Internationalization of Chinese Banks: How to Strengthen and Enhance Overseas Operations and Management

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ABSTRACT. Nowadays, lots of Chinese commercial banks, especially those with a powerful financial performance and government support, are beginning to expand their business by establishing branches or making acquisitions in foreign markets. However, the overseas expansion of Chinese banks is not as smooth as they are in China, problems of acclimatization with the foreign markets still exist. As is often the case, the lack of adequate operational and managerial experiences and measures seriously restricts the abroad development of Chinese banks, and even leads them to some severe and embarrassed regulatory penalties when issues are been arised from the perspective of compliance management, which is considered to be the fundamental part of Chinese banks' operating overseas. This research is focused mainly on the causes of Chinese banks' operating overseas and the effective measures to enhance their internal operations and management level in order to participate in the international competition.

1. INTRODUCTION

After the financial crisis, all developed countries, which are the first choice for Chinese banks' overseas expansion, have reflected on their banking supervision, and strengthened the supervision of banks through the adjustment of regulatory rules and structure, which put forward more and more stringent requirements for banks' compliance management and operations. Besides, when unilateralism prevails in the world, strong uncertainties in the international economic situation still exist, which have brought severe challenges to the overseas operation and management of Chinese banks. There is an old saying in China goes like this: If you know your enemies and know yourself, you will not be imperiled in a hundred battles. Under the increasingly strict situation of overseas supervision, fully understanding the rules in overseas markets and constantly strengthening the awareness of compliance will ensure the stability of operation and management of Chinese banks.

2. Reasons why banks are willing to expand business abroad

2.1. Internationalization of banks' clients

Back to 2006, the five state-owned commercial banks of China set up no more than 90 overseas institutions or branches [1]. By the end of 2006, the total overseas assets of the five state-owned commercial banks were 226.79 billion US dollars. The financial crisis sweeping the world in 2008 has provided great opportunities for China to move towards the world. Chinese enterprises have a good momentum of development overseas. At the same time, the acceleration of RMB internationalization process has also promoted the development of overseas business of Chinese banks.

In recent years, a large number of Chinese enterprises are deepening their transnational operation under the "Going-out Strategy" with our government's encouragement and stimulus such as export subsidies and facilitating conditions towards foreign investment. Moreover, this multinational trend is becoming more fiercely at a time when the Belt and Road Initiative is recognized as a global consensus.

It is reported that China's foreign direct investment is ranking the second largest in the world in 2018, reaching US $143.04 billion which is slightly lower than Japan (US $143.16 billion). China's influence in global foreign direct investment continues to expand down the road, it is estimated by experts that china will become the most powerful country that could attracts two-way flows of capital and investment during the next 10 years. Since the flow of capital between domestic and overseas markets depends on the financial system, Chinese banks are definitely willing to seize the business opportunities and step up overseas expansion through following their premium corporate and retail clients abroad.

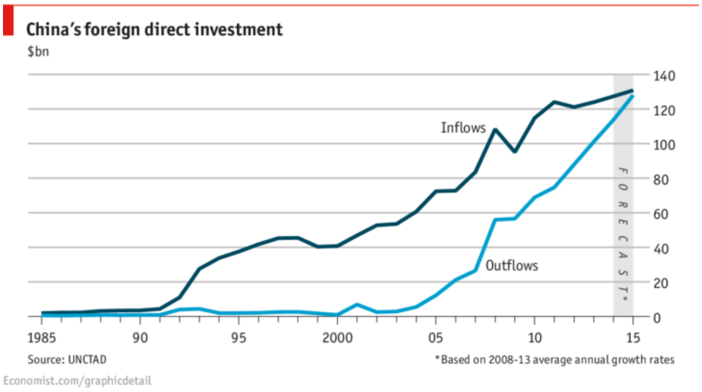

Figure 1 China's foreign direct investment

2.2. Inner necessity of bank's sustainable international development

The ability to participate in the international competition is considered to be the core competitiveness of banks according to the mainstream perspectives in the financial field. As is known to all, the globalization of asset allocation is a critical way to diversify risks and has long been realized within the world's major banks such as HSBC, Standard Chartered and JPMorgan Chase, whose profits come largely from foreign markets.

However, when it comes to Chinese banks, things are just the opposite. It is reported that, over the last ten years, Chinese banks completed more than 100 overseas mergers and acquisitions with billions of dollars. Although the overseas expansion continues to speed up, compared with the advanced foreign banks, the huge market value of Chinese banks is still disproportionate to the degree of their globalization. According to The Banker, a prestigious financial intelligence consulting firm based in UK, among the world's top 10 banks in 2019, the top four are all Chinese banks: Industrial and Commercial Bank of China (first), China Construction Bank (second), Agricultural Bank of China (third) and Bank of China (fourth), while the proportion of overseas business income of the top three banks in China is far behind the foreign banks as mentioned above, and only the overseas business profits of the fourth, Bank of China, was accounting for 29.86% of its group in 2017[2]. The internationalization process of Chinese banks is particularly in a primary stage and not on a par with the breadth of the out-going economy, and there is certainly an urgent need and press for Chinese banks to business expansion overseas so as to improve their global risk management level holistically.

In the future, with the increase of China's economic share in the world and the internationalization level of Chinese banks, it is estimated that there will have some multiple global full-functional banks with international business assets and profits accounting for about 50%, which is a surely an inevitable trend with our nation's rejuvenation in the world stage and growing influence of economic globalization. Meanwhile, the going-out and opening is complementary and a two-way journey, according to China Banking Regulatory Commission, banking assets of foreign banks are only accounting for 1.4% of China's total banking sectors in 2015, which proves from the opposite side that there is a huge potential for banks either from domestic or foreign markets to expand business in the bilateral markets.

Figure 2 Foreign banks in China

Moreover, with the weak growth of the project finance due to the impact of overcapacity in China these years, banks are beginning to turn to the foreign markets as the growth rate of profit in overseas business can keep double-digit speed, which is apparently become the real driving force for Chinese banks to speed up their overseas distribution.

3. Operational and managerial risks confronting by overseas Chinese banks

3.1. Risk of regulatory fines led by noncompliance

Although entering unfamiliar foreign markets could offer potential profit growth opportunities for Chinese banks, which means banks could make use of the advantage in RMB internationalization and the cross-border settlement and trade financing along with the promotion of Belt and Road Initiative. However, the standards and severity of regulatory requirements is unlikely to be uniform across countries, overseas institutions of Chinese banks must consistently enhance their internal risk control policies and procedures to ensure the daily executive activities to meet the external regulatory requirements, the focus of Chinese banks needs to shift more from expanding business to effective operational and managerial risk control [3].

The costs of inadequate operational and managerial risk control can be enormous overseas, once banks been identified irregularities, not only did the hard-earned money will be confiscated as a fine, but also the banks will be faced a great reputation loss, which is invisible and hard to recover. Although Chinese banks are still in the early stage of overseas expansion, they have suffered lots of setbacks in supervision. For instance, in November 2016, the New York branch of Agricultural Bank of China was ordered by the local banking regulator to pay a US$215 million penalty because of its poor anti-money laundering policies and internal controls [4]. In 2018, South Africa's central bank had fined China Construction Bank 75 million rand ($6 million) for non-compliance with the country's financial intelligence act. In 2017, the Commission de Surveillance du Secteur Financier (CSSF) in Luxembourg had imposed a record-high fine of more than €3.7m on Industrial and Commercial Bank of China, due to the bank's massive misconduct and serious violations of the regulations.

To some extent, it is maybe a necessary process for Chinese banks which pushing forward the internationalization strategy to encounter with the "money laundering dilemma" overseas. However, it also reflects that the relevant departments and institutions are not sensitive to the evolution trend of global banking supervision, exposing too much of their shortcomings and defects in compliance field, system construction, regulation enforcement, monitoring system and other aspects.

3.2. Country risk arised from international politics

With China's national rejuvenation and economic rise, hegemony led by some western countries and begin to rise in an increasingly unfriendly way. For example, 80% of the world's international trade is settled in U.S. dollars, the clearing system of which is under the jurisdiction of the U.S. government, who is accustomed to cite its domestic law and imposed sanctions on financial institutions [5]. For example, in 2012, Kunlun bank, controlled by the financial part of a Chinese state energy group, had been sanctioned by the U.S. government. A spokesman for China's foreign ministry once expressed strong dissatisfaction and firm opposition to this in a statement because the sanction is seriously violating the norms of international relations and harming China's interests.

Under the environment of trade tension between China and U.S., to some extent, Chinese banks that operating overseas are currently very apt to be focused and questioned by the some uncertain purpose from America and its allies. Since the U.S. dollar clearing transactions of individuals or institutions will be subject to strict review by the American government, which has the leverage to impose sanction on the subjected transactions, such as denial of service or even frozen or confiscate the money. For example, the recent various restrictions on Huawei levied by the U.S. government [6]. Therefore, all overseas Chinese banks should always keep vigilant in terms of compliance and target to improve the internal risk control and management, especially the compliance level, so as to cope with the uncertain external situation.

3.3. Lack of adequate compliance mindset and awareness

Nowadays, with the economic slowdown and the intensified competition in various industries, the risk factors caused and conducted by the economic downturn are increasingly prominent, and the competition among banks is increasing, so banks are facing more challenges and uncertainties. The banking circles at home and abroad is paying close attention to the huge loss caused by operational and managerial risks. However, compared to foreign banks, China's commercial banks' risk control culture is a little behind, and there is a big gap in management level.

Moreover, due to special historical reasons, China's commercial banks did not pay much attention to compliance independence in the past, and the compliance function was always placed under the risk department or others. Even some major state-owned banks have set up their independent compliance department only in recent years. With an inertial thinking formed domestically and a target to expand business in foreign markets, the bank's management members sometimes are apt to adopt profit-focus strategy and oversight the critical role that the compliance department is playing in the business sustainable development[7].

Last but not least, although overseas businesses of Chinese banks are mostly still in the service of Chinese out-going companies, the fast growing of offshore RMB market has brought opportunities for banks to diversify product types and market counterparties overseas, which injects new trends into the overseas business expansion of Chinese banks and also rises challenges for transnational operations and management.

4. Measures to improve operations and management of overseas Chinese banks

4.1. Attach great importance to the independence of compliance management

Compliance risk is mainly caused by the bank's violation of external regulations, industry standards and other external requirements, and the root of the problem is the illegality of the bank's daily operations and management. For example, banks with transnational operations are facing the dual regulatory requirements either from the home country and the host country of their overseas business, as well as the gray area involved in the comprehensive operational and managerial innovations. Besides, some researches and developments of new products and new businesses exceed the regulatory requirements, which will also bring compliance risks to the banks [8]. It can be said that compliance risk is the most critical one confronting by the overseas operation of commercial banks, which should be paid enough and more attention to.

In order to comply with the regulations and supervisions from the external authorities and meet the best standards of the financial industry, overseas branches of Chinese banks could increase investments to the compliance department, and set up an independent Compliance and Risk Control Committee, which reports only to the management, to fully address and manage the new and unfamiliar risks associated with the foreign markets. Meanwhile, the local management members should implement the unified decision of the Committee to prevent individuals from taking the place of collective decision-making to strike an effective checks and balances between the compliance and business expansion.

Besides, according to the best practices publicized by some of the western regulators, the overseas Chinese banks may try to establish a special institution or designate an internal department to take charge of the anti-money laundering responsibilities, such a framework of anti-money laundering is believed to minimize the profit-focused factors of business units from having interference and impacts on anti-money laundering decisions towards specific suspicious transactions [9]. Moreover, this structural specialization could finally enhance the compliance management of the overseas institutions by ensuring that there is an independent sub-department to perform the anti-money laundering functions without interfering.

4.2. Pay close attention to cultivate a healthy risk-prevention culture

As big as enterprise-wide decision, as slightly as daily email, the controlling of risk is ubiquitous. According to Basel Committee, there are three lines of defense of a bank's risk management. Likewise, in the banking industry practice, there is a widely recognized and used theory named three lines of defense of compliance, which comprehensively help banks to promote the compliance risk management inside of banks. The underlying spirit of the theory can be summarized as: compliance management is not just the responsibility of the compliance or risk control department, everyone in the bank bears his share of the responsibility for a safe and sound risk control and compliance framework.

To cultivate the risk-prevention culture among the employees is to increase their awareness of conscientiousness is the basis for the risk-control mechanism’s running well. Particularly in the business units that are considered to be the first line of defense of internal control and compliance in the overseas institutions. At this regard, I highly recommend overseas Chinese banks to establish a compliance representation mechanism among their business units, which is believed to be great help for the bank to cultivate the general compliance culture efficiently by strengthening the links between the front line and back-office departments. Subsequently, under the guidance of compliance culture, relationship managers from different business units are surely will change their attitude towards risk control and management from “wanting me to do” to “I want to do” in the future.

4.3. Keep meticulously manner on the internalization of regulations

In the internal structure of Chinese banks, the internal control and compliance department and the risk department are jointly responsible for cultivating the risk compliance culture and ensuring the proper behavior of the bank, which is also recognized as the focus of external supervision and inspection when operating overseas. Therefore, the internalization of the regulatory requirements is the cornerstone of a bank’s compliance operation. In this regard, banks should first master the regulatory rules through classification, deciding which one is belong to the local laws and regulations and which are the industry guidelines. As for the regulatory rules in the form of laws and regulations, banks should follow them in a meticulously manner, for the ones pertaining industry guidelines such as some best practices publicized by foreign regulators, banks should organize staffs to keep leaning from and absorb the achievable part into internal framework.

Since compliance is the critical part of a bank’s risk management operating overseas, a special team should be designated in overseas Chinese banks to shoulder the major task of the policy and procedure development inside of the compliance department. Among all the compliance policies and procedures, the sanction issue related anti-money laundering is always considered to be the focus and stringent part of regulatory concerns. Basically, the designated team has to pay close attention to the new sanction list from the international organizations such as UN (the United Nations), OFAC (the Office of Foreign Assets Control of the US Department of the Treasury) and

EU (the European Union), as well as the new compliance related requirements from the local regulators, especially those regarding the anti-money laundering issues[10].

Combined with the bank's internal practice and new external regulations, new implement details or amendments of existing policy and procedures across the bank should be made and published to all as soon as possible. Afterwards, in order to make it easier to understand and better implement among all employees in the bank, the team could organize some training with the division head or the department head to be the principal speaker, which will be an effective way to promote learning through lectures.

4.4. Draw particular emphasis on the communication with regulators

Continuous and good regulatory communication is very important for banks operating overseas. By keeping close contact with the local supervision, banks can get the focus of supervision previously so as to conduct self-examination from the bank's perspective in advance, ensuring that there is no violation of external regulations. Moreover, maintain a good regulatory communication can help banks to resolve potential regulatory risks and obtain timely guidance from supervisors.

Overseas Chinese banks should pay close attention to the new trends and policies of the regulatory standards and communicate with the regulators periodically. When problems or potential violations of the regulations pertaining to compliance have been found by the regulators, the overseas Chinese bank institutions should Keep dynamic and adjustable to the regulator's most updated requirement and confront the issues arised instead of avoiding, and make sure to find the positive way to solve the tough situation that maybe lead to a severe punishment [11]. Under no circumstance can the overseas institutions conceal the details by deliberately deceiving the investigators. By doing this, banks may maintain a timely and effective communications with the external regulators either in the management or the operational level.

4.5. Increase the investment in the excellent employees

The future competition is the competition of talents. With the regulations in the foreign markets are increasingly stringent, the lack of adequate and experienced staffs in the field of risk management and compliance has become a common phenomenon among the overseas Chinese banks. Therefore, the management of the banks should adopt diversified measures to overhaul and improve the selection and appointment mechanisms by uplifting the welfare of first class talents and getting through their professional ceilings to create a pragmatic, inclusive and cooperative internal culture with trust and authorization, which will surely help the overseas excellent employees adapt themselves quickly to the Chinese bank's culture and enhance their loyalty.

5. Conclusion

As is shown in this research, problems arising in the international process of Chinese banks should be taken seriously and resolved thoroughly, especially those related with overseas compliance management and risk control must be treated prudently. In order to achieve the effect of "throwing a brick and attracting jade", some countermeasures targeted to address the issues have been put forward at the end of the research. Even though in reality, there are lots of difficulties with Chinese banks going abroad, we are still pleased to see that with the continuous internationalization of banking industry in China, the awareness of compliance and risk management is increasingly growing, which I do believe is the essential element that can help the Chinese banks participate in the international competition deeply and make full use of foreign markets to achieve healthy and sustainable development in the future.

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