

FEDERAL RESERVE SYSTEM

China Merchants Bank Co., Ltd.
Shenzhen, People's Republic of China

Order Approving Establishment of a Branch

China Merchants Bank Co., Ltd. ("CMB"), Shenzhen, People's Republic of China, a foreign bank within the meaning of the International Banking Act ("IBA"), has applied under section 7(d) of the IBA¹ to establish a branch in New York, New York. The Foreign Bank Supervision Enhancement Act of 1991, which amended the IBA, provides that a foreign bank must obtain the approval of the Board to establish a branch in the United States.

Notice of the application, affording interested persons an opportunity to comment, has been published in a newspaper of general circulation in New York, New York (*New York Post*, March 7, 2007). The time for filing comments has expired, and the Board has considered all comments received.

CMB, with total assets of approximately \$145.6 billion, is the sixth largest bank in China.² CMB is indirectly controlled by the Government of China through a number of wholly owned companies. One of these companies, China Merchants Group, Limited, Shenzhen, People's Republic of China, indirectly owns approximately 17.6 percent of CMB's total outstanding shares.³ Two other government-owned companies, China Ocean Shipping (Group) Company and China Shipping (Group) Company, own 6.4 percent and 5.4 percent, respectively, of the

¹ 12 U.S.C. § 3105(d).

² Asset and ranking data are as of June 30, 2007.

³ China Merchants Group Limited has six director interlocks with CMB and is considered to control CMB for purposes of the Bank Holding Company Act. 12 U.S.C. § 1841 et seq.

shares of CMB. No other shareholder owns more than 5 percent of the shares of CMB.

CMB engages primarily in corporate and retail banking and treasury operations throughout China and operates a branch and an investment advisor subsidiary in Hong Kong. In the United States, CMB operates a representative office in New York. CMB would be a qualifying foreign banking organization under Regulation K.⁴

The proposed New York branch would engage in wholesale deposit-taking, lending, trade finance, and other banking services. Under the IBA and Regulation K, in acting on an application by a foreign bank to establish a branch, the Board must consider whether (1) the foreign bank engages directly in the business of banking outside the United States; (2) has furnished to the Board the information it needs to assess the application adequately; and (3) is subject to comprehensive supervision on a consolidated basis by its home country supervisors.⁵ The Board also considers additional standards as set forth in the IBA and Regulation K.⁶

⁴ 12 CFR 211.23(a). China Merchants Group Limited and CMB would also together meet the standards to be a qualifying foreign banking organization.

⁵ 12 U.S.C. § 3105(d)(2); 12 CFR 211.24. In assessing this standard, the Board considers, among other indicia of comprehensive, consolidated supervision, the extent to which the home country supervisors: (i) ensure that the bank has adequate procedures for monitoring and controlling its activities worldwide; (ii) obtain information on the condition of the bank and its subsidiaries and offices through regular examination reports, audit reports, or otherwise; (iii) obtain information on the dealings with and relationship between the bank and its affiliates, both foreign and domestic; (iv) receive from the bank financial reports that are consolidated on a worldwide basis or comparable information that permits analysis of the bank's financial condition on a worldwide consolidated basis; (v) evaluate prudential standards, such as capital adequacy and risk asset exposure, on a worldwide basis. No single factor is essential, and other elements may inform the Board's determination.

⁶ 12 U.S.C. § 3105(d)(3)-(4); 12 CFR 211.24(c)(2).

The IBA includes a limited exception to the general standard relating to comprehensive, consolidated supervision.⁷ This exception provides that, if the Board is unable to find that a foreign bank seeking to establish a branch, agency, or commercial lending company is subject to comprehensive supervision or regulation on a consolidated basis by the appropriate authorities in its home country, the Board may nevertheless approve the application if: (i) the appropriate authorities in the home country of the foreign bank are actively working to establish arrangements for the consolidated supervision of such bank; and (ii) all other factors are consistent with approval.⁸ In deciding whether to exercise its discretion to approve an application under authority of this exception, the Board must also consider whether the foreign bank has adopted and implemented procedures to combat money laundering.⁹ The Board also may take into account whether the home country of the foreign bank is developing a legal regime to address money laundering or is participating in multilateral efforts to combat money laundering.¹⁰ This is the standard applied by the Board in this case.

As noted above, CMB engages directly in the business of banking outside the United States. CMB also has provided the Board with information necessary to assess the application through submissions that address the relevant issues.

Based on all the facts of record, the Board has determined that CMB's home country supervisory authority is actively working to establish arrangements for the consolidated supervision of CMB and that considerations relating to the steps taken by CMB and its home jurisdiction to combat money laundering are consistent with approval under this standard. The China Banking Regulatory Commission

⁷ 12 U.S.C. § 3105(d)(6).

⁸ 12 U.S.C. § 3105(d)(6)(A).

⁹ 12 U.S.C. § 3105(d)(6)(B).

¹⁰ Id.

(“CBRC”) is the principal supervisory authority of CMB, including its foreign subsidiaries and affiliates, for all matters other than laws with respect to money laundering.¹¹ The CBRC has the authority to license banks, regulate their activities, and approve expansion, both domestically and abroad. It supervises and regulates CMB, including its subsidiaries and overseas operations, through a combination of targeted on-site examinations and continuous consolidated off-site monitoring. Since its establishment in 2003, the CBRC has enhanced existing supervisory programs and developed new policies and procedures designed to create a framework for the consolidated supervision of banks in China.

On-site examinations by the CBRC cover, among other things, the major areas of banks’ operations: corporate governance and senior management responsibilities, capital adequacy, asset structure and asset quality (including structure and quality of loans), off-balance-sheet activities, earnings, liquidity, liability structure and funding sources, expansionary plans, internal controls (including accounting control and administrative systems), legal compliance, accounting supervision and internal auditing (including accounting control and administrative systems), and any other areas deemed necessary by the CBRC.

Off-site monitoring is conducted through the review of required annual, semiannual, quarterly, or monthly reports on, among other things, asset quality, capital adequacy, liquidity, corporate governance, affiliate transactions, and internal controls.

¹¹ Before April 2003, the People’s Bank of China (“PBOC”) acted as both China’s central bank and primary banking supervisor, including with respect to anti-money laundering matters. In April 2003, the CBRC was established as the primary banking supervisor and assumed the majority of the PBOC’s regulatory functions. The PBOC maintained its roles as China’s central bank and primary supervisor for anti-money laundering matters.

CMB is required to be audited annually by an accounting firm approved by the PBOC, and the results are shared with the CBRC and the PBOC. The scope of the required audit includes a review of CMB's financial statements, asset quality, and internal controls. The CBRC may order a special audit at any time. In addition, in connection with its listing on the Shanghai and Hong Kong stock exchanges, CMB is required to have external audits conducted under both International Financial Reporting Standards and generally accepted accounting practices under Chinese law. CMB is required to publish its financial statements annually. CMB conducts internal audits of its offices and operations, including its overseas operations, generally on an annual schedule. The internal audit results are shared with the CBRC, the PBOC, and CMB's external auditors. The proposed branch would be subject to internal audits.

Chinese laws impose various prudential limitations on banks, including limits on transactions with affiliates and large exposures. The CBRC is authorized to require any bank to provide information and to impose sanctions for failure to comply. The CBRC also has authority to impose administrative penalties, including warnings, fines, and removal from office, for violations of applicable laws and rules. Criminal violations are transferred to the judicial authorities for investigation and prosecution.

In recent years, the Chinese government has enhanced its anti-money laundering regime. In 2005, the Chinese government took initial steps to adopt an anti-money laundering law, the PRC Anti-Money Laundering Law ("AML Law"). The AML Law and two related rules, the Rules for Anti-Money Laundering by Financial Institutions ("AML Rules") and the Administrative Rules for the Reporting of Large-Value and Suspicious Transactions by Financial Institutions ("LVT/STR Rules") were enacted in October 2006 and December 2006, respectively. The AML Law and AML Rules became effective on January 1, 2007, and the LVT/STR Rules became effective on March 1, 2007. Together, the law and two related rules establish a regulatory infrastructure to assist China's anti-money laundering effort.

An Anti-Money Laundering Bureau (“AML Bureau”) was established within the PBOC in 2003.¹² The AML Bureau coordinates anti-money laundering efforts at the PBOC and among other agencies. The AML Bureau also supervised the creation in September 2004 of the China Anti-Money Laundering Monitoring and Analysis Center (“AML Center”). The AML Center collects, monitors, analyzes, and disseminates suspicious transaction reports and large-value transaction reports. The AML Center sends suspicious transaction reports to the AML Bureau for further investigation. The PBOC issued additional rules in June 2007 providing clarification on reporting suspicious transactions to the AML Center and on customer due diligence and recordkeeping.

China participates in international fora that address the prevention of money laundering and terrorist financing. China is a member of the Financial Action Task Force (“FATF”)¹³ and is a party to the 1988 U.N. Convention Against the Illicit Traffic of Narcotics and Psychotropic Substances, the U.N. Convention Against Transnational Organized Crime, the U.N. Convention Against Corruption, and the U.N. International Convention for the Suppression of the Financing of Terrorism.

As noted, the PBOC is China’s primary supervisor for anti-money laundering matters. Like the CBRC, the PBOC supervises and regulates CMB through a combination of on-site examinations and off-site monitoring. On-site examinations focus on CMB’s compliance with anti-money laundering laws and rules, including the AML Law and the AML and LVT/STR Rules. Off-site monitoring is conducted through the review of periodic reports. In performing its responsibilities, the PBOC may require any bank to provide information and can impose administrative penalties for violations of applicable laws and rules.

¹² The AML Bureau conducts administrative investigations and handles violations of AML Rules. Money laundering cases are referred to the Ministry of Public Security, China’s main law enforcement body, for investigation and prosecution.

¹³ China became a member of FATF in June 2007.

CMB has policies and procedures to comply with Chinese laws and rules regarding anti-money laundering. CMB has represented that it has taken additional steps on its own initiative to combat money laundering and other illegal activities. CMB states that it has implemented measures consistent with the recommendations of FATF and that it has put in place policies, procedures, and controls to ensure ongoing compliance with all statutory and regulatory requirements, including designating anti-money laundering officers and conducting employee training at the head office, branch, and sub-branch levels. CMB's compliance with anti-money laundering requirements is monitored by the PBOC and by CMB's internal and external auditors.

The Board also has taken into account the additional standards set forth in section 7 of the IBA and Regulation K.¹⁴ The CBRC has no objection to CMB's establishment of the proposed branch.

The Board has also considered carefully the financial and managerial factors in this case. China has adopted risk-based capital standards that are consistent with those established by the Basel Capital Accord ("Accord"). CMB's capital is in excess of the minimum levels that would be required by the Accord and is considered equivalent to capital that would be required of a U.S. banking organization. Managerial and other financial resources of CMB are consistent with approval, and CMB appears to have the experience and capacity to support the proposed branch. In addition, CMB has established controls and procedures for the proposed branch to ensure compliance with U.S. law. In particular, CMB has stated that it will apply

¹⁴ See 12 U.S.C. § 3105(d)(3)-(4); 12 CFR 211.24(c)(2). The additional standards set forth in section 7 of the IBA and Regulation K include the following: whether the bank's home country supervisor has consented to the establishment of the office; the financial and managerial resources of the bank; whether the appropriate supervisors in the home country may share information on the bank's operations with the Board; whether the bank and its U.S. affiliates are in compliance with U.S. law; the needs of the community; the bank's record of operation.

strict anti-money laundering policies and procedures at the branch consistent with U.S. law and regulation and will establish an internal control system at the branch consistent with U.S. requirements to ensure compliance with those policies and procedures.

With respect to access to information about CMB's operations, the Board has reviewed the restrictions on disclosure in relevant jurisdictions in which CMB operates and has communicated with relevant government authorities regarding access to information. CMB has committed to make available to the Board such information on the operations of CMB and any of its affiliates that the Board deems necessary to determine and enforce compliance with the IBA, the Bank Holding Company Act, and other applicable federal law. To the extent that the provision of such information to the Board may be prohibited by law or otherwise, CMB has committed to cooperate with the Board to obtain any necessary consents or waivers that might be required from third parties for disclosure of such information. In light of these commitments and other facts of record, and subject to the condition described below, the Board has determined that CMB has provided adequate assurances of access to any necessary information that the Board may request.

On the basis of all the facts of record, and subject to the commitments made by CMB, as well as the terms and conditions set forth in this order, CMB's application to establish a branch is hereby approved. Should any restrictions on access to information on the operations or activities of CMB and its affiliates subsequently interfere with the Board's ability to obtain information to determine and enforce compliance by CMB or its affiliates with applicable federal statutes, the Board may require termination of any of CMB's direct or indirect activities in the United States. Approval of this application also is specifically conditioned on compliance by CMB with the commitments made in connection with this application

and with the conditions in this order.¹⁵ The commitments and conditions referred to above are conditions imposed in writing by the Board in connection with its decision and may be enforced in proceedings under 12 U.S.C. § 1818 against CMB and its affiliates.

By order of the Board of Governors,¹⁶ effective November 8, 2007.

(signed)

Robert deV. Frierson
Deputy Secretary of the Board

¹⁵ The Board's authority to approve the establishment of the proposed branch parallels the continuing authority of the State of New York to license offices of a foreign bank. The Board's approval of this application does not supplant the authority of the State of New York or its agent, the New York State Banking Department ("Department"), to license the proposed office of CMB in accordance with any terms or conditions that the Department may impose.

¹⁶ Voting for this action: Chairman Bernanke, Vice Chairman Kohn, and Governors Warsh, Kroszner, and Mishkin.