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S&P Global China Ratings

Foreign Bank Subsidiaries Maintain Sound Credit Quality Despite COVID-19

A Study on the Creditworthiness of Foreign Bank Subsidiaries in China

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Key Takeaways

- Foreign bank subsidiaries have been less affected by COVID-19 because of their very good capitalization and asset quality before the pandemic and conservative approach during the outbreak.
- While domestic banks accelerated lending in 2020, foreign bank subsidiaries generally continued lending at the same pace, or even reduced their loan books for risk management considerations. This may result in their overall market share shrinking further, which was already very small before the pandemic.
- The indicative issuer credit quality of foreign bank subsidiaries is typically closely aligned with the credit standing of their parents. Ratings by S&P Global Ratings demonstrate how the credit quality of large international banks has remained relatively stable despite the pandemic, and this further underpins the generally good credit quality of foreign bank subsidiaries in China.

Contents

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, 12 joint-stock banks, 30 foreign banks, 100 city banks 50 rural banks and two private 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.

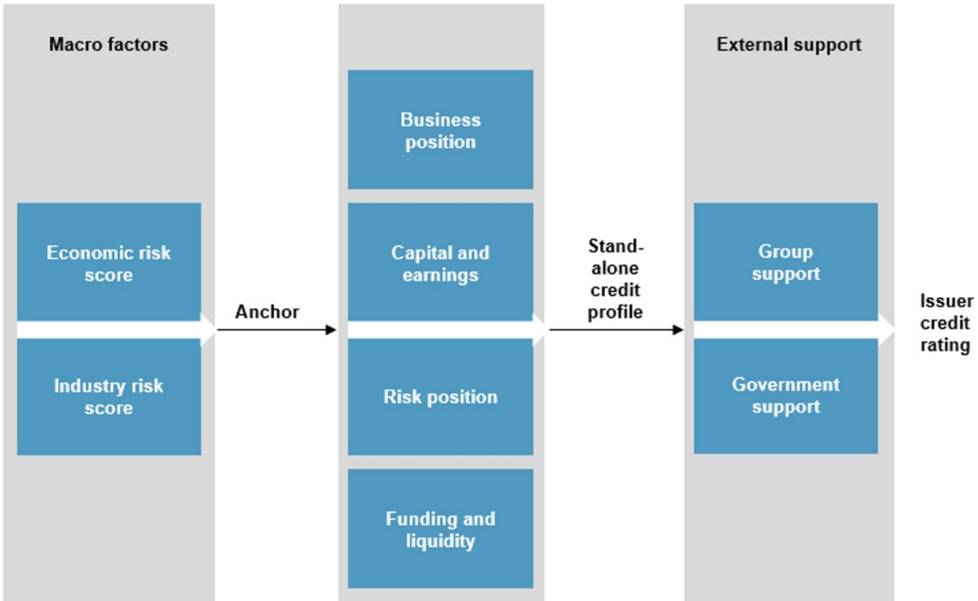
We have conducted this desktop analysis on individual institutions and present the results contained herein at an aggregate group level by types of institutions. The different sections of this research show the statistics and performance of different groups of institutions and the market more broadly 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.

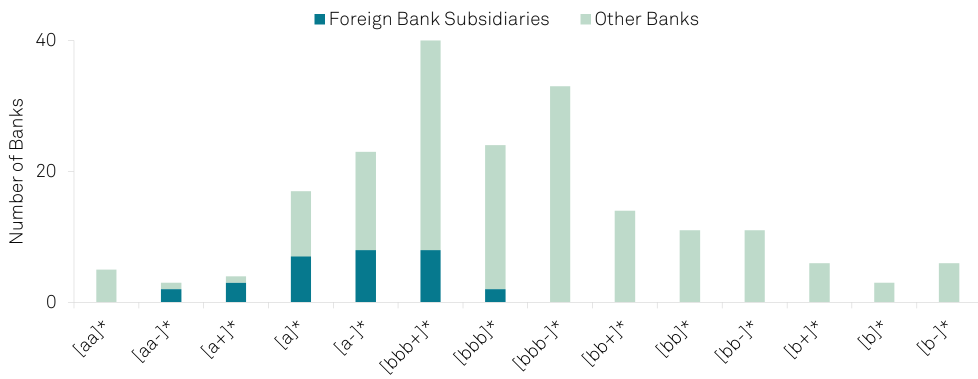
Overview

There are 41 foreign financial institutions that have set up locally incorporated banking subsidiaries in China, with an overall asset market share of around 1.2%. Despite their small sizes, these foreign bank subsidiaries play a unique role as facilitators of cross-border banking business.

Because of their good asset quality and strong capitalization, these foreign bank subsidiaries tend to have good indicative stand-alone credit quality despite their small business footprints in China. Compared to domestic banks, their indicative stand-alone credit quality has been less affected by COVID-19 because of their very good capitalization and asset quality before the pandemic and their conservative approach during the outbreak.

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.

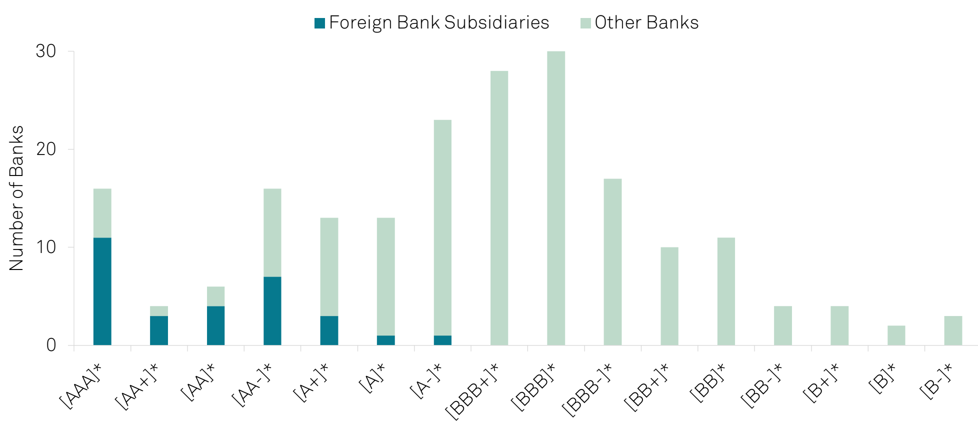
Note 2*: The indicative credit quality distributions expressed in this report are only S&P China's indicative views of credit quality derived from a desktop analysis based on public information without interactive review with any particular institution or the full credit rating process such as a rating 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 China's domestic banks.

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.

The relatively stable credit quality of large international banks during the COVID-19 outbreak, as demonstrated by rating actions taken by S&P Global Ratings, has also underpinned the generally good credit quality of foreign bank subsidiaries in China for the foreseeable future.

Table 1

Credit Outlook of Foreign Bank Subsidiaries for the Next 12 Months

Risk Factor	Outlook	Key Comments
Business Position	Stable	Foreign bank subsidiaries are typically small in asset size with a limited client base in China. They are usually strong in cross-border business and enjoy synergy with parent banks in terms of client base sharing. Their overall market share may shrink during the pandemic because they are lending at a much slower pace compared to domestic banks in 2020.
Capital & Earnings	Stable	Capital adequacy ratios are usually high because of low leverage and low credit exposure. Small size, high market risk exposure and high operational costs have led to weak and volatile profitability. However, we may not necessarily regard low profitability as a negative for their capitalization, because their business model usually leads to slow capital consumption. Foreign bank subsidiaries have witnessed improved capital ratios in the first half of 2020 as they reduced credit exposure in the face of the pandemic We expect generally stable earnings in 2020 as their higher credit cost due to COVID-19 is more or less balanced out by higher investment returns amid falling interest rates.
Risk Position	Stable	Foreign bank subsidiaries are usually integrated into their parents in terms of risk management and we have seen well-coordinated management of cross-border credit risk exposure during the global pandemic. 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 has been less affected by COVID-19. Having said that, we still expect a marginal increase in bad debt for their credit card and small and mid-sized enterprise lending in China.
Funding & Liquidity	Stable	Their retail deposit base is typically small, and their 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	Stable with downward pressure	We believe that, in times of stress, foreign bank subsidiaries are highly likely to receive parental support as they are integral parts of their parent banks. As COVID-19 puts pressure on economies and financial institutions across the world, it has inevitably weighed on the capability of parent banks to support their subsidiaries in China. However, thanks to the generally good international credit ratings of large international banks before the pandemic, COVID-19's impact on parent banks has remained controllable. The overall stability of parent banks' creditworthiness despite the pandemic continues to underpin the subsidiaries' issuer credit quality.

Source: S&P Global (China) Ratings.

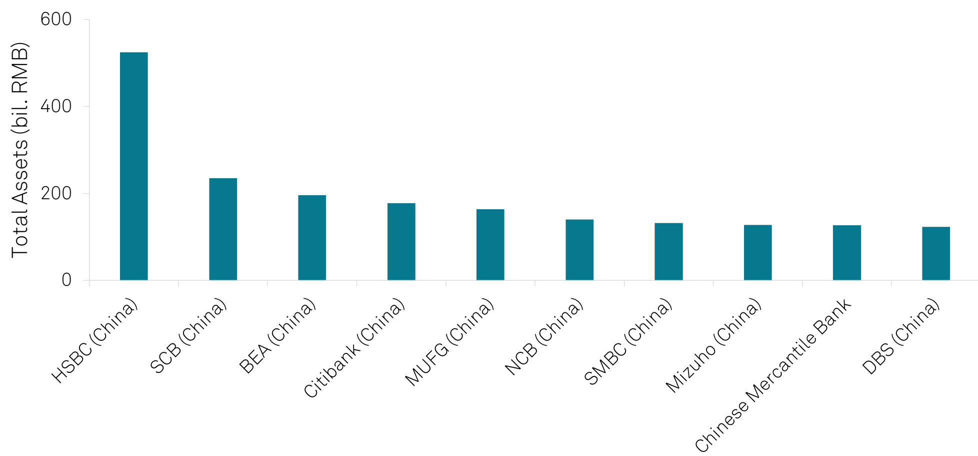
Business Position

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. Although they tend to have smaller lending business than domestic banks, many have strong competitive advantage in terms of product offerings, in particular cash management, trade finance and foreign currency trading, which are strengths built on their global and regional banking networks.

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

Chart 4

10 Largest Foreign Bank Subsidiaries in China as of End of 2019



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

Note: SCB (China) - Standard Chartered Bank (China) Limited, BEA (China) - Bank of East Asia (China) Limited, NCB(China) - Nanyang Commercial Bank (China) Limited, SMBC (China) - Sumitomo Mitsui Banking Corporation (China) Limited.

Sources: Public information of banks, collected and adjusted by S&P Global (China) Ratings.

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 networks in China. The 41 foreign bank subsidiaries had a market share of only 1.2% by asset in China before the pandemic.

Domestic banks have accelerated lending in 2020 to help out the real economy in the face of the pandemic, but foreign bank subsidiaries have typically maintained their lending at a stable pace, or even reduced their loan books because of risk concerns. This will probably lead to further shrinking of their overall market share.

Table 2

Characteristics of Banks with Different Indicative Business Position Scores

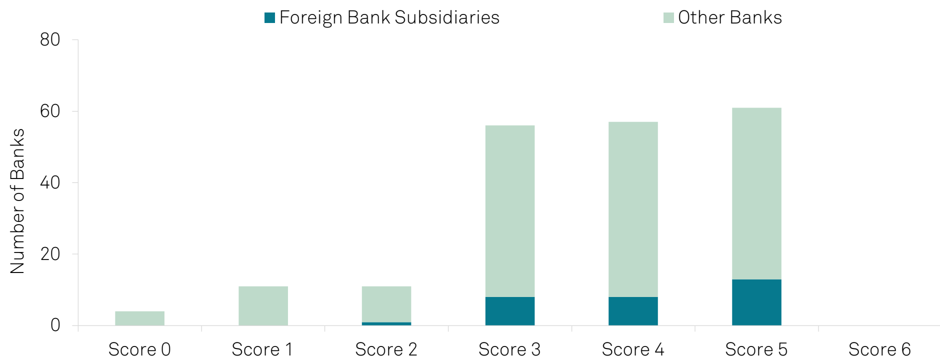
Score	Typical Profile
0	Very large state-owned mega banks with very good geographic diversification across China or beyond, or mega banks with systemic importance in the global.
1	Large state-owned mega banks or large national joint-stock banks, with good geographic diversification across China.
2	Mid-sized joint-stock banks or large regional banks with good geographic diversification at least at a provincial level, or leading large foreign bank subsidiaries.
3	Joint-stock banks with smaller scale and higher geographic concentration, mid-sized regional banks based in first or second tier cities, or mid-sized foreign bank subsidiaries.

4	Small regional banks in second or third tier cities with high geographic concentration, or mid and small-sized foreign bank subsidiaries.
5	Very small regional banks in third or fourth tier cities with very high geographic concentration, or small foreign bank subsidiaries.
6	The bank's business operations are materially riskier than its peers. This category applies only in exceptional circumstances.

Source: S&P Global (China) Ratings.

Chart 5

Indicative Business Position Score Distribution of 200 Major Banks in China



Foreign bank subsidiaries typically have limited business footprints in China.

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 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.

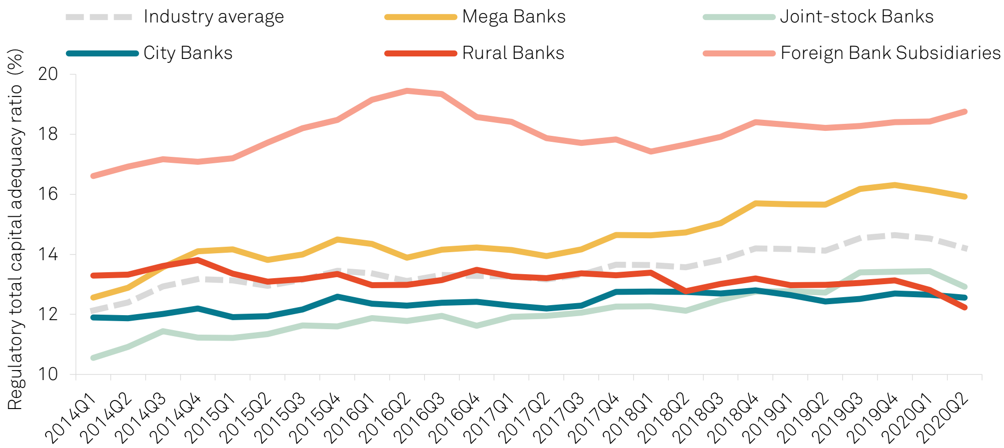
Source: S&P Global (China) Ratings.

Capital & Earnings

Foreign bank subsidiaries have generally maintained high capital adequacy ratios because their loan books tend to be small with slow growth and their overall leverage level is lower than the industry average. As of the end of June 2020, their average capital adequacy ratio was 18.76%, 0.36 percentage points higher than the end of 2019. While domestic banks typically witnessed a mild drop in their capital ratios in the first half of 2020 as they increased lending to the real economy amid the pandemic, foreign bank subsidiaries typically refrain from doing what the domestic banks are doing due to risk control considerations.

Chart 6

Reported Regulatory Capital Adequacy Ratios of Different Types of Banks

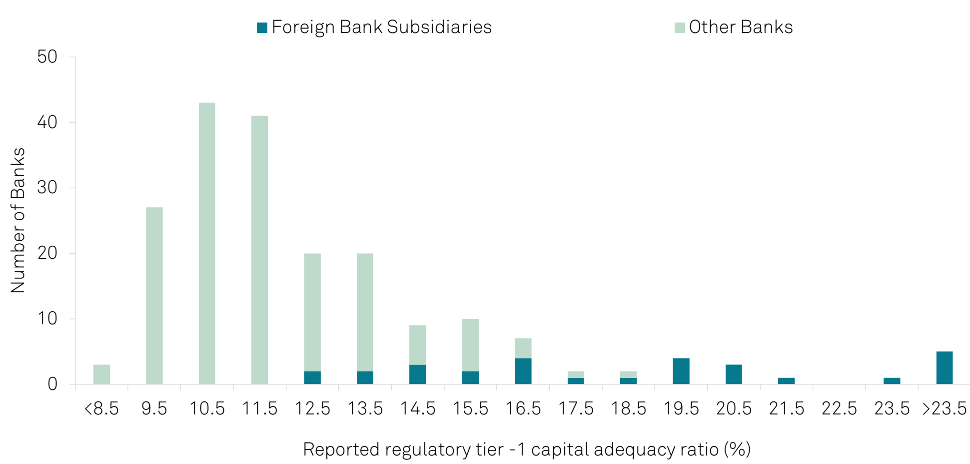


Source: CBIRC, collected and adjusted by S&P Global (China) Ratings.

In the first half of 2020, capitalization of foreign bank subsidiaries increased while that of domestic banks decreased.

Chart 7

Distribution of Reported Regulatory Tier-1 Capital Adequacy Ratio of Major Banks in China as of End of 2019



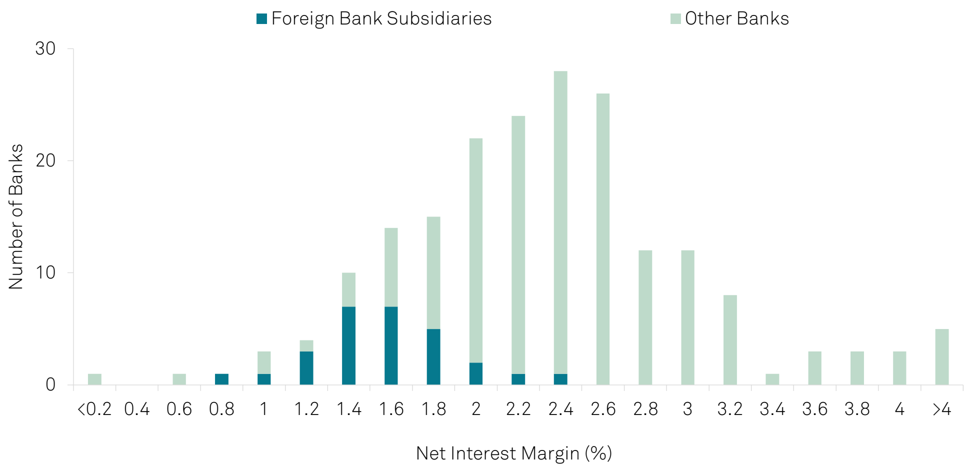
Sources: Public information of banks, collected and adjusted by S&P Global (China) Ratings.

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

The net interest margin ("NIM") of foreign bank subsidiaries is typically lower than the industry average. Their low risk appetite usually leads to a lower credit risk charge in their loan pricing. The few foreign bank subsidiaries with good NIMs typically have very strong cash management and trade finance business thanks to their global networks, which lead to a sticky and low-cost deposit base.

Chart 8

Net Interest Margin of Major Banks in China in 2019



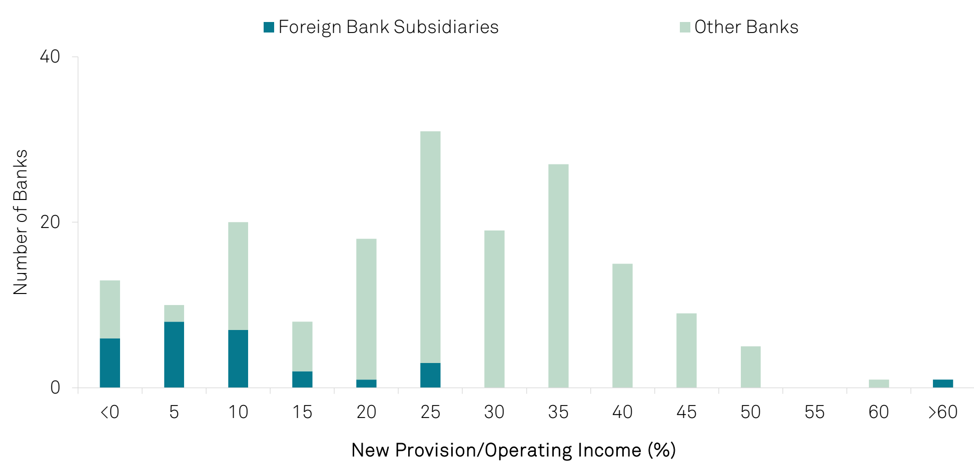
Sources: S&P Global Market Intelligence Database, public information of banks, collected & adjusted by S&P Global (China) Ratings

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

Thanks to low non-performing loan ("NPL") ratios, foreign bank subsidiaries tend to have lower provisioning costs, but we expect them to step up provisioning efforts in 2020 due to the economic uncertainty caused by coronavirus. In our view, their provisioning pressure is much lower than domestic banks, and most of them will be able to maintain a very strong reserve buffer throughout the pandemic.

Chart 9

New Provision/Operating Income of Major Banks in China in 2019



Note: When the new provision/operating income ratio is negative, it means the bank has a reserve reversal.

Source: S&P Global Market Intelligence Database, collected & adjusted by S&P Global (China) Ratings

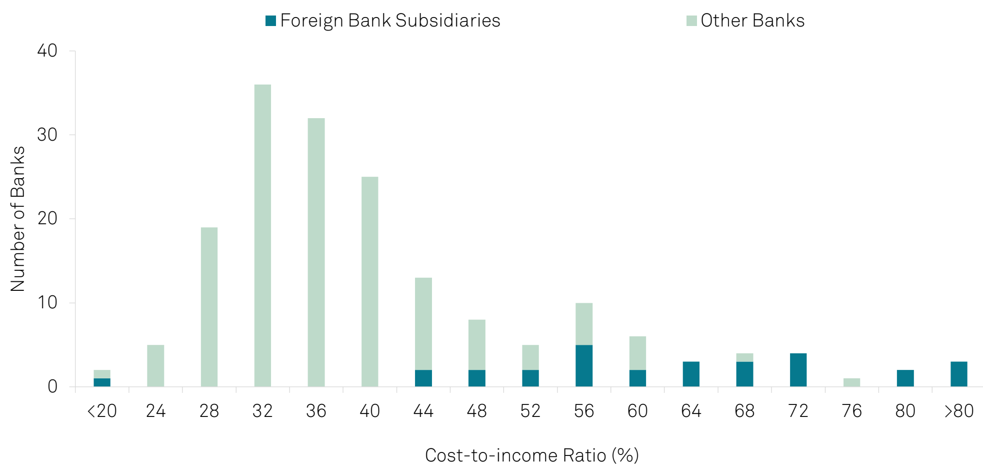
Thanks to low bad debt levels, foreign bank subsidiaries tend to have low provisioning costs.

Although foreign bank subsidiaries typically have low credit risk exposures, they may be exposed to relatively high interest rate risk if they hold large treasury bond investments. The inherent volatility of interest rate risk increases the volatility of their earnings. Having said that, the earnings swings generally don't hurt their capital base due to their prudent credit risk management.

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

Chart 10

Cost-to-income Ratio of Major Banks in China in 2019



Source: S&P Global Market Intelligence Database, collected & adjusted by S&P Global (China) Ratings

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

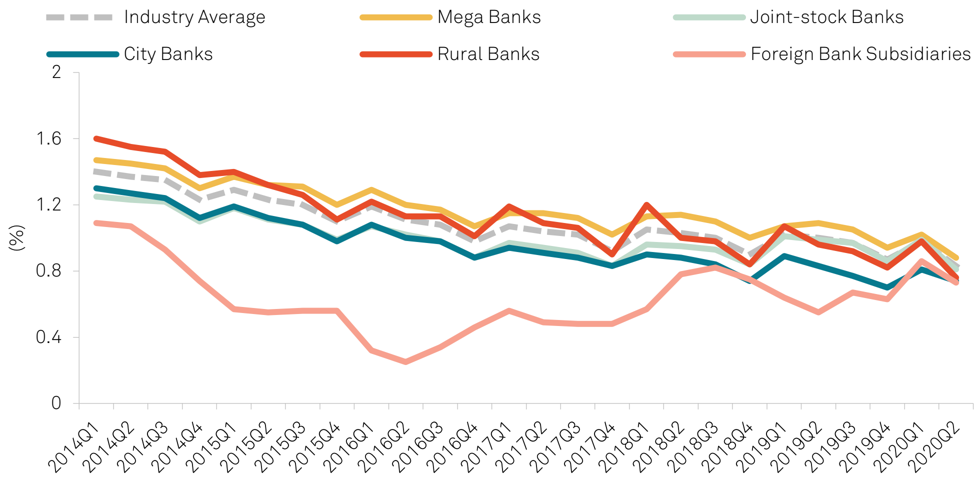
Due to low correlation with China's general credit environment, foreign bank subsidiaries tend to see distinctively different profitability trends than domestic banks in China, as they are less exposed to credit risk and have more exposure to market risk when compared with their domestic peers.

Foreign bank subsidiaries witnessed stable profitability in the first half of 2020. Any higher credit cost as they stepped up provisioning efforts was more or less balanced out by higher investment returns as interest rates dropped. Their average annualized ROA was 0.73% in the first half of the year, 0.18 percentage points higher than the same period last year.

In previous years, due to low leverage, low risk appetite and high operational costs, foreign bank subsidiaries have typically had lower profitability than the industry average. But as this year has seen domestic city and rural banks come under higher bad debt pressure, their profitability level in the second quarter of 2020 fell to a level similar to foreign bank subsidiaries.

Chart 11

Return on Assets of Different Types of Banks



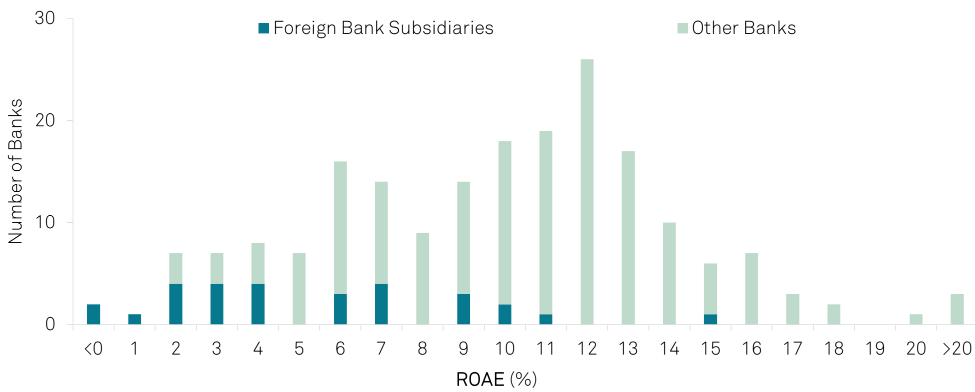
Source: CBIRC, collected and adjusted by S&P Global (China) Ratings.

The profitability trends of foreign bank subsidiaries are distinctively different from domestic banks in China, with the former less exposed to credit risk and more exposed to market risk.

We may not necessarily regard the low profitability of foreign bank subsidiaries as a negative for their capitalization, because their business models usually lead to slower capital consumption. In addition, thanks to their good asset quality and strong reserve buffer, we generally view their earning quality as solid.

Chart 12

Distribution of Return on Average Equity of Major Banks in China in 2019



Sources: Wind, 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.

Table 3

Characteristics of Banks with Different Indicative Capital and Earnings Scores

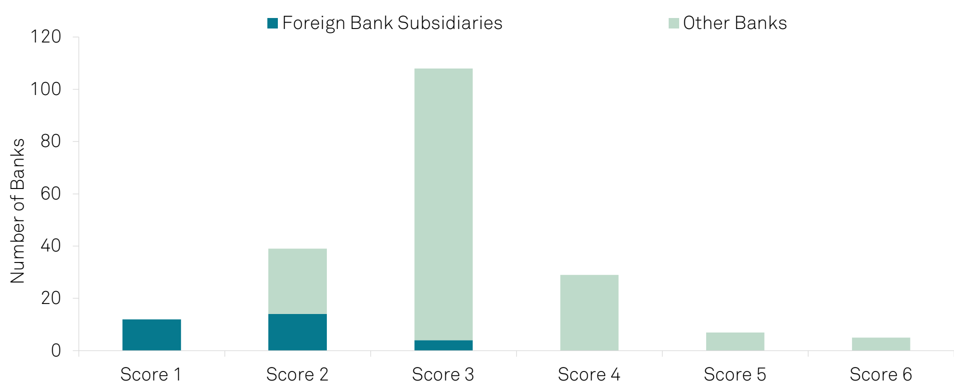
Score	Typical Profiles
1	We expect the capital adequacy ratios adjusted by S&P Global (China) Ratings to be much higher than the industry average at least for the next 24 months.
2	We expect the capital adequacy ratios adjusted by S&P Global (China) Ratings to be somewhat higher than the industry average at least for the next 24 months.

3	We expect the capital adequacy ratios adjusted by S&P Global (China) Ratings to be consistent with the industry average and able to meet the minimum regulatory capital requirements at least for the next 24 months.
4	We expect the capital adequacy ratios adjusted by S&P Global (China) Ratings to be somewhat lower than the industry average in the next 24 months.
5	We expect the capital adequacy ratios adjusted by S&P Global (China) Ratings to be lower than the industry average in the next 24 months.
6	We expect the capital adequacy ratios adjusted by S&P Global (China) Ratings to be significantly lower than the minimum regulatory requirements and we expect that without timely capital injection, the bank's operations would become unsustainable.

Source: S&P Global (China) Ratings.

Chart 13

Indicative Capital and Earnings Score Distribution of 200 Major Banks in China



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.

Foreign bank subsidiaries typically have stronger indicative capital scores because of their higher capital adequacy ratios than industry average.

Risk Position

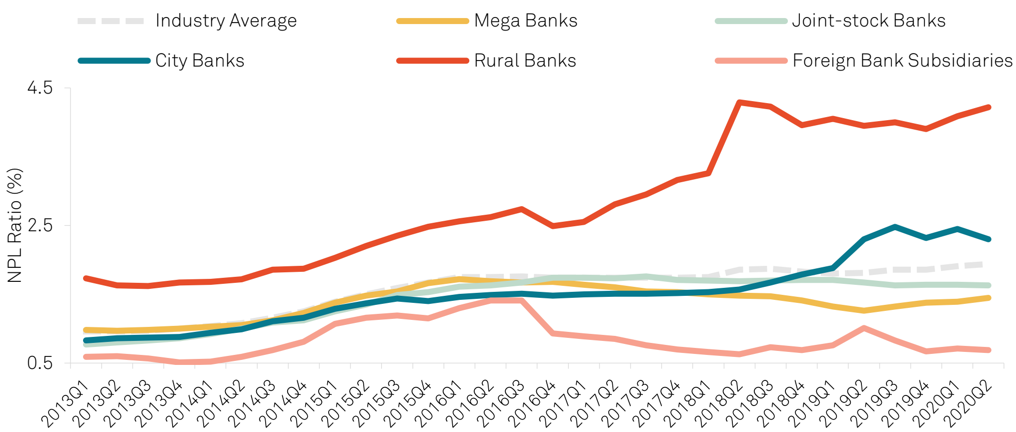
Foreign bank subsidiaries generally have lower NPL ratios than their domestic peers because of their low risk appetite. They typically set up branches in a limited number of big cities and target a clientele base with good credit standing. As a result, they have much less exposure to China's small and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

In 2020, multinationals and companies worldwide have all affected by COVID-19 in different degrees, leading to huge asset quality pressure across the world. Generally speaking, large international banks have a group-level international-scale risk monitoring and credit limit management frameworks, which help the foreign bank subsidiaries to leverage the risk management practices of their parents in the face of the global pandemic.

Foreign bank subsidiaries' asset quality is not immune to China's credit environment, particularly in the credit card and small and mid-sized enterprise ("SME") sectors. However, because their overall credit card and SME exposure is very small, we haven't seen noticeable change in their NPL ratios. As of the end of June 2020, the foreign bank subsidiary sector's average NPL ratio was only 0.69%, 2 basis points higher than the end of 2019

Chart 14

NPL Ratios of Different Types of Banks

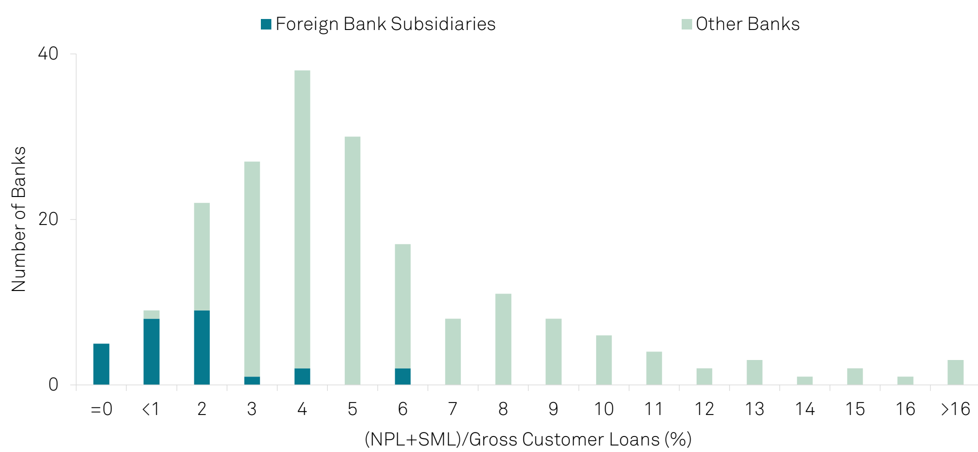


Source: CBIRC, collected and adjusted by S&P Global (China) Ratings.

Thanks to their prudent risk appetite, foreign bank subsidiaries' average NPL ratio remained at 0.7% in the first half of 2020 despite the pandemic.

Chart 15

Distribution of NPL+SML Ratio of Major Banks in China as of End of 2019



Sources: Public information of banks, collected & adjusted by S&P Global (China) Ratings.

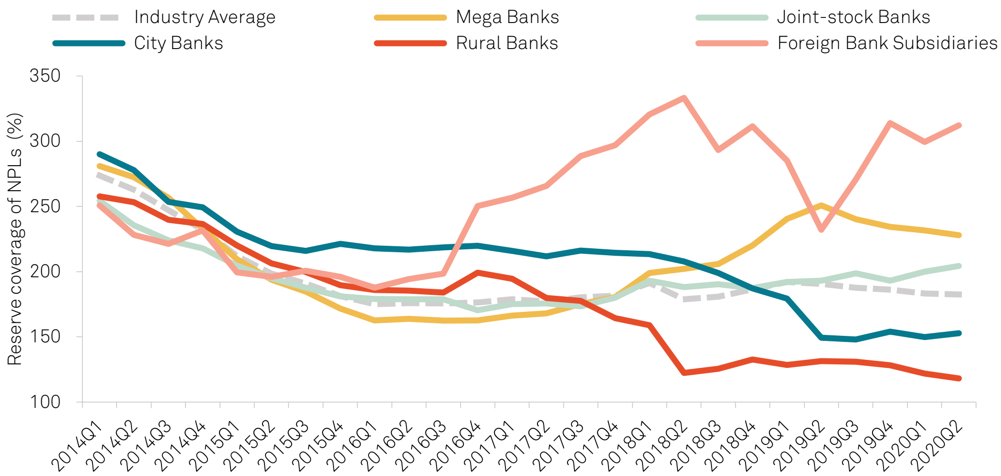
Foreign bank subsidiaries have the best asset quality metrics in China because of their low risk appetite.

We have also observed that, compared to domestic banks, many foreign bank subsidiaries may have a more prudent approach to loan risk classification, which is demonstrated by the big difference between their overdue loan ratio and NPL + SML ratio.

In the face of COVID-19, foreign bank subsidiaries have continued to maintain the highest reserve buffer compared to other banks. As of the end of June 2020, their reserve coverage of NPLs was 312%, basically unchanged from the end of last year, almost 130 percentage points higher than the industry average of 182%.

Chart 16

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 remains significantly higher than the industry average.

Table 4

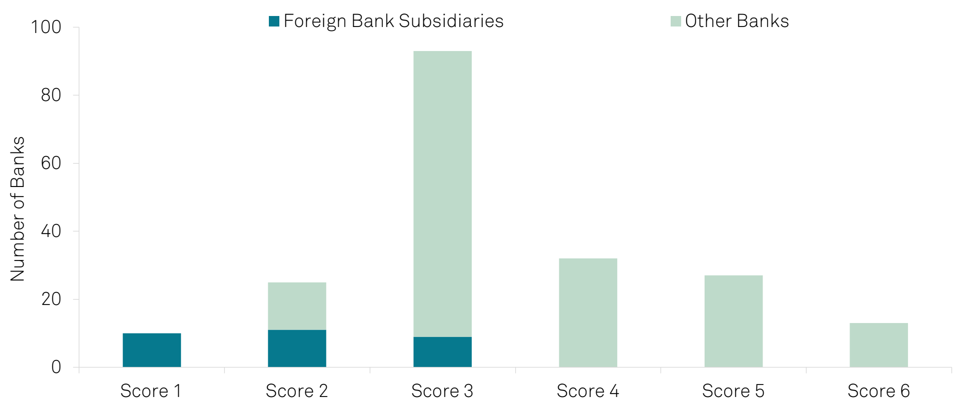
Characteristics of Banks with Different Indicative Risk Position Scores

Score	Typical Profile
1	Risk appetite is much lower than the industry average, and asset quality is generally insensitive to the economic cycle in China.
2	Risk management is better than the industry average, risk appetite is prudent, and the asset quality performance is better than the industry average through the economic cycle.
3	Risk management capability and asset quality performance are consistent with the industry average.
4	Risk management capability and asset quality performance are somewhat worse than the industry average.
5	Risk management capability and asset quality performance are worse than the industry average.
6	Risk management capability and asset quality performance are far worse than the industry average, and there may be serious flaws with its overall internal control.

Source: S&P Global (China) Ratings.

Chart 17

Indicative Risk Position Score Distribution of 200 Major Banks in China



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

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.

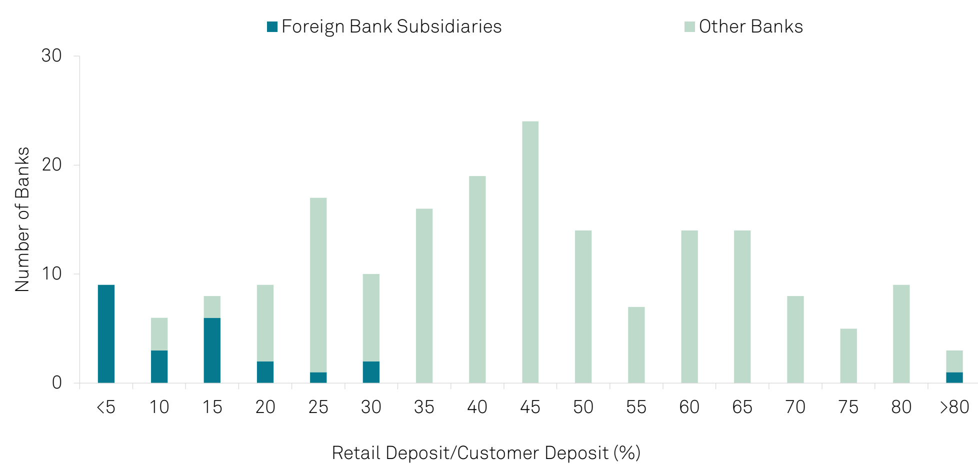
Source: S&P Global (China) Ratings.

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 do not 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 18

Distribution of Retail Deposit/Customer Deposit Ratio of Major Banks in China as of End of 2019



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

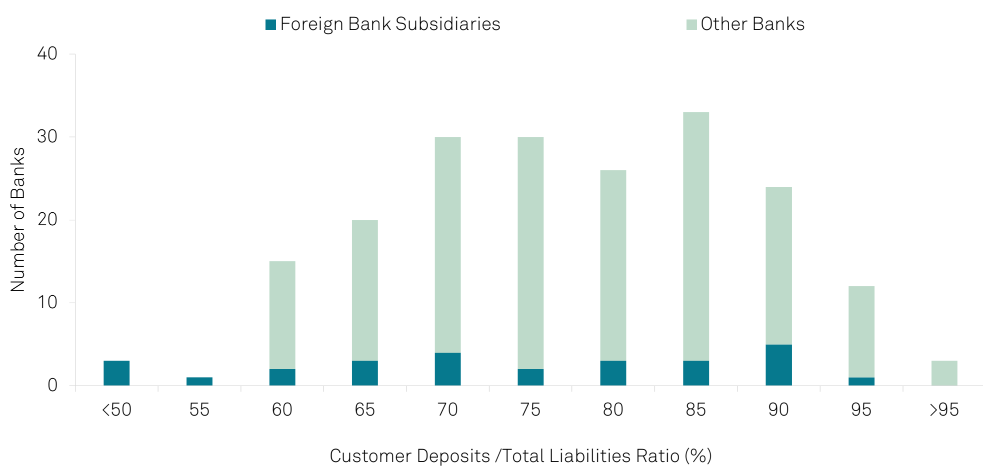
Sources: Public information of banks, collected & adjusted by S&P Global (China) Ratings.

Foreign bank subsidiaries' reliance on customer deposits varies. In our view, thanks to prudent liquidity management, foreign bank subsidiaries' funding and liquidity risk is generally controllable despite their limited deposit base. In some cases, parent banks also provide some ongoing funding support, which further stabilizes the funding profile of these banks.

Foreign bank subsidiaries' reliance on customer deposits varies.

Chart 19

Distribution of Customer Deposits /Total Liabilities Ratio of Major Banks in China as of End of 2019



Sources: Public information of banks, collected & adjusted by S&P Global (China) Ratings.

Table 5

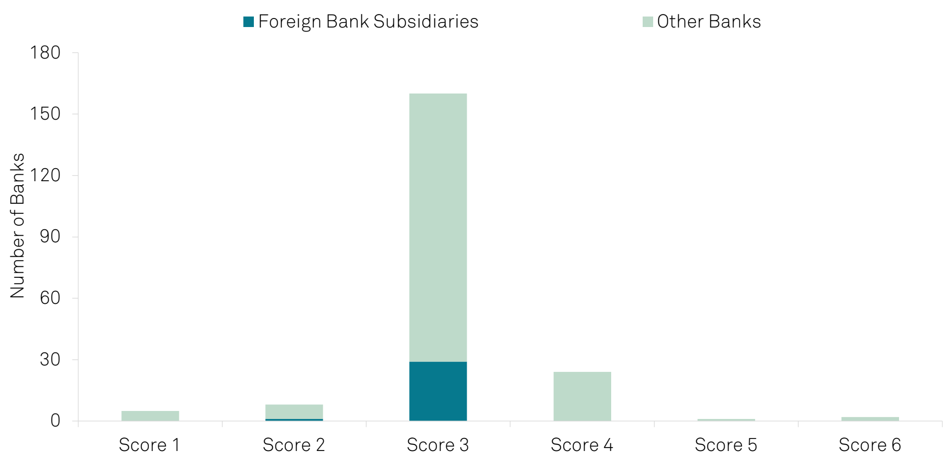
Characteristics of Banks with Different Indicative Funding & Liquidity Scores

Score	Typical Profiles
1	Strongest retail deposit base across China, and lower-than-industry-average reliance on wholesale funding. Strongest liquidity position in China and tendency to benefit from "flight to quality" phenomenon when the market is stressed, thanks to very strong investor confidence.
2	Strong deposit base in its region, lower-than-industry-average reliance on wholesale funding, and conservative liquidity management with superior liquidity-related ratios compared with the industry average.
3	Funding structure and liquidity position consistent with the industry average, with sufficient liquidity to meet minimum regulatory requirement on liquidity ratios even when the market is stressed.
4	Funding structure and liquidity position somewhat worse than the industry average, typically with a high reliance on wholesale funding, but still able to meet minimum regulatory requirements on liquidity ratios under normal market circumstances.
5	Liquidity position worse than the industry average, and the bank may have persistent difficulty in meeting minimum regulatory requirements on liquidity ratios when the market is stressed.
6	Eroded market confidence in the bank leading to a highly unpredictable liquidity position, high chance of requiring central bank intervention for liquidity support.

Source: S&P Global (China) Ratings.

Chart 20

Indicative Funding & Liquidity Score Distribution of 200 Major Banks in China



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.

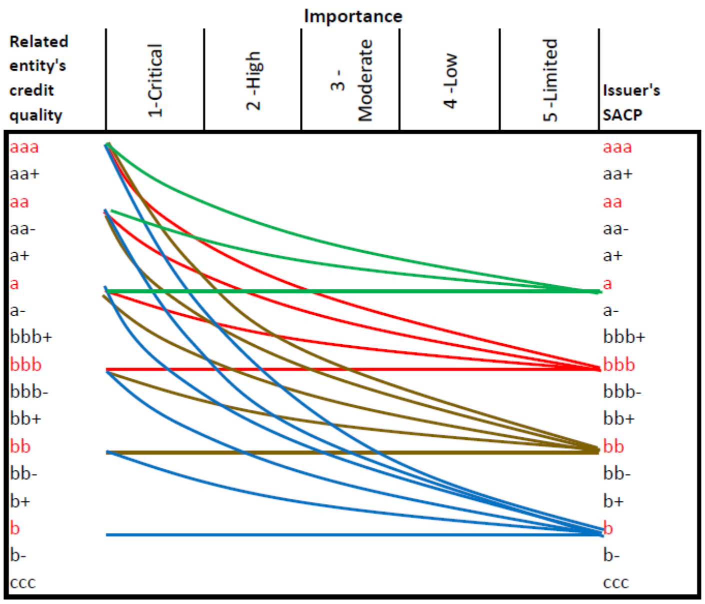
In our view, despite their limited deposit base in China, foreign bank subsidiaries generally have controllable funding and liquidity risk because of their prudent risk management.

Group Support

We believe that, in times 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 their parents' tight supervision, share their parents' brands and logos, and conduct cross-selling activities with their parents. Therefore, we typically view their importance to their parent banks as 1/critical or 2/very high in our five-point scale for assessing the importance level of subsidiaries.

Chart 21

Demonstration of Support Assessment Framework



Source: S&P Global (China) Ratings.

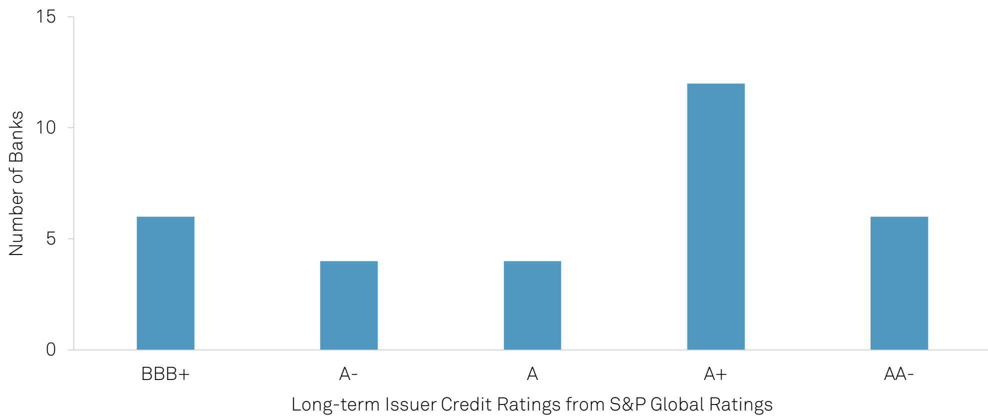
We typically view foreign bank subsidiaries' importance to their parent banks as 1/critical or 2/high in our five-point scale for importance level assessment.

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. 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 risk unique to foreign bank subsidiaries.

As COVID-19 puts pressure on economies and financial institutions around the world, it has inevitably weighed on the capability of parent banks to support their subsidiaries in China. However, we believe the pandemic's impact on most parent banks has been controllable, as demonstrated by the generally good credit ratings of large international banks despite the pandemic. The overall stability of parent banks' creditworthiness continues to underpin the good issuer credit quality of their subsidiaries in China.

Chart 22

Distribution of S&P Global Ratings of Foreign Banks with Locally Incorporated Banking Subsidiaries in China



Note: 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. Among those 32 foreign banks, one bank was downgraded by one notch in 2020. As of October 16, 2020, 6 of them had negative outlook and one was put into negative credit watch.

Source: S&P Global Ratings, collected by S&P Ratings (China)

Foreign banks which set up locally incorporated banks in China tend to be strong global or regional banks and most of them have maintained good credit quality despite the global pandemic.

This report does not constitute a rating action.

Appendix: Related Methodologies, Ratings & Research

- S&P Global (China) Ratings Financial Institutions Methodology.
- Diversity Across China's Banking System – A Deep Dive A Study on Credit Quality Differentiation Among Chinese Banks.
- Mega Banks: Strong Enough to Withstand COVID-19.
- Joint-Stock Banks Capable of Sustaining Lending Growth Under Earning Pressure: A Study on the Credit Quality of Chinese Joint-stock Banks Amid COVID-19.
- City Banks: Indispensable Financiers of China's SMEs
- The Role of Rural Banks in China's County Economy -- A Study into the Creditworthiness of China's Rural Banks
- Small but Solid – Foreign Bank Subsidiaries as Niche Players in China's Banking Sector
- Credit Rating Report: JPMorgan Chase Bank (China) Company Limited.
- Credit Rating Report: Sumitomo Mitsui Banking Corp.
- Credit Rating Report: Citibank (China) Company Limited.