Chinese Auto Finance Companies Deliver Steady Performance Despite Growth Challenge

July 2023

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Outlook for the Next 12 Months

Credit Outlook of Auto Finance Companies for the Next 12 Months

Rating Factor	Key Points	Changes in 2022	Expectations for 2023
Business Position	◻ Auto finance business intrinsically connect to sales prospects of automobile manufacturers.	◻ Auto finance companies' assets slightly dipped in 2022. ◻ Stagnant asset growth across the industry was caused by sluggishness in new vehicle sales, slight shrinkage in auto finance penetration and increasing prepayments of loan among existing clients.	◻ We expect overall assets of auto finance to maintain stable. ◻ New energy vehicle (NEV)-related business may become a new growth driver for auto finance.
Capital & Earnings	◻ Our approach for assessing auto finance companies' capital & earnings is the same as that for banks. ◻ Auto finance companies' NIM is closely related to interest rate subsidy offered by automobile manufacturers, and the NIM is less affected by market rates compared to banks.	◻ Capital adequacy ratio remained high due to flat asset scale. ◻ Auto finance companies' solid asset quality guaranteed their sound capital quality, with low risk of capital erosion induced by bad debts. ◻ Sector's NIM stayed higher than that of banks. ◻ Given good asset quality and ample provisions, auto finance companies kept credit costs low and maintained profitability above bank's average.	◻ We anticipate solid capital adequacy and profitability for auto finance companies over the next 12 months.
Risk Position	◻ The characteristics of auto finance business ensure that the sector's asset quality transparency stands above financial institutions' average. ◻ We expect auto finance penetration to improve with good asset quality sustained at the same time.	◻ Auto finance's risk control stood the test of the pandemic, demonstrating mature risk management expertise across the industry. ◻ Despite higher NPL ratio in absolute terms, overall asset quality stayed at a good level in 2022. ◻ A higher NPL ratio in 2022 was attributable to the pandemic and a decreased loan size (thus a smaller denominator).	◻ We expect NPL ratio of auto finance to slightly move downward as long as economic recovery.

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Auto Finance Companies' Credit Outlook for the Next 12 Months (continued)

Rating Factor	Key Points	Changes in 2022	Expectations for 2023
Funding & Liquidity	◻ Auto finance companies raise funds through ABS issuance. ◻ Asset-liability mismatch risk remains controllable.	◻ Auto finance companies kept stable financing and adequate liquidity.	◻ Considering sufficient capital and good asset quality, we expect auto finance companies to maintain easy and stable access to wholesale funding. ◻ Lackluster growth in credit assets and slowing ABS issuance may lead to weak financing demand.
Group Support	◻ Automobile manufacturers' credit quality has a significant influence on auto finance companies, which can be either positive or negative. ◻ The significance of auto finance subsidiaries to their automobile manufacturer parents remains high.	◻ Automobile manufacturers' credit profile improved, thus enhancing their capability of supporting auto finance subsidiaries.	◻ Car makers' willingness to support should remain unchanged. ◻ Major automobile manufacturers' credit quality may remain stable, but traditional car makers will be challenged by rapid increase in NEV penetration.
Issuer Credit Quality	◻ Sales and credit quality of automobile manufacturers are decisive factors for issuer credit quality of auto finance companies.	◻ Both the stand-alone credit quality and issuer credit quality of the overall auto finance remained stable. ◻ The only remarkable change was the sharp fall in total assets of some auto finance companies, posing a challenge to their business growth.	◻ We believe that stand-alone credit quality and issuer credit quality for auto finance companies will remain stable.

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NAFR’s No.1 Order is favorable for auto finance’s business development

On July 11, 2023, China’s National Administration of Financial Regulation (“NAFR”) issued its No.1 order for 2023 – “Administrative Measures for Auto Financing Companies”, which will come into effect on August 11, 2023.

Key Revisions	Potential Impact on Auto Finance Companies’ Credit Quality
Auto finance companies are encouraged to focus on their main business and they are no longer allowed to conduct equity investment.	There’s no significant impact on major auto finance companies in terms of business operation as they only have a very small size of equity investment business.
Financial leasing business is permitted under the sale-and-leaseback mode, and such leaseback business must be conducted based on real trade of cars.	The business scope of auto finance companies is broadened, which may become a driver for their business growth.
Business scope is extended to include financing for car periphery, for which clients are allowed to make separate funding applications after they submit auto loan applications.	
Auto finance companies can grant loans intended for inventory procurement, maintenance and purchase of equipment to auto after-sales service providers.	
Auto finance companies are allowed to set up offshore subsidiaries.	
A regulatory indicator of liquidity risk is added, requiring that liquidity ratio shall be no less than 50%.	The stricter requirement on auto finance companies’ risk management should help improve their risk profile.
Enhanced regulation regarding key emergency reporting and on-site inspection.	

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Credit Profile of Major Auto Finance Companies

Rating Factor	Median of testing results for 10 major auto finance companies	Typical Features
Anchor	bbb-	We typically set our auto finance anchor at "bbb-"
Business Position	0	Auto finance companies' business positions are strongly associated with their parents' ability to sell cars. Compared to other non-bank financial institutions with a "bbb-" anchor, they have much higher industry concentration. But they can enjoy stable business position if they are associated with strong car makers.
Capital & Earnings	+2	We expect auto finance companies to maintain strong capitalization and good earnings going forward. Their capitalization and profitability will remain higher than the banking industry average.
Risk Position	+1	Due to the good granularity of their loan portfolios and prudent underwriting standards, we expect auto finance companies to maintain very good asset quality, much better than the banking industry.
Funding & Liquidity	0	Auto finance companies rely on wholesale funding. Given their strong capital and good asset quality, we expect them to maintain stable funding structures and adequate liquidity.
Stand-alone Credit Quality	a-	Due to their strong capital and earnings and low bad debt levels, major auto finance companies have stand-alone credit quality much higher than the 'bbb-' anchor.
Group Support	+2	We believe auto finance companies are of critical importance to their car making parents. They may receive strong support when parents have the capability to support. In some cases, the car makers' credit quality may be poorer than that of their auto finance subsidiaries, leading to negative parent influence.
Issuer Credit Quality	a+	As the stand-alone credit quality of auto finance companies remains stable, the volatility of their issuer credit quality in recent years has largely been caused by the fluctuation in their parent companies' credit quality.

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Note: The indicative credit quality notchings expressed in this report are only S&P China's indicative views of group support notchings derived from a desktop analysis based on public information without interactive review with any particular institution or the full credit rating process such as a rating committee. The opinions expressed herein are not and should not be represented as a credit rating and should not be taken as an indication of a final credit rating of any particular institution or its bonds.

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Auto finance companies have strong stand-alone credit quality

- We have tested the credit quality of 500 financial institutions, including 10 major auto finance companies.
- We view the average stand-alone credit quality of auto finance companies as better than average NBFIs. According to our desktop analysis, the indicative stand-alone credit quality of China's 10 largest auto finance companies ranges from [bbb_{spc}] category to [a_{spc}] category, with the median at [a_{spc}] category.
- These major auto finance companies have maintained stable stand-alone credit quality based on their very good asset quality and very strong capital.
- Despite a marked slowdown in business growth in recent years, we believe the stand-alone credit quality of auto finance companies will remain stable.

Distribution of Indicative Stand-alone Credit Quality of 500 Financial Institutions

Note 1: Our assessment of indicative stand-alone credit quality doesn't consider the possibility of group or government support in times of stress.

Note 2*: The indicative credit quality distributions expressed in this report are only S&P China's indicative views of credit quality derived from a desktop analysis based on public information without interactive review with any particular institution or the full credit rating process such as a rating committee. The opinions expressed herein are not and should not be represented as a credit rating and should not be taken as an indication of a final credit rating of any particular institution.

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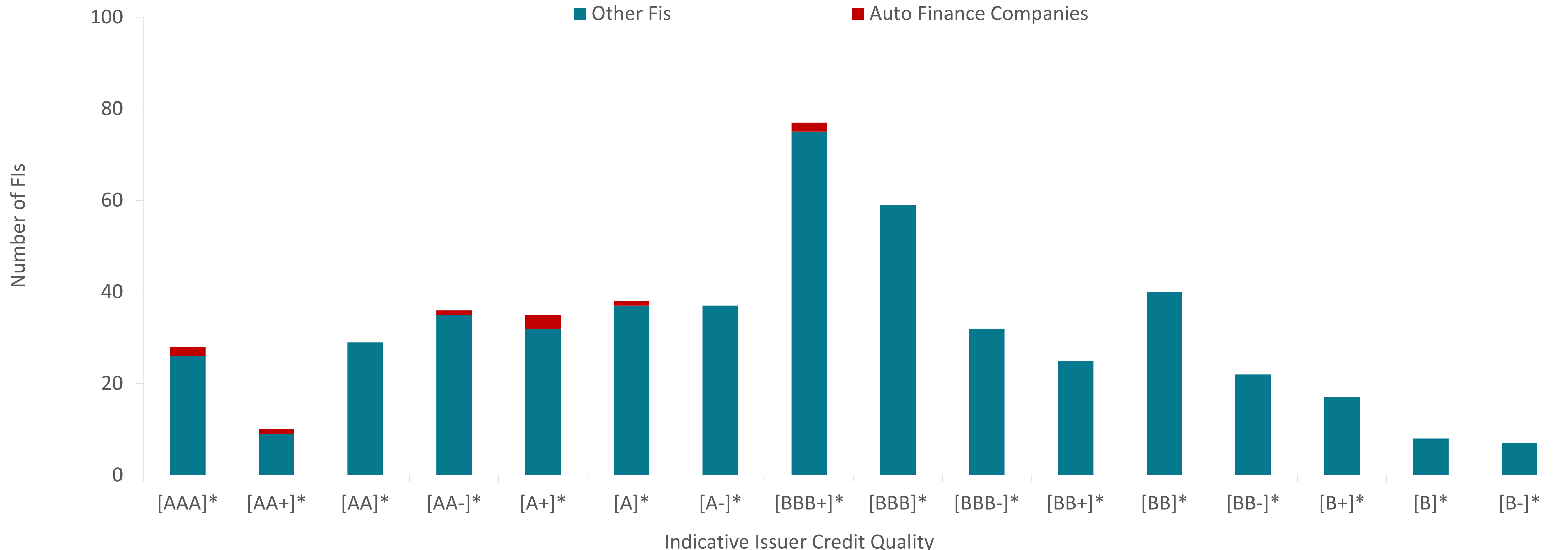
Major auto finance companies have issuer credit quality above investment grade

The indicative issuer credit quality of major auto finance companies typically falls into a range of [BBB_{spc}] category to [AAA_{spc}] category. Hence, few of these companies are with high credit risk.



Note 1: Our assessment of indicative issuer credit quality considers the possibility of group or government support in times of stress.
Note 2*: The indicative credit quality distributions expressed in this report are only S&P China's indicative views of credit quality derived from a desktop analysis based on public information without interactive review with any particular institution or the full credit rating process such as a rating committee. The opinions expressed herein are not and should not be represented as a credit rating and should not be taken as an indication of a final credit rating of any particular institution.
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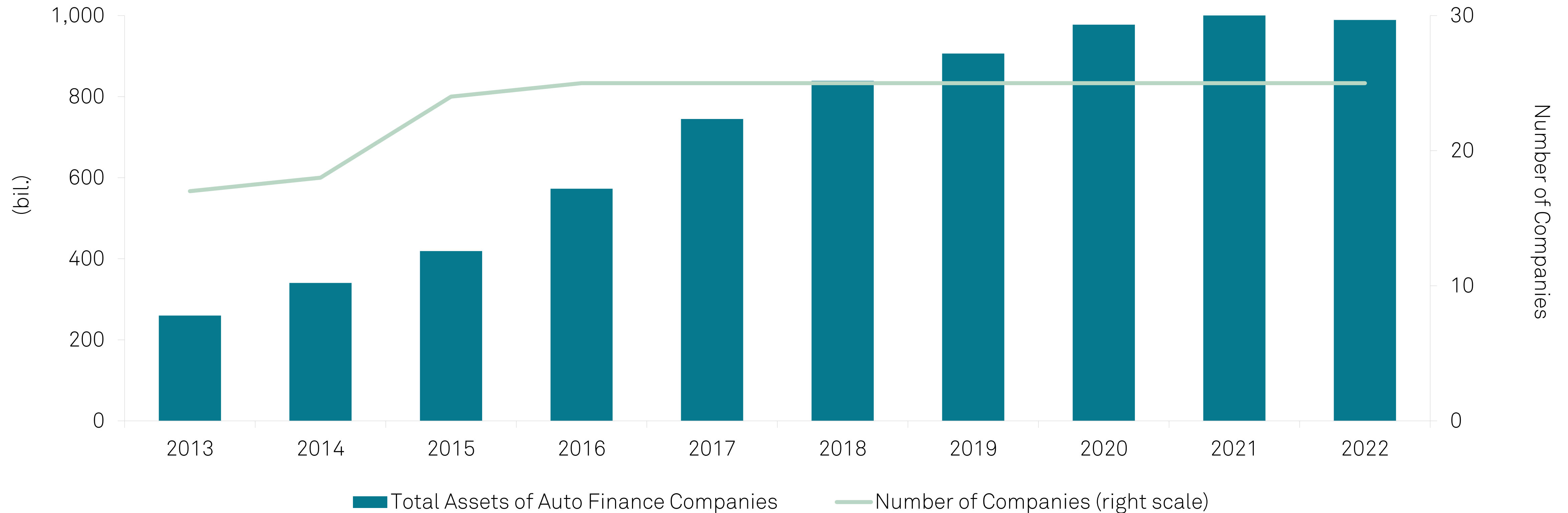
Business Position

Total assets of auto finance companies edged down in 2022

- As of the end of 2022, auto finance companies had total assets of 989.2 billion RMB, accounting for about 0.3% of Chinese commercial banking industry.
- In 2022, demand of auto finance significantly slowed down. As of the end of 2022, total assets of auto finance companies decreased by 2%, and total asset of Chinese commercial banking industry increased by 10%.

Total Assets and Number of Auto Finance Companies in China



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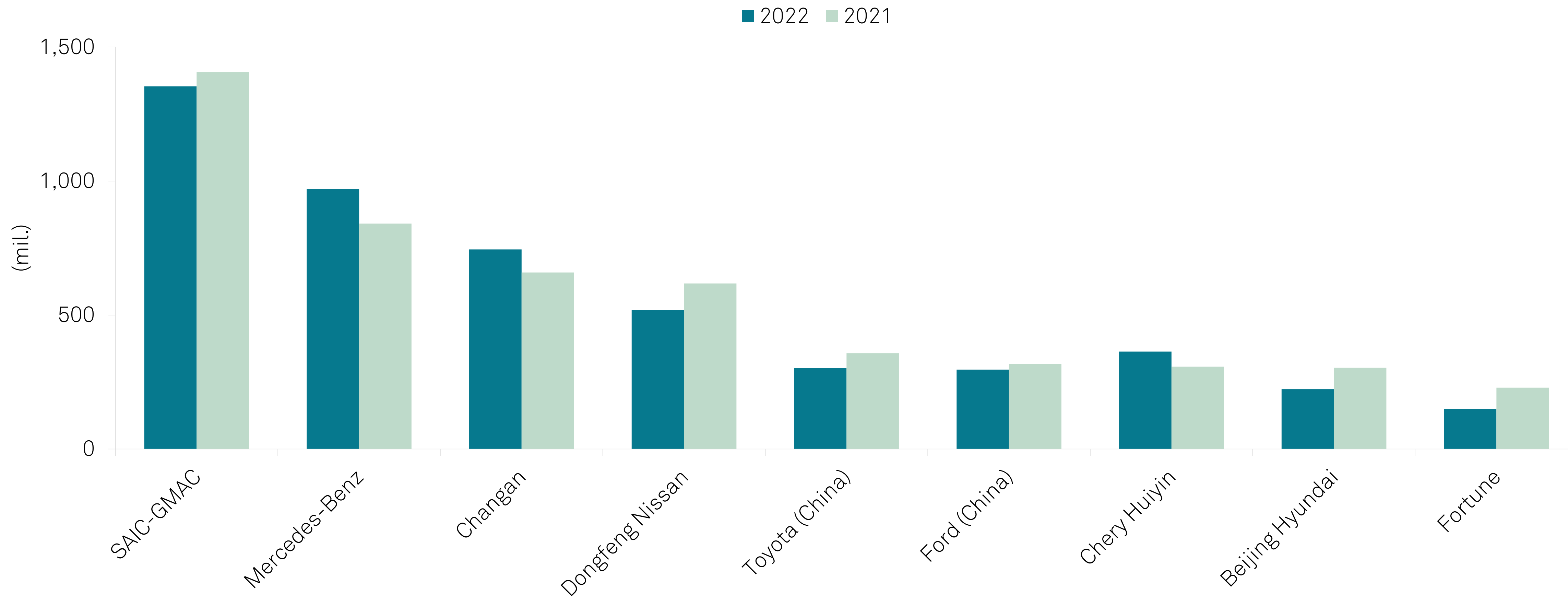
Business growth diverges, with sharp decline of total assets among some auto finance companies in 2022



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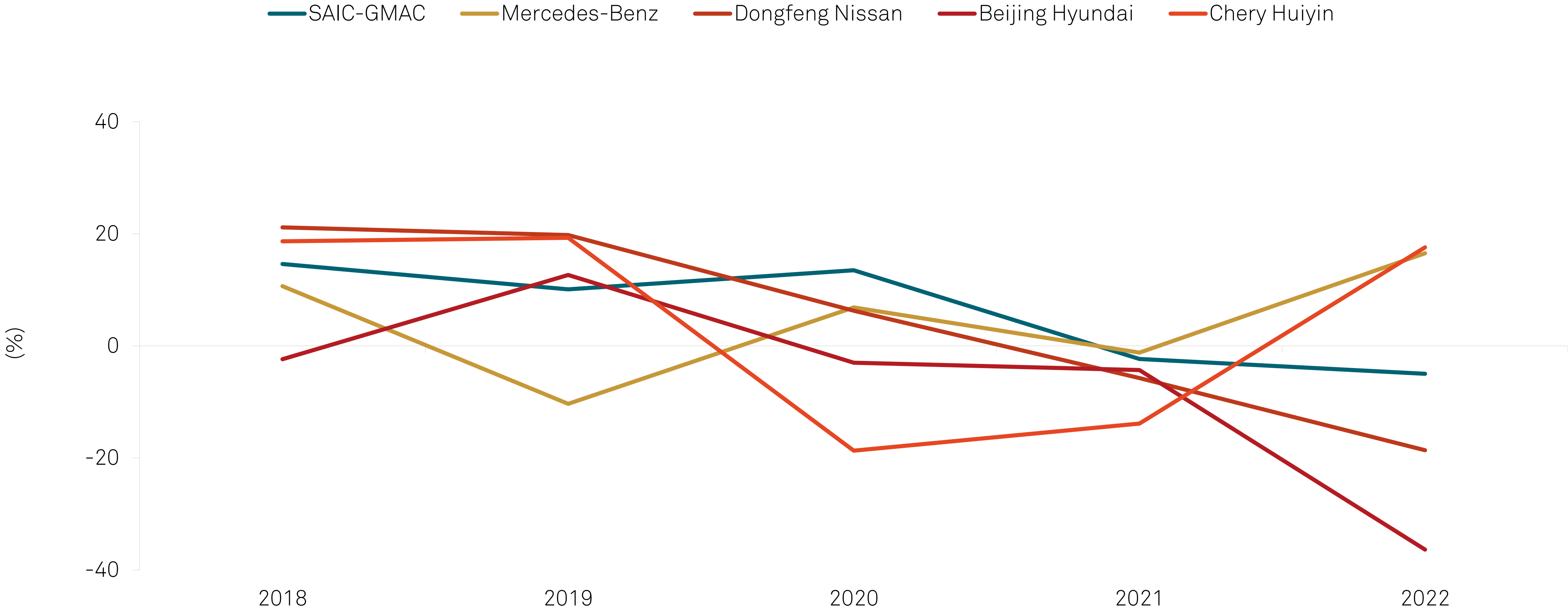
Loan growth of major auto finance companies has slowed down in recent years



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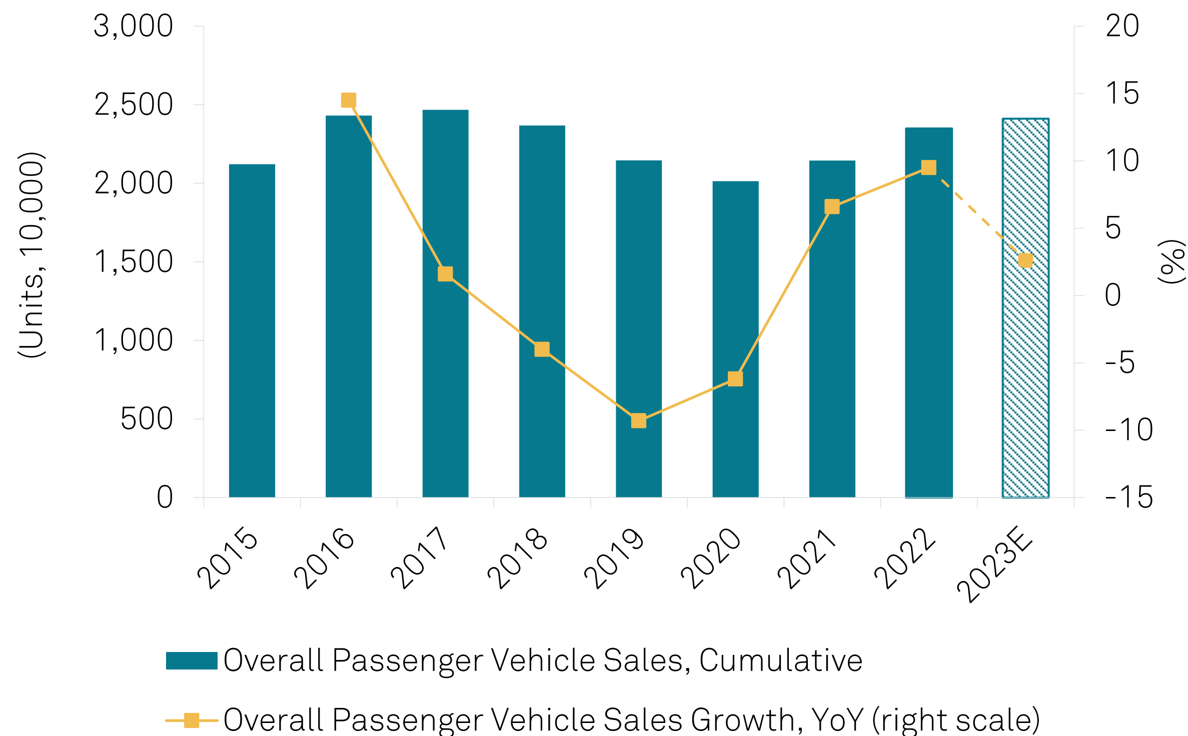
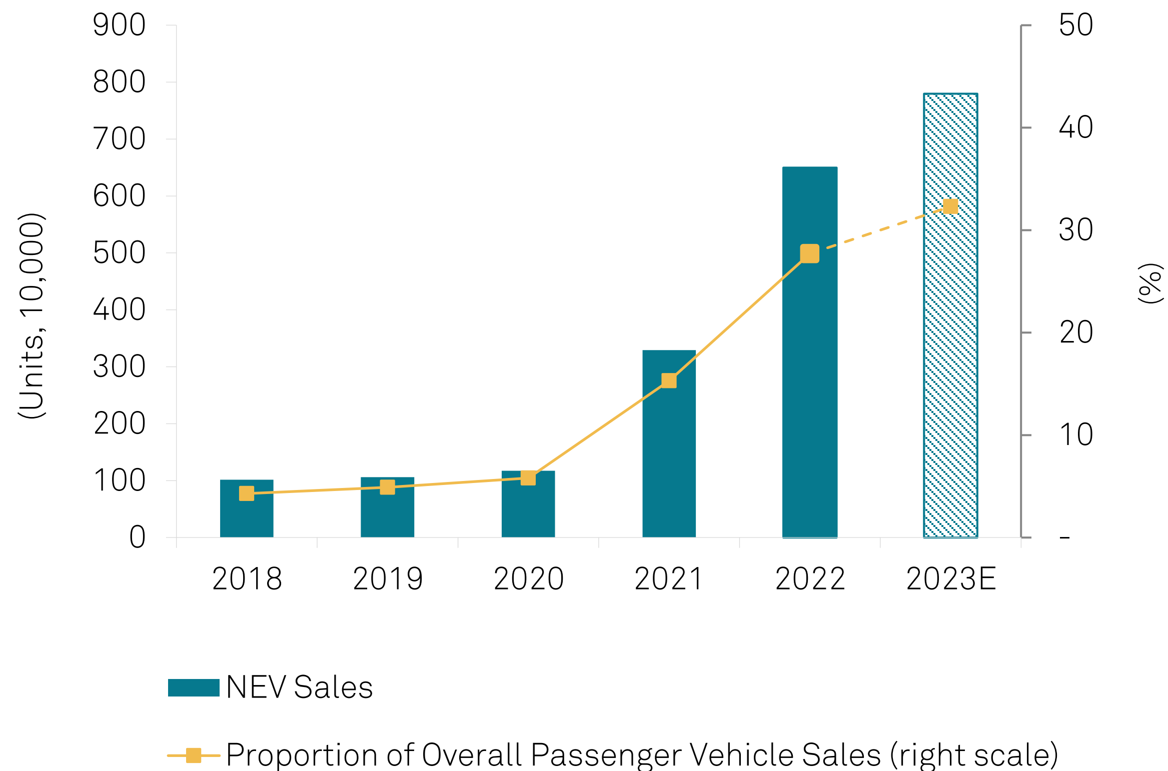
Car sales have remained stable in recent years, with new energy vehicles being the key growth driver





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Note: E - Estimate.
Source: China Passenger Car Association, Wind, S&P Global (China) Ratings
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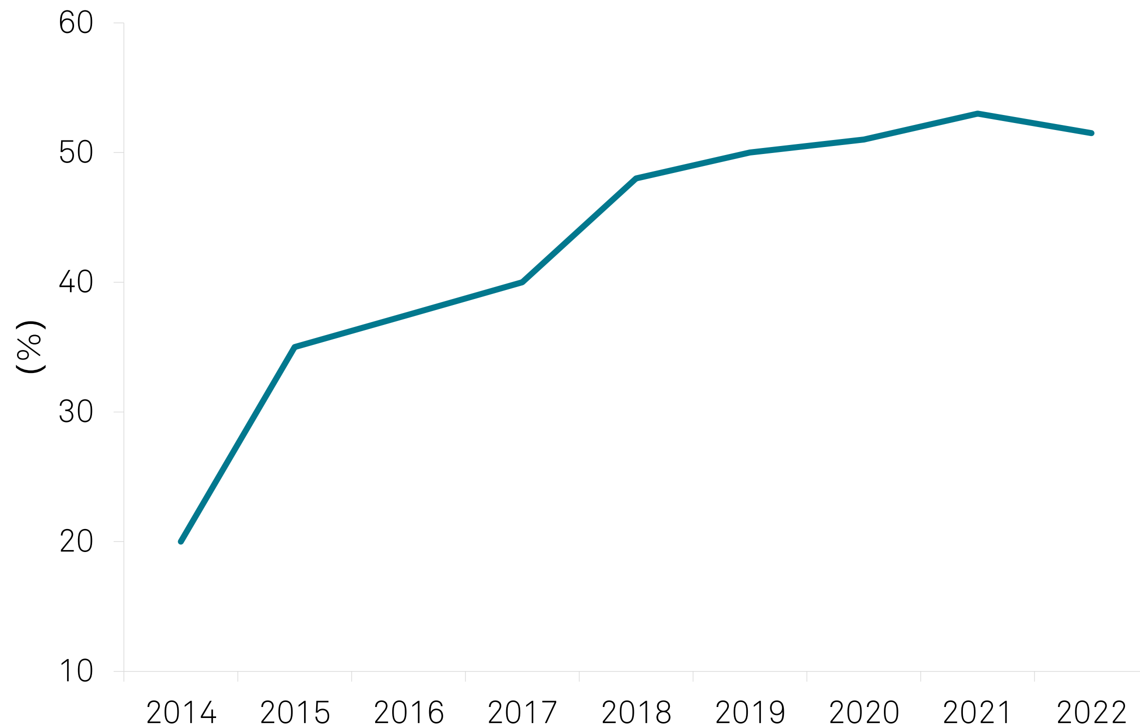
The rare downtick in auto finance penetration in 2022 is another reason behind auto finance growth slowdown



Note: Penetration rate of auto financing represents the percentage of loan funding in new car sales.
Source: China's penetration rate of auto financing is jointly published by the financial branch of China Automobile Dealers Association (CADA) and 21st Century New Automobile Research Institute, collected and adjusted by S&P Global (China) Ratings.
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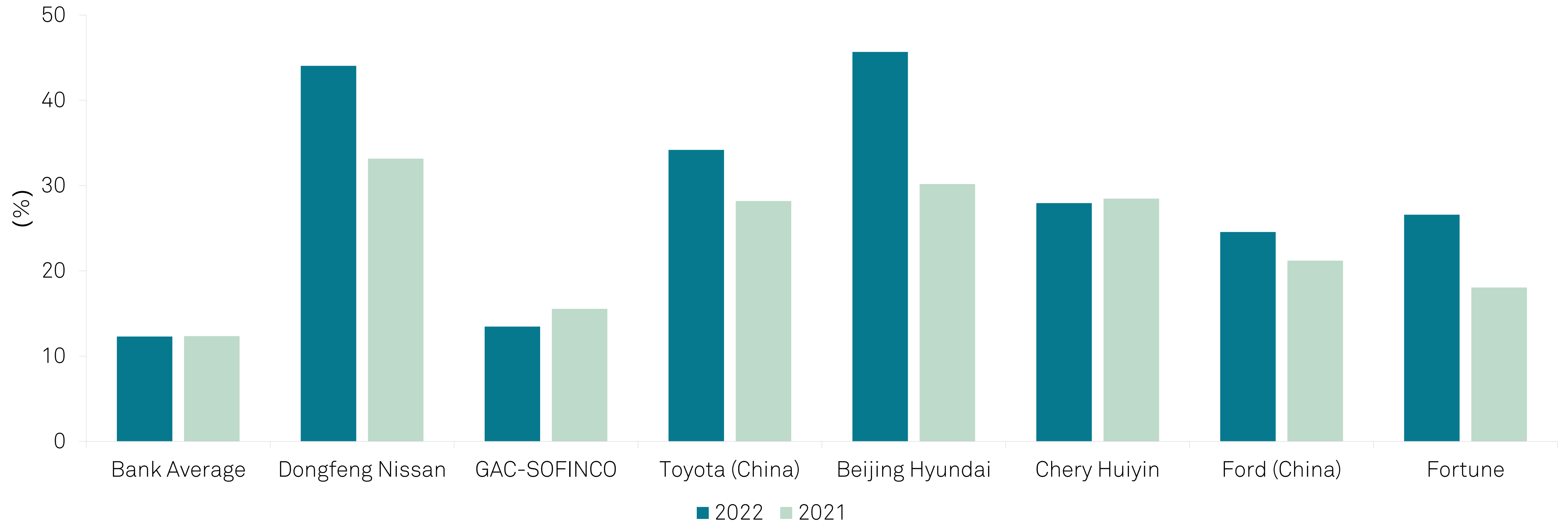
- In addition to car sales growth, increased use of leverage by car buyers has been another driving force for the auto finance industry. The use of auto loans witnessed steady growth in the past few years. However, China's auto finance penetration rate, measured as the percentage of new car sales supported by loans, was about 51.5% in 2022, slightly down by one percentage point from 2021. The decreased auto finance penetration rate is relevant to changes in Chinese households' willingness to invest, consume and borrow. In comparison, developed countries typically have penetration rates of around 70%.
- In the medium and long run, we believe auto finance penetration rate still has room for further growth in China. As China's auto market matures, we expect higher financial leverage to become more important in driving business growth for auto finance.

Capital & Earnings

Capital adequacy ratios of some auto finance companies increased in 2022 due to shrinkage in business scale

Auto finance companies' capital adequacy ratios stay at high level, which are much higher than those of banks.



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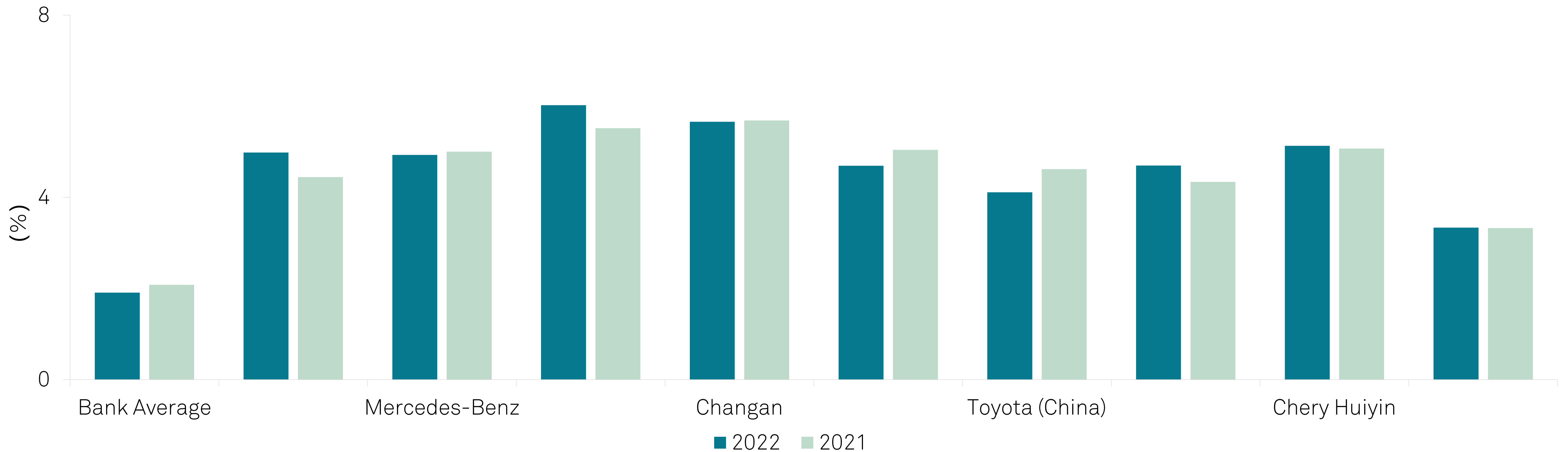
Auto finance companies have higher NIM than banks, leading to sound profitability

- Although auto finance has higher funding cost than bank, interest rate on the asset side was higher than the funding side, leading to higher NIM than banks.
- There are two main reasons accounting for high interest rate of auto loans. Many automobile manufacturers hold subsidy strategies for their clients. On the other hand, retail loans generally earn a high interest rate. NIM of auto finance stayed stable in the past two years. NIM of most auto finances is more sensitive to their subsidy strategies.



Note: NIM = net interest income/average interest-bearing assets.
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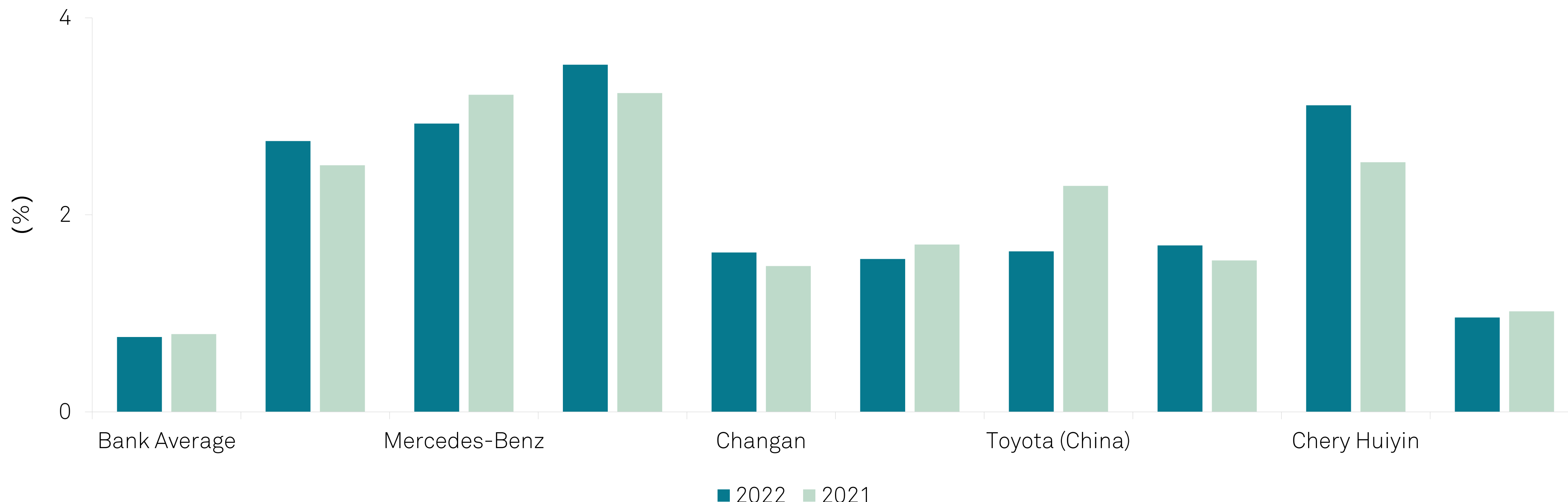
Thanks to higher NIM and lower credit cost, major auto finance companies continue to deliver better profitability compared to banks

- Banks' earnings expose to pressure from both decreased NIM and increased provision, but auto finance companies have much less pressure on these two issues.
- The main auto finance companies we tested obtained return on average total assets of 2.19% in 2022, down by 0.05 percentage point compared to 2021, but much higher than that of 0.76% for banks.



Note: Return on average assets =net income/ [(total assets at the beginning of the year +total assets at the end of the year)/2].
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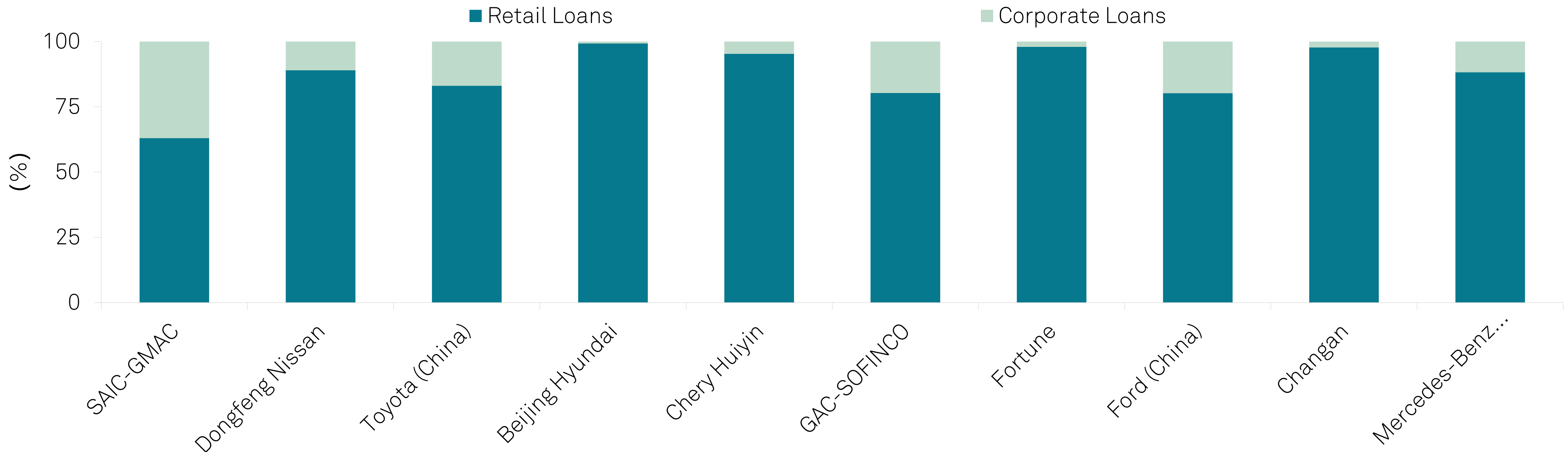
Risk Position

Auto finance companies' loan portfolios are dominated by retail loans, leading to better business transparency

- Compared with banks and other NBFIs with diversified business, auto finance companies focus on auto finance, leading to good business transparency. Their loan portfolios typically include two parts: a retail portfolio composed of lending to car buyers and a corporate portfolio of lending to car dealerships.
- Auto finance companies can also conduct auto leasing business, which has more flexibility in terms of product design. But so far, auto leasing business is more concentrated in financial leasing companies established additionally by automobile manufacturers.



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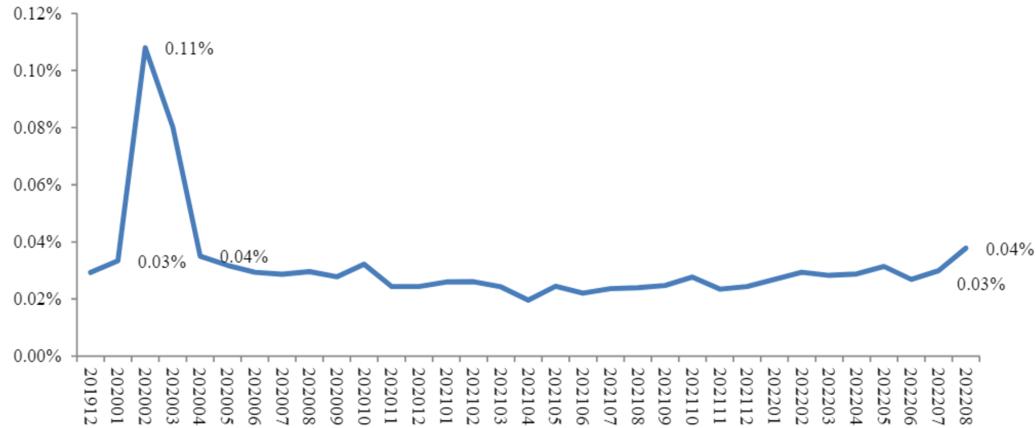
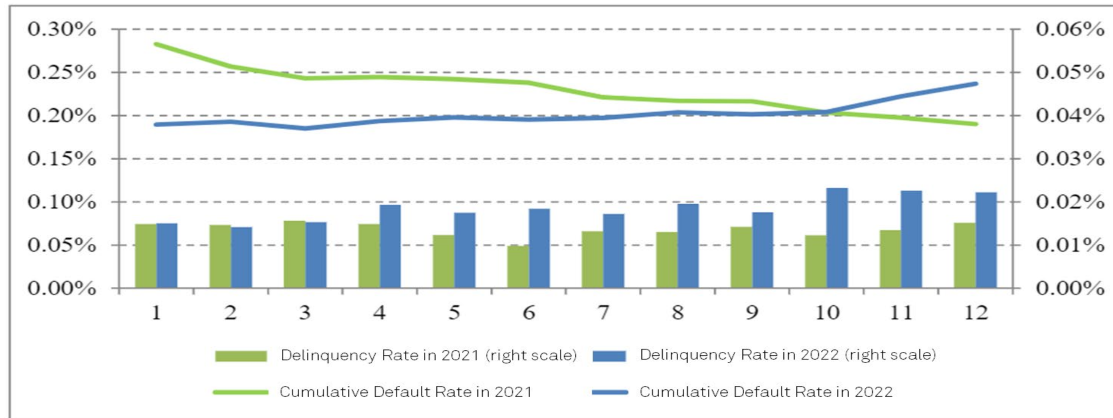
Auto ABS in interbank market continue to have good asset performance

30-plus-day Auto ABS Delinquencies published by China Bond Rating

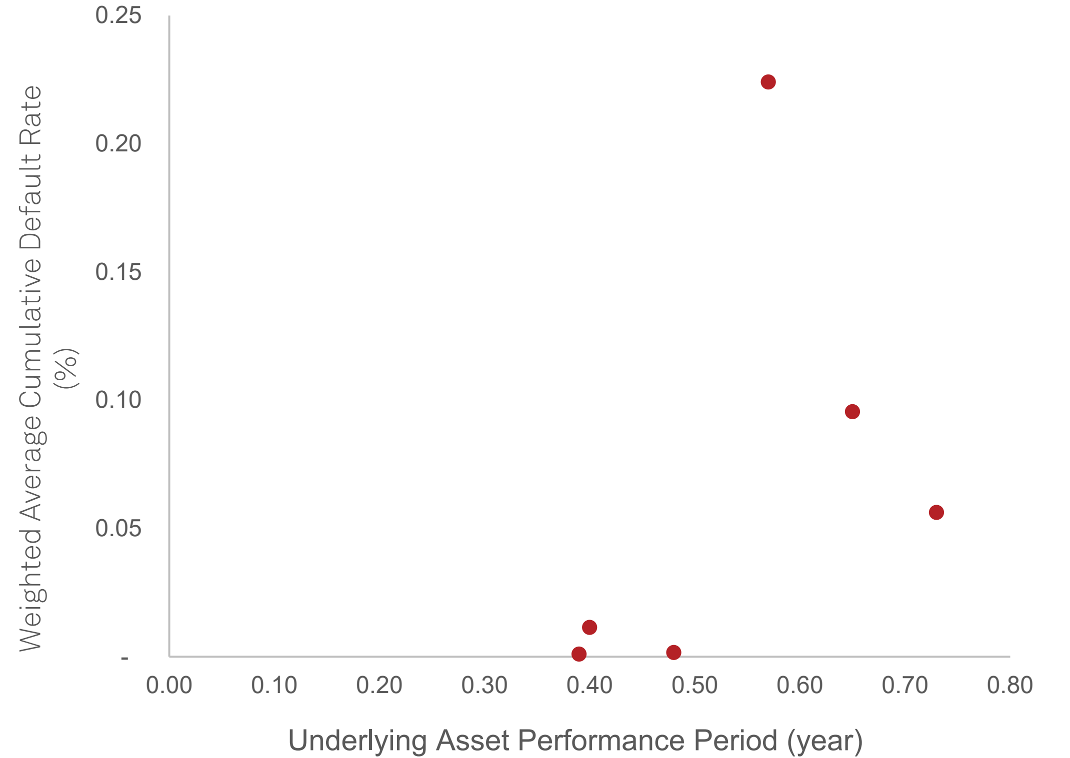


Default Rates of Outstanding Auto ABS in 2021 and 2022 published by China Bond Rating



Source: China Bond Rating Co., Ltd.

Cumulative Default Rates of Underlying Assets of Auto ABS in the First Half of 2023



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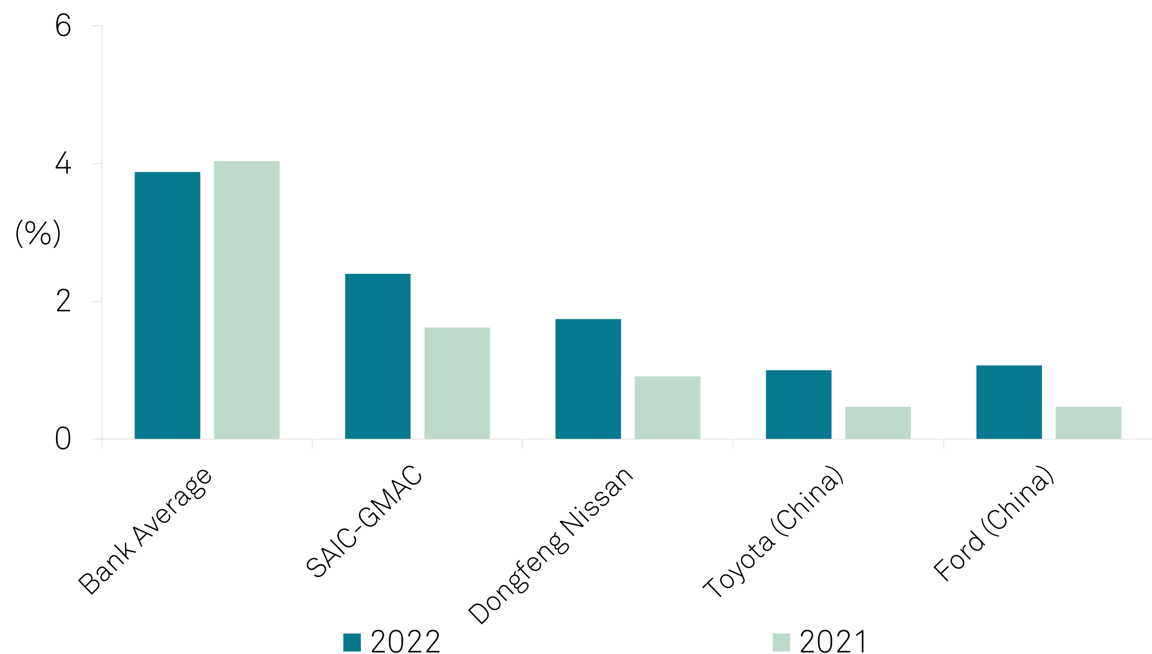
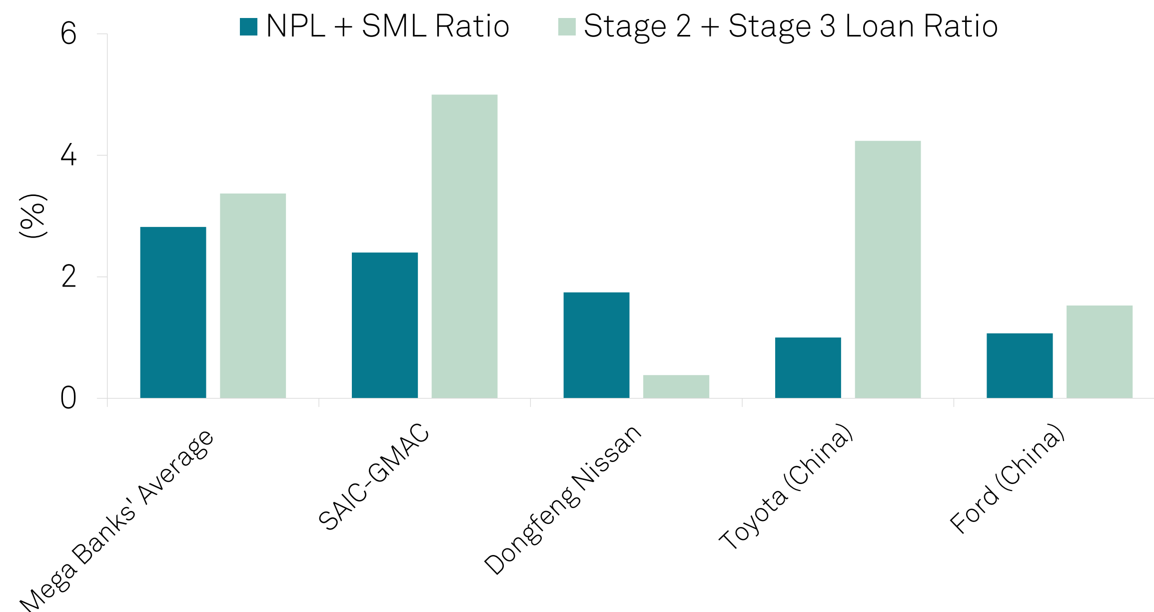
Leading auto finance companies have very low bad debts

- In 2022, NPL ratio of leading auto finance companies show an increase compared to that in 2021, but it is still standing at a good level in general. The increase of NPL ratio in 2022 was led by the Covid-19 pandemic and shrinking loan size (thus a smaller denominator). We expect NPL ratio for auto finance to edge down amid economic recovery in 2023.
- Under IFRS 9, some auto finance companies apply stricter criteria on stage 2 and stage 3 loan classification, leading to a higher ratio of stage 2 and stage 3 loans than the sum of NPL ratio and SML ratio. However, accounting treatment will not affect our assessment regarding these companies' risk positions.





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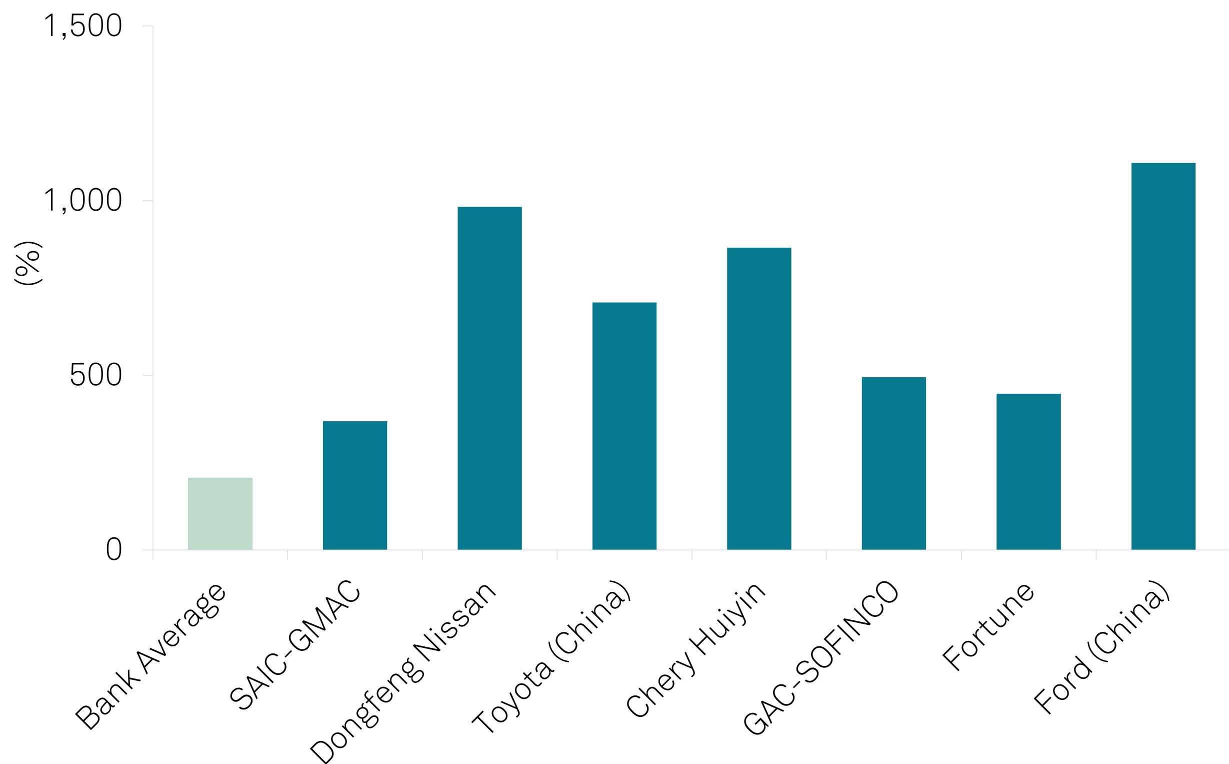
Auto finance companies typically have prudent provisioning and comfortable reserve buffer



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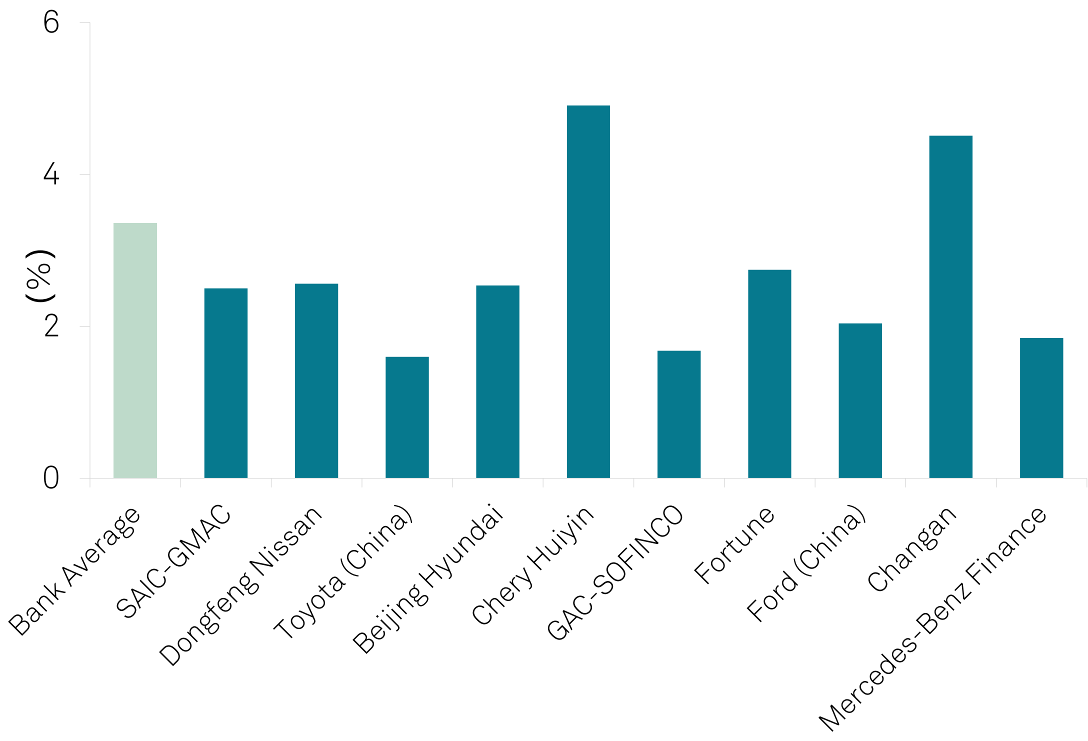

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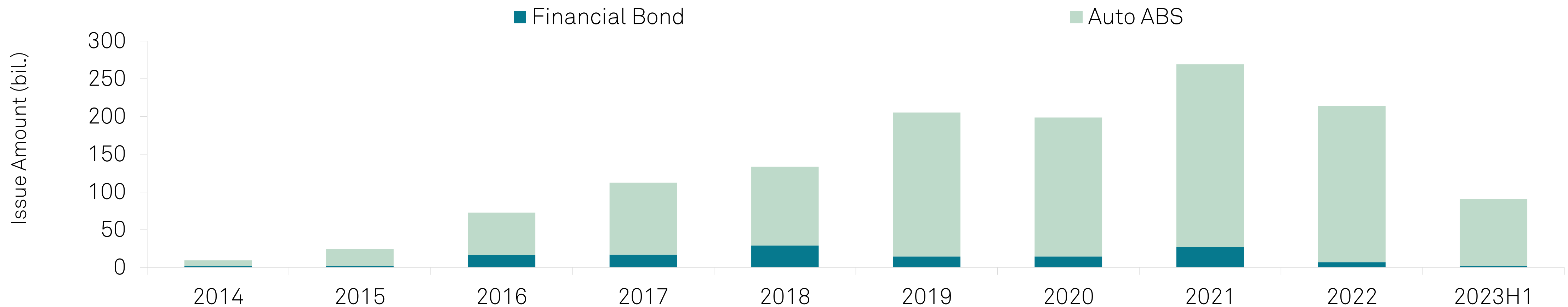
Funding & Liquidity

Auto finance companies' funding demand subdued in recent years

- Major auto finance companies have diversified funding sources composed of bank loans, interbank market borrowing and the bond and ABS markets. Structural finance has became one of most important funding method. Auto finance companies focus on funding through asset back security, rather than off-balance.
- In the first half of 2023, auto finance companies' ABS issuance slumped due to a slowdown in asset growth.
- According to the "Measures for the Implementation of Administrative Licensing Matters for Non-bank Financial Institutions (draft)" issued in July 2023 ("new measures"), the approval-based non-capital bond issuance of auto finance companies is replaced with the filing-based approach; the new measures also make it easier to issue capital bond. The new measures, if implemented, would be favorable for auto financing companies in terms of bond issuance. Because of low demand of funding through financial bonds and capital bonds in 2023, auto finance companies may not be significantly affected by the new measures in terms of funding.

Bonds and ABS Issued by Auto Finance Companies



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Asset-liability mismatch risk remains controllable for major auto finance companies

The auto loans' maturity are typically short, laying a good foundation for auto finance companies' liquidity management.

Company	Assets			Liabilities		
	Percentage of Loans Due within 3 Months (%)	Percentage of Loans Due within 3 Months to 1 Year (%)	Percentage of Loans Due within 1 to 5 Years (%)	Percentage of Financial Liabilities Due within 3 Months (%)	Percentage of Financial Liabilities Due within 3 Months to 1 Year (%)	Percentage of Financial Liabilities Due within 1 to 5 Years (%)
SAIC-GMAC	35.20	32.10	32.22	29.45	48.78	21.77
Toyota (China)	32.08	34.40	33.52	14.90	67.20	14.07
Ford (China)	23.65	39.09	36.24	23.74	59.21	13.84
Beijing Hyundai	20.00	43.46	36.55	17.04	52.02	30.55
Fortune	3.88	20.23	74.57	20.24	71.37	7.87

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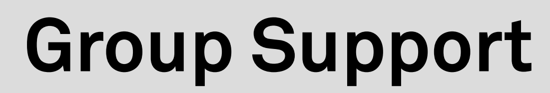


Group Support

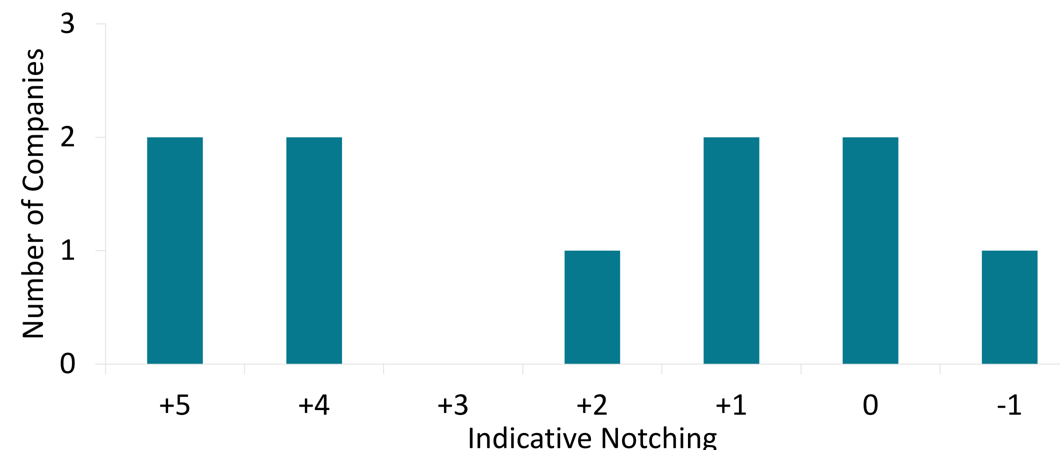
We typically view auto finance companies' importance to their parent companies as "critical" given their close business synergy

- According to "Administrative Measures for Auto Financing Companies", auto financing companies' articles of association shall state that major shareholders shall provide capital assistant, and liquidity support shall be promised when the company is in payment difficulties. Major shareholders is defined as shareholders that hold or control more than 5% of the shares or voting rights of the auto finance company or that hold less than 5% of total capital or total shares but have significant impact on the business management of the company. Similar requirements can also be found in "CBIRC Measures on the Implementation of Administrative Licensing of Non-bank Financial Institutions".
- Auto finance companies play an integral role in their parents' auto sales business. If the parent can obtain government support, we usually expect indirect government support to flow to the auto finance subsidiary.
- In a few cases, because of a car maker's poor financial performance, its credit quality may be lower than that of its auto finance subsidiary. In such cases, group influence is negative rather than positive. But given the auto finance company under strict supervision by regulator, unless there is evidence of inappropriate related-party transactions, we may typically view the auto finance company's credit quality as higher than that of its parent company.

We typically monitor the following factors when assessing group support for auto finance subsidiaries:

- The parent's credit quality;
- The parent's business strategy in China;
- China's contribution to the car maker's total sales;
- Corporate governance of the subsidiary, and synergy in business development and risk management;
- On-going support from the parent on capital and funding; and
- Any irrevocable and unconditional guarantees on subsidiary debts by the parent (if applicable).

Indicative Notching of Group Support of 10 Major Auto Finance Companies



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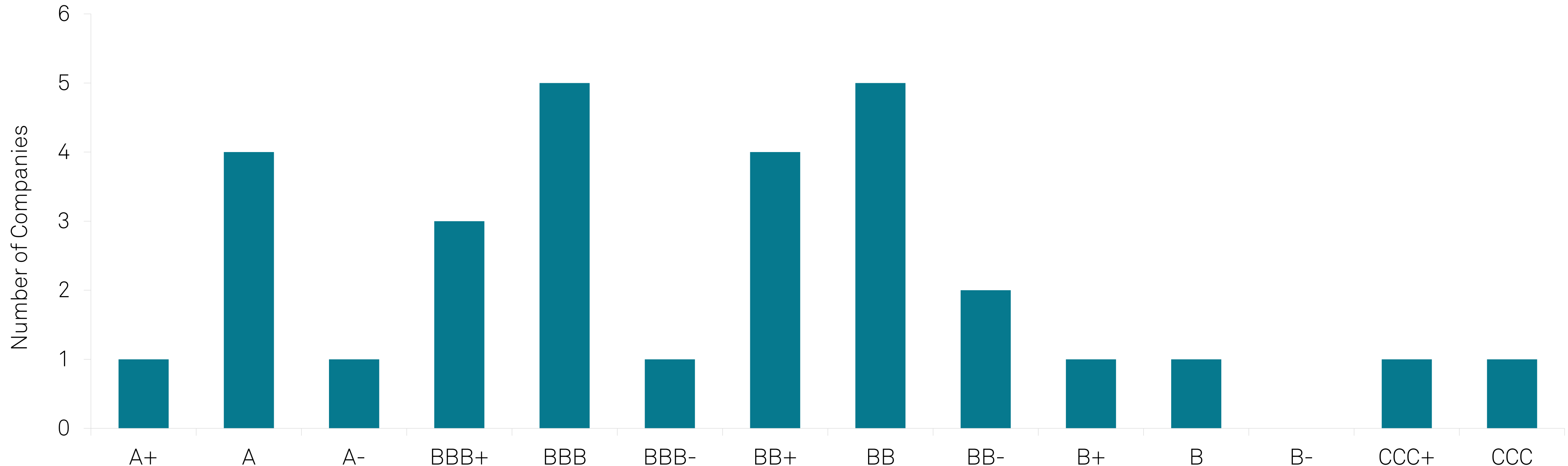
The global car making industry has wide credit divergence, resulting in varying capacity to support auto finance subsidiaries

- If auto finance companies' parents are Chinese automobile manufacturers, we arrange their credit analysis based on our Corporate rating Methodology".
- If auto finance companies' parents are foreign institutions, either foreign automobile manufacturers or foreign auto finance companies, their credit analysis will rely on our Panda Bond rating methodology.

S&P Global Ratings' Issuer Credit Ratings of 30 Major Automobile Manufacturers as of End of June 30, 2023



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S&P Global Ratings conducted more positive than negative rating actions on car markers worldwide over the past 12 months

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Note: Rating actions shown in the chart represent changes in issuer credit ratings as of the end of June 30, 2023 compared to the end of June 30, 2022.
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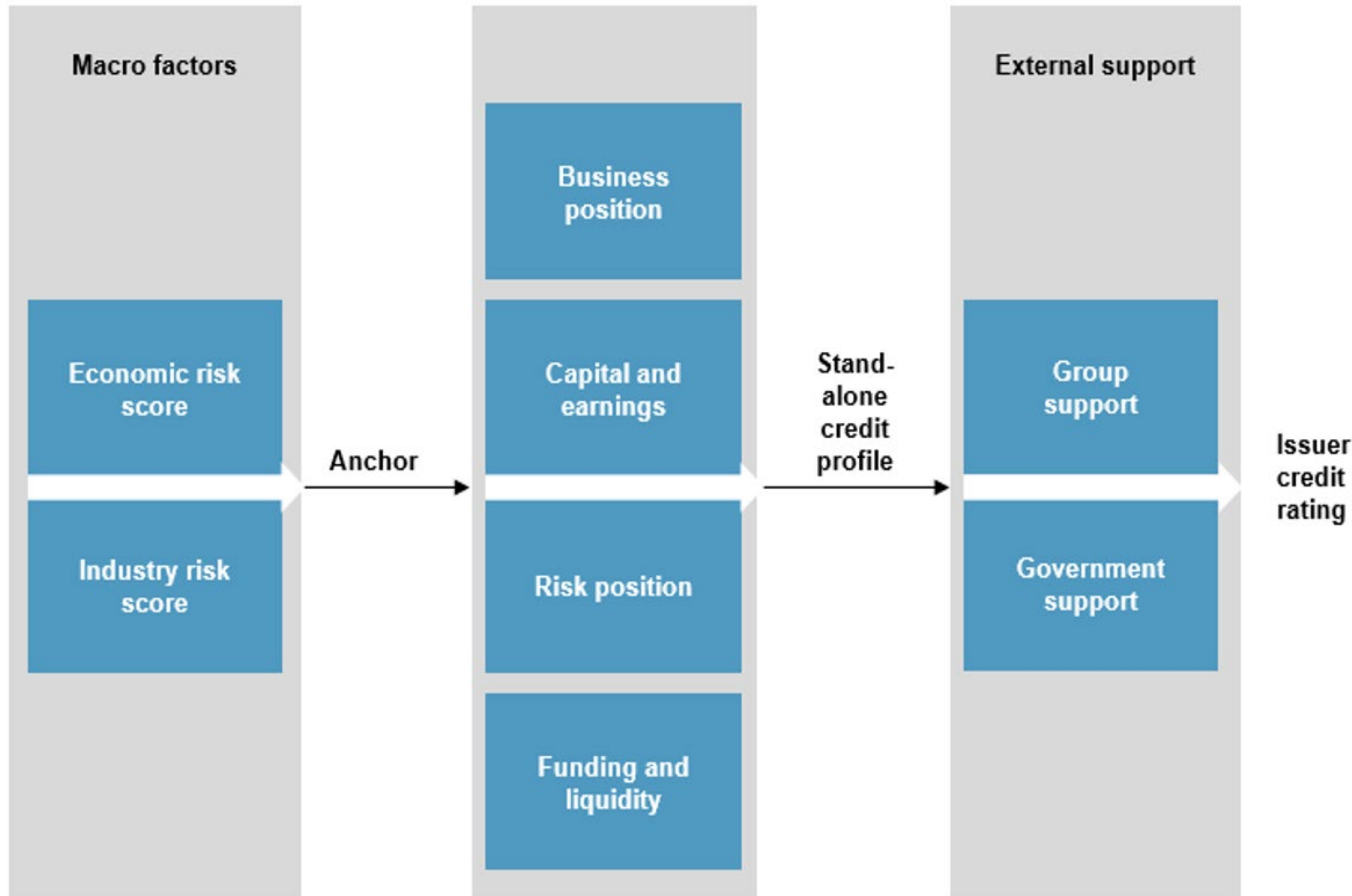
Appendix:

FInancial Institution Rating Methodology Framework



The main differences between the Financial Institutions Methodology of S&P Global (China) Ratings and that of S&P Global Ratings lie on the following aspects:

- Less consideration given to country risk analysis related to China;
- Instead of adopting a proprietary capital model like S&P Global Ratings, we leverage on the regulatory capital ratios in our capital & earnings analysis;
- Peer comparison is limited to financial institutions operating in China.

Note: After assessing the issuer's entity-specific factors, a holistic assessment may be applied to evaluate its credit characteristics in aggregate and versus peers before arriving at SACP.

Source: S&P Global (China) Ratings.

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Our approach to analyzing auto finance companies is consistent with our general approach to assessing FIs to ensure cross-sector comparability

Rating Factor	How it is Analyzed
Anchor	The anchor for auto finance companies is the same as that for other finance companies ("fincos") regulated by CBIRC, which is two notches lower than the bank anchor to reflect the credit quality differences between the banking sector and regulated finco sector.
Business Position	Business position assessment for auto finance companies focuses on comparison among fincos with the same 'bbb-' anchor, particularly the peer comparison among auto finance companies.
Capital & Earnings	Since auto finance companies' capital is generally regulated by CBIRC in the same way as banks, our approach for assessing auto finance companies' capital & earnings is the same as for banks.
Risk Position	Risk position assessment is to reflect risk not fully captured by the capital & earning assessment. Since auto finance companies' capital & earnings assessment is consistent with banks, the risk position assessment is also consistent. We compare the underwriting standards and asset quality performance of auto finance companies with those of banks.
Funding & Liquidity	Funding & liquidity assessment for auto finance companies is consistent with other NBFIs. We compare auto finance companies' funding stability with other fincos with 'bbb-' anchor. Liquidity is analyzed in absolute terms to see how well the company can sustain liquidity stress.
Group Influence	Our approach to assessing auto finance companies' group influence is the same as for other entities.

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The Anchor is our starting point for determining SACP

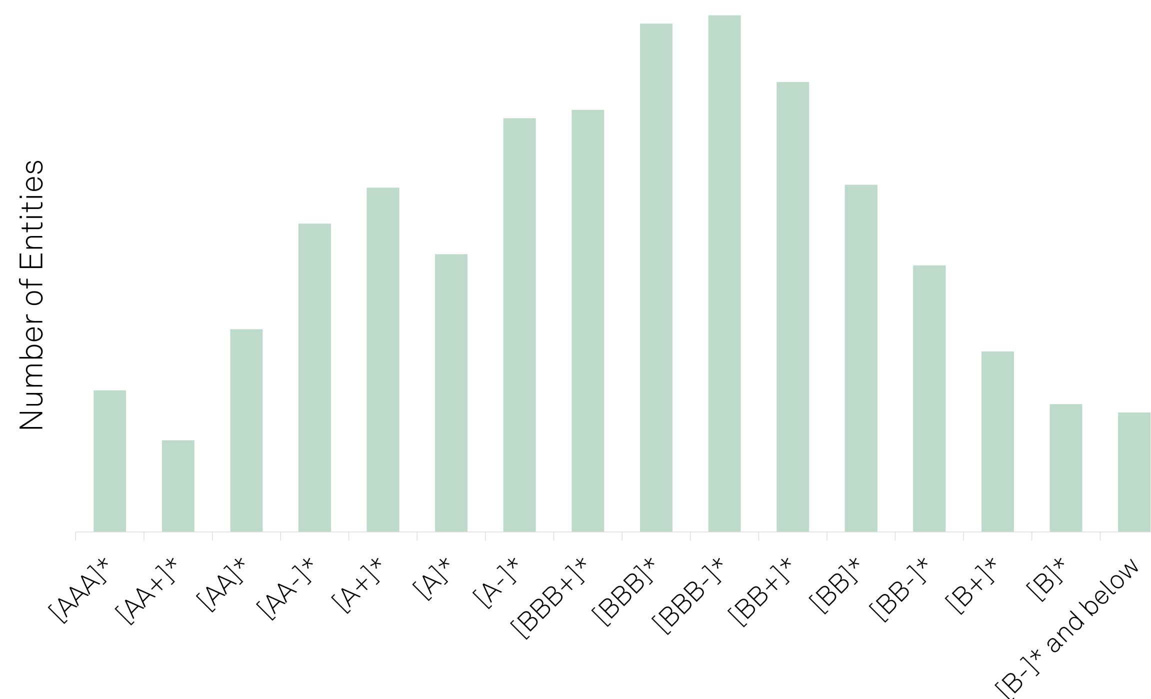
The anchor represents the strengths and weaknesses of an FI's broader operating conditions and gives the starting point for determining the SACP.

The anchor typically reflects the economic risk and industry risk in China. We typically put much less weight on China's country risk assessment when deciding the anchor. Usually, we assume the China's country risk is extremely low in our national scale rating.

We set our bank anchor at 'bbb+' for the following reasons.

- The credit profile of the banking sector in China should be a reflection of the broader credit markets in China. We believe the [BBB_{spc}] category anchor for FI is a reasonable reflection of the broader credit risks in China, particularly for the corporate issuers in the rating universe.
- We believe overall industry risk for the broader financial institution sector is broadly in the 'bbb' category with banks towards the higher end and brokers and other NBFIs towards the lower end.

Distribution of Indicative Issuer Credit Quality of 1,700 Corporates Tested



Note: *The indicative issuer credit quality distributions expressed in this report are only S&P China's indicative views of credit quality derived from a desktop analysis based on public information without interactive review with any particular entity or the full credit rating process such as a rating committee. The opinions expressed herein are not and should not be represented as a credit rating and should not be taken as an indication of a final credit rating on any particular entity

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Preliminary Anchors for Different Financial Subsectors

- The 'bbb-' anchor for auto finance companies also reflects their smooth access to the interbank market and strict regulatory framework, given their status as NBFIs regulated by CBIRC.
- We typically use a 'bb+' anchor for leasing companies under car makers because they are not licensed and regulated by CBIRC and have no access to short-term borrowing on the interbank market.

Preliminary Anchor	Typical Financial Subsectors
bbb+	Commercial banks
bbb-	Brokers, **auto finance companies**, regulated leasing companies, captive finance companies of corporate groups, regulated consumer finance companies, the "big four" national distressed asset management companies, asset investment companies under banks and other fincos regulated by CBIRC or CSRC
bb+	Unregulated leasing companies, micro-lending companies, financial guarantors, factoring companies, regional distressed asset management companies, and other fincos without tight regulatory oversight by CBIRC or CSRC

Note: This table shows the preliminary anchor assessment results. Our final anchor applied to an institution may also subject to sector – and entity -specific anchor adjustment, thus may be different from the preliminary anchor.
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Notching Rules For Stand-alone Credit Profile ("SACP")

We arrive at financial institutions' SACP through upward or downward notching adjustment from the anchor using four SACP factors, namely business position, capital & earnings, risk position and funding & liquidity. The four SACP factors represent specific strengths and weaknesses of an FI. Based on the analysis of these factors, the SACP can be higher or lower than the anchor. These adjustments reflect entity-specific characteristics.

Business Position		Capital and Earnings		Risk Position	
Score	# Notches	Score	# Notches	Score	# Notches
1	+3*/+2	1	+2	1	+2
2	+1	2	+1	2	+1
3	0	3	0	3	0
4	-1	4	-1	4	-1
5	-2	5	-2	5	-2
6	-3	6	-3	6	-3

Note*: When the business position score is "1", the adjustment is usually "+2". "+3" can only be considered when the business position of the evaluated entity has significant advantages compared with peers.

Funding & Liquidity (# Notches)					
Funding Assessment	Liquidity Score				
	1	2	3	4	5
Better than Average	+2/+1	+1/0	-1	-2	-3
Average	0	0	-1	-2	-3
Worse than Average	-1	-1	-1	-2	-3

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Business Position Assessment Framework

Business position measures the strength of a financial institution's business operations, which typically considers business stability, concentration or diversity, and management and corporate strategy. It has a six-point scale, with '1' indicating the lowest risk and '6' the highest. We take business stability as the primary driver to reach a preliminary assessment on business position. We then consider diversity and management as a supplemental driver, allowing for flexibility to further adjust our assessment.

Step 1: Primary driver – business stability

Business stability is usually measured by the entity's market share, revenue stability, and customer base compared with domestic peers in a similar industry.

Step 2: Supplemental drivers - diversity, management and other adjustments

- Diversity of business activities typically consider the contributions of different business lines and geographies to a financial institution's revenues.
- Management and strategy typically considers management's ability to execute operational plans in a consistent manner, strategic direction, management's risk appetite, and ownership and governance.

Factors that are typically considered	Positive	Negative
Market share	Higher than peers	Lower than peers
Entrance barriers	High	Low
Revenue volatility	Lower than peers	Higher than peers
Recurring income as a percentage of revenue	Higher than peers	Lower than peers
Diversified business lines and geographic coverage	More diversified than peers	Higher concentration than peers
Matching between strategies and actual execution capability	Nearly always consistent with enterprise's capabilities	Limited evidence that strategic plans exist or are meaningful
Track record of achieving financial/operational goals	Better than peers	Weaker than peers
Risk tolerances of management	More conservative	More aggressive

Comparison of Various Players in the Auto Finance Market

- Compared with other NBFIs, the auto finance sector has relatively high barriers to entry. So far, China has only 25 auto finance companies licensed by CBIRC, and the last license was issued in 2016. One reason is the relatively high concentration in the automaker industry. All auto finance companies have to be closely associated with car makers to receive a CBIRC-granted auto finance license.
- However, auto finance companies are not the only FIs providing auto finance services. Commercial banks, financial leasing companies and captive finance companies of car making groups compete in the same market. The auto finance companies are the biggest players with total market share of about 50%.
- Compared with competitors in other subsectors, auto finance companies have distinctive advantages in brand association and synergy with car makers. As institutions founded by car makers, auto finance companies typically have the mandate of promoting car sales in addition to earning interest income.

Comparison Among Different Players in Auto Finance Business	
Auto Finance Company	– Deep knowhow about cars – Close ties with car makers and dealerships – Able to offer borrowers interest discounts given by car makers – Able to bundle credit products with other car-related services – Fast credit review and processing
Commercial Bank	– Very extensive physical business network – Lengthy credit review and processing phase
Financial Leasing Company	– Flexible underwriting standards – Flexible credit product design – Higher interest rates charged to borrowers

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Indicative Business Position Notching of FIs with Anchor of ‘bbb-’

Preliminary Notching Guidance for Business Position Testing

Notching	Score	Typical features
+2	1	Very large auto finance companies associated with very strong car makers, with very stable business resistant to external shocks, typically with an asset market share larger than 10%.
+1	2	Large auto finance companies associated with strong car makers, with very stable business, typically with an asset market share between 7% and 10%.
0	3	Mid-sized auto finance companies with stable business, typically with an asset market share between 4% and 7%.
-1	4	Small auto finance companies with somewhat less stable business, typically with an asset market share between 1% and 4%.
-2	5	Very small auto finance companies with less stable business, typically with an asset market share of less than 1%.
-3	6	Companies with business risk much higher than peers in the auto finance industry. This typically only applies to businesses in crisis.

Note 1: The thresholds used in our testing is only the starting point of scoring. We also consider other qualitative and quantitative factors, so our final notching conclusion may differ from the conclusion drawn from the preliminary threshold analysis.
Note 2: The market share is calculated as asset market share in the auto finance company subsector, excluding banks and other fincos in the auto finance business.
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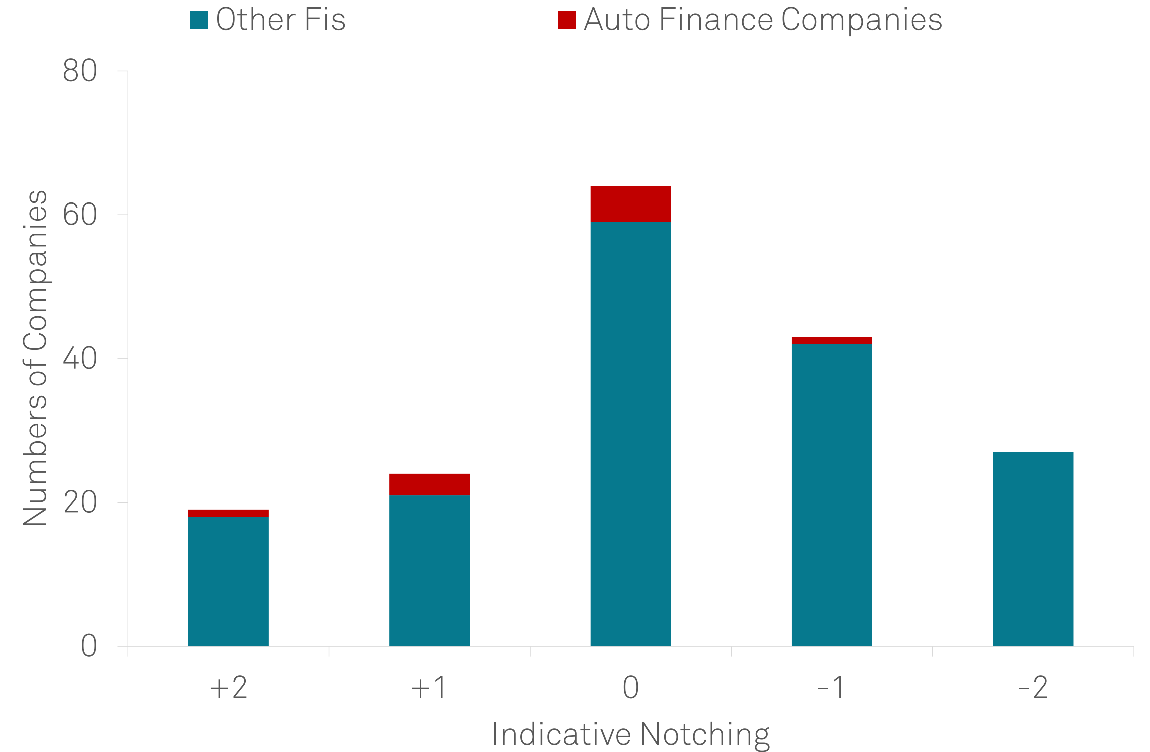
Distribution of Indicative Business Position Notching of FIs with Anchor of ‘bbb-’



Note 1: Most of the notchings are applied to the anchor of bbb-, and in a few cases bbb. Entities using bbb- anchor typically include entities licensed and regulated by CBIRC or CSRC, such as brokers, financial leasing companies, auto finance companies, captive finance companies of corporate groups, consumer finance companies, and asset investment companies under banks. Entities using bbb anchor are typically highly regulated financial holding companies whose subsidiaries include both banks and non-bank FIs.
Note 2: The indicative notching expressed in this report are S&P China’s indicative views of risk factors derived from a desktop analysis based on public information without interactive review with any particular institution or the full credit rating process such as a rating committee (except for some institutions for which we have assigned ratings on). The opinions expressed herein are not and should not be represented as part of a credit rating.
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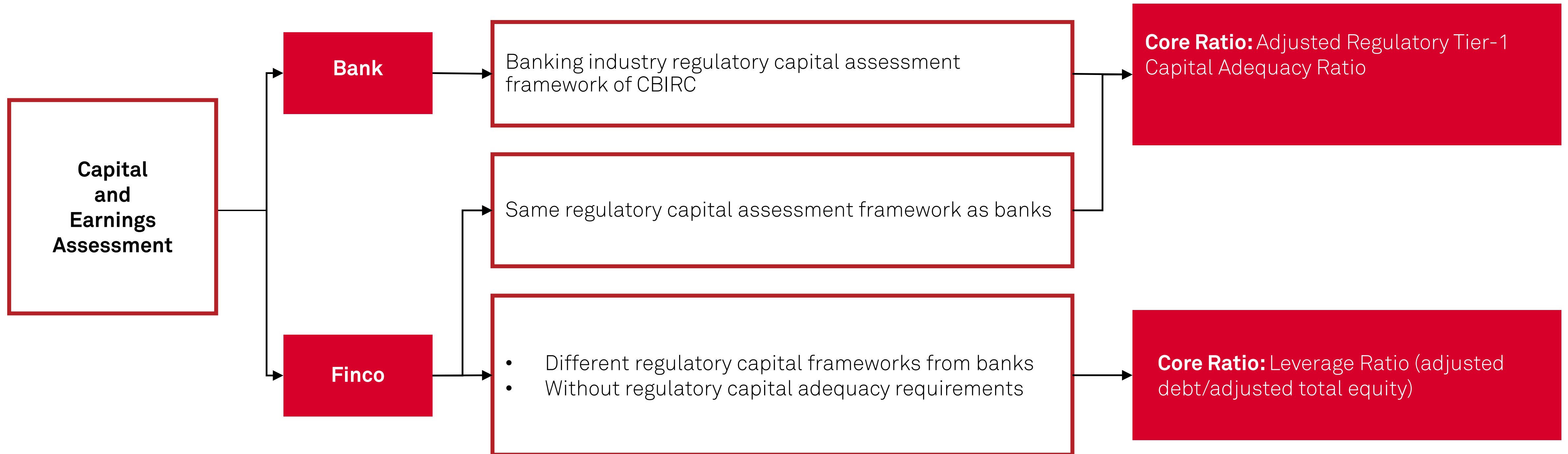
Two Different Approaches For Assessing Fincos' Capital And Earnings

- For fincos which are subject to the same regulatory capital assessment framework as banks (including auto finance companies), we apply the same approach used for banks. In such cases, the core capital metric we use is adjusted regulatory tier-1 capital adequacy ratio.

- For fincos that fall under different regulatory capital frameworks and those that don't have regulatory capital adequacy requirements, we typically use their leverage ratio as our core capital metric.



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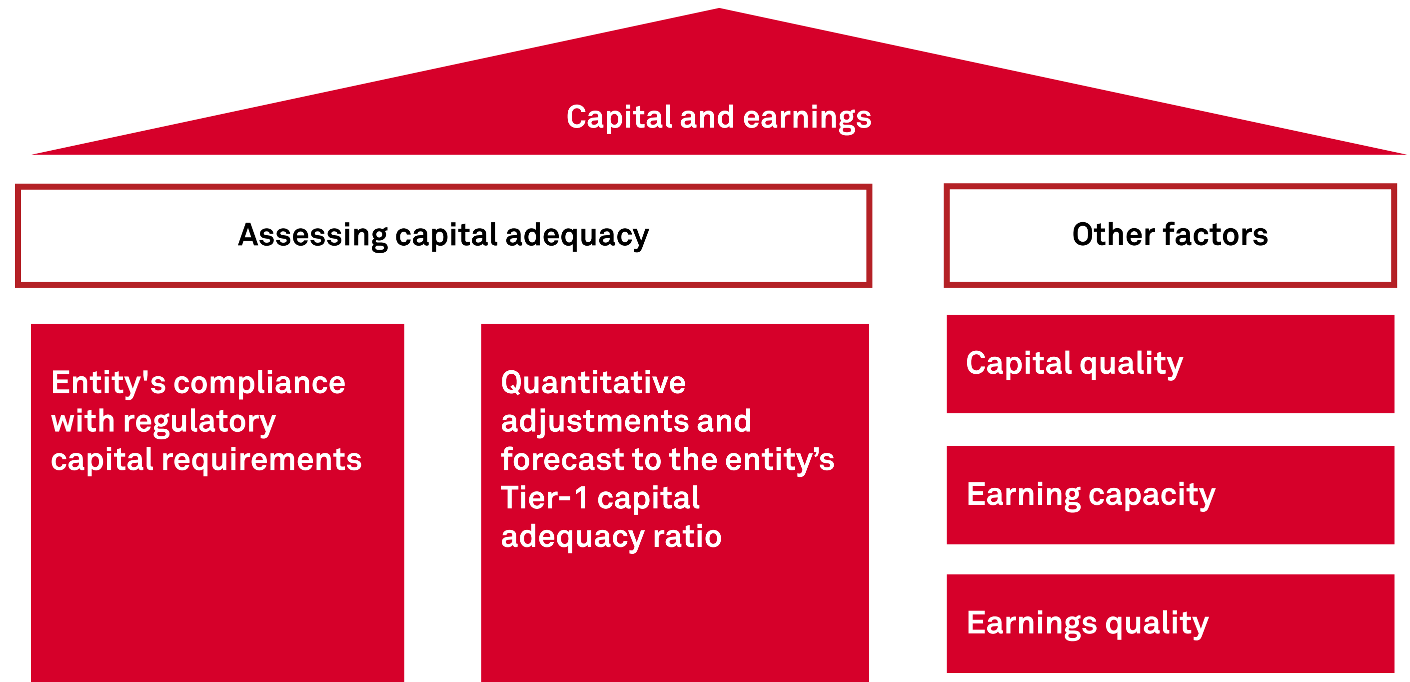
There are three steps in our capital and earnings assessment

- Capital and earnings is the second factor in our assessment of a financial institution' SACP. It covers an entity's ability to absorb losses under stress.
- We usually take an institution's capital adequacy as a starting point of our analysis which forms its initial capital and earnings score. We then consider additional factors like capital quality, earning capacity and earning quality, which help determine whether we need to adjust our initial score.
- Our capital and earnings assessment is forward-looking.



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Major Auto Finance Companies' Capital and Earnings Assessment Summary

Step	Description	Major Auto Finance Company's Characteristics
Step 1	Assess compliance with regulatory capital requirements	Major auto finance companies have high reported regulatory capital ratios and can comfortably meet the regulatory requirements
Step 2	Adjust and forecast Tier 1 capital adequacy ratio	Given their strong provisioning, we typically don't conduct downward adjustments on their reported ratios. Their strong internal capital generation capacity (high earnings) can typically sustain the capital consumption of their new business growth
Step 3	Assess the entity's capital quality, earnings capacity and earnings quality	We typically have positive/neutral views on major auto finance companies' earning capacity and quality
3.1	Assess capital quality and capital structure	They seldom issue hybrid bonds, thus their capital quality is healthy
3.2	Assess the entity's earnings capacity	Major auto finance companies have strong and robust earnings
3.3	Assess the entity's earnings quality	Their strong reserve buffers ensure robust earnings quality
3.4	The entity's capital adequacy over the next 12-24 months under a stressed scenario	They have high reserve buffers, strong capitalization and robust earnings buffers, making them resilient even under stress scenarios
3.5	Assess other additional factors, such as ongoing group support	Auto finance companies enjoy on-going capital support from their parents
3.6	Combine the assessment results from the previous steps to arrive at final score	Therefore, we typically have favorable views on major auto finance companies' capital & earnings

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Indicative Capital & Earnings Notching of FIs with Anchor of 'bbb-'

Preliminary Notching Guidance for Capital & Earnings Testing

Notching	Score	Typical features
+2	1	We expect the Tier-1 capital adequacy ratio adjusted by S&P Global (China) Ratings to be much higher than the banking industry average, typically above 20% for the following 12-24 months.
+1	2	We expect the Tier-1 capital adequacy ratio adjusted by S&P Global (China) Ratings to be somewhat higher than the banking industry average, typically in the range of 14% - 20% for the following 12-24 months.
0	3	We expect the Tier-1 capital adequacy ratio adjusted by S&P Global (China) Ratings to be consistent with the banking industry average, typically in the range of 9% - 14% for the following 12-24 months; and able to meet the minimum regulatory capital requirements under stress scenario.
-1	4	We expect the Tier-1 capital adequacy ratio adjusted by S&P Global (China) Ratings to be somewhat lower than the banking industry average, typically in the range of 7% - 9% for the following 12-24 months; and it may have difficulty meeting minimum regulatory capital requirements under stress scenario while being able to meet those requirements in normal time.
-2	5	We expect the Tier-1 capital adequacy ratio adjusted by S&P Global (China) Ratings to be lower than the banking industry average, typically in the range of 5% - 7%, for the following 12-24 months; and it may have difficulty meeting minimum regulatory capital requirements even in normal time.
-3	6	We expect the Tier-1 capital adequacy ratio adjusted by S&P Global (China) Ratings to be significantly lower than the banking industry average, typically below 5% for the following 12-24 months; and it may have a significant risk of breaching the minimum regulatory capital requirements or having already breached them, and we expect that without timely capital injection, its operations may become unsustainable.

Note 1: We may adjust the Tier-1 capital adequacy ratio base on our views on specific entity's asset quality.
Note 2: This table is supposed to be used in a forward-looking manner based on our view on the institution's future capitalization in the next 12 to 24 months or longer period if we see fit.
Note 3: We may make downward notching adjustment if an entity's capital quality is significantly weaker than industry average. If an entity has very strong Tier-2 capital which is not reflected in our assessment to its Tier-1 capitalization, we may make upward notching adjustment.
Note 4: The threshold used in our testing is only the starting point of scoring. We also consider other qualitative and quantitative factors, so our final notching conclusion may differ from the conclusion drawn from the preliminary threshold analysis.
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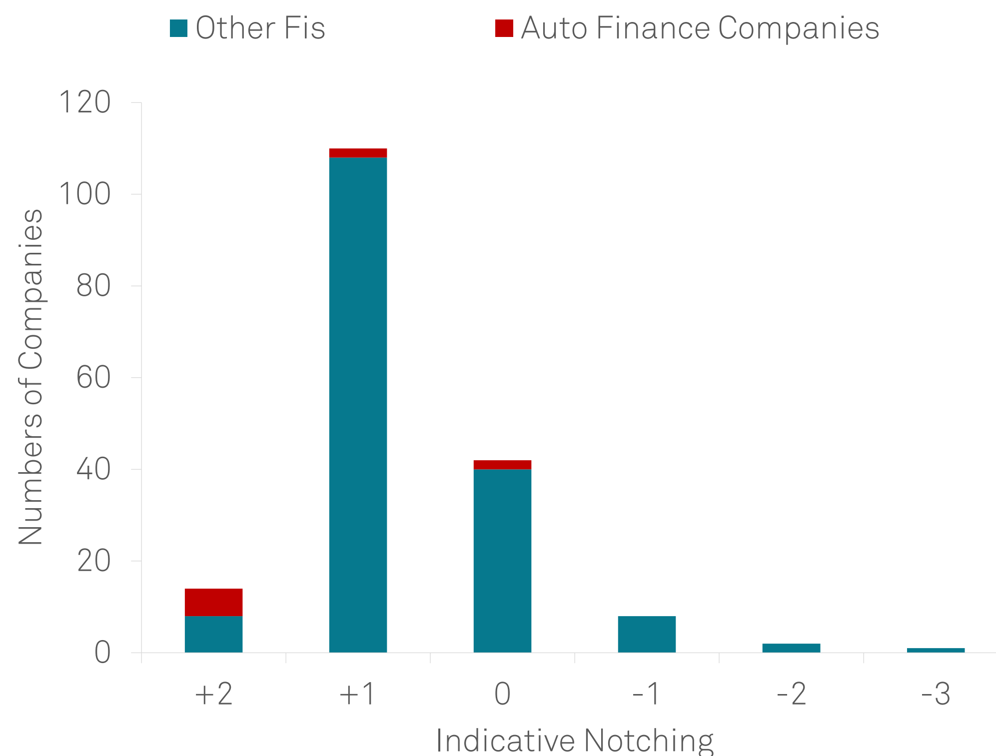
Distribution of Indicative Capital & Earnings Notching of FIs with Anchor of 'bbb-'



Note 1: Most of the notchings are applied to the anchor of bbb-, and in a few cases bbb. Entities using bbb- anchor typically include entities licensed and regulated by CBIRC or CSRC, such as brokers, financial leasing companies, auto finance companies, captive finance companies of corporate groups, consumer finance companies, and asset investment companies under banks. Entities using bbb anchor are typically highly regulated financial holding companies whose subsidiaries include both banks and non-bank FIs.
Note 2: The indicative notching expressed in this report are S&P China's indicative views of risk factors derived from a desktop analysis based on public information without interactive review with any particular institution or the full credit rating process such as a rating committee (except for some institutions for which we have assigned ratings on). The opinions expressed herein are not and should not be represented as part of a credit rating.
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Risk position assessment framework

- Risk position is the third factor we assess to determine SACP. This assessment refines our views on an entity's risks beyond those captured in the capital and earnings analysis.
- We assess factors other than those reflected in the capital and earnings analysis, such as asset quality and risks related to other exposures.
- We do not have any set weighting on these factors, which are listed below, and instead take a holistic approach depending on the exposures. These factors are:

Key factors	Major considerations
Risk appetite	This covers growth and changes in exposures. We typically use this factor as the primary driver for our risk position assessment
Loss experience and expectations	A comparison of past and expected losses on the current mix of business with those of peers and the loss experiences during past economic downturns. Greater-than-average losses may indicate a weaker risk position
Concentrations	The impact of risk concentrations or risk diversification
Complexity	How increased complexity adds risk
Other material risks	Risk that are not captured in our capital and earnings assessment

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Indicative Risk Position Notching of FIs with Anchor of 'bbb-'

Preliminary Notching Guidance for Risk Position Testing

Notching	Score	Typical Features
+2	1	Risk appetite is much lower than the banking industry average, or business concentrates in sectors with very low risk; asset quality is generally insensitive to the economic cycle in China, and we expect its problem asset ratio adjusted by S&P Global (China) Ratings (if applicable) to be about 1% or less in the next 24 months.
+1	2	Risk appetite is lower than the banking industry average, and lending/underwriting standards are more prudent than average banks, or business concentrates in low-risk sectors; asset quality performance is better than the banking industry average through the economic cycle, and we expect its problem asset ratio adjusted by S&P Global (China) Ratings (if applicable) to be in the range of 1% - 3% in the next 24 months.
0	3	Risk management capability, lending/underwriting standards and asset quality performance are consistent with the banking industry average, and we expect its problem asset ratio adjusted by S&P Global (China) Ratings (if applicable) to be in the range of 3% - 6% in the next 24 months.
-1	4	Risk management capability and asset quality performance are somewhat worse than the banking industry average; or lending/underwriting standards are somewhat less stringent compared to average banks, or business concentrates in high-risk or highly cyclical sectors. We expect its problem asset ratio adjusted by S&P Global (China) Ratings (if applicable) to be in the range of 6% - 8% in the next 24 months.
-2	5	Risk management capability and asset quality performance are worse than the banking industry average, or lending/underwriting standards are much more aggressive compared to average banks. We expect its problem asset ratio adjusted by S&P Global (China) Ratings (if applicable) to be in the range of 8% - 11% in the next 24 months.
-3	6	Risk management capability and asset quality performance are far worse than the banking industry average, there may be serious flaws with its overall internal control. Our basic assumptions in the capital and earnings assessment may no longer apply because of the significantly higher risk profile. We expect its problem asset ratio adjusted by S&P Global (China) Ratings (if applicable) to be higher than 11% in the next 24 months.

Note 1: The problem asset ratio adjusted by S&P Global (China) Ratings takes into account NPL ratio and SML ratio, the percentage of assets classified as stage 2 or 3 under IFRS 9, the percentage of overdue loans, and the percentage of extended and restructured loans, and loans that, despite not being classified as NPLs or SMLs, have incurred serious risks and led to creditors' committees being established. We may also consider bad debts in non-standard product investments and bond investment. We may also make adjustments based on the strictness of the asset classification practices of a specific finco.

Note 2: The threshold used in our testing is only the starting point of scoring. We also consider other qualitative and quantitative factors, so our final notching conclusion may differ from the conclusion drawn from the preliminary threshold analysis.

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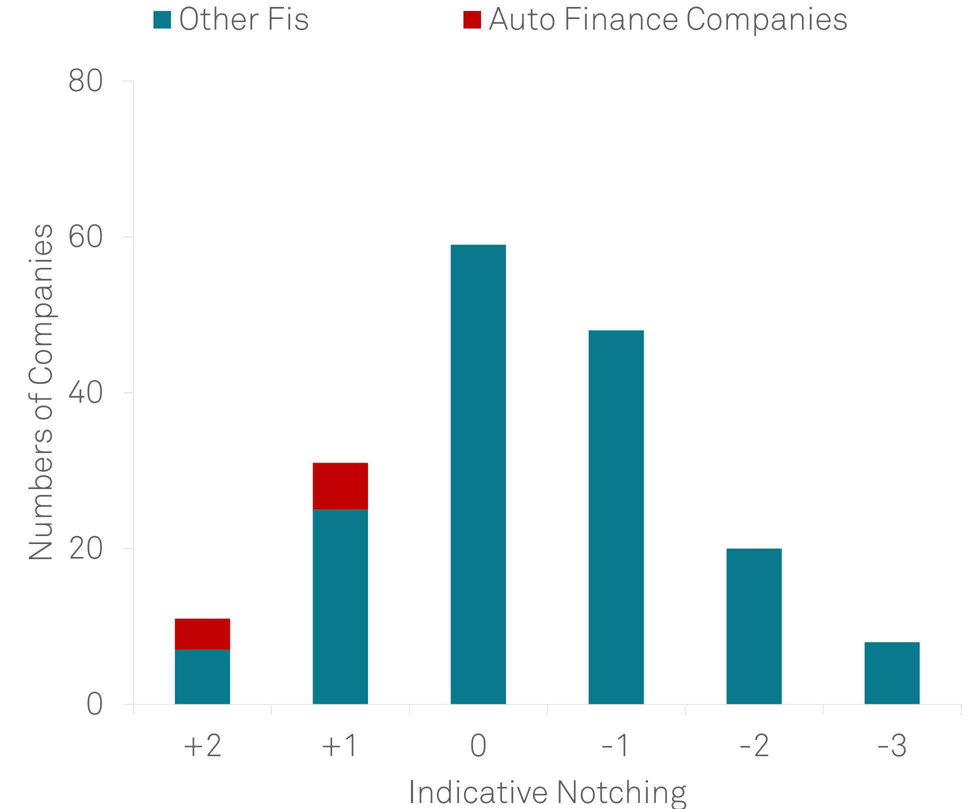
Distribution of Indicative Risk Position Notching of FIs with Anchor of 'bbb-'



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Note 2: The indicative notching expressed in this report are S&P China's indicative views of risk factors derived from a desktop analysis based on public information without interactive review with any particular institution or the full credit rating process such as a rating committee (except for some institutions for which we have assigned ratings on). The opinions expressed herein are not and should not be represented as part of a credit rating.
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Qualitative Assessment of Funding

Key qualitative factors we consider for fincos' funding assessment

- Mix of unsecured debt versus secured debt;
- Access to secured and unsecured funding;
- Currency mismatches or reliance on foreign creditors;
- Maturity or single-creditor concentrations (debt maturity profile);
- How the funding strategy takes into account potential exposure to margin calls;
- Reliance on funding sources that have proven unstable in the past;
- Risk of a sharp increase in cost of funding that could substantially impair earnings capacity; and
- Ability to retain funding over the next year.

Key Factors	Typical Characteristics of Stable Funding
Term structure	The majority of funding consists of a reasonable mix of long-term or medium-term unsecured debts, without over-reliance on unstable short-term debt financing
Funding source	The institution has easy access to a variety of stable debt funding, including interbank markets, securitization market and bond markets
Currency risk	If the institution holds a large amount of assets in different currencies, it has reliable hedging strategies to manage and hedge the associated market risk, and in addition, the institution does not rely heavily on funding from foreign creditors
Maturity concentration	For institutions with any significant debt maturity or single obligator concentration, we believe that such concentration would not trigger serious refinancing risk
Market confidence	The institution will not lose access to funding as a result of investors/counterparties losing confidence in it
Funding cost	The institution's funding costs will not increase significantly due to weakening market confidence and will not put significant pressure on its profitability

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Qualitative Assessment of Funding

Our funding analysis considers the strength and stability of a financial institution's funding mix compared with the domestic industry average. It can be assessed as 'above average', 'average', or 'below average'.

Funding Descriptor	What it typically means
Better than Average	Reflects our view that there is strong excess capacity of stable long-term funding sources relative to needs given the firm's assets, businesses, and markets. Funding is well-matched with asset maturities and well-diversified by type (secured and unsecured) and lender. The entity has demonstrated regular access to unsecured debt markets, and unsecured maturities are well-staggered.
Average	Reflects our view that there is adequate capacity of stable, long-term funding sources relative to needs given the firm's assets, businesses, and markets. Funding is well-matched with asset maturities and is well-diversified by type and lender. Typically, the entity has good access to unsecured debt markets or has deep and stable secured funding with diverse facilities and providers. Unsecured maturities are well-staggered. We expect the company could easily access multiple sources of secured and unsecured funding.
Worse than Average	Reflects our view that funding risk is high because the entity funds a large portion of long-term illiquid assets with less stable sources, which raises the potential for funding gaps. Funding may be significantly shorter than asset maturities or concentrated by type and lender. The entity may have limited access to unsecured debt markets, or we believe it may have difficulty retaining funding over the next year.

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Qualitative Assessment of Liquidity

Our liquidity assessment focuses largely on an FI's ability to withstand liquidity outflows that could occur typically under stress over the coming 12 months by considering the entity's: (1) Potential liquidity sources--on- and off-balance-sheet; (2) Potential liquidity uses--on- and off-balance-sheet; and (3) Liquidity sources compared with liquidity uses.

Typical Characteristics of Sound Liquidity
The liquidity management system provides good tracking of cash inflows and outflows.
The entity has an effective liquidity stress scenario management plan.
There are no significant concentrations of assets or liabilities that could affect the company's liquidity in the next 12 months.
There is no possibility of large unexpected outflows of funds that would strain liquidity resources.
There is no significant liquidity trigger event in the next 12 months.
Even in a stressed scenario, overall funding will not deteriorate significantly.
Market signals are stable, and it has easy access to unsecured funding from counterparties in the interbank market.
Liquidity on the asset side is expected to remain stable over the next 12 months.
We don't expect any other significant liquidity stress over the next 12 months.

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Liquidity Assessment Framework

Liquidity assessment has a five-point scale, with '1' indicating the strongest liquidity and '5' the weakest.

Liquidity Descriptor	What it typically means
1/Strong	In our view, the entity will withstand a stressed outflow of liquidity completely or largely by utilizing on-balance-sheet liquidity sources.
2/Adequate	In our view, the entity is highly likely to withstand a stressed outflow of liquidity, but our confidence in that assessment is somewhat lower than for an entity with "1/strong" liquidity. The entity may also need to utilize secondary sources of liquidity under some plausible stress scenarios.
3/Moderate	In our view, the entity has a lower likelihood than an entity with "2/adequate" liquidity of withstanding a stressed outflow of liquidity and a higher likelihood of having to access secondary or emergency liquidity sources.
4/Constrained	In our view, the entity has a lower likelihood than an entity with "3/moderate" liquidity of withstanding a stressed outflow of liquidity and a much higher likelihood of having to access secondary or emergency liquidity sources.
5/Weak	We have limited confidence that the entity could withstand a stressed outflow of liquidity without significantly utilizing emergency sources of liquidity. Its liquidity profile becomes unpredictable or weak.

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Indicative Funding & Liquidity Notching of FIs with Anchor of 'bbb-'

Preliminary Notching Guidance for Funding & Liquidity Testing

Notching	Typical features
+2	The company has very stable funding structure, and it will withstand a stressed outflow of liquidity completely or largely by utilizing on-balance-sheet sources of liquidity. We believe its funding & liquidity risk will remain very low even without considering on-going group/government support.
+1	The company has very stable funding structure, and it is highly likely to withstand a stressed outflow of liquidity, but it may also need to utilize secondary sources of liquidity under some stress scenarios. We believe its funding & liquidity risk will remain very low after considering on-going group/government support.
0	The company has stable funding structure, consistent with the regulated finco average, and it is likely to withstand a stressed outflow of liquidity, and our confidence in that assessment is consistent with that for regulated finco average.
-1	The company's funding stability is worse than the regulated finco average. The entity has a somewhat low likelihood of withstanding a stressed outflow of liquidity and a somewhat high likelihood of having to access secondary or emergency liquidity sources.
-2	The company's funding stability is much worse than the regulated finco average, and the entity has a low likelihood of withstanding a stressed outflow of liquidity and a high likelihood of having to access secondary or emergency liquidity sources.
-3	The company's funding structure is unstable, and its liquidity is unpredictable or weak.

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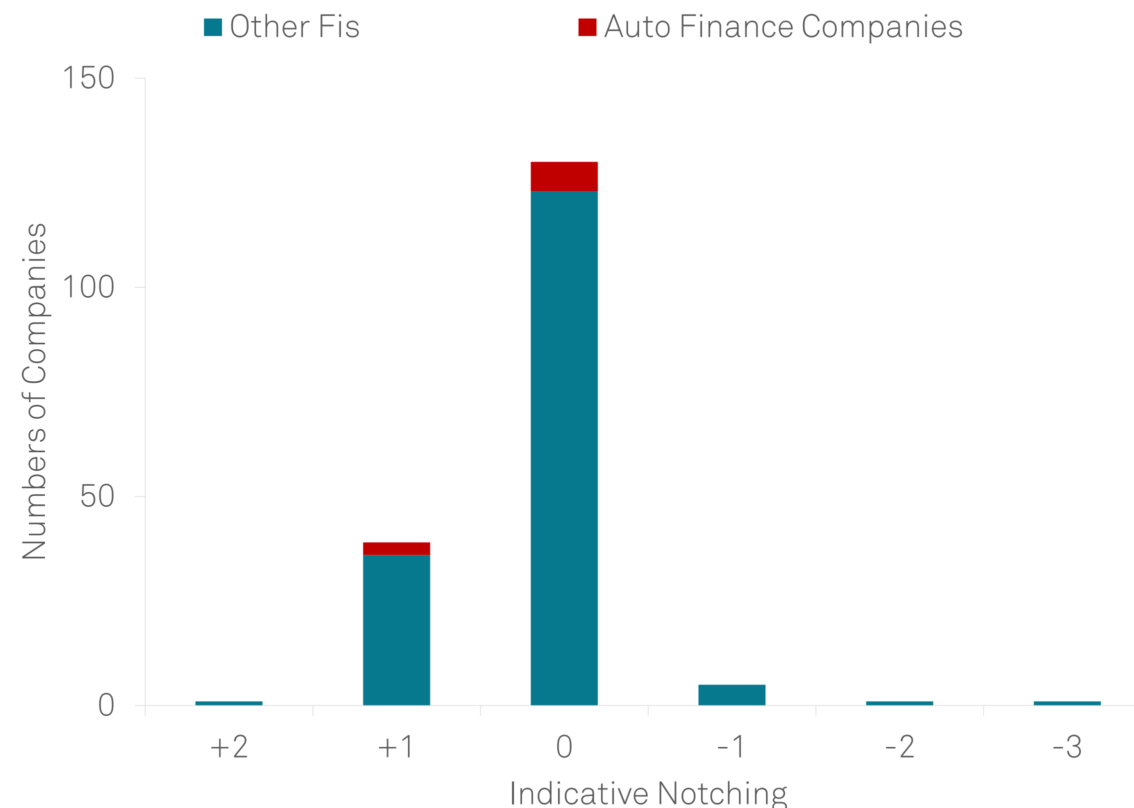
Distribution of Indicative Funding & Liquidity Notching of FIs with Anchor of 'bbb-'



Note 1: Most of the notchings are applied to the anchor of bbb-, and in a few cases bbb. Entities using bbb- anchor typically include entities licensed and regulated by CBIRC or CSRC, such as brokers, financial leasing companies, auto finance companies, captive finance companies of corporate groups, consumer finance companies, and asset investment companies under banks. Entities using bbb anchor are typically highly regulated financial holding companies whose subsidiaries include both banks and non-bank FIs.

Note 2: The indicative notching expressed in this report are S&P China's indicative views of risk factors derived from a desktop analysis based on public information without interactive review with any particular institution or the full credit rating process such as a rating committee (except for some institutions for which we have assigned ratings on). The opinions expressed herein are not and should not be represented as part of a credit rating.

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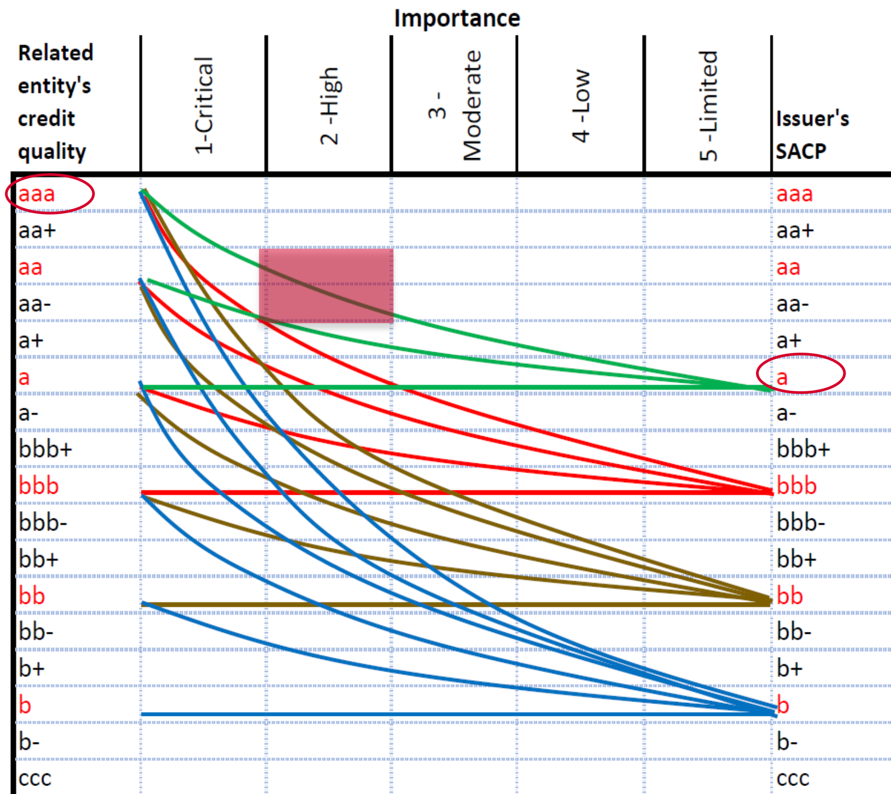
Our support notching decisions are guided by a support curve framework



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- We determine notching for group support by first considering the following factors:
  - the parent's creditworthiness,
  - the subsidiary's stand-alone credit profile ("SACP"), and
  - our assessment of the importance level of the subsidiary to the parent on a scale of 1 to 5.
- We use the support curve chart on the left to help us arrive at a reasonable decision on support notching. For example, where the parent has creditworthiness equivalent to "AAA_{spc}", and the subsidiary has an SACP of "a_{spc}" and its importance level is "2/high", the corresponding section on the support curve would give us a possible issuer credit rating ranging from "AA_{spc}-" to "AA_{spc}". The analyst would typically choose from these options through applying more nuanced considerations, such as peer comparison. Our starting point is usually the mid-point of the corresponding section on the curve, with the flexibility to adjust up or down within that category; however, the starting point may be higher when the importance level is assessed as critical.
- It is worth mentioning that the support curve framework is not intended to be used in a rigid manner. It is a tool to help us make reasonable and consistent analytical decisions. In rare cases, we may determine an outcome that does not fall on the curve when we deem it appropriate.

Group influence can be positive or negative

Theorical Example of Group Influence Notching

	ICR of parent	SACP of auto finance subsidiary	Group influence notching	ICR of auto finance subsidiary	Note
Company A	BBBspc	aspc+	-2 notches	Aspc-	Since the car maker's creditworthiness is weaker than that of its auto finance subsidiary, group influence is negative. Given the auto finance company's status as a highly regulated entity, unless there is evidence of inappropriate related-party transactions, we typically don't equalize the auto finance company's ICR to that of the car maker. Instead, we may choose a middle point between the parent ICR and auto finance company SACP.
Company B	AAAspc	aspc+	+4 notches	AAAspc	Since we typically believe auto finance companies are of critical importance to their parents, we may equalize the ICR of the auto finance company to that of the parent when group influence is positive.

Note: ICR-issuer credit rating; SACP- stand-alone credit profile.

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Credit Differences among Key Finance Subsidiaries of Car Makers

Rating Factor	Auto Finance Company	Captive Finance Company	Commercial Leasing Company
Anchor	bbb- since it is licensed by CBIRC	bbb- since it is licensed by CBIRC	bb+ since it is not licensed by CBIRC
Business Position	Driven by asset market share	Driven by its auto finance business as well as its treasury role for the whole corporate group and its ability to collect deposits within the group	Driven by asset market share
Capital & Earnings	Driven by regulatory capital adequacy ratio assessment	Driven by regulatory capital adequacy ratio assessment	Driven by leverage ratio (debt to equity) assessment since it is not subject to regulatory capital framework
Risk Position	Driven by underwriting standards, asset quality performance, and overall risk appetite	Driven by underwriting standards, asset quality performance, and overall risk appetite	Driven by underwriting standards, asset quality performance, and overall risk appetite
Funding & Liquidity	Access to short-term borrowing in the interbank market, sound market confidence given its status as a licensed finco	Stable funding given its ability to collect deposits within the group. Its funding & liquidity reflects the group's overall liquidity profile	No access to short-term borrowing in the interbank market, heavily reliant on the group's ongoing funding and liquidity support
Stand-alone Credit Profile		Aligned to the group's stand-alone credit quality because it is captive	
Group Support	Critical importance to the group	Critical importance to the group	High importance to the group, but short of being critical
Issuer Credit Rating (ICR)	Typically equalized to the group's ICR	Typically equalized to the group's ICR	Typically one or two notches lower than the group's ICR

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Analyst

Xuefei Zou，CPA：+86-10-6516-6063；eric.zou@spgchinaratings.cn

Jiachuan Xu： +86-10-6516-6018；jiachuan.xu@spgchinaratings.cn

Jiancheng Yang， FRM： +86-10-6516-6072；allen.yang@spgchinaratings.cn

Ying Li， CFA， FRM： 010-6516-6061；ying.li@spgchinaratings.cn

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