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Specialists in Risk Metrics Analytics

Uncertain Future of China's State Banks: Implications of the Agricultural Bank of China IPO

Dangerous and undisclosed risks await unwary investors in China's state-run banks.

Press Release/ - TUCSON, AZ, July 25, 2010 - A newly issued [research note](#) by risk metrics firm Sovereign Advisers references the recent Agricultural Bank of China (AgBank) IPO within the context of the deteriorating economic fundamentals of the Chinese domestic market, and suggests caution when deciding whether to invest in China's state-run banks.

The economic bulletin references the Chinese Government's repudiation of China's defaulted external sovereign debt and refusal to repay China's foreign loans, and the possible effect on investor sentiment, as made evident by AgBank's IPO performance which fell far short of management's target despite intervention by government-controlled entities attempting to shore up the bank's share price.

The bulletin also references the emerging risks endemic to the Chinese economy, including the inability of Chinese corporations to refinance commercial bank loans via bonded debt in the wake of serial bond defaults. The Chinese Government also recently announced that it will nullify existing guarantees and no longer provide the central government's guarantee of repayment on sub-sovereign debt issued by local governments. The willingness to repay debt is the central tenet of whether debt will be ultimately repaid.

The research note reveals that the volume of loan origination by China's big state-run banks continues unabated through the use of private trust companies which disguise new commercial loans as "investments", thereby setting the stage for yet another massive write-down of nonperforming loans.

China's Sovereign Credit Rating at Risk Under New U.S. Financial Reform Rules

The recently enacted U.S. financial reform legislation will also have an adverse effect on the ability of China to maintain an investment-grade sovereign credit rating in the face of its defaulted full faith and credit sovereign debt, as investors may now sue the credit rating agencies for knowingly or recklessly publishing demonstrably [false](#) (i.e., fraudulent) credit rating classifications, as in the instance of China. Previously, the credit rating agencies were immune to suit by claiming that they were merely publishers and thus afforded free speech protection under the First Amendment.

The credit rating agencies are incentivized to maintain a false sovereign credit rating for China in the face of the government's selective default by virtue of the "issuer pay" business model, whereby the issuer of debt pays for the rating, in conjunction with the "sovereign ceiling" convention, whereby sub-sovereign entities (e.g., Chinese domestic corporations) generally may not be rated higher than the sovereign rating. By maintaining a false sovereign rating for China, the credit rating agencies have been able to reap windfall profits from debt issued by Chinese domestic corporations. Moody's Investors Service had even gone so far as to sponsor a [conference](#) encouraging Chinese corporations to exploit China's sovereign credit rating, so that Moody's could obtain additional credit rating fees.

Chinese Issuers Facing Increased Disclosure of "Country Risk" in United States Financial Markets

The United States-China Economic and Security Review Commission heard testimony on June 30, 2010 concerning the present inadequacy of disclosure by the Chinese Government and Chinese companies within the United States capital markets.

The call for increased country risk disclosure for Chinese issuers comes in the face of uncertain future prospects for the Chinese economy and escalating corporate bond defaults by mainland Chinese

corporations, including bonds sold to investors within the United States.

The testimony stated that faulty risk disclosures in the prospectuses of U.S. listed Chinese companies may constitute violations of U.S. securities law, and that U.S. underwriters may be held liable for failure to perform adequate due diligence in connection with disclosure under U.S. law (e.g., Sarbanes-Oxley).

The research note may be accessed at:

http://www.globalsecuritieswatch.org/gswupload/AgBank_Research_Summary.pdf

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