regulatory commission, People's Bank of China and the State Administration of Foreign Exchange Control joint issued a pilot program on securities investment by fund management firm security firms as RMB qualifying foreign institutional investments, which enables a qualifying fund management firm or security firm using their subsidiaries in Hong Kong to engage in securities investment business with RMB rates in Hong Kong. They can raise capital in RMB, which could be invested in the Mainland stock exchange market.

This is very interesting, because it actually allows two way flow (in & out) of RMB.



I call this a major step towards the internationalization of the RMB. Also there is the RQFII - Renminbi Qualified Foreign Institutional Investors, which is the policy responsible for companies engaging in the securities business in China. This is a major step by the Chinese government in the process of internationalizing the RMB, which could make RMB offshore circulation flow back to China.

CF: Actually it is a major step in opening China's capital account.

ZJH: Yes. It's an initial step towards the full liberalization of the Chinese capital market. Also, one should note that given the trade volume between Brazil and China, the bilateral swap agreement would be the best solution to engage in business using RMB. In this situation, companies in both countries will enjoy benefits from the RMB internationalization process, generated by a relatively stable RMB, either in terms of financial cost or FX risk. And thus become a further impetus to bilateral trade in the years ahead.

CF: Of course. You're reducing the transaction costs.

ZJH: That's right.

CF: Therefore the volume should be expanding.

ZJH: Right, again. That's the impact. Now I think we can discuss some other questions from operational point of view.

CF: OK. Consider that I am a Brazilian exporter and it's in my interest, from a cash management perspective, to hold Renminbi. For example, I want to have dollars, Renminbi, Euros, and Yen. Would I be able to hold Renminbi outside of China, first of all?

ZJH: Yes. You either convert the RMB to US dollars then to Reals, in order to meet cash flow. Or you can Invest it through Chinese financial institutions by opening non-resident accounts in RMB.

CF: Perfect.

ZJH: Of course it could be perfect matched if you have to purchase goods in China. You could use RMB from your non-resident account to pay for your purchase. That's what happens with Brazilian companies that import equipment or machinery from China. Or for example, companies like Vale or Petrobras. Although they export to China, they might like to use RMB to meet their cash flow. They can use Bank of China to lock FX risks through NDF. Bank of China Brazil can provide these kinds of services.



CF: But suppose I am a company that has a significant cash imbalance. I basically export, I could import a bit, but I basically export to China. Could I open an account with the Bank of China as a non-resident?

ZJH: Yes, you can apply for Nonresident account (NRA A/C) in China but not in Brazil.

CF: And then can I use Bank of China as my service provider to invest in Renminbi dominated securities?

ZJH: A very good question. Generally speaking, at this moment, it is still highly restricted but will, in my view, be getting to be regulated. Of course this money in the A/C can be invested to earn some interest in this way.

CF: Could I buy Renminbi denominated government bonds issued in China, through Bank of China, or Renminbi denominated corporate bonds issued in China by Chinese corporations?

ZJH: Well, that would be very much in details. As I understand this money could be invested in some bonds and inter-bank market as well, although the interest rate is not so high.

Let me add this, that a non-resident account must be opened or held with mainland Chinese financial institutions. We are studying whether if it is possible, instead of opening a non-resident account, for Brazilian companies to open an account with us, here in Brazil, and if we can convert the RMB they need to receive in China to Reals, directly to the companies.

Once they have RMB proceeds by selling the goods in China, the Chinese importer will pay in RMB to a financial institution in China. They can instruct them to remit the money (RMB) to Bank of China Brazil, for example, the Shanghai branch, indicating that the proceeds go to Brazil ABC Company, for 10 million RMB, then this money would be reflected in Reals for the Brazilian company account with Bank of China Brazil. But we are still studying this possibility, because Brazil has a lot of regulations, and we are studying whether we could handle this sort transaction. In China, this not a problem, because of the time zone difference, so we can provide real-time service to them and, at their request, we can manage that money in that account for investment, and that would be much easier.

CF: You're testing the waters. Very good.

ZJH: We're studying all of this.



CF: One final question. As you know, within ALADI, which is the Latin American Trade Organization, there is something called the Payment and Reciprocal Credits Program (Convênio de Pagamentos e Créditos Recíprocos - CCR), which is a very simple mechanism where different central banks act as clearing houses. Basically, there's one central bank: the Central Bank in Peru is the true clearing house. The point is that this mechanism does two things: it facilitates trade and the central banks provide the guarantees. For example, if I'm an exporter to Ecuador and I exported a million dollars to Ecuador, and for some reason the Ecuadorian government decides to control foreign exchange and my client can't pay me, then through the CCR, all central banks are automatically bound to guarantee this payment. As a result, the risk is minimal, because if the Ecuadorian government is unwilling to pay a Brazilian credit, for example, then all central banks are proportionately bound to pay. It's a guarantee that facilitates trade in Latin America and is actually working quite well. Do you foresee some kind of parallel scheme as the CCR between the Brazilian Central Bank and the People's Central Bank in China?

ZJH: Between these two countries, Brazil and China?

CF: Yes. Do you envision a similar mechanism that could facilitate trade, or don't you see the need?

ZJH: What you said is actually very common in other regions. It is a way the world's financial organizations promote regional economic development. Countries cooperate to provide a type of guarantee to financial institutions in their member countries. With regard to Brazil and China, the relationship is very different, compared to Brazil's relations with countries from the region. The Brazil-China relationship is going very well, and we have executive-level meetings between the countries' leaders. So I don't think such a mechanism would be required. Also, because we have institutions like the China Development Bank, China Import-Export Bank, China Export Credit Insurance Company, also known as Sinosure, that could prevent this kind of problem.

CF: There is a second feature of the CCR that I would like to clarify. Let's assume Brazil exports a billion dollars to China and China exports a billion dollars to Brazil, leaving a zero balance. Therefore, at the end of the day there is no movement of foreign currency from one country to the other.

ZJH: This is what the currency swap agreement prescribes.

CF: So it would be natural for Brazil to move towards a swap agreement?

ZJH: That's right. I see this kind of agreement as something very good. And I don't think it will take a long time to go into practice. And this is actually a benefit to both countries.



CF: Thank you for your attention. This has been a great opportunity to discuss these issues.

ZJH: It was my pleasure.