Credit Opinion

20 September 2024

Ratings	
Category	Financial Institution
Domicile	China
Rating Type	Solicited Rating
Long-Term Credit Rating	AA_g-
Outlook	Stable

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China Bond Insurance Co., Ltd.

Surveillance credit rating report

CCXAP affirms China Bond Insurance Co., Ltd.'s long-term credit rating at AA_g-, with stable outlook.

Summary

The AA_g- long-term credit rating of China Bond Insurance Co., Ltd. ("CBIC" or the "Company") is underpinned by the Company's (1) strong market position as the largest credit enhancement company and bond guarantor in China; (2) solid asset quality with a low level of historical claims; and (3) sufficient capital adequacy and good access to capital.

However, the rating is constrained by the Company's (1) profitability under challenges of higher loss provision; and (2) concentrated guarantee portfolio; and (3) moderate level of internal liquid resources.

The rating also incorporates our expectation that the Company has a high likelihood of government support given its (1) indirect ownership by the Chinese government through several large central SOEs and operation under the guidance of the National Association of Financial Market Institutional Investors ("NAFMII") and the People's Bank of China ("PBOC"); (2) strong policy role in the development of China's capital market, particularly in resolving the financing needs of SMEs and innovating financing products; and (3) reputation risk to the Chinese government if failure.

The stable outlook on CBIC's rating reflects our expectation that the willingness and ability of the Chinese government to provide support is unlikely to change. We also expect the Company to sustain its leading market position and solid financial profile in the next 12 to 18 months.

Rating Drivers

- Strong market position as the largest credit enhancement company and bond guarantor in China
- Good profitability which is challenged by higher loss provisions
- Solid asset quality with a low level of historical claims
- Sufficient capital adequacy and good access to capital
- Moderate level of internal liquid resources
- High likelihood to receive government support when necessary

Rating Sensitivities

What could upgrade the rating?

The rating could be upgraded if (1) the likelihood of receiving government support increases such as higher policy roles or greater strategic importance; and (2) the Company's standalone credit profile improves, such as improved quality of guarantee portfolio, better coverage in potential claims on guarantees and larger high-liquid asset holdings.

What could downgrade the rating?

The rating could be downgraded if (1) the likelihood of receiving government support decreases such as weakened strategic importance; or (2) the Company's standalone credit profile worsens, such as hindered profitability, or sharp decrease in asset quality.

Key Indicators

	2021FY	2022FY	2023FY	2024Q1
Total Assets (RMB billion)	16.2	14.7	14.2	14.0
Total Equity (RMB billion)	12.2	11.0	9.8	10.0
Net Profit (RMB billion)	0.6	0.7	0.5	0.3
Return on Equity (%)	5.1	6.1	5.3	-
Accumulated Claim Ratio (%)	0.3	0.3	0.2	0.2
Risk Reserve/Outstanding Guarantees (%)	3.3	4.2	6.3	6.9
High Liquid Assets/Total Assets (%)	22.4	28.8	29.7	33.5

All ratios and figures are calculated using CCXAP's adjustments.

Source: Company data, CCXAP research

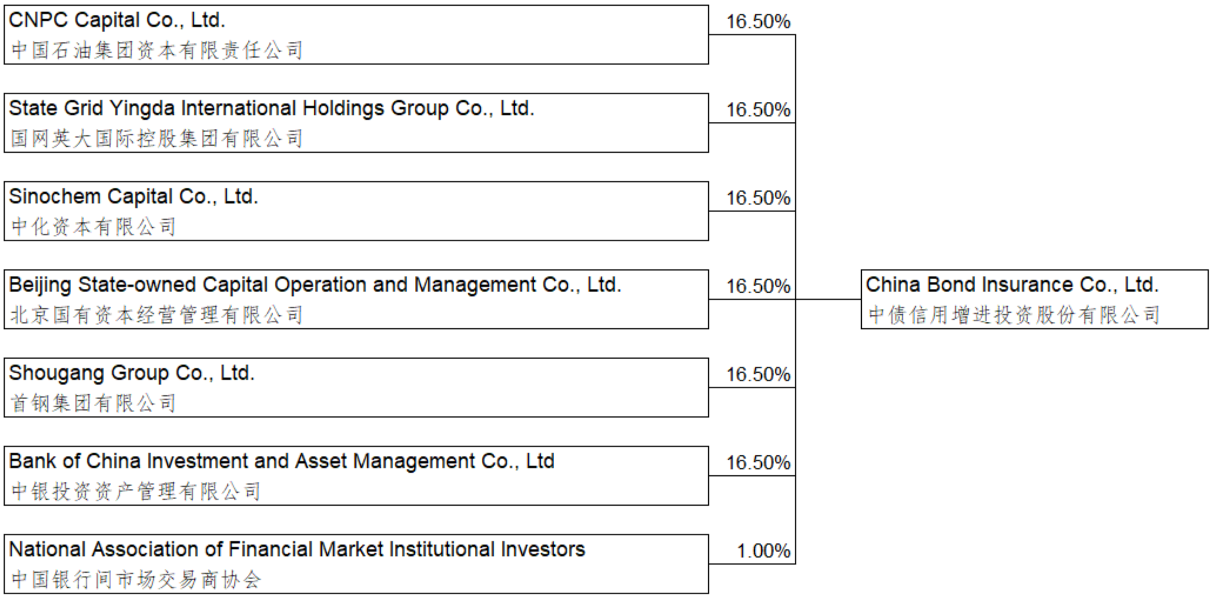
Corporate Profile

Headquartered in Beijing, CBIC was founded under the guidance of the People's Bank of China, with the policy role in facilitating the development of domestic direct finance and the finance of small-to-medium enterprises (SMEs). It was jointly established by the NAFMII and several large state-owned enterprises (SOEs), including China National Petroleum Corporation, State Grid Yingda International Holdings Group Co., Ltd., Sinochem Corporation, Beijing State-owned Capital Operation and Management Co., Ltd., Shougang Group Co., Ltd. and Bank of China Investment and Asset Management Co., Ltd. It is one of the largest credit enhancement companies and bond guarantors in China.

CBIC mainly provides traditional credit enhancement services, particularly standardized products, and gradually extends to other innovating financing products with wider business coverage. Its credit enhancement services not only cover traditional products such as Medium-term Notes (MTN), Short-term

Commercial Paper (SCP), Corporate Bonds, Financial Bonds, but also more complex derivative products including Trust Plans, Asset-backed Security (ABS), Credit Risk Mitigation Agreement (CRMA) and Credit Risk Mitigation Warrant (CRMW).

Exhibit 1. Shareholding chart as of 31 March 2024



Source: Company information, CCXAP research

Rating Considerations

Operating Environment

CBIC is domiciled in China and most of its revenue is generated in China. CBIC's macro profile is **Medium +** which reflects China's (1) robust economy and fiscal strength, (2) good institutional strength, and (3) improving operating environment for financial guarantors. However, the macro profile is undermined by (1) low barriers to entry of China's financial guaranty sector, which drive a lower rate of underwritten premium; and (2) weakened credit condition, which may increase the industry's vulnerability.

China has strong economic fundamentals and institutional strength. China's strong institutional strength is reflected in the long-term stability of its political environment and the high efficiency of its government. In addition, it is the second-largest economy in the world, with large population and economic base, as well as stable economic growth. China demonstrated a good, albeit moderating, economic recovery since the pandemic. In 2023, China's GDP grew 5.2% YoY to RMB126.1 trillion, supported by its border reopening and the recovery in production and demand. Nevertheless, the economy remains under challenges given the moderate domestic demand. GDP growth recorded 4.7% YoY in the second quarter of 2024.

The operating environment for Chinese financial guarantors is improving with a clearer regulatory framework and supportive government stance. In 2017, the State Council issued the "*Regulation on the Supervision and Administration of Financing Guarantee Companies*" (《融资担保公司监督管理条例》) and the China Banking and Insurance Regulatory Commission released the supplementary provisions in 2018 and 2019, to clearly define the responsibility of the supervisory bodies and related regulatory metrics. In addition, the government has highly promoted financial guarantors in the provision of the finance of SMEs and rural entities. In July 2018, the Ministry of Finance founded a national financing guarantee fund with several state-owned financial institutions, such as Bank of China Limited, China Development Bank and China Life Insurance Company

Limited, to encourage the establishment of local financial guarantors to assist SMEs in financing. The registered capital of the fund was RMB66.1 billion.

However, the Chinese financial guaranty industry has low concentration with low entry barriers, and the sector is highly fragmented with different market participants. This may put higher pricing pressure on premium rates and erode financial guarantors' profitability in the long run. The narrowed credit spreads in China's broad capital market, given the easing of monetary policy, also intensify competition among financial guarantors and drive down their profitability. In addition, the weakened credit condition, such as increasing default events and a limited financing environment in particular industries, may increase provision costs for financial guarantors. We believe that the market accumulated claim ratio will remain flat for the next 12 to 18 months, backed by China's supportive monetary policy and sufficient broad market liquidity.

Institutional Profile

Strong market position as the largest credit enhancement company and bond guarantor in China

CBIC is one of the largest credit enhancement companies and bond guarantors in China. It has enjoyed the ongoing growth of China's bond market in its traditional business in standardized bond products and has extended the coverage to other innovative products such as ABS, CRMA, and CRMW. CBIC has demonstrated fast business development and good market recognition. It has provided guarantee services for various type of enterprises in China over the past decade. As of 31 March 2024, the Company had an outstanding guarantee amount of RMB49.9 billion (excluding its exposure to real estate sector). Moreover, CBIC's strong capital strength also supports the implementation of comprehensive risk management and hiring expertise. The Company is one of the largest state-owned financial guarantors in terms of the amount of total capital.

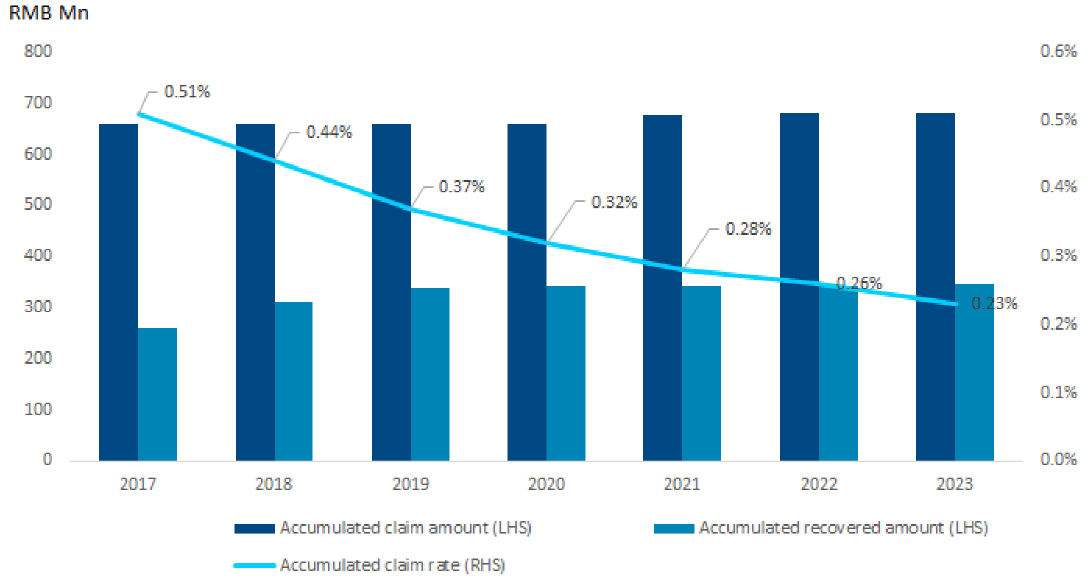
CBIC has multiple qualifications such as the qualification for interbank lending, Class B custody, CRMW creation and trading in the inter-bank market, as well as the qualification of the primary dealer in China. In addition, the Company obtained a license from the Beijing Local Financial Supervision and Administration in June 2021.

Solid asset quality with a low level of historical claims

CBIC has solid asset quality with a low level of historical claims, a simple product structure, and a high-quality client base. Compared with its top-tier peers, the Company's accumulated claim ratio remained low at around 0.23% as of 31 March 2024. It had a moderate recovery rate on claims of approximately 50% in aggregate. CBIC had a total claim of RMB680 million from 2009 to 2023, which mostly occurred in 2015, when there was a higher default rate for the private SME enterprises. In 2021, CBIC reported new claims of RMB20.0 million, all from the guarantees in SME collective notes. The new claims were mainly driven by the tightened operating environment for SMEs. There have been no new claims from 2022 to 2024Q1.

However, the ongoing economic slowdown and tightening financing policy on local infrastructure investment and financing company ("LIIFC") may weaken the creditability of its guaranteed clients and heightened its provision costs. The number of CBIC's clients that fell into special-mentioned and doubtful categories were 33 and 6, respectively, as of 31 March 2024, which shown an increasing trend. We believe that CBIC's prudent client selection and limiting new business growth are able to help stabilize the credit quality on its guarantee portfolio.

Exhibit 2. CBIC's accumulated claim amount and recovered amount from 2017 to 2023



Source: Company information, CCXAP research

The Company's guarantee portfolio is mainly made up of guarantees on traditional products in the domestic market such as MTN, SCP, CP, and corporate bonds, most of which are simple and have higher information transparency that lowers the risk of misevaluating them. Nevertheless, the business's extension to other complex and innovative products, such as ABS, project revenue notes, CRMA and CRMW, may increase the opacity of risk assessment and has higher modelling risk. The participation of CRMA and CRMW has a policy aim to support the finance of private sector. Nevertheless, such business is mostly targeted at enterprises with relatively weak credit strength that may expose CBIC to higher business risk.

CBIC's asset quality is constrained by its concentrated portfolio because the Company tends to participate in large construction projects that have great funding needs. The construction sector, affordable housing and urban renewal projects represented more than 60% of outstanding guarantees of the Company. CBIC's exposure to the single client risk remains high, with the largest client guarantee accounted for around 15.4% of its core capital and the top ten client guarantees accounted for 121.8% as of 31 March 2024. The concentrated risk could be mitigated by CBIC's high-quality client base and sufficient risk control measures. The top ten clients are mostly SOEs and LIIFCs that are backed by government support. These clients are relatively less vulnerable to the economic cycles and are more likely to receive solid government support in stressed scenarios. For risky projects, the Company would take necessary risk mitigation measures, such as third-party guarantees or asset pledges, to reduce the potential losses.

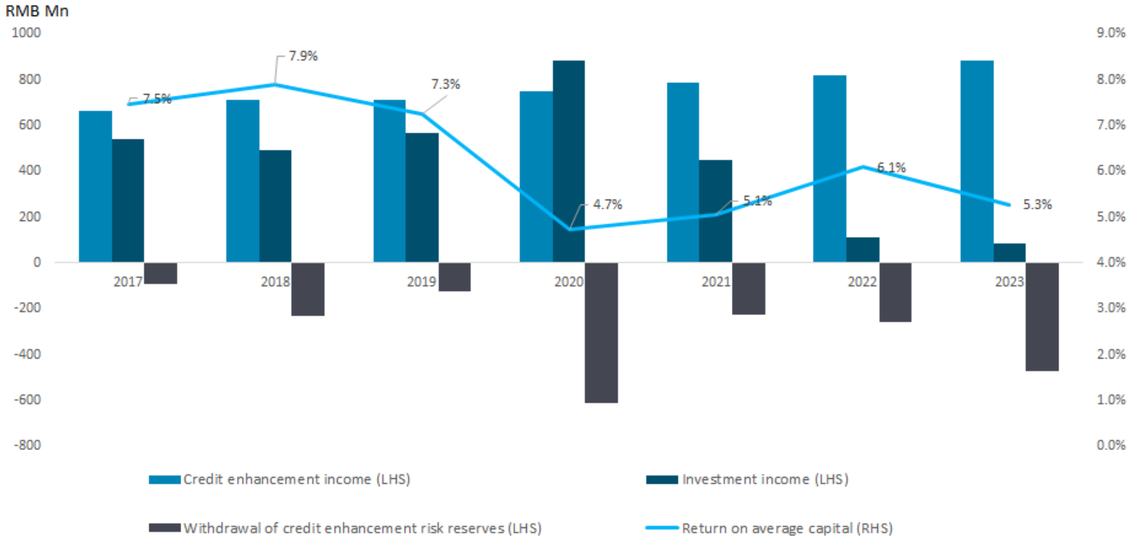
In addition, we expect that CBIC will have increased exposure to the real estate sector because the Chinese government has instructed CBIC to provide guarantees to some private-owned developers for their onshore bond issuance, a way to support the financing of private-owned property developers. Such activities are expected to increase CBIC's risk exposure with guaranteed amount of more than RMB30.0 billion, while we believe that the Company will receive policy or financial support from the government for this type of business.

CBIC will continue to face the economic downside pressure on weak regions, which may adversely affect its asset quality over the next 12-18 months. It will carry a red flag if CBIC encounters a large number of clients that turn to doubtful or lower levels, although we believe such scenario is less likely.

Good profitability but is challenged by higher loss provisions

Benefiting from its strong market position and credit management technique, CBIC demonstrated stable profitability over the past years. From 2019 to 2023, it had an average return on equity ("ROE") of around 5.7%, with a five-year Sharpe ratio of 562.1% (exceeding the reasonable level of 100%). CBIC's good profitability could help it reserve sufficient capitals for business expansion or future potential claims. However, the ongoing economic slowdown increased provision pressure for guarantee business and the volatility of capital markets caused diminished investment income. In 2023, the Company increased the provisions of risk reserve for credit enhancement business to RMB471.4 million from RMB259.5 million in 2022 due to the increasing proportion of doubtful and substandard assets, resulting in a lower ratio ROE of 5.3% in 2023.

Exhibit 3. CBIC's revenue structure from 2017 to 2023



Source: Company information, CCXAP research

CBIC's good investment skills also help support its bottom-line profitability. The Company implements a consistent and prudent investment strategy and adjusts its investment portfolio timely to meet the change in market environment. The Company's investment portfolio is mainly composed of fixed income with moderate exposure to listed stocks, leased properties, and currency funds. As of 31 March 2024, CBIC had high-quality investment portfolio of RMB10.2 billion, of which 87.2% were fixed income investments and 10.5% were equity investments. The Company's fixed income investments are largely composed of public bonds with good liquidity, including bonds issued by government, financial institutions or other large corporates. As the Company adjusted its investment strategy, the investment in credit bonds such as the bonds issued by LIIFCs has been decreasing over the past year. The Company's equity investments comprised defensive stock listed in A-share or H-share markets as well as trust investments covering alternative investment projects. However, the high volatility in the stock market, coupled with the frequent occurrence of credit events, exerts greater challenges to the Company's investment strategy and asset allocation. Its income including investment and interest decreased from RMB808 million in 2021 to RMB401.5 million in 2023.

Overall, the fluctuations in the stock market and the slowdown in economic growth, coupled with narrowed credit spreads in the capital market may bring more uncertainty on the Company's future investment and financial performance.

Sufficient capital adequacy and good access to capital

With strong capital raising ability and good internal capital accumulation, CBIC's capital profile is relatively strong. These provide the Company with a healthy loss-absorption buffer against unexpected market volatilities. As the perpetual bonds were redeemed, the Company's net assets decreased to RMB10.0 billion as of 31 March 2024 from RMB11.0 billion as of end-2022. Nevertheless, the Company's risk provisions increase to RMB3.4 billion from RMB2.9 billion over the same period, supporting the expansion of the credit enhancement business and the absorption of the potential loss. The provisions to outstanding guarantees ratio kept improving over the past year and recorded approximately 6.9% as of 31 March 2024, as compared to 4.2% as of 31 December 2022. Meanwhile, the outstanding guarantees to equity ratio reduced from 6.2x at end-2022 to 5.0x at end-2024Q1.

In addition, after years of business practice, CBIC has established a comprehensive risk management system, covering the optimal allocation, the monitoring and management mechanism, and the hedging and transfer mechanism for risk assets. A three-level risk management organizational structure is formed by the Company, including the board of directors, management, and business lines. Three lines of defense with a proven track record in the Company's risk aversion demonstrates a relatively high quality of management.

CBIC also demonstrated good funding ability which supports its business development as well as enhances its risk resistance capability. The Company has a proven track record of access to the debt capital market. For example, it raised RMB3.0 billion in total via 2 tranches of onshore perpetual bonds in 2019 and 2020, with coupon rates of 4.69% and 3.8%, respectively, providing the Company with high financial flexibility. The Company also had a large amount of unutilized credit facilities of RMB28.4 billion as of 31 March 2024, indicating sufficient standby liquidity. In addition, the Company's qualification for interbank lending could enhance its funding ability.

Moderate level of liquid resources

The liquidity risk of CBIC mainly comes from the mismatch between its on-balance sheet assets and off-balance sheet contingent liabilities. Liquid resources offer buffers to a financial guarantor to meet its unexpected liabilities. We consider CBIC's liquid resources were fair with moderate liquidity ratio (measured by high liquid assets/total assets) of approximately 33.5% as of 31 March 2024. It has high-quality and reliable liquid resources that includes government bonds, quasi-governmental bonds and other trading securities. CBIC's liquidity is also underpinned by its good funding access with its strong state-owned background. With CBIC's good risk management ability and prudent business development strategy, we believe that the existing liquid assets are able to cover the possible claims in the following 12-18 months.

External Support

High likelihood to receive government support when necessary

We expect that CBIC is likely to receive support from the Chinese Government when necessary. This expectation incorporates our considerations that the Company (1) is indirectly owned and controlled by the Chinese government through several large central SOEs and is under the close guidance from the NAFMII and the PBOC; (2) has a relatively high strategic importance given its public policy role in resolving the financing needs for SMEs and the development of domestic direct financing; and (3) has significant market position in China's credit enhancement sector and the failure of the Company will cause material impact on capital market and concerns over the government's reputation. In addition, CBIC has been the key state-owned financial guarantors in executing Chinese government's measures for helping the property sector. We believe that the Company will retain its strong policy role and market position over the medium to long term.

Rating Methodology

The methodology used in this rating is the Rating Methodology for Financial Guarantors (January 2022).

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