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China Ratings

Small but Solid – Foreign Bank Subsidiaries as Niche Players in China's Banking Sector

A Study on the Creditworthiness of Foreign Bank Subsidiaries in China

February 26, 2020

Key Takeaways

- Foreign banks subsidiaries have small business footprints in China, but they offer a unique value proposition in cross-border banking services.
- Foreign bank subsidiaries have maintained high capital adequacy ratios through the years.
- Foreign bank subsidiaries typically have low non-performing loan ratios because of their low risk appetite.
- Thanks to prudent liquidity management, foreign bank subsidiaries' funding and liquidity risk is generally controllable.
- Most foreign bank subsidiaries are fully owned and tightly controlled by their parent banks.
- The indicative issuer credit quality of foreign bank subsidiaries is typically closely aligned with the credit standing of their parents and is less sensitive to the credit environment in China compared with their domestic peers.

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Introduction

S&P Ratings (China) Co., Ltd. (S&P China) has conducted a desktop analysis of a selection of 200 banks in China, including six mega banks, 11 joint-stock banks, 34 foreign banks, 100 city banks and 49 rural banks, representing 93% of China's banking industry by assets. We have chosen these banks based on their asset size, representativeness of any specific type of bank and availability of public information. This report looks specifically into foreign bank subsidiaries, one sub-sector of the banking universe we examined in our other report (see Diversity Across China's Banking System – A Deep Dive A Study on Credit Quality Differentiation Among Chinese Banks, 21st October 2019). The analysis contained herein has been performed using S&P China Methodologies. S&P China Methodologies and analytical approaches are intended specifically for use in China only and are distinct from that used by S&P Global Ratings. An S&P China opinion must not be equated with or represented as an opinion by S&P Global Ratings or relied upon as an S&P Global Ratings opinion.

This desktop analysis has been conducted using publicly available information only and is based on S&P China's methodology for banks and our understanding of both the banking industry in China as well as our understanding of the institutions themselves. The analysis involves applying our methodology to public information to arrive at a potential view of credit quality across the banking sector. It is important to note that the opinions expressed in this report are based on public information and are not based on any interactive rating exercise with any particular institution. However, where we have conducted an interactive rating with a specific issuer, our insights and analysis learned from that review with those issuers, may have also been incorporated in our results contained herein. 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 but are initial insights of potential credit quality based on the analysis conducted. This desktop analysis does not involve any surveillance. The opinions expressed herein are not and should not be viewed as recommendations to purchase, hold, or sell any securities or to make any investment decisions, and do not address the suitability of any security.

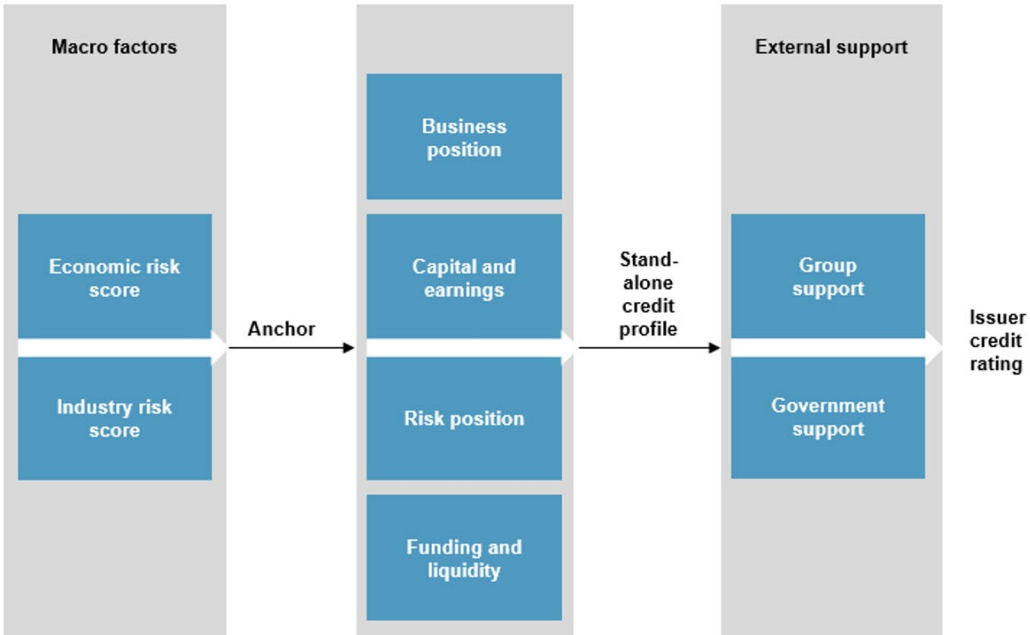
We have conducted this desktop analysis on individual institutions and present the results contained herein at an aggregate group level by types of institutions. The different sections of this research show the statistics and performance of different groups of institutions and the market more broadly against the metrics we generally consider most relevant under our methodology.

Given the desktop nature of this analysis, and that we have not conducted an interactive review with most of those institutions, we may have made certain assumptions in lieu of confirmed information and where relevant we may also have attempted to consider any possibility of parent, group, government or other forms of potential support, to inform our view of potential credit quality. S&P China is not responsible for any losses caused by reliance on the content of this desktop analysis.

This desktop analysis is based on S&P Global (China) Ratings Financial Institutions Methodology. We typically determine the stand-alone credit quality based on our assessment of an institution's anchor, a starting point, and then incorporating its own characteristics compared with the anchor. S&P Global (China) Ratings typically applies an anchor of 'bbb+' for banks. The entity-specific factors that we may use to adjust from the anchor include business position, capital and earnings, risk position, and funding and liquidity. We then determine the issuer credit quality based on the stand-alone credit quality and our assessment of potential group and government influence.

Chart 1

Financial Institution Methodology Framework



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.

S&P Global (China) Ratings typically applies an anchor of 'bbb+' for banks.

Overview

There are 41 foreign financial institutions that have set up locally incorporated banking subsidiaries in China, with an overall asset market share of around 2%.

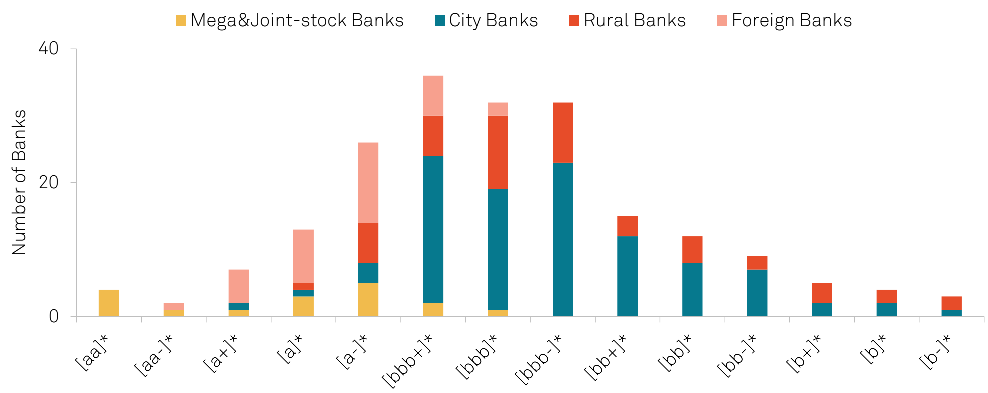
Despite their small sizes, these foreign bank subsidiaries play a unique role in China's banking industry as facilitators of cross-border banking businesses. As the Chinese government tries to internationalize Renminbi and the Chinese economy further integrates into the world economy, we expect these banks to enjoy more business opportunities in the future.

Nonetheless, we expect foreign bank subsidiaries to remain relatively small in terms of asset size in the foreseeable future, as they are still less willing to increase their credit exposure to China's real economy compared with their domestic peers, given the rising economic uncertainty in China. Their low risk appetite and fierce competition from domestic banks are among the important reasons why foreign bank subsidiaries remain small after operating in China for decades.

Because of their good asset quality and strong capitalization, these foreign bank subsidiaries tend to have good stand-alone credit quality despite their small business footprints in China.

Chart 2

Distribution of Indicative Stand-alone Credit Quality of 200 Major Banks in China



Despite their small sizes, foreign bank subsidiaries typically have good indicative stand-alone credit quality because of their strong capital base and low risk appetite.

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

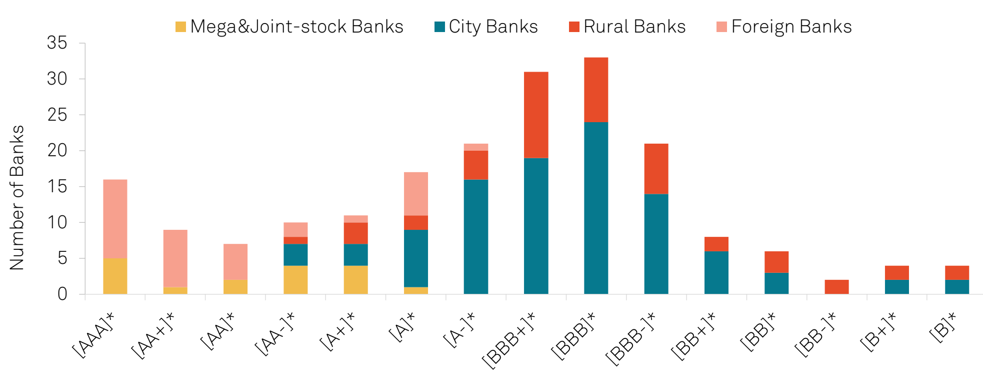
Note 2*: The indicative credit quality distributions expressed in this report are only S&P China's indicative views of credit quality derived from a desktop analysis based on public information without interactive review with any particular institution or the full credit rating process such as a rating committee (except for a few cases where we have already assigned public ratings on a bank). 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.

Source: S&P Global (China) Ratings.

Most foreign bank subsidiaries are fully owned and tightly controlled by their parent banks and receive strong support from parents. Therefore, their indicative issuer credit quality is typically more in line with the credit standing of their parents and is less sensitive to the general economic landscape in China compared with domestic banks in China.

Chart 3

Distribution of Indicative Issuer Credit Quality of 200 Major Banks in China



The indicative issuer credit quality of foreign bank subsidiaries is typically in line with the credit standing of their parents.

Note 1: Our assessment of indicative issuer credit quality considers the possibility of group or government support in time 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 (except for a few cases where we have already assigned public ratings on a bank). 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.

Source: S&P Global (China) Ratings.

Business Position

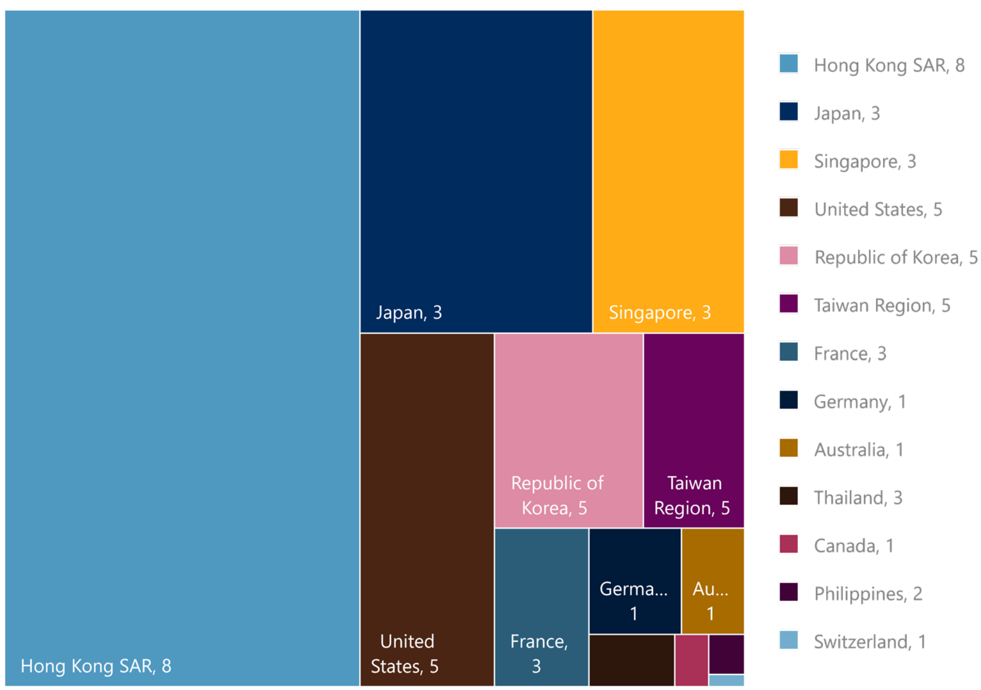
Foreign bank subsidiaries have a solid niche market in serving multinationals, foreign companies operating in China and Chinese companies with overseas business by capitalizing on their synergy with parent banks. Their access to international banking networks through their parents gives them a unique competitive edge that most domestic banks cannot match.

The business franchise of foreign bank subsidiaries has a strong relationship with the economic ties between their parent countries/regions and China. The parents of the biggest foreign bank subsidiaries are typically based in the Hong Kong SAR, Japan, Singapore, US and South Korea.

The business franchise of foreign bank subsidiaries has a strong relationship with the economic ties between their parent countries/regions and China.

Chart 4

Total Asset Sizes and Numbers of Foreign Bank Subsidiaries in China Grouped by the Homebase of Parent Banks

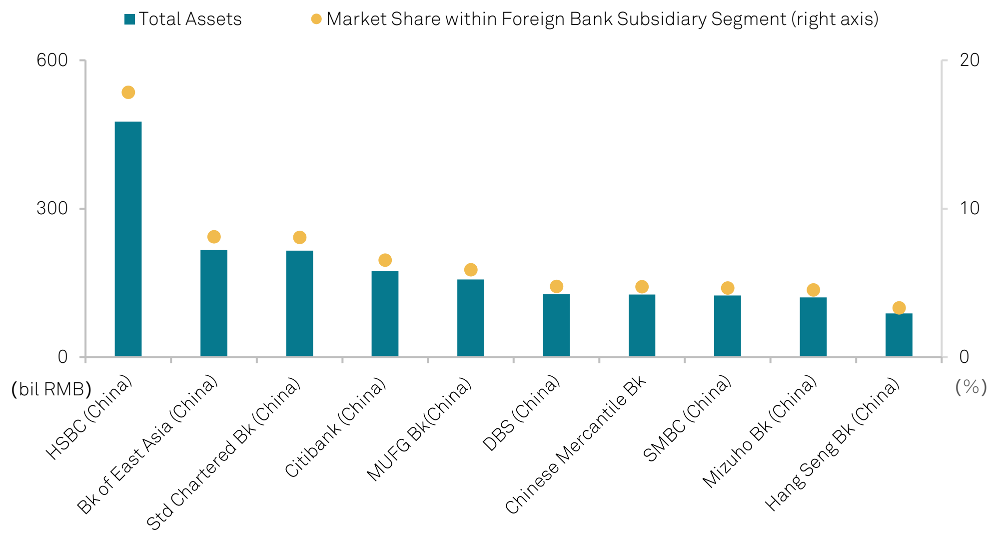


Note: Numbers in the chart denote number of foreign bank subsidiaries in China of each country/region; and the size of the rectangle denotes relative size of the total assets of the foreign bank subsidiaries of each country/region.

Sources: S&P Global Market Intelligence Database, public information of banks, collected and adjusted by S&P Global (China) Ratings.

Chart 5

Top 10 Foreign Bank Subsidiaries in China in Terms of Assets as of the End of 2018



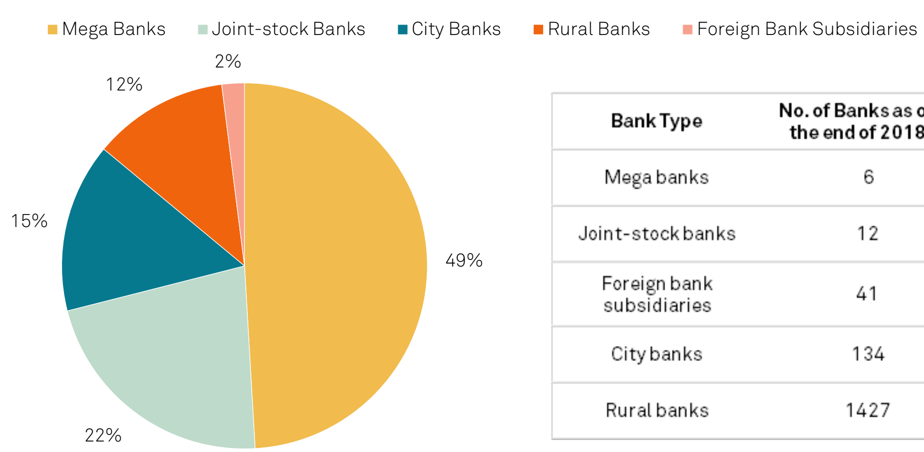
Sources: S&P Global Market Intelligence Database, public information of banks, collected and adjusted by S&P Global (China) Ratings.

The parents of the biggest foreign bank subsidiaries are typically based in the Hong Kong SAR, Japan, Singapore and US.

Compared with domestic banks which have been quickly expanding their loan books in the past decade, foreign bank subsidiaries have experienced much slower growth thanks to their lower risk appetite and smaller network. The 41 foreign bank subsidiaries only account for about 2% of asset market share in China.

Chart 6

Asset Market Share Breakdown of China's Commercial Banking Industry as of the End of 2018



Bank Type	No. of Banks as of the end of 2018
Mega banks	6
Joint-stock banks	12
Foreign bank subsidiaries	41
City banks	134
Rural banks	1427

Source: CBIRC, collected and adjusted by S&P Global (China) Ratings.

The 41 foreign bank subsidiaries only account for 2% of asset market share in China.

The Chinese government and regulators have been opening up China's financial market to foreign players and gradually leveling the playing field. We expect foreign bank subsidiaries to have more business opportunities in China, but we don't expect them to grow fast in the foreseeable future given the country's rising economic uncertainty. In our view, foreign banks' low risk appetite in China and the fierce competition from domestic banks have been the major reasons for their slow growth. Amid the current economic headwinds in China, we don't expect foreign bank subsidiaries to significantly increase their risk appetite over the next two years.

Table 1

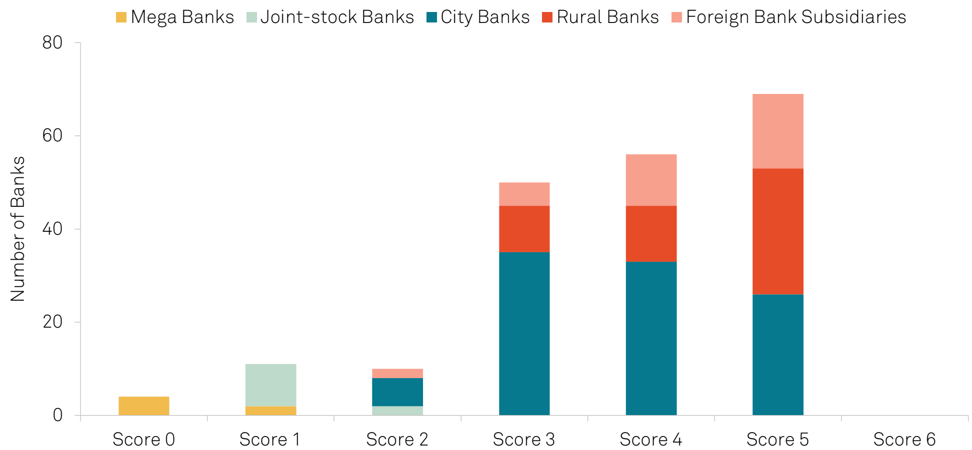
China accelerated the opening-up of its financial industry in 2018 and 2019

Entry barriers lowered	Removal of total asset threshold for foreign banks to set up branches, locally incorporated banks, or joint-venture banks in China;
	Removal of the FI status requirement for a domestic shareholder in a joint-venture bank; and
	Foreign banks permitted to have both branches and locally incorporated banks in China at the same time.
Business scope broadened	Foreign bank subsidiaries, JV banks and foreign bank branches allowed to underwrite government bonds, and serve as payment and insurance agents in China;
	Threshold for foreign bank branches to accept single-name RMB retail time deposit lowered from 1,000,000 RMB to 500,000 RMB;
	RMB-denominated business license approval process simplified for foreign banks;
	Removal of the requirement of having at least 30% of working capital as interest-bearing assets for foreign bank branches;
	Foreign financial institutions encouraged to participate in the setup and investment of wealth management subsidiaries of Chinese commercial banks; and
	Foreign institutions allowed to obtain Class A lead underwriter licenses in the interbank bond market.

Sources: Government websites, public information, collected and adjusted by S&P Global (China) Ratings.

Chart 7

Indicative Business Position Score Distribution of 200 Major Banks in China by S&P Global (China) Ratings



Note 1: For our testing purpose, we score the business position of banks in a scale of 0 to 6. 0 means the strongest business position and 6 means the weakest.

Note 2: The indicative scores 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.

Source: S&P Global (China) Ratings.

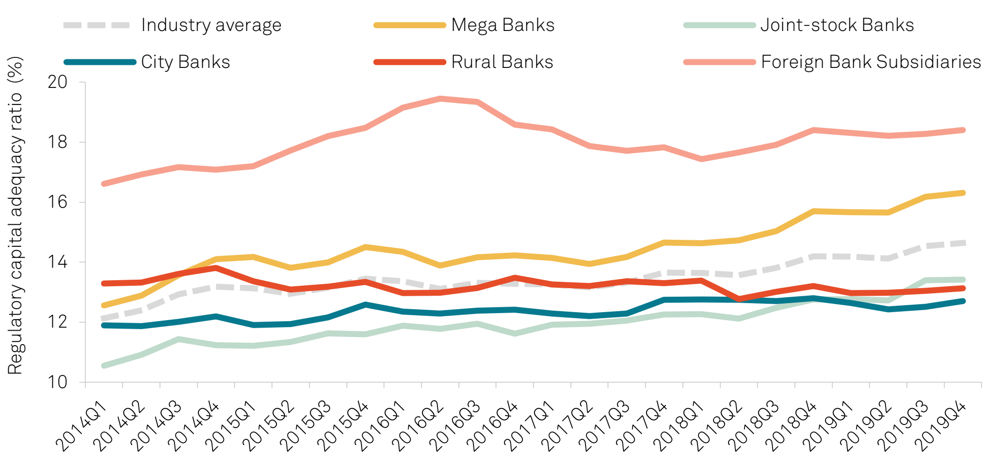
Foreign bank subsidiaries typically have limited business footprints in China.

Capital & Earnings

Foreign bank subsidiaries have maintained high capital adequacy ratios in recent years because their loan books tend to be small and their overall leverage level is lower than the industry average.

Chart 8

Reported Regulatory Capital Adequacy Ratios of Different Types of Banks

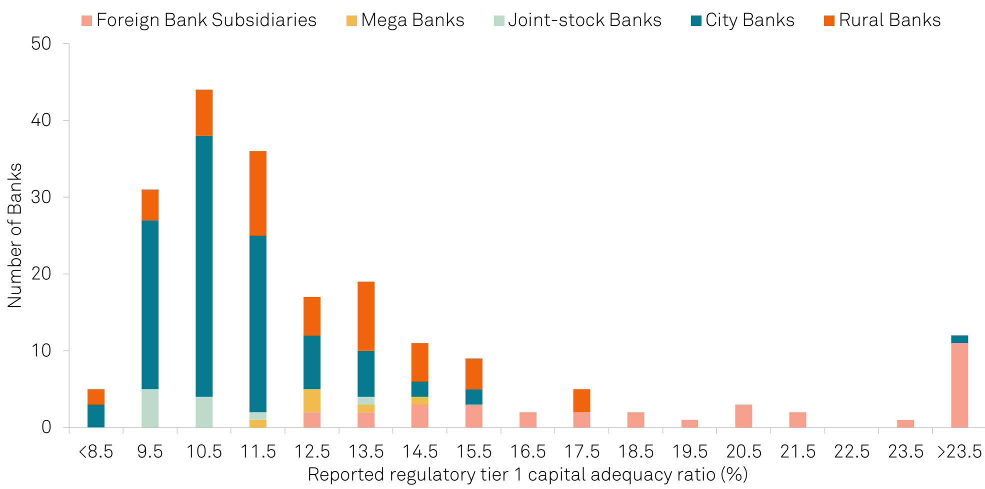


Source: CBIRC, collected and adjusted by S&P Global (China) Ratings.

Foreign bank subsidiaries have had a capital base significantly stronger than the industry average in recent years.

Chart 9

Distribution of Reported Regulatory Tier 1 Capital Adequacy Ratio of Major Banks in China as of the End of 2018



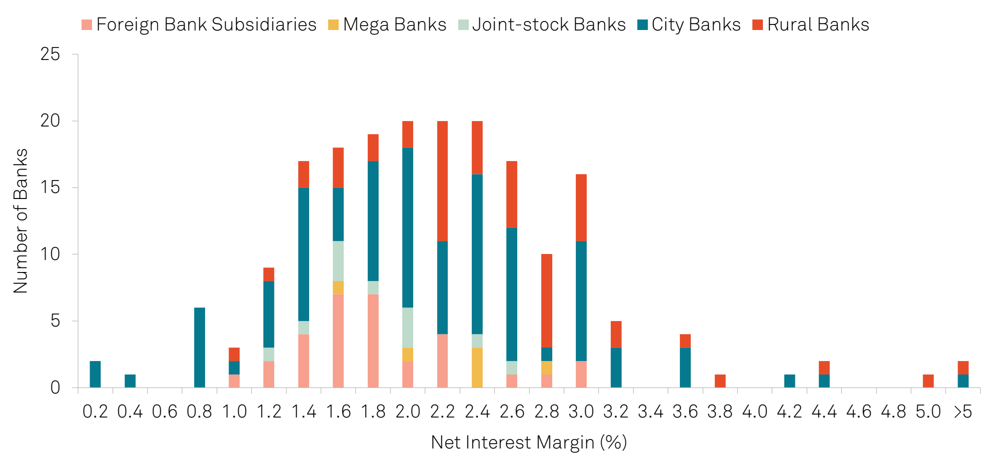
Sources: S&P Global Market Intelligence Database, public information of banks, collected and adjusted by S&P Global (China) Ratings.

Thanks to low leverage and low credit risk exposure, foreign bank subsidiaries typically have high capital adequacy ratios.

The net interest margin ("NIM") of foreign bank subsidiaries is typically consistent with or lower than the industry average. Their low risk appetite typically leads to a low credit risk charge in their loan pricing.

Chart 10

Net Interest Margin of Major Banks in China in 2018



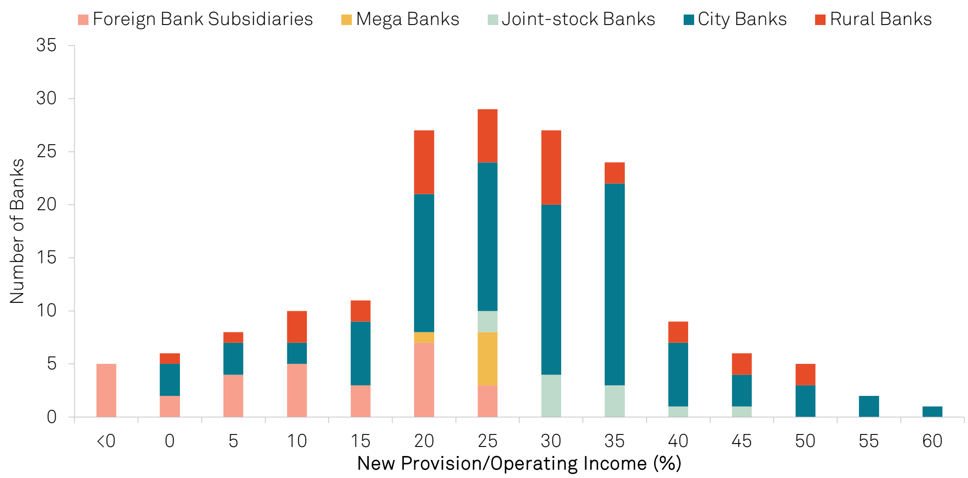
Sources: S&P Global Market Intelligence Database, public information of banks, collected and adjusted by S&P Global (China) Ratings.

NIM of foreign bank subsidiaries is typically consistent with or lower than the industry average.

Thanks to low non-performing loan ("NPL") ratios, foreign bank subsidiaries tend to have low provisioning costs.

Chart 11

New Provision/Operating Income of Major Banks in China in 2018



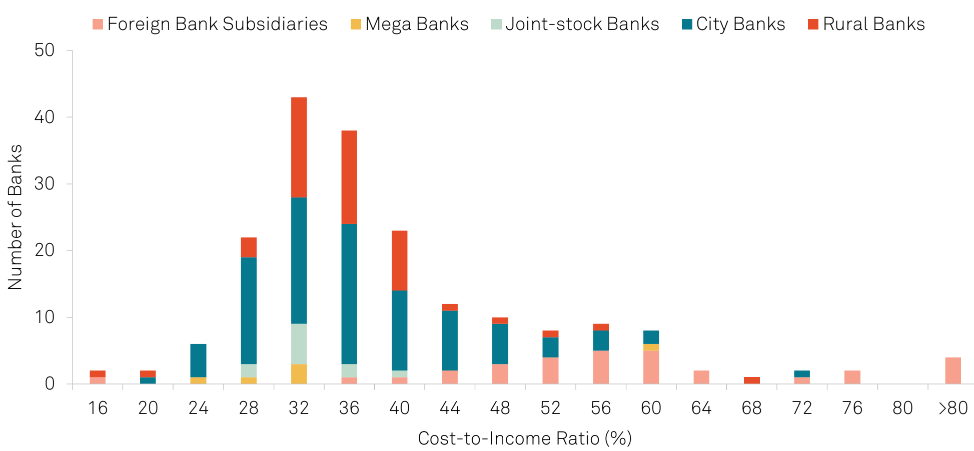
Sources: S&P Global Market Intelligence Database, public information of banks, collected and adjusted by S&P Global (China) Ratings.

Thanks to low bad debt levels, foreign bank subsidiaries tend to have low provisioning costs.

Foreign bank subsidiaries' cost-to-income ratio is typically high because of their lack of economies of scale and high human resources costs.

Chart 12

Cost-to-income Ratio of Major Banks in China as of the End of 2018



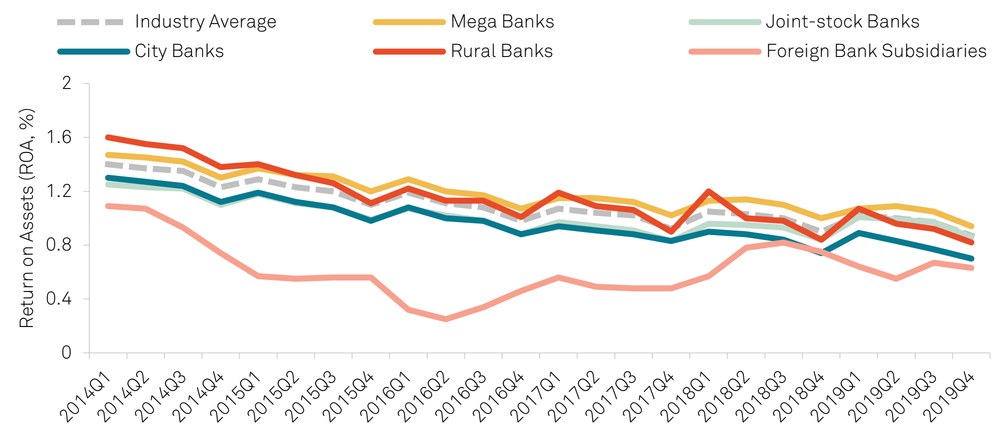
Sources: S&P Global Market Intelligence Database, public information of banks, collected and adjusted by S&P Global (China) Ratings.

Foreign bank subsidiaries' cost-to-income ratio is typically higher than the industry average because of the lack of economies of scale.

Due to a low correlation with China's general credit environment, the profitability trend of foreign bank subsidiaries is distinctively different from that of the domestic banks in China, as foreign bank subsidiaries are less exposed to credit risk and more exposed to market risk when compared with their domestic peers. The inherent volatility of market risk leads to high fluctuation of their profitability.

Chart 13

Return on Assets of Different Types of Banks



Source: CBIRC, collected and adjusted by S&P Global (China) Ratings.

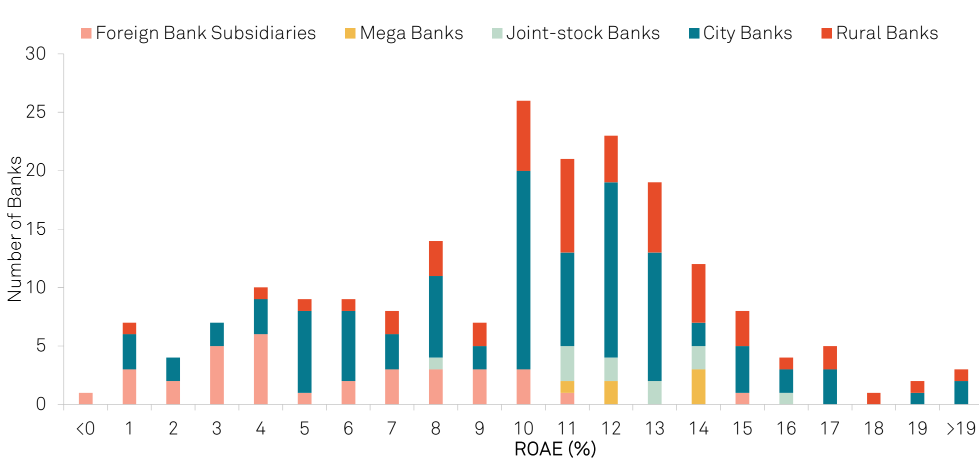
The profitability trend of foreign bank subsidiaries is distinctively different from the domestic banks in China as they are less exposed to credit risk and more exposed to market risk when compared with domestic peers.

Thanks to low leverage, low risk appetite and high operational costs, foreign bank subsidiaries typically have a profitability level lower than the industry average.

However, we may not necessarily regard low profitability as a negative for their capitalization, because their business model usually leads to slow capital consumption. In addition, thanks to good asset quality, we view their earning quality as solid.

Chart 14

Distribution of Return on Average Equity of Major Banks in China in 2018



Sources: S&P Global Market Intelligence Database, public information of banks, collected and adjusted by S&P Global (China) Ratings.

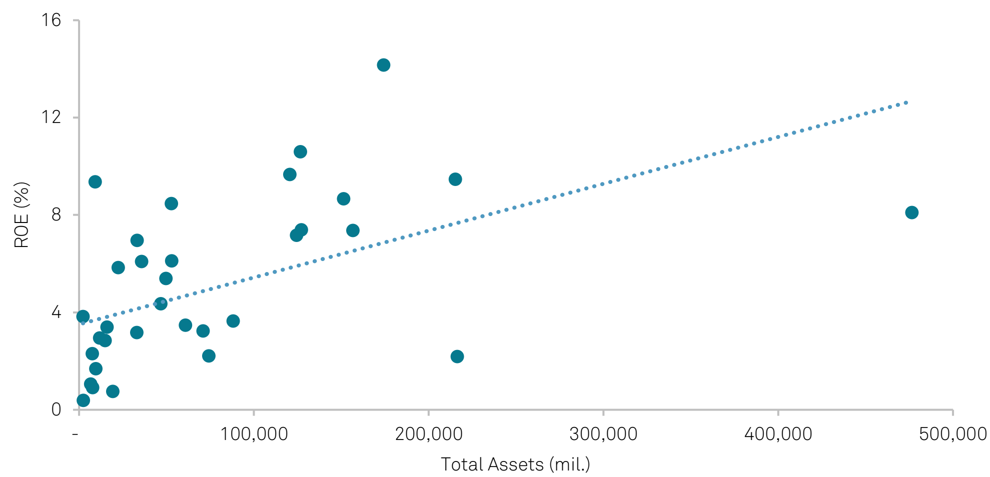
Because of low leverage and high operational costs, the profitability level of foreign bank subsidiaries is typically lower than the industry average.

While the profitability of domestic banks is now typically constrained by credit costs, the earnings of foreign bank subsidiaries are more influenced by business size, as they tend to have high operational costs due to lack of scale.

The earnings of foreign bank subsidiaries are heavily influenced by business size as they tend to have high operational costs due to lack of scale.

Chart 15

Scatterplot: Foreign Bank Subsidiary ROE in 2018 VS. Total Assets as of the End of 2018

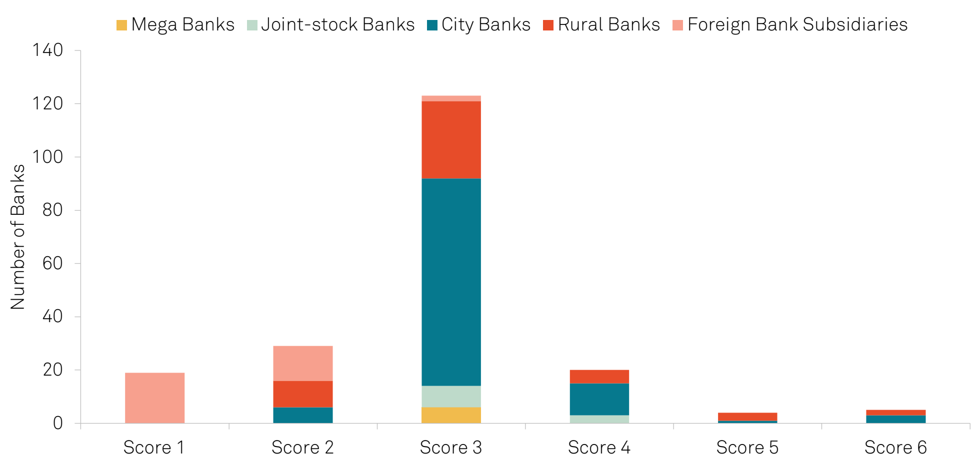


Sources: S&P Global Market Intelligence Database, public information of banks, collected and adjusted by S&P Global (China) Ratings.

Foreign bank subsidiaries typically have strong capital scores because of their high capital adequacy ratios.

Chart 16

Indicative Capital Score Distribution of 200 Major Banks in China by S&P Global (China) Ratings



Note 1: For our testing purpose, we score the capital position of banks in a scale of 1 to 6. 1 means the strongest capital position and 6 means the weakest.

Note 2: The indicative scores 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.

Source: S&P Global (China) Ratings.

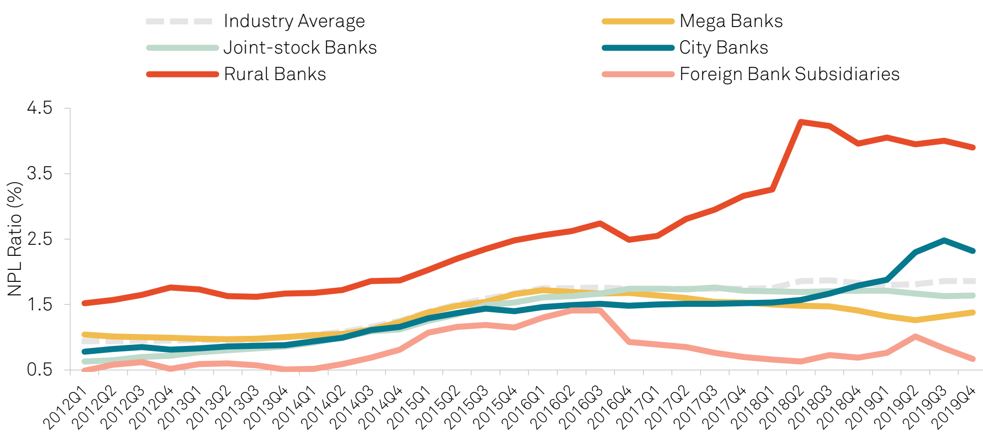
Risk Position

Foreign bank subsidiaries typically have low NPL ratios compared with their domestic peers because of their low risk appetite. They typically set up branches in a limited number of big cities and target a clientele base with good credit standing. As a result, they have much less exposure in China's small and micro enterprises and rural areas compared with their domestic peers. In the case of many small foreign bank subsidiaries, their loan books are highly concentrated to loans to multinationals and foreign companies in their home countries.

Nevertheless, foreign bank subsidiaries' asset quality is not immune to China's credit environment. As China's economy slowed down, the NPL ratio of foreign bank subsidiaries rose mildly in 2015 and 2016, but decreased steadily after effective de-risking measures in recent quarters.

Chart 17

NPL Ratios of Different Types of Banks

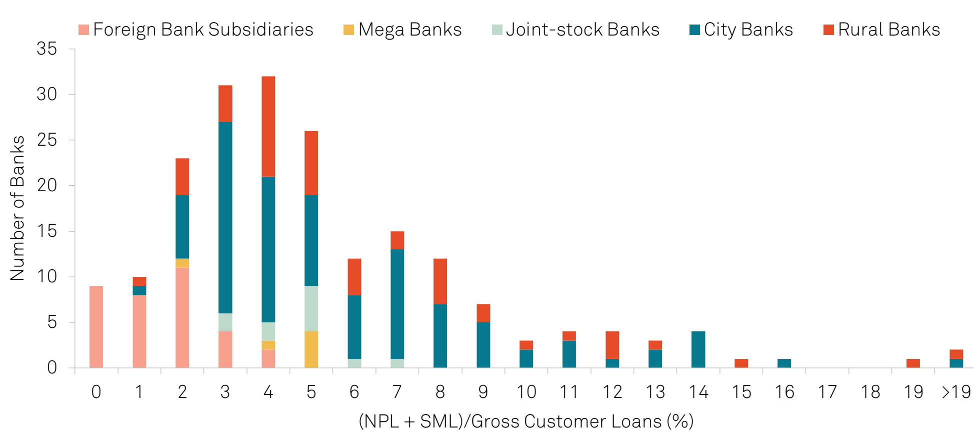


Source: CBIRC, collected and adjusted by S&P Global (China) Ratings.

As China's economy slowed down, the NPL ratio of foreign bank subsidiaries rose mildly in 2015 and 2016 but decreased steadily after effective de-risking measures.

Chart 18

Distribution of NPL+SML Ratio of Major Banks in China as of the End of 2018



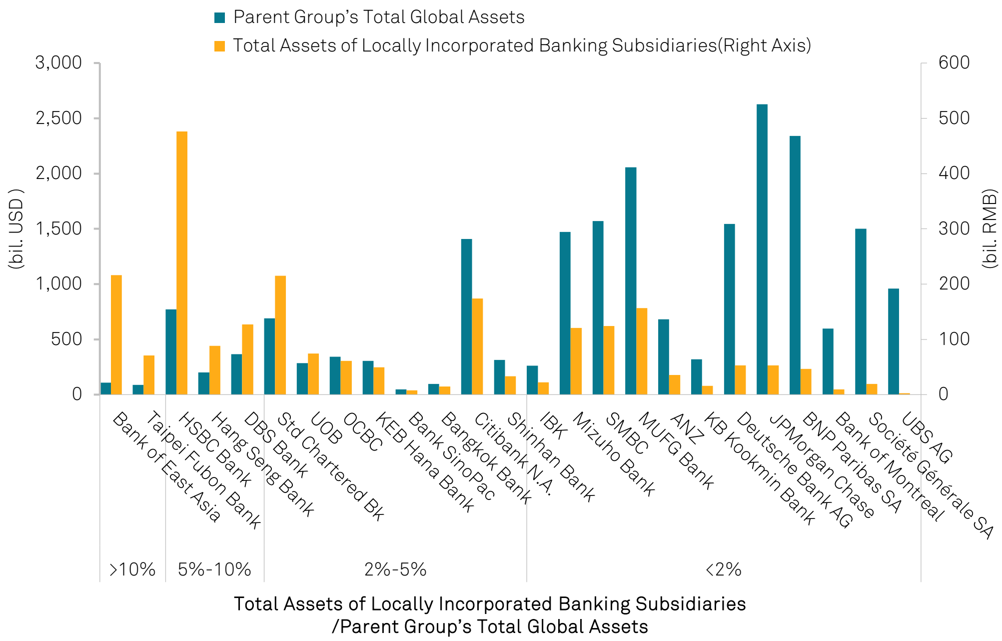
Sources: S&P Global Market Intelligence Database, public information of banks, collected & adjusted by S&P Global (China) Ratings.

Foreign bank subsidiaries have the best asset quality in China because of their low risk appetite.

Foreign banks' exposure to China's real economy through their banking subsidiaries varies a lot. Typically, foreign banks based in Hong Kong SAR and APAC regions have higher risk exposure to China, and they can be more vulnerable to China's economic slowdown than foreign banks based in the US or Europe.

Chart 19

Foreign Banks' China Exposure through Locally Incorporated Banking Subsidiaries



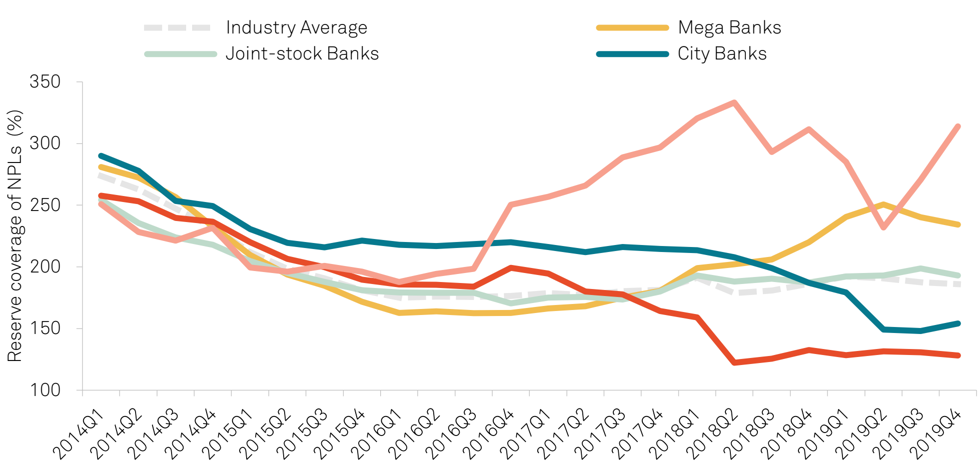
Sources: S&P Global Market Intelligence Database, public information of banks, collected and adjusted by S&P Global (China) Ratings.

Regional banks in APAC typically have more exposure to China compared with their global peers.

As the average NPL ratio of foreign bank subsidiaries rose in recent quarters, their reserve coverage of NPLs dropped but remains higher than the industry average.

Chart 20

Reserve Coverage of NPLs of Different Types of Banks



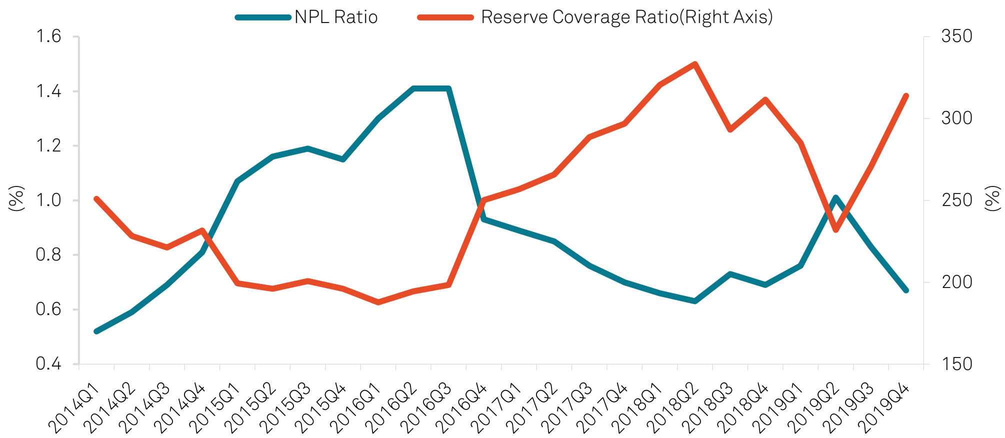
Source: CBIRC, collected and adjusted by S&P Global (China) Ratings.

Foreign bank subsidiaries' reserve coverage of NPLs is significantly higher than the industry average.

Foreign bank subsidiaries, as a group, typically maintain a roughly stable ratio of reserve to gross loans of 2.5%, so their reserve coverage tends to move in the opposite direction to their NPL ratio. Despite the fluctuation, foreign bank subsidiaries have maintained a very strong credit loss reserve buffer in recent years.

Chart 21

NPL Ratio and Reserve Coverage of Foreign Bank Subsidiaries

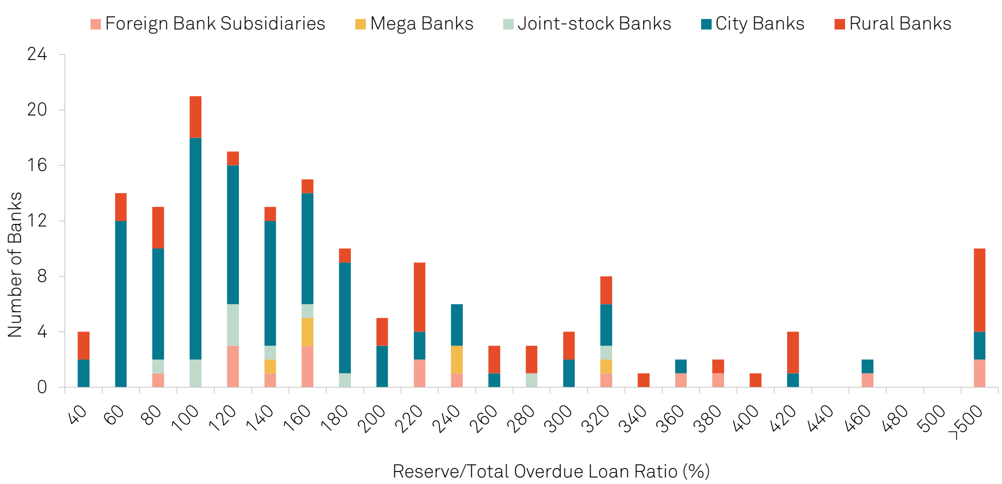


Foreign bank subsidiaries' reserve coverage tends to move in the opposite direction to their NPL ratio.

Source: CBIRC, collected and adjusted by S&P Global (China) Ratings.

Chart 22

Distribution of Reserve/Total Overdue Loan Ratio of Major Banks in China as of the End of 2018



Most foreign bank subsidiaries have adequate reserve coverage for overdue loans.

Sources: S&P Global Market Intelligence Database, public information of banks, collected & adjusted by S&P Global (China) Ratings.

Chart 23

Indicative Risk Position Score Distribution of 200 Major Banks in China by S&P Global (China) Ratings

Note 1: For our testing purpose, we score the risk position of banks in a scale of 1 to 6. 1 means the strongest position and 6 means the weakest.

Note 2: The indicative scores 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.

Source: S&P Global (China) Ratings.

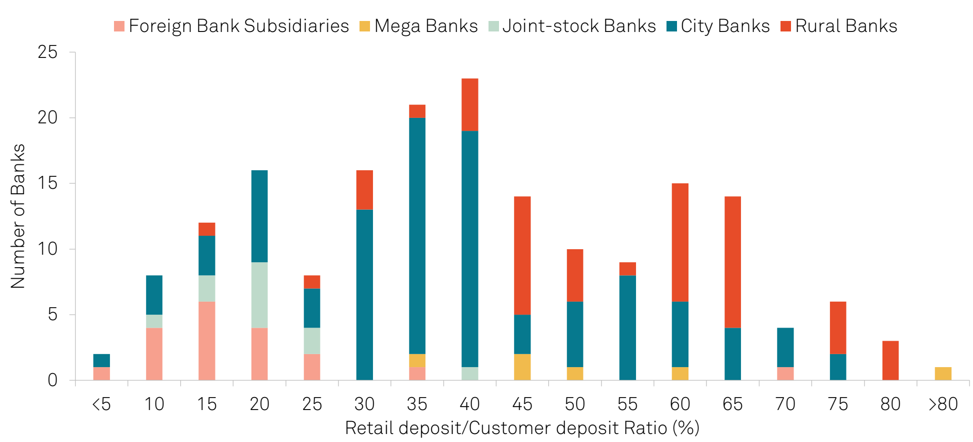
Many foreign bank subsidiaries have good indicative risk position scores because of their low risk appetite and prudent risk management.

Funding & Liquidity

Considering their very limited branch network in China, the high initial cost of developing a retail deposit base and the strong retail deposit franchise of domestic banks, most foreign bank subsidiaries don't prioritize retail deposit growth in their business strategy. As a result, their retail deposit base tends to be small, and some of them choose not to have any retail deposit business in China.

Chart 24

Distribution of Retail Deposit/Customer Deposit Ratio of Major Banks in China as of the End of 2018



Sources: S&P Global Market Intelligence Database, public information of banks, collected & adjusted by S&P Global (China) Ratings.

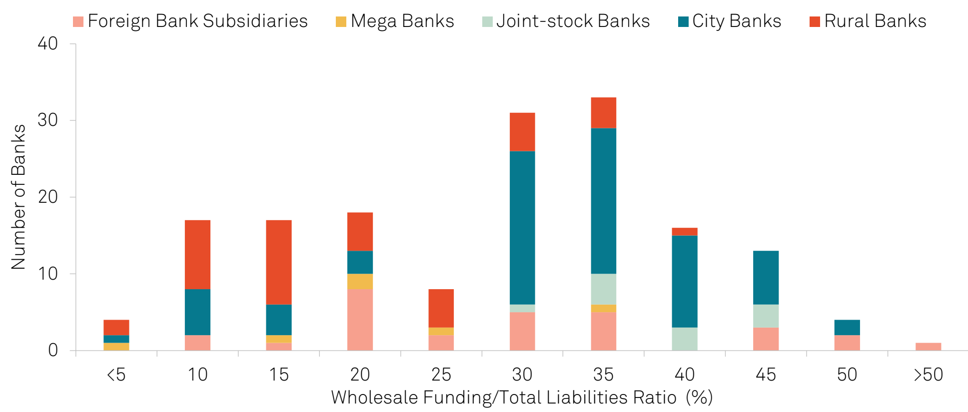
Foreign bank subsidiaries have a smaller retail deposit base than their domestic peers.

Foreign bank subsidiaries' use of wholesale funding varies. In our view, thanks to prudent liquidity management, foreign bank subsidiaries' funding and liquidity risk is generally controllable despite their limited deposit base.

Foreign bank subsidiaries' use of wholesale funding varies.

Chart 25

Distribution of Wholesale Funding/Total Liabilities Ratio of Major Banks in China as of the End of 2018



Sources: S&P Global Market Intelligence Database, public information of banks, collected & adjusted by S&P Global (China) Ratings.

In our view, despite their limited deposit base in China, foreign bank subsidiaries generally have controllable funding and liquidity risk because of their prudent risk management.

Chart 26

Indicative Funding & Liquidity Score Distribution of 200 Major Banks in China by S&P Global (China) Ratings

Note 1: For our testing purpose, we score the funding and liquidity position of banks in a scale of 1 to 6. 1 means the strongest position and 6 means the weakest.

Note 2: The indicative scores 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.

Source: S&P Global (China) Ratings.

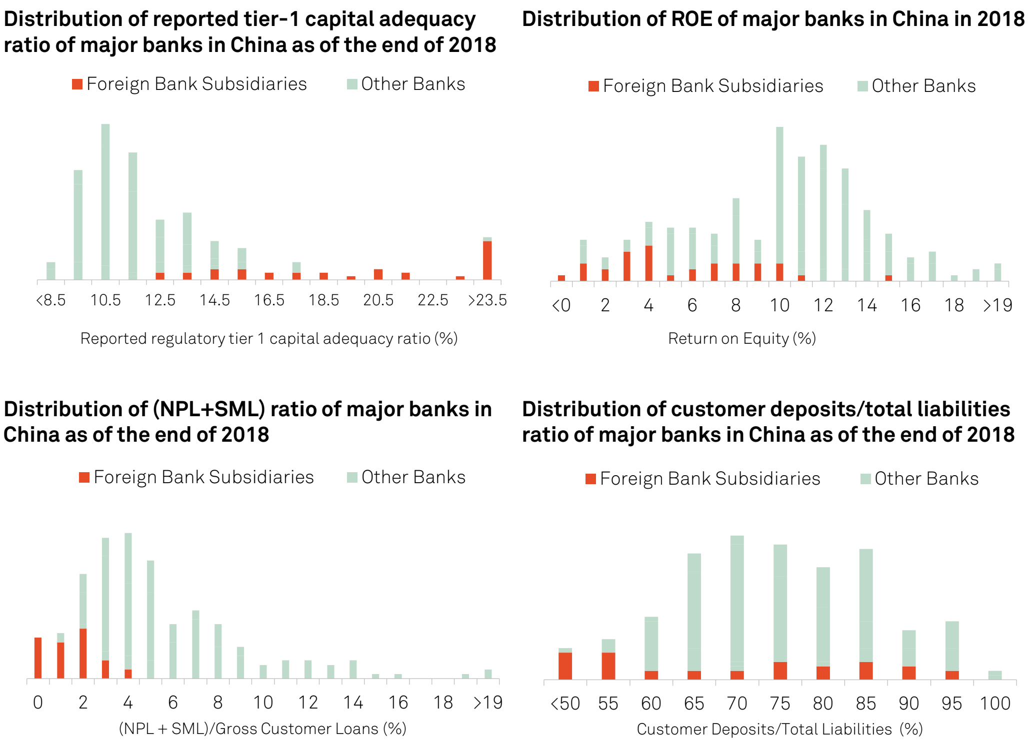
Stand-alone Credit Quality

Typically, foreign bank subsidiaries are small in size, strong in capital, weak in profitability and low in credit risk. In terms of management and business strategy, the parent banks usually have strong control over their subsidiaries in China. The parent banks typically view their bank subsidiaries as a key part of their China strategy.

Typically, foreign bank subsidiaries are small in size, strong in capital, weak in profitability and low in credit risk.

Chart 27

Financial Metrics of Selected Foreign Bank Subsidiaries in Comparison with Other Major Banks in China



Sources: S&P Global Market Intelligence Database, public information of banks, collected and adjusted by S&P Global (China) Ratings.

Given the current challenges in the real economy in China, small and medium-sized domestic banks may face challenges in legacy bad debts and weaker capital, but foreign bank subsidiaries typically have more difficulty in developing their business franchise and maintaining stable revenue and profitability in China.

Group Support

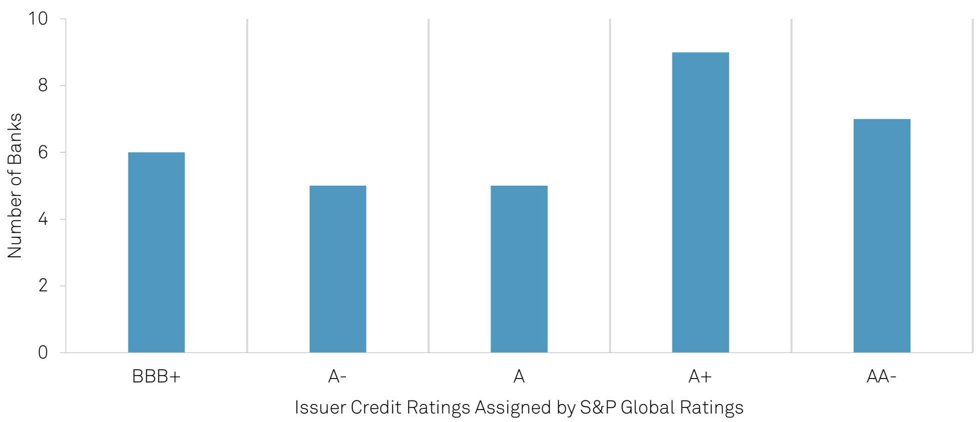
We believe that, in time of stress, foreign bank subsidiaries are highly likely to receive support from their parent banks as they are typically integral parts of their parents' international banking network. Most of these subsidiaries are 100% owned by their parents and subject to parents' tight supervision, share parents' brands and logos, and conduct cross-selling activities with their parents.

Foreign bank subsidiaries typically have high indicative issuer credit quality because of the strong credit standing of their parents. Foreign banks which set up locally incorporated banks in China tend to be strong global or regional banks that follow their clients to China.

Foreign banks which set up locally incorporated banks in China tend to be strong global or regional banks that follow their clients to China.

Chart 28

Distribution of the Ratings of Foreign Banks with Locally Incorporated Banking Subsidiaries Assigned by S&P Global Ratings



Note 1: Among the 41 foreign institutions which have set up locally incorporated banks in China, 32 of them have public ratings assigned by S&P Global Ratings.

Note 2: China's sovereign rating assigned by S&P Global Ratings is A+.

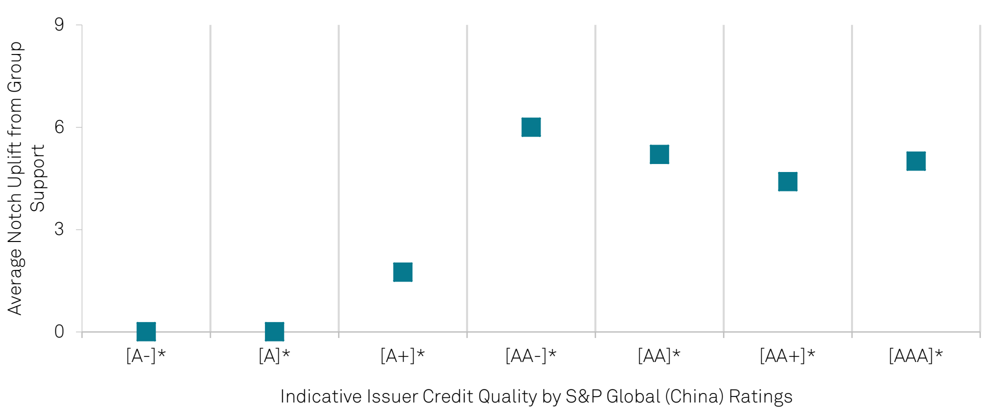
Source: S&P Global Market Intelligence Database.

The indicative issuer credit quality of these foreign bank subsidiaries is typically more in line with the creditworthiness of their parents, rather than the credit cycle in China. Therefore, their credit standing is typically vulnerable to credit quality deterioration of their parents and the general credit environment in their home countries, which is a unique risk to foreign bank subsidiaries.

Given their close ties with their parents and parents' strong credit standing, the indicative issuer credit quality of foreign bank subsidiaries is typically high because of group support.

Chart 29

Foreign Bank Subsidiaries' Average Indicative Notch Uplift Due to Group Support



Note*: 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 (except for a few cases where we have already assigned public ratings on a bank). 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.

Source: S&P Global (China) Ratings.

Issuer Credit Quality

Table 2

Credit Characteristics of Foreign Bank Subsidiaries

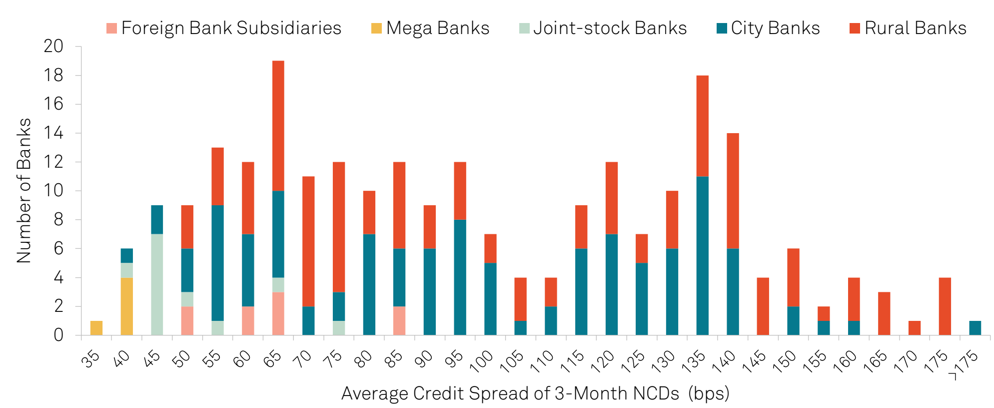
Risk Factor	Typical Profile
Business Position	Foreign bank subsidiaries are typically small in asset size with a limited client base in China. They are usually strong in cross-border businesses and enjoy synergy with parent banks in terms of client base sharing.
Capital & Earnings	Capital adequacy ratios are usually high because of low leverage and low credit exposure. Low leverage, high market risk exposure and high operational costs have led to weak and volatile profitability.
Risk Position	Foreign bank subsidiaries are usually integrated into their parents in terms of risk management. They tend to have low risk appetite and prudent risk management. They have less credit risk exposure to the real economy in China compared with their domestic peers. Therefore, their asset quality is less affected by the current economic downturn in China.
Funding & Liquidity	Retail deposit base is typically small and corporate deposit base tends to be limited too. Thanks to a strong capital base, good risk position, and prudent liquidity management, the funding and liquidity risk of foreign bank subsidiaries is generally controllable.
External Supports	We believe that, in time of stress, foreign bank subsidiaries are highly likely to receive parental support as they are integral parts of their parent banks.

Source: S&P Global (China) Ratings.

Foreign bank subsidiaries typically have higher negotiable certificate of deposit ("NCD") Z-spreads than their domestic peers with similar indicative issuer credit quality. In our view, this higher spread is more attributed to non-credit risk related factors rather than credit risk premium. The sizes of the NCDs issued by foreign bank subsidiaries are much smaller than their domestic peers. In addition, foreign bank subsidiaries may also have a more limited number of counterparties and investors who buy their NCDs. All those factors irrelevant to credit risk also have an impact on the market spreads.

Chart 30

Average Z-spreads of 3-month NCDs of Banks after Baoshang Bank Takeover



In our view, foreign bank subsidiaries are paying a premium for non-credit risk related factors, such as the small sizes of their NCDs and a limited investor base.

Note 1: The samples in the chart include 5 mega banks, 12 joint-stock banks, 109 city banks, 111 rural banks and 9 foreign bank subsidiaries that issued 3-month NCD from June 1st, 2019 to November 30th, 2019. Baoshang Bank takeover happened in late May 2019.

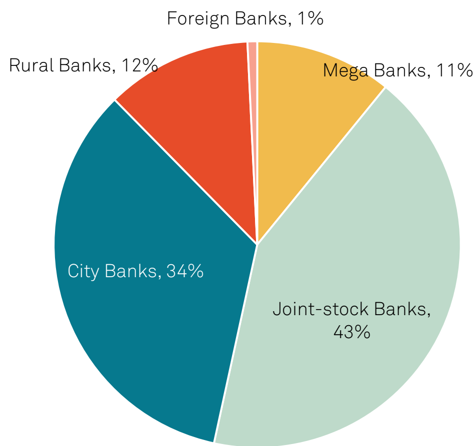
Note 2: Z-spread = 3M NCD issuance rate - 3M treasury note spot rate.

Source: Wind, collected and adjusted by S&P Global (China) Ratings.

Chart 31

NCD Issuance Size Breakdown in 2019

Foreign bank subsidiaries are very small issuers of NCDs in China's interbank market.



Source: Wind, collected and adjusted by S&P Global (China) Ratings.

This report does not constitute a rating action.

Appendix: Related Methodologies & Research

Methodology:

– S&P Global (China) Ratings Financial Institutions Methodology.

Related Research & Commentary:

– S&P Global (China) Ratings General Considerations on Rating Modifiers and Relative Ranking.

– Diversity Across China's Banking System – A Deep Dive A Study on Credit Quality Differentiation Among Chinese Banks.