

**Citi's
Online
Academy**



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Doing business in China

Brett Krause

China Head

Global Transaction Services

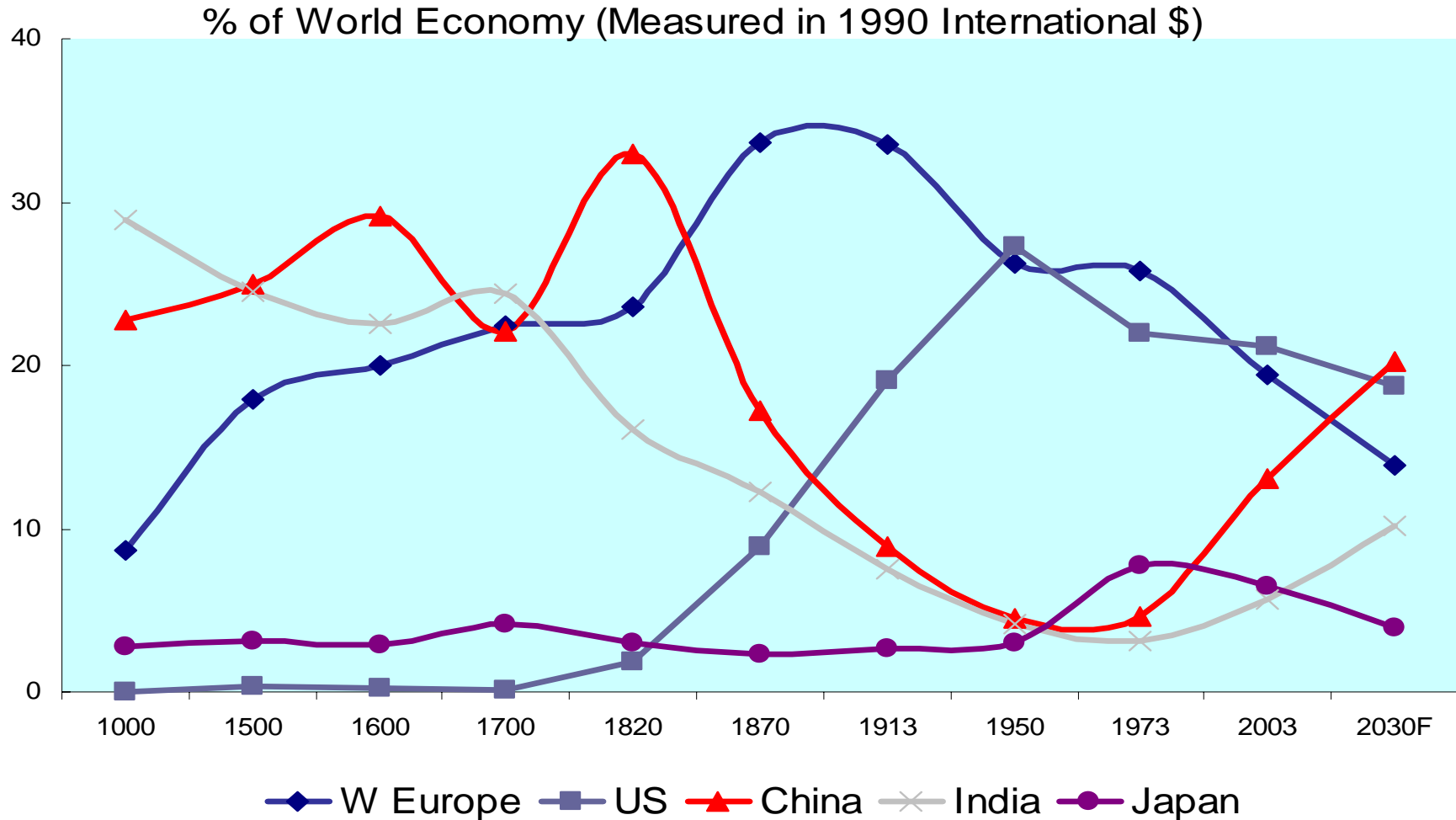
28 June, 2007



Agenda

- Key Macro Trends in China
- Chinese Banking Environment
- Regulatory and Tax Update
- Solutions Update
- Case Studies
- Q & A

China: Already 4th Largest World Economy

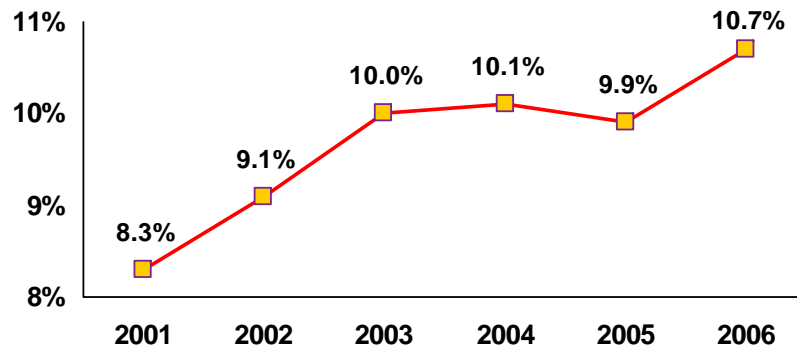


Source: Citi estimates based on original data from Angus Maddison, 2001, *The World Economy: A Millennial Perspective*, Development Research Center, OECD, Paris, and Angus Maddison, 2005, "The west and the rest in the world economy: 1500-2030", Australian National University, Canberra.

China's Sustained Economic Growth

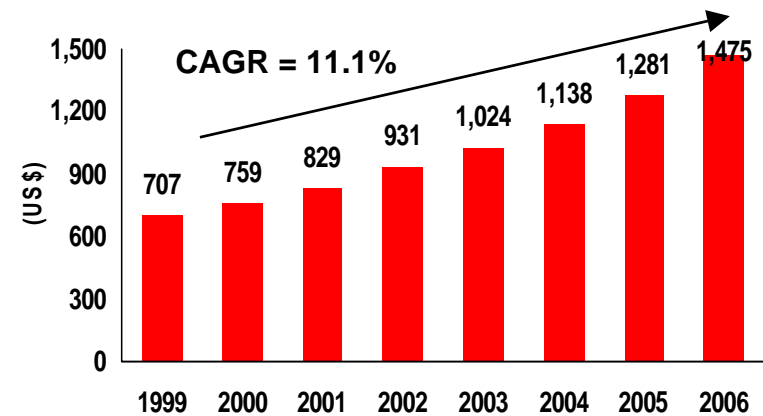
Strong GDP growth and income level is spurring rapid expansion in banking and other sectors

Strong GDP Growth



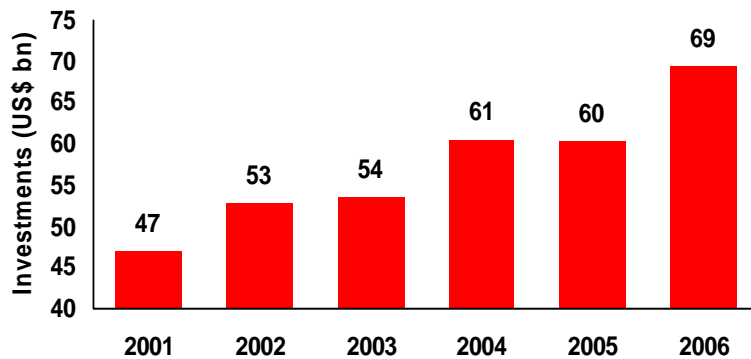
Source: National Bureau of Statistics of China

Disposable Income per Urban Capita



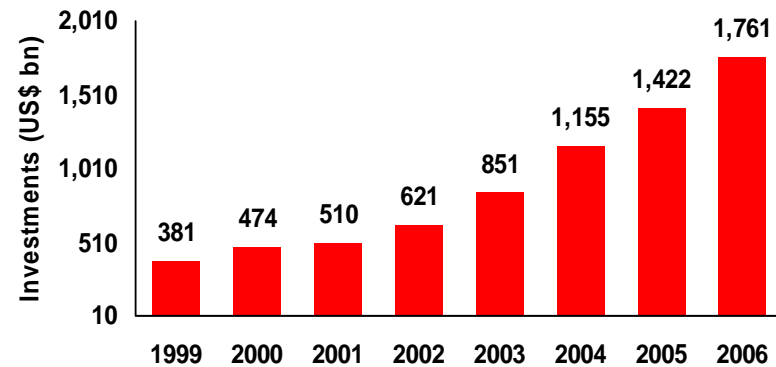
Source: China Almanac

Utilized Foreign Direct Investment



Source: National Bureau of Statistics of China

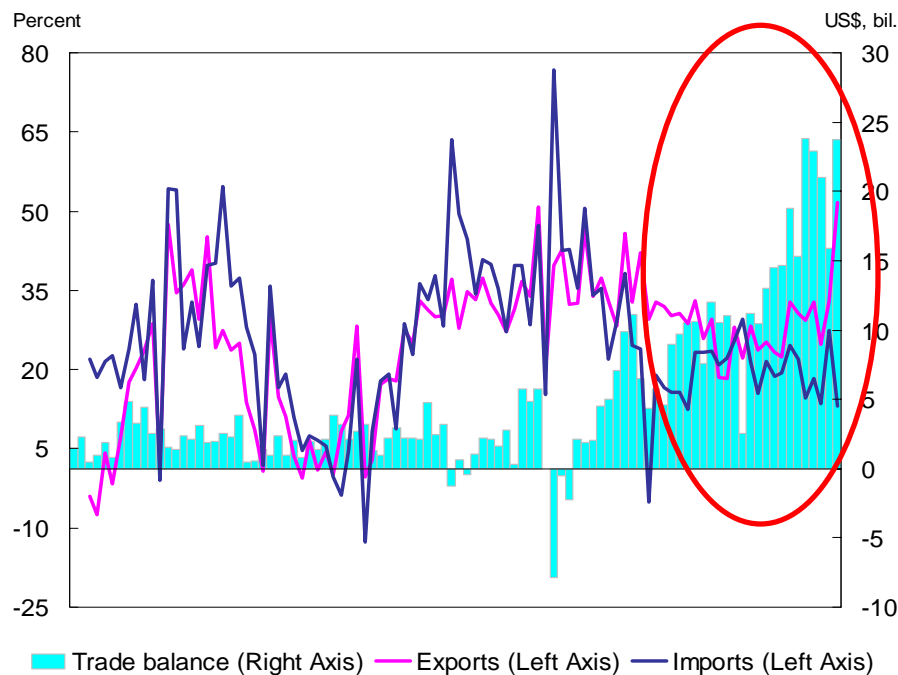
Aggregate Import and Export Volume



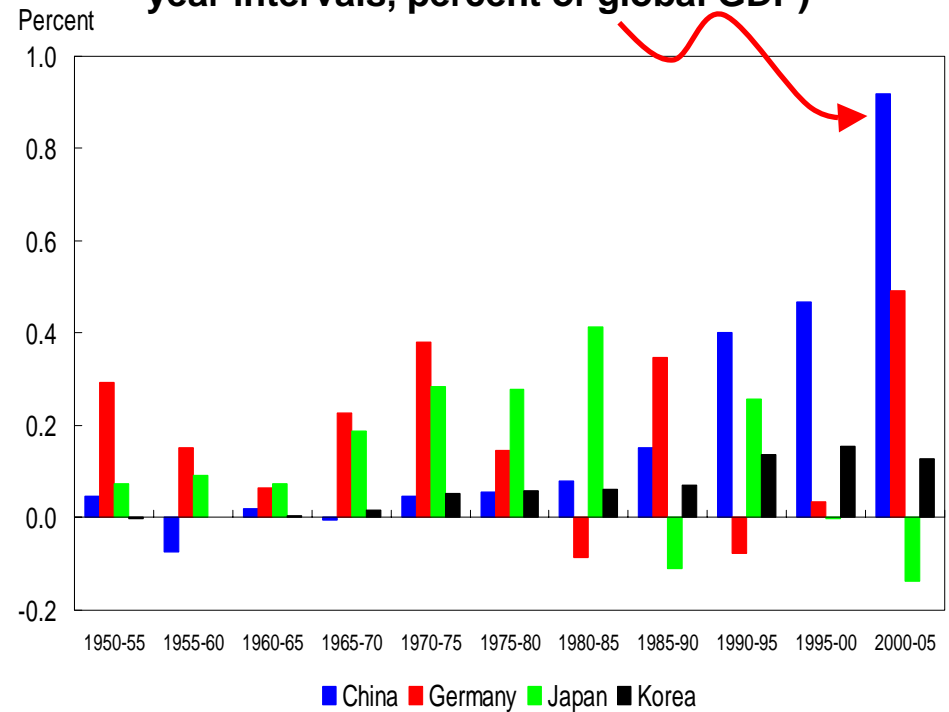
Source: China Statistic Yearbook

Balanced Trade Remains A Distant Goal

Trade Balance and Export/Import Growth



Change in the ratio of Exports from Individual Countries to Global GDP (five-year intervals, percent of global GDP)

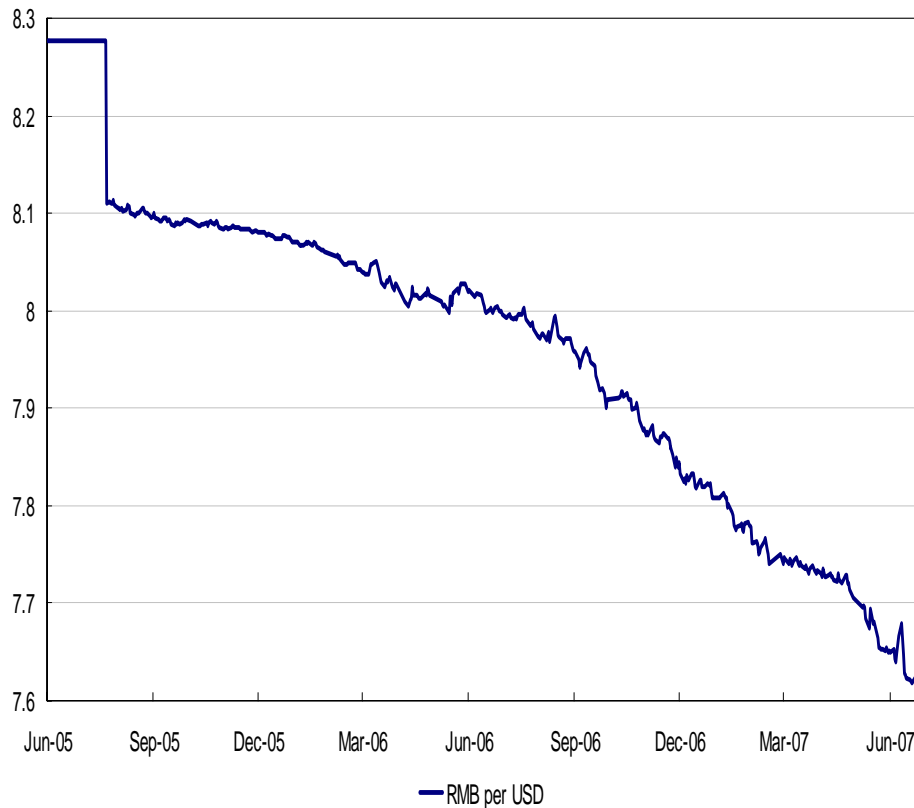


Source: Citi estimates using data from CEIC Data Company

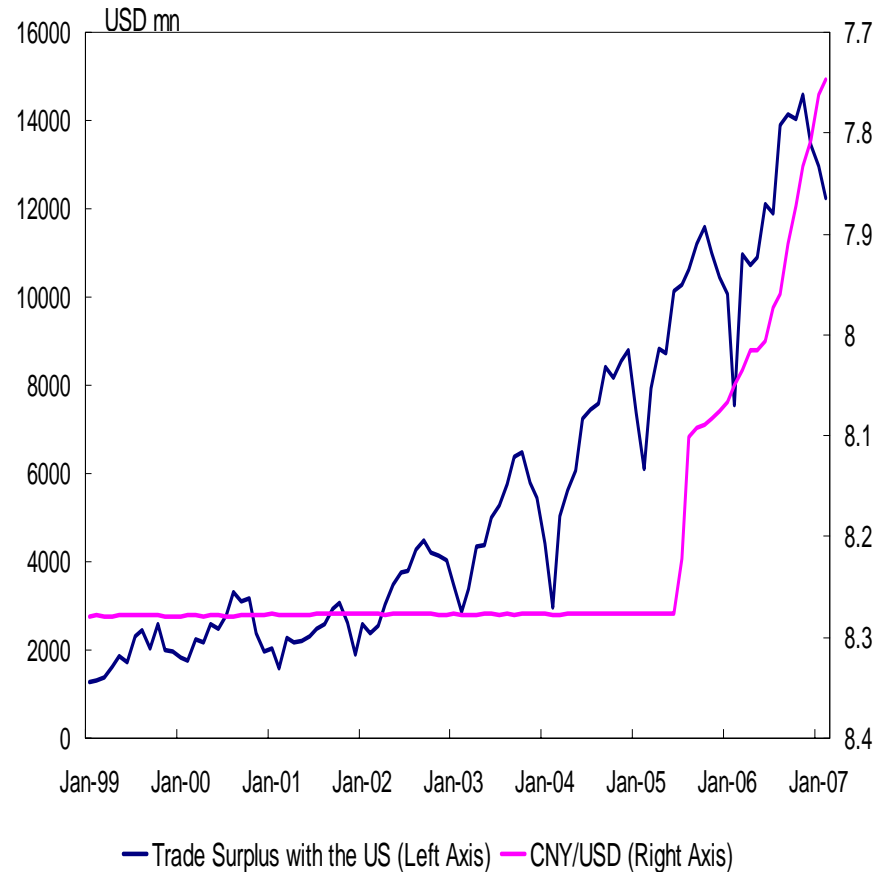
More Flexible FX Regime and RMB Gains



RMB/USD rates

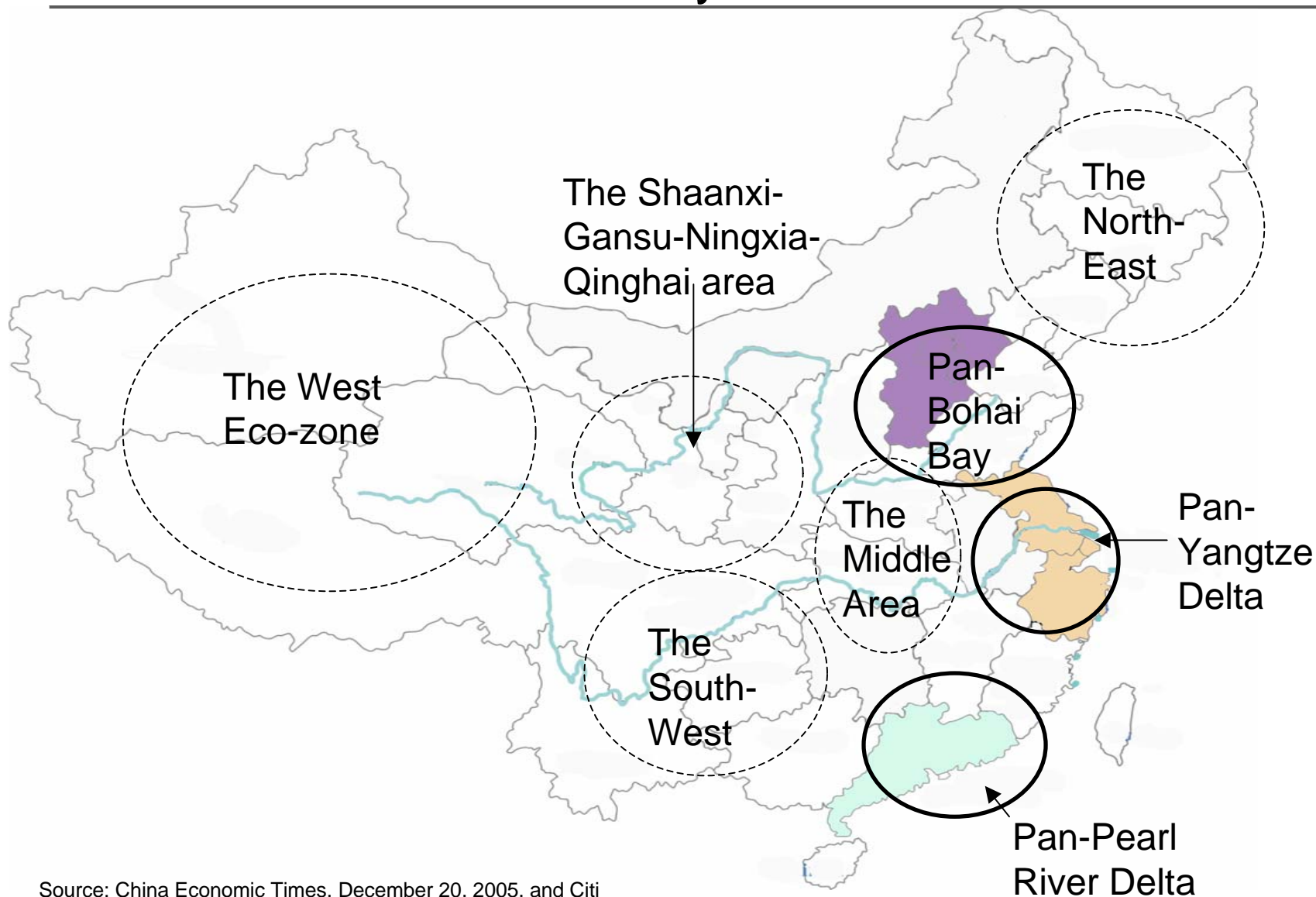


The Growth of Trade Surplus with the US Led Currency Appreciation



Sources: CEIC Data Company Limited, Reuters data

Investment Boom Will Likely Continue



Source: China Economic Times, December 20, 2005, and Citi

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Chinese Banking Environment



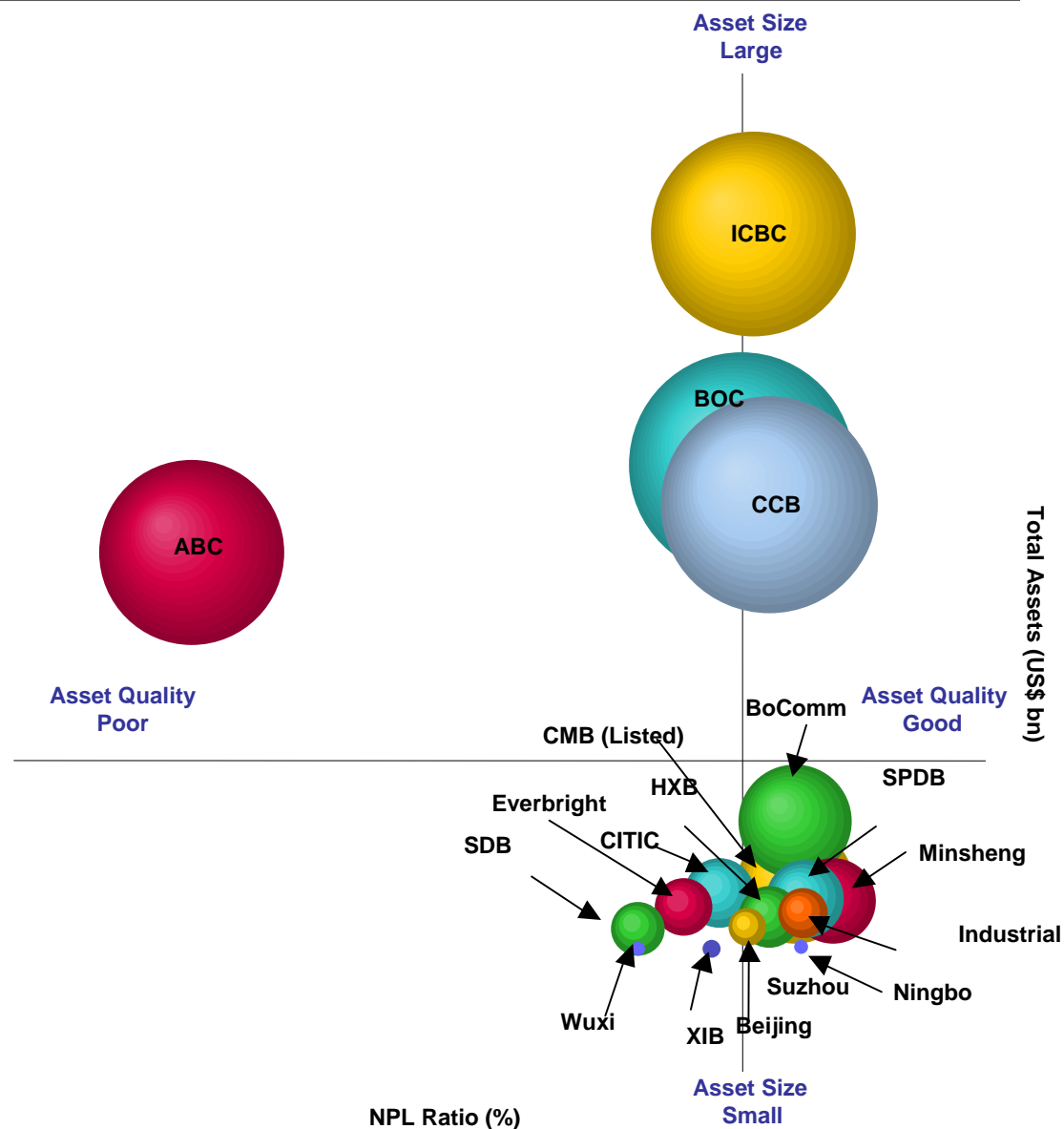
Banks

State Owned Commercial Banks (Big 4)	Industrial & Commercial Bank of China (ICBC), Agricultural Bank of China (ABC), Bank of China (BOC), China Construction Bank (CCB)
Joint Stock Commercial Banks (13 commercial banks)	Bank of Communications, China Merchants Bank, Shanghai Pudong Development Bank, CITIC, etc
City Commercial Banks	Guangzhou City Commercial Bank, Tianjin City Commercial Bank, etc
Locally Incorporated Foreign Banks	Citibank, Bank of East Asia, HSBC, SCB
Foreign Banks	JPM, Mizuho, Deutsche, ABN AMRO, etc.
Other	Policy banks, finance companies, postal savings, rural banks, etc

Chinese Banking Environment

Key Governing Bodies

- **Central Bank**
 - People's Bank of China (PBOC)
- **Banking Regulator**
 - China Banking Regulatory Commission (CBRC)
- **Foreign Currency Control**
 - State Administration of Foreign Exchange (SAFE)
- **Trade Legislation**
 - Ministry of Commerce (MOFCOM)
- **Securities Regulator**
 - China Securities Regulatory Commission (CSRC)



Clearing Infrastructure



Clearing Infrastructure	Information Exchange	Settlement Method
CNAPS (China National Advance Payment System) HVPS (High Value Payment System)	Electronic (Nationwide coverage since June '05)	On-line real-time settlement
CNAPS BEPS (Bulk Electronic Payment System)	Electronic Batch Settlement (Nationwide coverage since June '06)	3 times a day
GIRO (Intra-city paper funds transfer)	Paper based batch settlement	2 times a day
Big Four Bank Networks	Electronic and paper	2 ~ 3 batches a day
Check and Bank Draft	Paper based batch settlement	2 times a day
Nationwide Check Image Clearing System	PBOC Image System (Live in 6 pilot cities on December 18, 2006)	N.A
Foreign Currency Clearing System (Shanghai and Shenzhen)	Electronic	On-line Settlement

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Regulatory Principles

Regulatory Cornerstones: Foreign Currency

- **Managed Float of RMB FX Rate**
- **Current Capital Items: minimum limitation**
 - Ensure genuine transaction background for and tax fulfilment of foreign currency funds flow
- **Foreign Direct Investment (FDI) (including Foreign guarantee)**
 - Control of FDI (promoting, restricting or prohibiting industry sectors)
 - Approval required from Commerce Department and from SAFE to ensure transaction substance
- **Foreign Debt (including Foreign guarantee)**
 - Limitation: “total investment” minus “registered capital”
 - Approvals: National Development and Reform Commission for Medium and long term debt, and SAFE for short term debt

Regulatory Cornerstones: RMB

- **Local Currency Related**
 - Control of interest rate
 - Control of “physical cash” (notes) flow
 - Ensure genuine transaction background from corporate to individual funds flow

Regulatory Principles

Control via Account Structure

- **Foreign Currency**
 - Capital Account
 - Settlement Account
 - Loan Account (Loan proceeds to be credited to) /
Loan Repayment Account (in certain cities)
- **Local Currency**
 - Basic Account (Petty Cash, Salaries, Reimbursement, etc.)
 - General Account
 - Tax Account (required by certain local tax authorities)

Deregulation

• Key Objectives

- Release revaluation pressure on RMB by allowing funds to (temporarily) exit China
- Encourage multinational companies (MNC) to invest in China
- Facilitate MNCs to setup Regional Headquarters/Operations centers in China
- Support large Chinese corporations to expand overseas

• Key Actions

- Relax Foreign Currency Controls in many areas
- Ensure actions are taken carefully with a “pilot” approach

Key Areas Still Regulated

- PBOC fixed interest rates
- Standard transaction fees at or below cost
- New products need to be filed with and approved by CBRC
- All products touching foreign currency need SAFE approval
- All cross-border flows controlled and need supporting documents

RMB Lending Interest Rates

<u>Loan Tenor</u>	<u>Base Rates</u>
Below 6 months	5.85%
6 months ~ 1 year	6.57%
1 year ~ 3 years	6.75%
3 years ~ 5 years	6.93%
Over 5 years	7.20%

PBOC base rates can be marked down by commercial banks within 10%

RMB Deposit Interest Rates

<u>Deposit Tenor</u>	<u>Deposit Rates</u>
Current Account	0.72%
7 Day Call	1.62%
3 months	2.07%
6 months	2.61%
1 year	3.09%
2 years	3.69%
3 years	4.41%
5 years	4.95%

Recent Regulatory and Legal Changes

Banking Reform

- China has, to a large extent, recapitalized and completed IPOs of the big five state-owned banks (except Agricultural Bank of China) and is in the process of implementing additional corporate governance and risk management measures
- Opening up the market to foreign and domestic investors
- Accelerating bond market development in particular for corporate bonds
- NPL in China's banking sector, although declining, is still an issue
- The next phase of the reform will be focused on the smaller ~115 city commercial banks that operate in different cities in China

Local Incorporation (Apr 07)

- First batch of foreign banks (Citi, HSBC, SCB, Bank of East Asia) have completed the subsidiarization exercises and commenced business as locally incorporated banks in China on April 2, 2007
- Second batch of foreign banks are currently going through the subsidiarization process

Anti-Money Laundering Law (Jan 07)

- Expands to cover securities companies, insurance companies and other non-bank financial institutions
- The definition of money laundering is expanded to include corruption and bribe-taking, violating financial management regulations and financial fraud
- Starting from November 1, 2007, all banks need to report large value and suspicious activities based on the new reporting criteria

Trust Companies

- Establishes corporate governance structures
- Allows qualified investors with minimum investment amount of RMB 1MM to invest in trust schemes; the maximum number of investors in one trust scheme is 200

Bankruptcy Law (Aug 06)

- Expands the scope of application from SOEs to FIs, non-SOEs, and foreign-invested enterprises, and to the bankrupt entity's overseas assets outside China
- Introduces a new role of "administrator", and allows reorganization and reconciliation proceeding
- Enforces Close-out netting and set-off and provides administrator the right of termination and cherry-picking

Property Law (Mar 07)

- For the first time, expressly enshrines private property ownership and the rights of private property owners
- The state is to ensure and protect equal legal positions and development rights of all market participants and no violation by any unit of the state, company, other organization or individual is allowed

Recent Regulatory and Legal Changes

Derivatives Market

- RMB/FX forward and swap were introduced to China's onshore FX market in the last 2 years
- With the rapid growth of RMB/FX forward and swap markets, RMB/FX option is expected to receive regulatory approval and make its debut soon
- There is growing demand from our customers for Credit Default Swap. Citi China has submitted the application for Credit Default Swap to CBRC and SAFE for approval
- China is likely to launch stock index futures in the first half of 2007

QDII Regulation

- Expands the QDII scope to include investments in overseas stocks and equity-linked products (e.g., derivatives) in addition to fixed income securities
- Approved the launch of QDII business by Trust companies with registered capital of RMB 1Bn or more
- Regulators require commercial banks to play an advisory role vs. being a distribution agent

Futures Market

- Expands the scope of futures transactions to cover financial futures (e.g., stock index, interest rates) in addition to commodity futures
- Requires futures transactions be conducted in futures exchanges or other approved trading places
- Raises single shareholder's cap from 50% to 100%

ST Foreign Debt Quota (Mar 07)

- 2007 Short-Term Foreign Debt Quota (STFDQ) for foreign banks will be reduced to 60% from their 2006 quota, with an aim to reduce foreign debt
- The reduction will be implemented in 4 stages: 85% by June 30, 2007; 75% by September 30, 2007; 65% by December 31, 2007; and 60% by March 31, 2008
- SAFE will relax rules for banks to borrow RMB and convert into USD or via foreign-exchange swap in order to facilitate banks to borrow from local money market

Interest Rate / FX Policy

- Introduced SHIBOR in January 2007 (from O/N to one year) and continued to move towards a market-based interest rate system
- Marching towards a more flexible FX regime and liberal capital account (e.g., band widening, allowing corporates to execute net-settled forwards, introduce FXO)
- Better benchmark yield curve – MOF to start fixed schedule auctions for fixed tenor bonds

Consumer Banking Regulatory Framework

The regulatory framework for consumer banking post-WTO is still evolving

Branch Expansion

- Branch license subject to CBRC's discretionary approval
- Within a city, a new sub-branch can be applied for only after previous sub-branch is in full operation
- Different capital requirements apply to main and sub branches
- Defined qualifications for branch and sub-branch managers

Bank Cards

- ATM, credit and debit card issuances are now allowed after recent US-Sino SED talks, but details of new regulations are still unclear
- Citi submitted an application to issue ATM/debit cards in early June

Off-site ATM Expansion

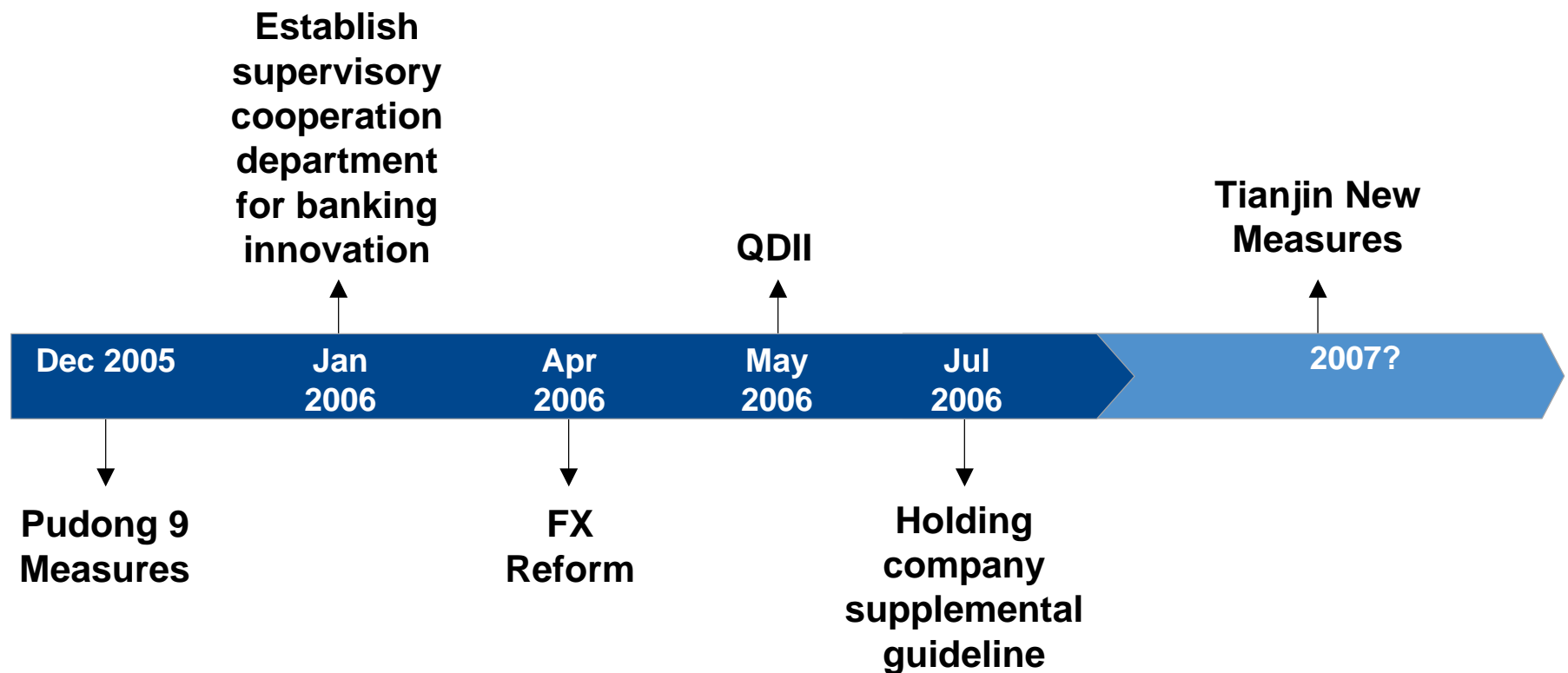
- All off-site ATMs require license approval from regulators. Off-site ATMs can be set up only in cities where branches are present. Only three off-site ATM licenses can be applied at one time per city.
- Stand-alone ATM kiosks are easier to get approved. ATM center licensing is equivalent to a sub-branch license approval – takes a long lead time for approvals

Interest Rate / Fees

- Deposit rates are capped – USD 1-year at 3.00%, RMB 1-year at 3.06%
- RMB asset rates are floored; for example, mortgage rates cannot be lower than 5.814%
- Credit card APR is regulated by CBRC at 0.05% per day (annual 18.25%)
- Tiered interchange for card issuers: 1.4% for hotels and restaurants, 0.7% for retail, 0.35% for hospitals and supermarkets; average is 0.7%

Key Deregulation Milestones

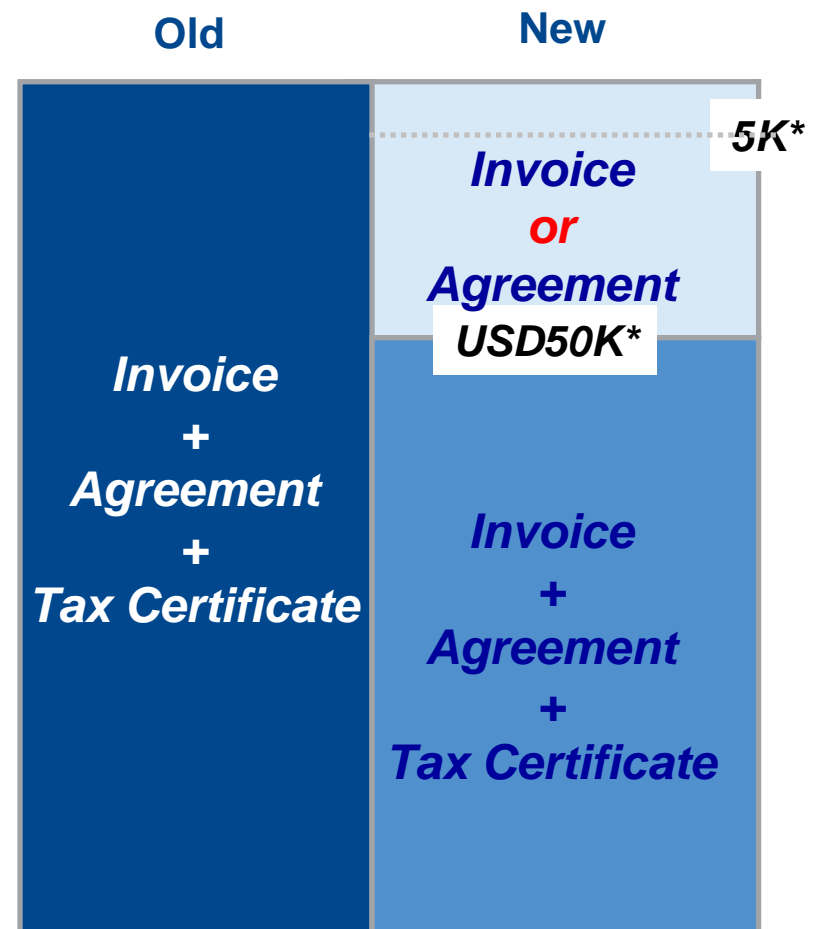
A number of FCY deregulations have occurred in 2006



Deregulation Example: Service Trade

Simplified Approval Process – non-listed Service Trade (for payments up to USD 100k)

Less Supporting Documents (for payments up to USD 50k)



* Threshold amounts

Corporate Tax Changes

National People's Congress approved and promulgated Corporate Income Tax Law (CIT), effective Jan 1, 2008	How will this impact Foreign Invested Enterprises (FIEs)
<ul style="list-style-type: none"> • Standardized tax rate from dual track corporate income tax to 25% • Unifies tax deductions and preferential treatment • Introduction of anti-avoidance provision • Limit the authorities of local governments in offering tax incentives 	<ul style="list-style-type: none"> • CIT enhanced competitiveness of domestic enterprises • Though CIT prohibits local governments from granting unauthorized tax incentives, it is still possible for FIEs to negotiate special deals. • Keep track of preferential policies to fully enjoy tax incentives • FIEs affected will enjoy a 5 years "grandfathering period."

Continue to consult your tax advisor for details

Corporate Tax Changes



Past Law	New Law
Tax holiday (2/3 holiday) for manufacturing FIEs	Removed
Extended tax holiday for export oriented FIEs	Removed
15%/24% rate applicable to FIEs in the specially designated economic zones	Removed
15% tax rate now applicable to high tech enterprises located in the national High-Tech Zones	To be expanded countrywide

Corporate Tax Changes



Industry / Sector	Tax Incentives under CIT
Small Enterprises with low profitability	Preferential tax rate of 20%
High-tech	Countrywide preferential tax rate of 15%
Agriculture, forestry, animal husbandry, fishery and State-encouraged infrastructure construction	Retention of preferential treatment – tax exemption or reduction
Venture capital investment in state encouraged investment	Tax deduction on portion of investment value
Encouraged industries in the Western region	Retention of preferential treatment
Environmental protection projects and eligible technology transfer	Tax exemption or reduction

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Hedging Solutions: CNY Forward



Source: Bloomberg, 27 June 2007

Citibank Forecast v.s. Forward Rates

Currency	Spot Jun 26 07	Q3 07		Q4 07		Q1 08		Q2 08	
		Forecast	Forward	Forecast	Forward	Forecast	Forward	Forecast	Forward
USD/CNY	7.62	7.41	7.52	7.27	7.43	7.18	7.35	7.10	7.25
EUR/CNY	10.20	10.02	10.13	9.97	10.04	9.92	9.94	9.66	9.84
GBP/CNY	15.13	14.91	15.00	14.85	14.79	14.52	14.58	14.20	14.38

Citibank Forecast as of June 25, 2007

Hedging Solutions: CNY Forward

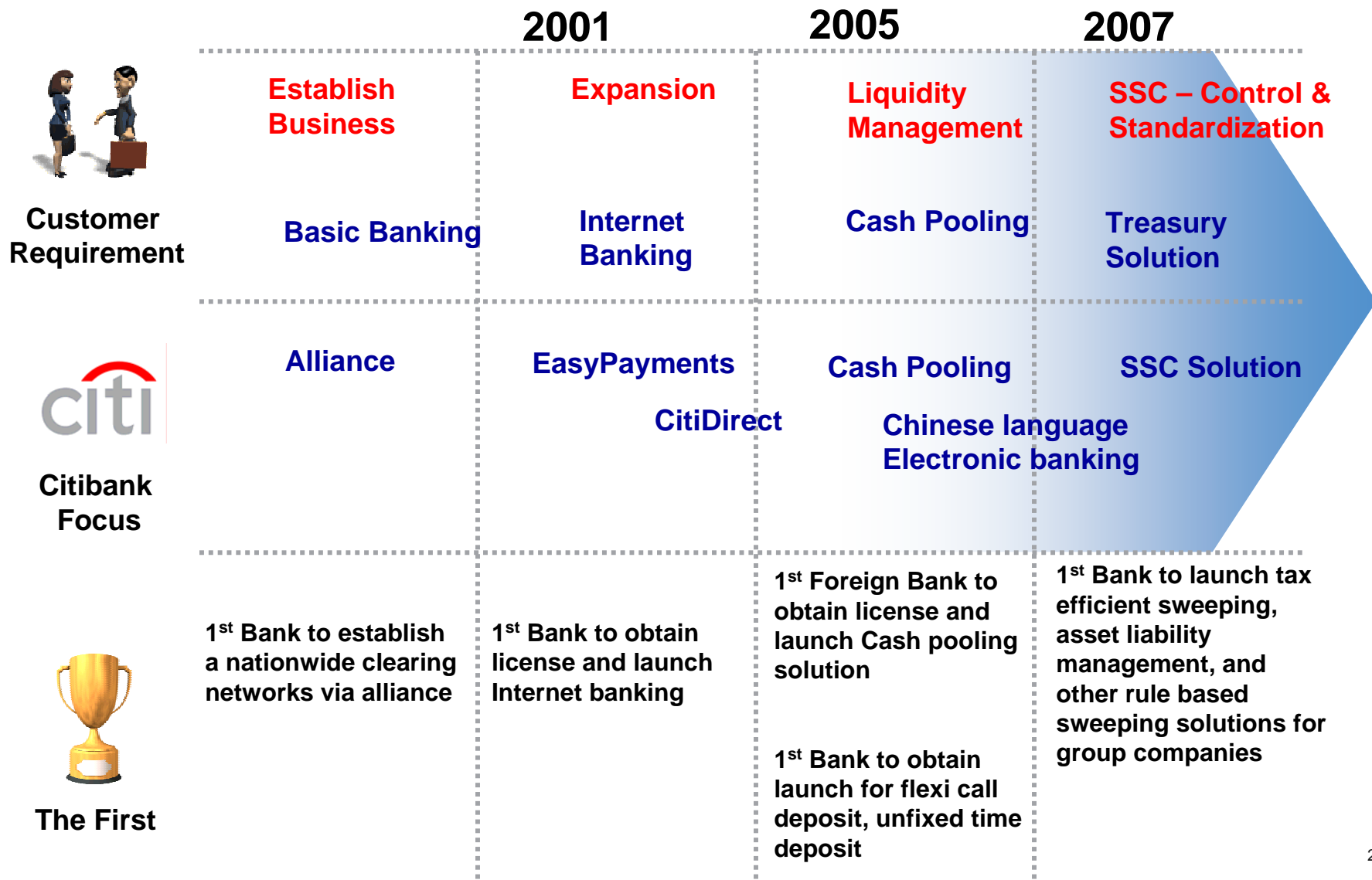
- Forward Hedging
 - Normal hedging environment
 - High trading volume in both Swap and Forward market

- Simplified Process
 - FX Master Agreement and Foreign Exchange account
 - No supporting documentation required on the FWD booking date, only upon settlement as per normal SPOT transactions

- Flexible Value Date
 - Fixed-Delivery-Date forward
 - Optional Forward transaction
 - Value date can be any working date within specific future period
 - Client can adjust the value date or amount through swaps based on genuine background

- Trading details
 - Currencies versus CNY: USD, EUR, HKD, JPY, AUD, GBP, CAD, CHF
 - Trading time: 9:30 -17:30 (Beijing) working days

Business Model Development in China

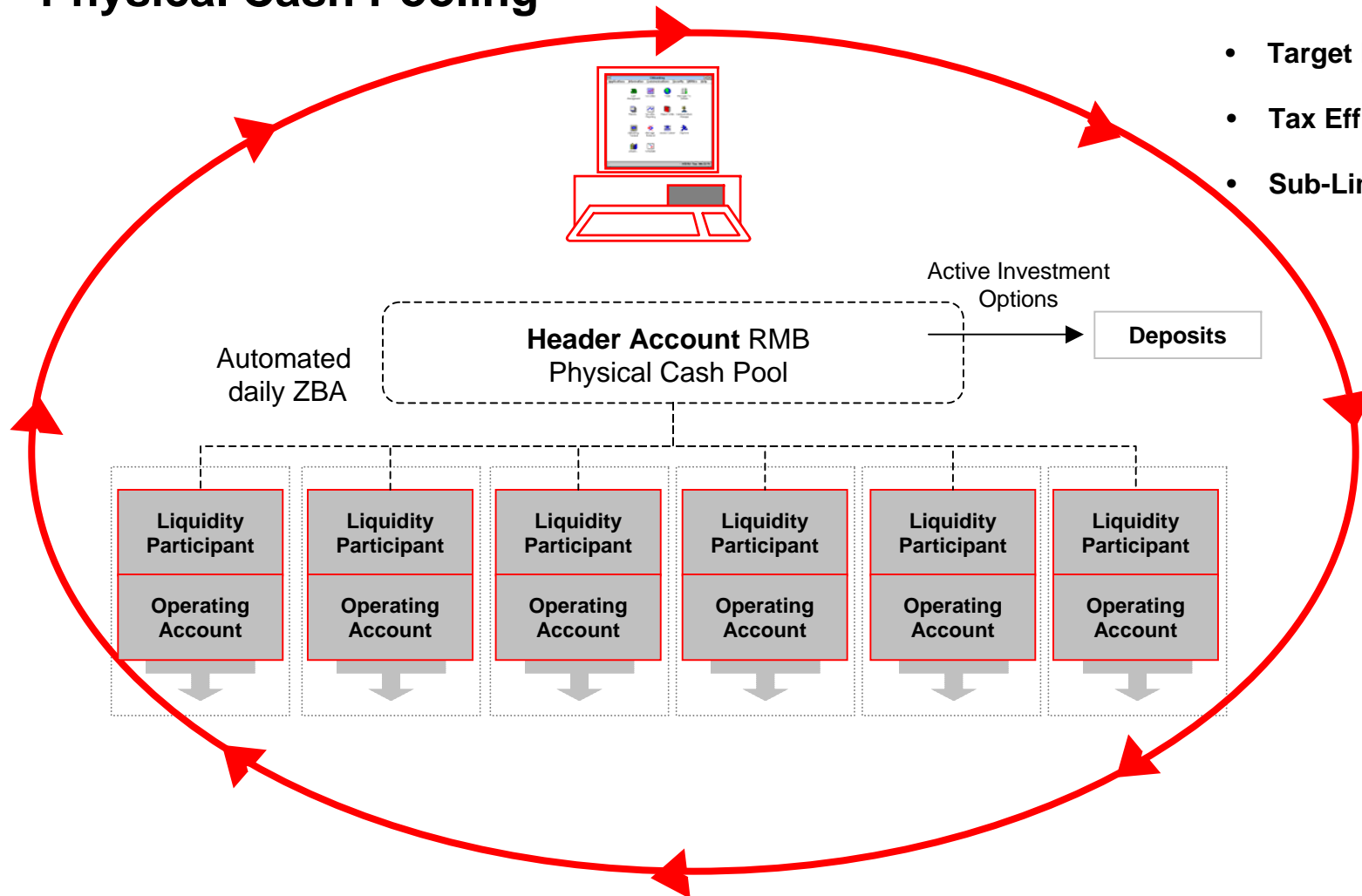


Liquidity Solutions in China



Physical Cash Pooling

- OD available for header Zero Balancing
- Target Balancing
- Tax Efficient Sweep
- Sub-Limit Control





Liquidity Solutions in China

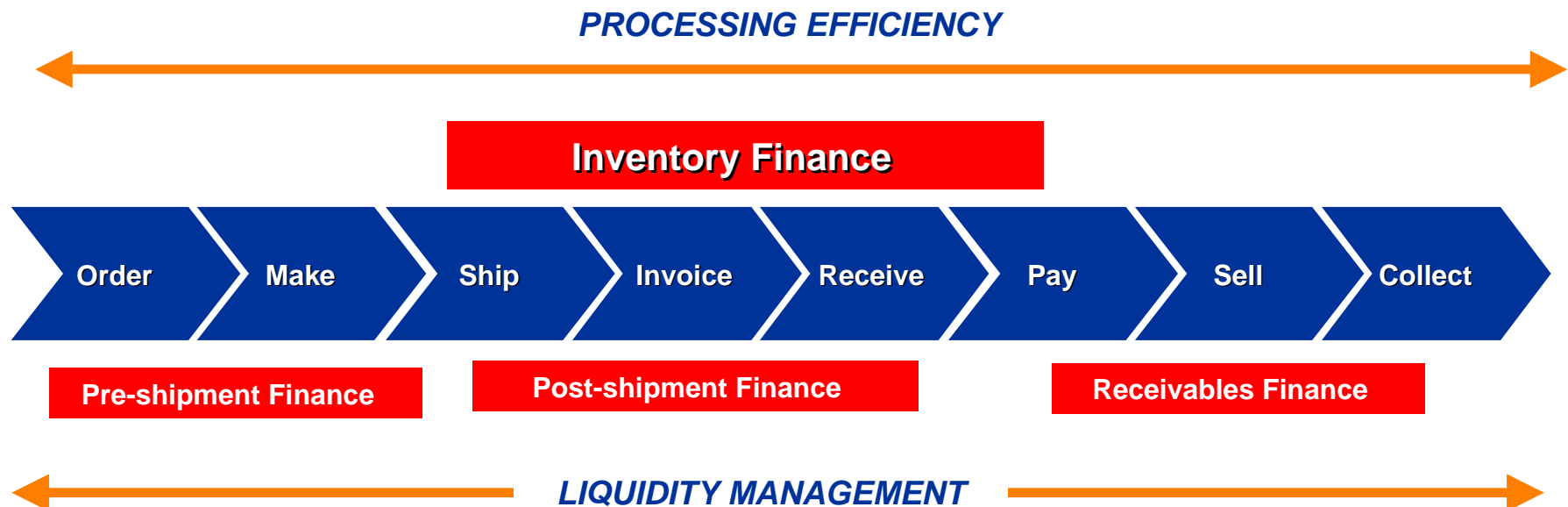
Liquidity Management Cost Savings

	Company 1	Company 2	Company 3	Company 4	Company 5	Company 6
Monthly Cost Saving	340,000	1,030,000	236,000	925,000	800,000	489,000
Industry	Electronics	Distribution	Chemical	Auto	Hardware	Foods
Number of entities	6	19	5	26	12	5
HQ Location	Europe	Europe	Japan	Europe	Asia Pacific	Asia Pacific
Funding Status	Mostly Cash Rich	Mostly Cash Rich	2 Deficit Entities	Mostly Deficit	Mostly Deficit	Mostly Cash Rich

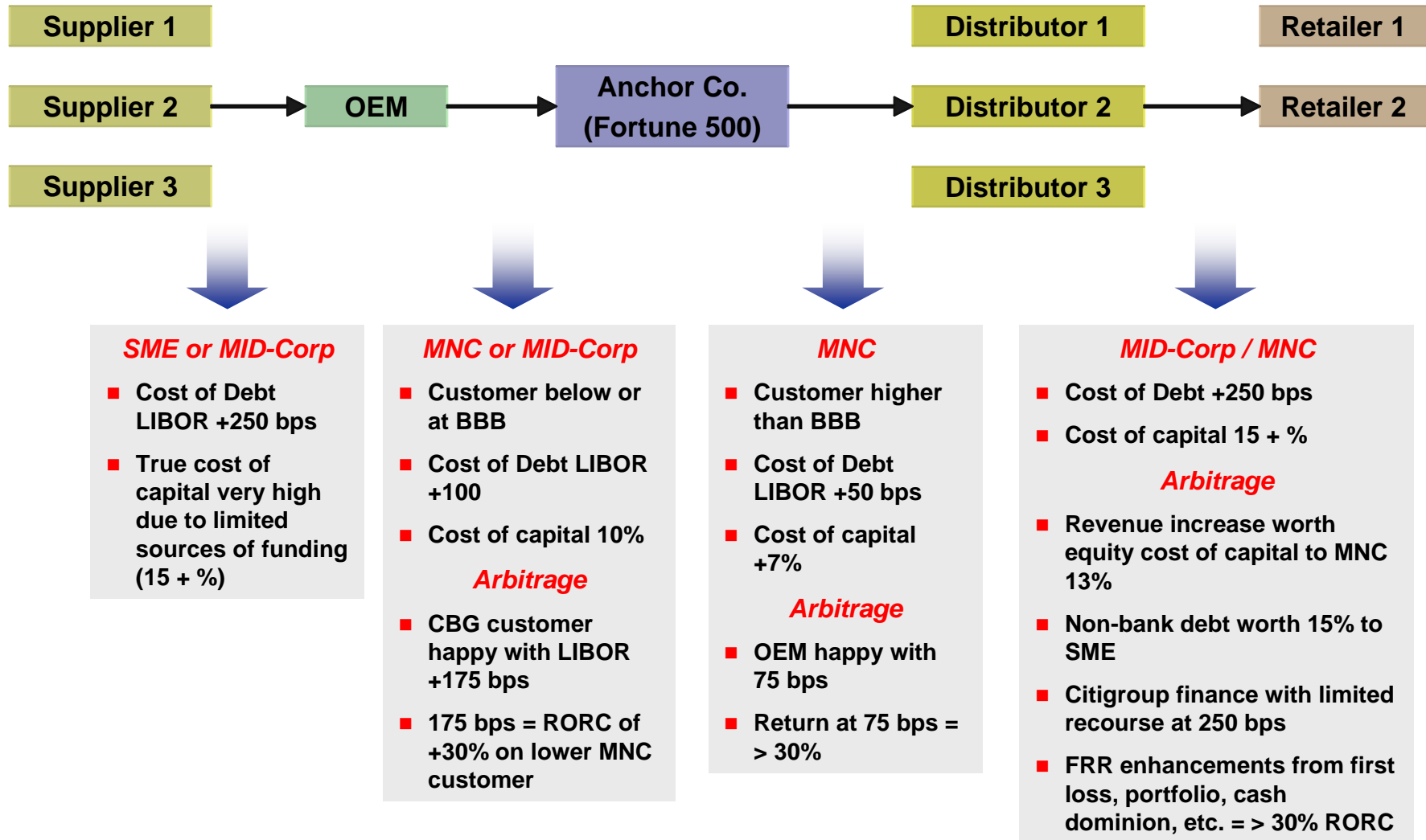
At end April 2007, Citibank China had implemented **125** Cash pooling structures for more than **700** participating accounts

Supply Chain Solutions in China

- Financing the supply chain can be viewed in dimensions:
 - Horizontal: Processing the end-to-end cycle of order to payment
 - Vertical: Ensuring that between order and payment, cost is contained and liquidity is infused



Supply Chain Solutions in China



Supply Chain: Cost of Capital Arbitrage

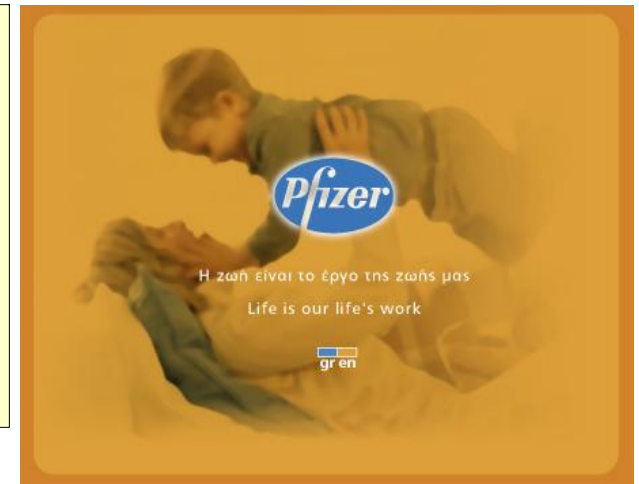
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Case Study: Cash Management – Pfizer

Need

- To streamline daily operation activities including payables, receivable, liquidity management with one single bank
- To have real-time visibility of cash position including day-end account balance as well as transaction details
- To reduce operating, banking and external financing cost
- To centralize treasury function



Solution

- Chose Citibank as the banking partner to setup fully automated RMB cash pooling structure and Standardize daily operation procedure by setting up strict internal control flow on ebanking platform

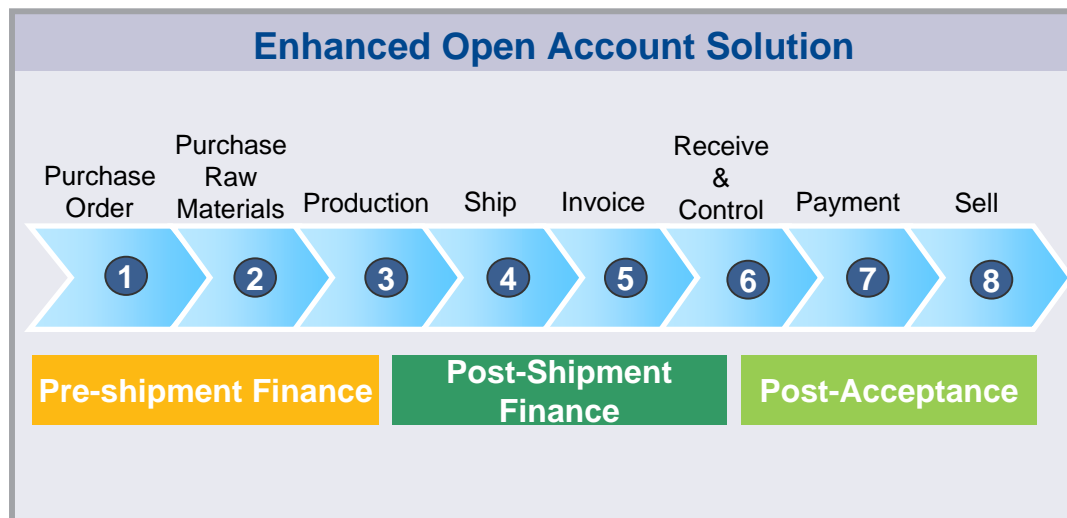
Results

- ✓ Saved 50% banking cost with high financial efficiency
- ✓ Improved access to groups liquidity; Average account balance in 2006 reduced to only half of that in 2004 with much more financial efficiency
- ✓ Further enhanced treasury function
- ✓ Standardized operation procedure with one single bank for cash management
- ✓ Significant efficiency for daily operations achieved including automation as well as real-time information access
- ✓ Improved access to groups liquidity

Case Study: Trade Finance

Need:

- Major hard goods retailer moving vendor base off LC payment terms to improve cost efficiency and reduce credit facilities
- Required an integrated straight through process for purchase order financing with their global SAP system
- Needed financial partner to provide liquidity to vendor base in absence of negotiable Import LC's



Solution:

- Via Enhanced Open Account, client sends purchase order and approved payment files to Citi for processing
- Citi GTS launched aggressive supplier adoption program in key Asian markets to provide vendor finance and other cross sell (FX, Cash Management) to sponsored vendors

Results:

- ✓ Client integrated vendor finance platform and supply chain visibility beyond traditional Import LC process
- ✓ Citi mandated to process payments and provide financing against \$10-\$15 billion procurement flow

Leadership: Global Transaction Banking in China and Asia Pacific



 <p>Awards for Excellence 2006</p> <p>Best Global Cash Management House</p> <p>Best at Cash Management in Asia (5 years in a row)</p> <p>Best at Investor Services in Asia</p> <p>Poll of Polls 2006</p> <p>Best Bank Overall (5 years in a row)</p> <p>Best Transaction Processing Cash Management (5 years in a row)</p>	 <p>Best Treasury and Cash Management Banks and Providers Awards 2007</p> <p>Best Overall Bank for Cash Management Globally (3 years in a row)</p> <p>Best Bank for Liquidity Management in Asia (5 years in a row)</p> <p>Best Internet Bank Awards 2006</p> <p>Best Overall Corporate/Institutional Internet Bank in Asia Pacific</p> <p>Best Online Cash Mgmt Bank in Asia (2 years in a row)</p>	 <p>Awards for Excellence 2007</p> <p>Best Trade Bank in Asia (3 years in a row)</p> <p>Best Trade Services Bank Globally (2 years in a row)</p> <p>Best Trade Bank: Malaysia, Philippines, Singapore, Vietnam</p> <p>Highly Commended: China, Hong Kong, India, Korea</p>	 <p>Major Markets Agent Bank Survey 2006</p> <p>Top Rated & Highest Score: Major Markets: Australia, Hong Kong, Japan, New Zealand, Singapore</p> <p>Emerging Markets Agent Bank Survey 2006</p> <p>Top Rated & Highest Score: China, India, Indonesia, Malaysia, Philippines, Sri Lanka, Taiwan, Thailand</p> <p>Commended: Korea</p> <p>Mutual Fund Administration Survey 2006</p> <p>Top Rated Mutual Fund Administration in Asia</p>	 <p>Cash Management Poll 2006</p> <p>Best Global Cash Management Bank in Asia (voted by large and medium companies)</p> <p>Best Cash Management Services (voted by Financial Institutions)</p> <p>Best Foreign Cash Management: Australia, China, Hong Kong, Indonesia, Korea, Malaysia, Singapore, Taiwan, Thailand (voted by large and medium companies)</p> <p>Best at Understanding Business Strategies, Objectives and Requirements</p> <p>Best at Implementing Cash Management Solutions</p> <p>Best After-Sales Customer Service</p> <p>Best Electronic Banking Platform</p>
 <p>Achievement Awards 2006</p> <p>Best Cash Management Bank in Asia (9 out of 10 years)</p> <p>Best Cash Solutions Bank</p>	 <p>Asia Asset Management Awards 2007</p> <p>Best Custodian in Asia</p> <p>Best Fund Administrator in Asia</p>	 <p>Triple A Transaction Banking Awards 2007</p> <p>Best Transaction Services Bank in Asia & Japan</p> <p>Best Cash Management Bank in Asia</p> <p>Best Regional Corporate Specialist</p> <p>Best Depository Receipts Bank in Asia</p> <p>Best Sub-Custodian in Japan, Malaysia, Vietnam</p>	 <p>Global Custody Survey 2007</p> <p>Best Global Custodian in Asia – Weighted</p> <p>Best Global Custodian for Insurance Companies - Unweighted</p>	

Citi China: Current Business Presence



Staff Profile (Q1, 2007)

China Total:	~3,200
<i>CIB:</i>	812
<i>GCG:</i>	578
<i>GWM:</i>	18
<i>CSTS:</i>	~1,800

Note: Excludes GDB with ~13,000 and SPDB with ~10,000 employees

Business Represented



- 7 operating branches, 1 rep office
- 2 Citi Global Markets rep offices (Shanghai, Beijing)



- 18 outlets in 7 cities
- Diners (HK) Beijing and Shanghai
- 85+ ATMs



- Shanghai Software House
- Guangzhou Service and Ops Center
- Zhuhai Operation Center
- Dalian Software Center



- Equity investment in Guangdong Development Bank (GDB)
- Equity investment in and credit card cooperation with Shanghai Pudong Development Bank (SPDB)



- Citi Management Consulting Company (CMC)
- Citi Private Bank branch opened in March 2006 in Shanghai

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