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# Panda Bonds in 5 Years:
# Finding its Way out

CHINA CHENGXIN INTERNATIONAL CREDIT RATING CO.,LTD

# Panda Bonds in 5 Years: Finding its Way out

Since international development institutions made their first forays into the Chinese bond market in 2005, the Panda Bond market experienced a decade of sluggish growth. Starting from 2015, regulatory policies were geared toward market liberalization which propelled the Panda Bond market onto a fast track. From 2016 to 2020, the Panda Bond market went through rapid expansion, substantial tightening and gradually entered a relatively stable stage. By the end of 2020, the outstanding volume of Panda Bond reached RMB253 bn, accounting for 0.22% of the total Chinese bond volume. In many ways, Panda Bond market is still in the pilot stage, with a relatively small size, and overseas institutions' participation remains lukewarm. In the future, the Panda Bond market will benefit from the accelerated pace of opening-up of the Chinese bond market. In addition, the advancement of the BRI and the burgeoning undertakings of foreign companies in China would attract more foreign issuers with real long-term demand of RMB.

As an active observer and service provider in the Panda Bond market, China Chengxin International Credit Rating Co., Ltd. ("CCXI") not only enjoys a dominant role in the field of Panda Bond rating, but also has extensive experiences in research and practice. Since 2016, CCXI has been constantly monitoring the Panda Bond market and publishing the series report of Panda Bond Market Review and Outlook on a yearly basis. Year 2020 has witnessed dramatic changes worldwide. The Panda Bond market is also faced with challenges and opportunities more than ever. The report analyses and summarizes the key factors affecting the market in the past five years, thus to offer insights for market status and future trends.

# I. Market Recap

The Panda Bond market from 2016 to 2020 could be roughly divided into two stages, moving from a period of volatile growth onto the path of stable development, with moderate pace of growth in size. While overseas institutions render lukewarm participation, some automobile companies emerge as prominent bond issuers. Red-chip enterprises[1] have been the main contributor to date, featuring smaller size and shorter tenor since 2019. As for issuer types and industry backgrounds, the distribution has been reshuffled after the real estate inflow subsided. At present, non-financial entities take the leading share in issuer types, and the industry background of participating entities carries on the route of diversification.

## (I) From 2016 to 2020, the Panda Bond market went through rapid expansion, remarkable waning and gradually entered a relatively stable pathway

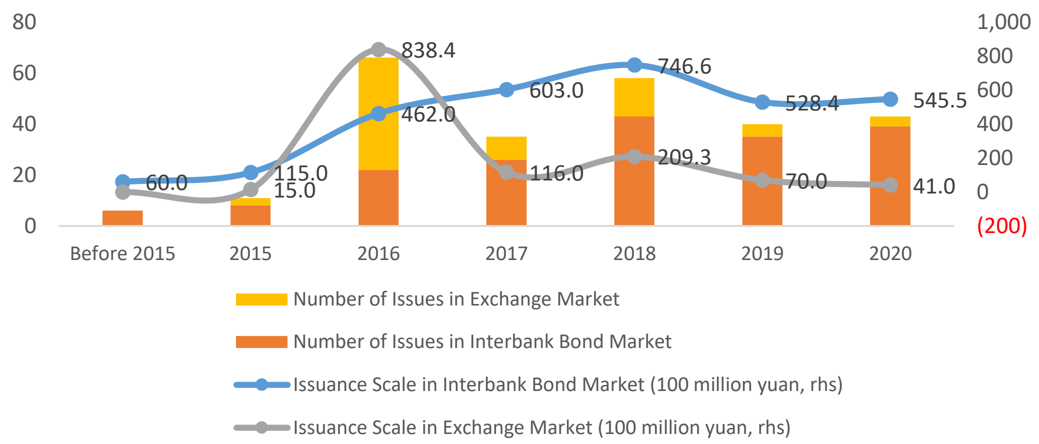
The 2016-2020 Panda Bond market could be divided into two stages, of which 2016-2018 is the fluctuating stage, which has gone through rapid expansion, substantial tightening and returning to stability, while 2018-2020 manifests a relatively stable period of development. Year 2016 witnessed the explosion of this market due to the rapid expansion of real estate companies in the exchange market. Since 2017, the tide receded with the policy set designed to tighten real estate financing. In 2018, the decline in issuance costs and the advancement of the regulatory system drove the market to pick up, with the issuance volume reaching a stage high. From 2018 to 2020, the market rendered a relatively stable pathway. Yet the still-high approval threshold along with the persisting comparative advantage of dollar bond in times of the widening interest rate spread between China and the US inhibits the market from further expansion.

As the major platform for Panda Band issuance, the interbank market took more than 90% of the total issuance in 2020. The issuance scale in the exchange market once relied on red-chip real estate companies, hitting a record high in 2016 and had entered a tightening range since 2017. The interbank market's dominant role for Panda Bond issuance aligns with the financing landscape in China, a market in which the banking system

[1] A red-chip company is a corporation that has its business operation mainly in China, while being incorporated outside mainland China and listed on the Hong Kong Stock Exchange.

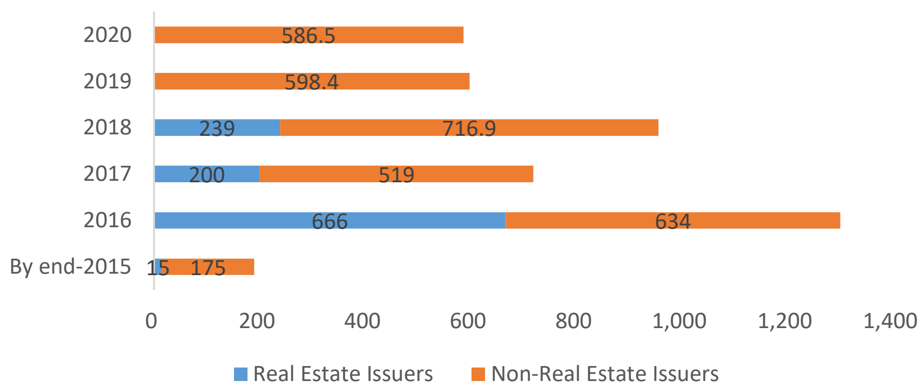
dominates. It is worth mentioning that with the landing of the interconnection mechanism, these two market are moving towards unified management and coordinated development in areas such as investor participation, rating acknowledgement and mutual recognition of institutional qualifications.

**Figure 1：Panda Bond Issuance in Interbank Market and Exchange Market**




Source: Public information, edited by CCXI

**Figure 2. Panda Bond Issuance Scale**
**(Real Estate Issuers vs. Non-Real Estate Issuers)**

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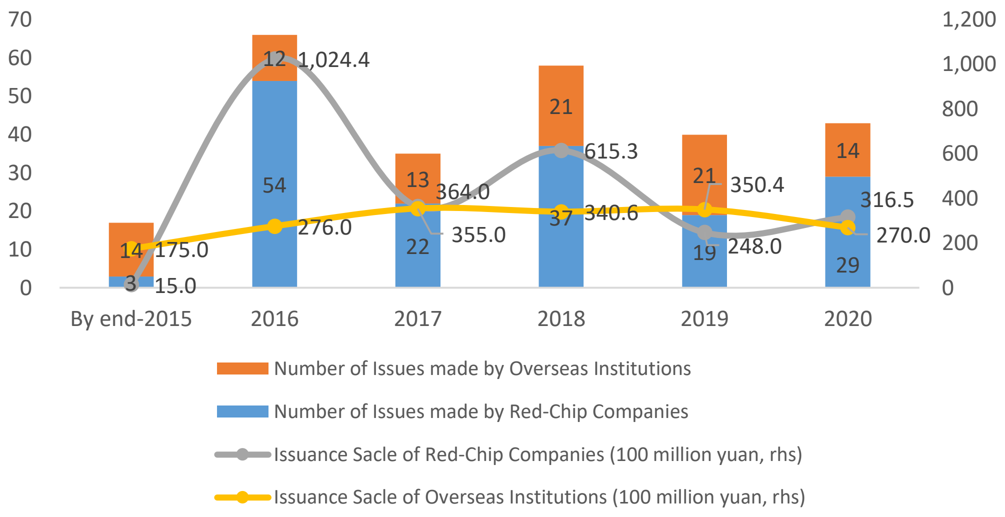
**(II) Red-chip companies render volatile issuance volume, while that of overseas institutions stayed relatively stable, with a participation rate less than 50%. Also, some foreign automakers emerge as**

**prominent bond issuers**

In terms of issuer structure, from 2016 to 2020, red-chip companies exhibited volatile issuance volume and were the major player in the Panda Bond market, while overseas institutions rendered relatively stable issuance volume and lukewarm participation. Red-chip companies are largely affected by the trends of offshore and onshore financing costs, while the tightening financing policies for real estate sector also contributes to the volatility. As for overseas institutions, despite continuous advancement in policy making, the examination and approval for bond issuance still face hurdles such as relatively long processing time and high cost. Such scenario are further compounded by exchange and interest rates fluctuations, which hinders overseas institutions' issuance from rapid expansion, particularly given their highly market-oriented consideration for bond issuance. Meanwhile, certain entities with strategic layout in China emerge to become active Panda Bond issuers. For example, some overseas auto companies – namely, Daimler AG and BMW - are looking to tap China's huge market potential and seek to span their asset and business in China. Among overseas institutions, more than half issuers are from the Asia-Pacific region, while European issuers account for about 58% in terms of issuance scale. As for industry background, European issuers render more diversified industry distribution, with automobile manufacturers taking the largest share, while banks are still the dominant issuers in Asia Pacific.

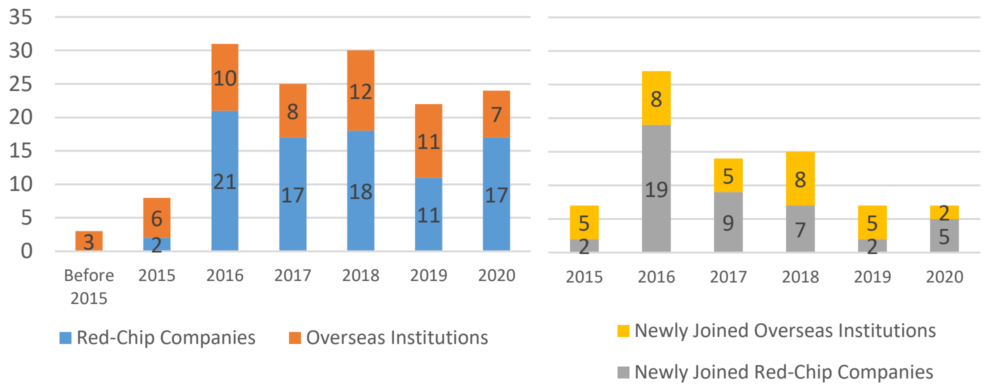
**Figure 3. Panda Bond Issuance Volume of Red-Chip Companies and Overseas Institutions**




Source: Public information, edited by CCXI

**Figure 4. Distribution of Panda Bond issuers by type**

**(Red-Chip Companies and Overseas Institutions)**

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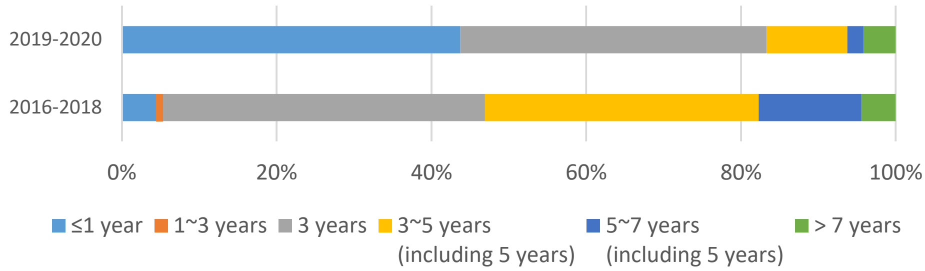
### (III) Three-year bonds takes the largest share among all tenors, with RMB 1bn being most frequently issued size. Starting in 2019, red-chip companies are further biased towards short-term

From the perspective of term structure, maturity of Panda Bonds cluster at the short and medium term, with tenors within three years accounting for 69.2% of the total, of which three-year bonds takes 47.9%, representing the largest share. Short-dated bonds have come to take hold since 2019, and the proportion of bond issuance within three years in 2019-2020 moved up to 88.0% from the 2016-2018 level of 61.0%. Red-chip companies render significantly increased proportion for tenors within one year, as they often take Panda Bond financing as a preventive measure for financial risk management, and the widening interest rate spread between China and the US puts pressure on their willingness for long-term issuance. The tenor structure of overseas institutions stays relatively stable, with long-term issuers consisting mainly of multilateral development institutions, given their long-term RMB financing needs.

**Figure 5. Panda Bonds Issuance Term Structure of Red-Chip Companies**

**（2016-2018 vs. 2019-2020）**

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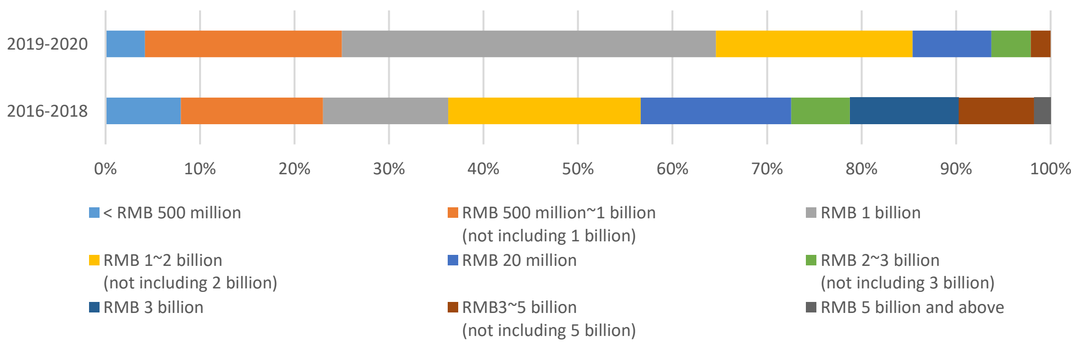
In terms of the issuance scale per bond, size of less than RMB1 bn still dominate the Panda Bond market, accounting for 48.4% of the 2016-2020 pool. Preference for smaller issuance has been standing out for red-chip companies because of permeating uncertainty in the market, and the share of bond size within RMB1 bn climbed from 36.3% in 2016-2018 to 64.6% in 2019-2020, among which the size of RMB1 bn 13.3% to 39.6%, taking up the largest proportion of red-chip issuance. As for overseas institutions, issuers with long-term engagement plans in China exhibit a larger issuance size per bond. On the whole, auto enterprises having Chinese business agendas, along with foreign governments and multilateral development institutions tend to have larger issuance size.

**Figure 6. Panda Bonds Issuance Size of Red-Chip Companies**

**（2016-2018 vs. 2019-2020）**

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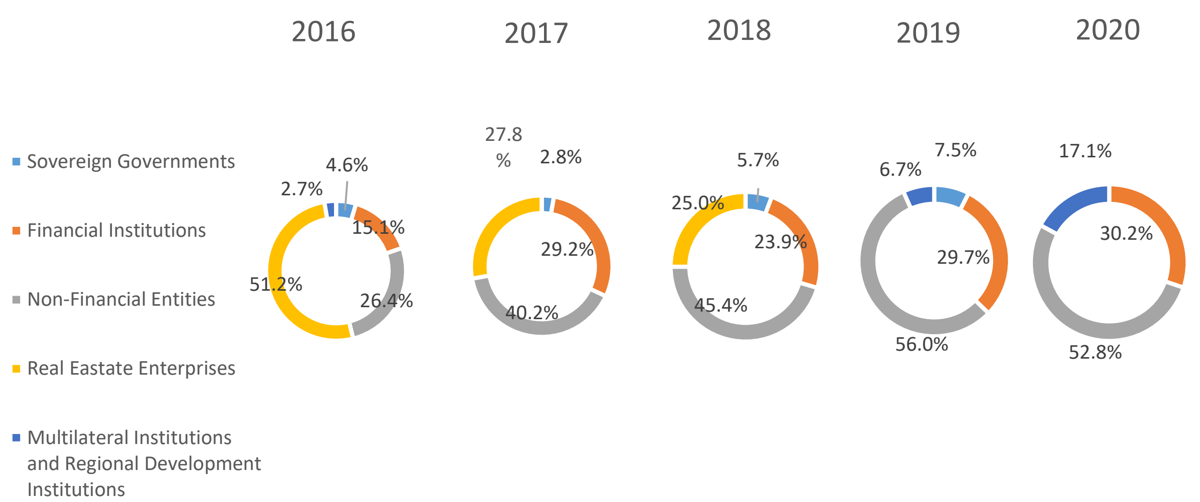
### (IV) Industry distribution of Panda Bonds issuers has been reshuffled after the wave of real estate issuance subsided. At present, issuers are comprised mainly of non-financial entities, and the industry background of participants continues to diversify

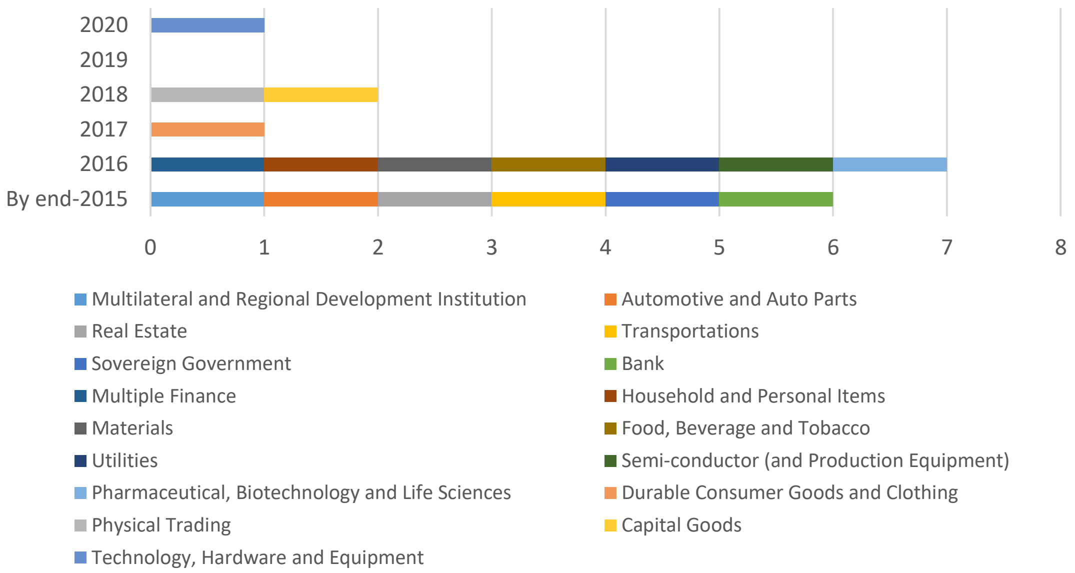
Red-chip real estate enterprises, once a major player in the market, have their issuance dropped to zero after the year of 2018, a pattern that reshuffles the distribution of Panda Bond issuers. At present, sovereign and multilateral institutions (17.1%), financial institutions (30.2%) and non-financial entities (52.8%) takes up the market. In terms of issuance scale, the proportion of multilateral institutions and regional development institutions significantly climbed in 2020, reaching 17.1%. Such trend is expected to carry on in the next few years, given the post-epidemic global economic recovery and the demand for construction along the Belt and Road. In terms of industry breakdown, the Panda Bond market witnessed expanding diversity as enterprises with various backgrounds emerge. In 2020, with Xiaomi – a group that engages in technical hardware and equipment production – made its first Panda Bond issuance, the number of industry categories in the market reached 17.

**Figure 7. Distribution of Panda Bond Issuers by Type (according to Issuance Scale)**




Source: Public information, edited by CCXI

**Figure 8. Industries of Panda Bond Issuers[2]**




Source: Public information, edited by CCXI

[2] Customers with new issuances and remaining Panda bonds in the corresponding year are all included.

## Part II. Policy Evolvement

The authorities has been taking multiple measures on both the issuing end and the investment end to bolster the Panda Bond market since its launch. The "Measures"[3] were introduced as the first general regulatory framework to offer clear guidelines in 2018. Since then, a number of regulatory policies, including rules for tiered management, have been refining the issuance policies in terms of information disclosure, registration system and so on. Meanwhile, the authorities also set out to optimize the investment channels of offshore investors by unifying regulatory rules and removing quota restrictions, which to some extent has a positive impact on the Panda Bond market.

However, the effect brought by regulatory policies on the issuance willingness and investors behavior remains to be seen. According to Detailed Rules for the Administration of Tiered Management of Debt Financing Instruments of Overseas Non-Financial Enterprises (the "Tiered Management Rules"), overseas seasoned enterprises could bypass the case-by-case discussion and benefit from a simplified registration and issuance process, while the original issuers would bear the cost of adaptation during the transition period. Under the existing regulatory regime of the Panda Bond Market, the issuance process awaits further simplification, whereas further alignment with the rules and practices of the international bond market would be appreciated from the perspective of overseas issuers.

### (I) Issuance: Innovation and Challenges

In 2005, the *Interim Administrative Measures for the Issuance of RMB Bonds by International Development Institutions* was formulated to set preliminary rules on the threshold for RMB bond issuance by international development institutions in China[4]. From 2014 to 2016, several documents were issued successively, which gave instructions on fund remittance, the issuance, trading or transfer of bond and macro-prudential management of cross-border financing. Up till then, restrictions on the qualifications and the use of proceeds were being relaxed, which lays the foundation for the Panda Bond market, yet a unified regulatory framework remained absent.

In September 2018, the People's Bank of China (PBOC) and the Ministry of Finance (MOF) jointly issued *Interim Measures for the Administration of Bond Issuances by Overseas Issuers in the Chinese Interbank Bond Market* (Notice [2018] 16) (the “Measures”), which further defined the accounting and auditing standards

[3] In September 2018, the People's Bank of China (PBOC) and the Ministry of Finance (MOF) jointly issued *Interim Measures for the Administration of Bond Issuances by Overseas Issuers in the Chinese Interbank Bond Market.*

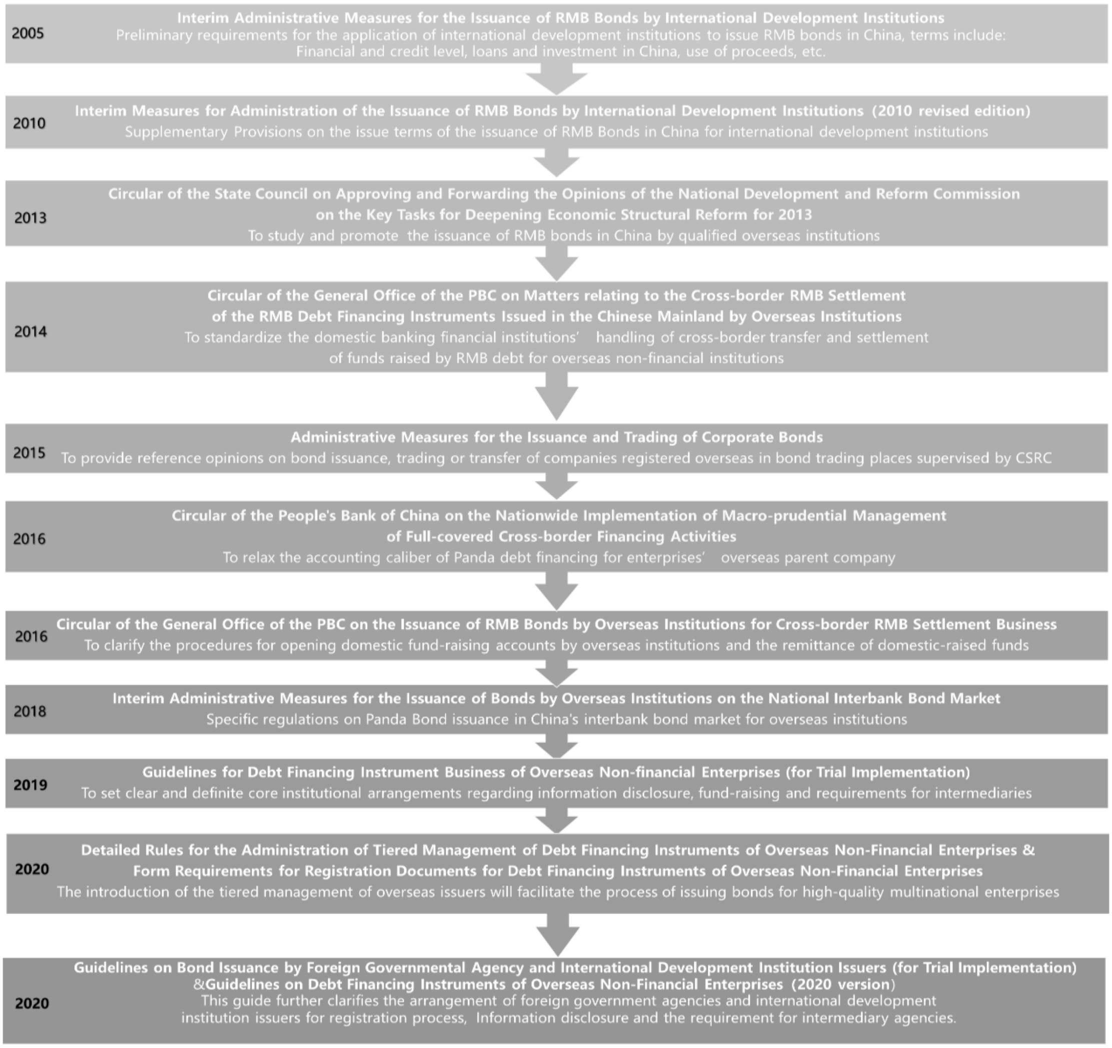
[4] This document was revised in 2010.

along with the use of proceeds for bond issuers. Clarification was made for overseas financial companies on procedures of bond financing, contents of registration and issuance documents, information disclosure, use of proceeds, etc., and the application scope got extended to non-financial companies in the supporting framework guidelines promulgated in January 2019. Remarkable relaxation on accounting and auditing standards marks the main policy breakthrough made in the Measures. According to this document, if an overseas institution applying for public bond issuance is not using the Chinese accounting standards or the equivalent, one could disclose the accounting standards adopted and provide explanations for major differences as compared to Chinese ones while having audits conducted by an overseas accounting firm, which greatly reduced the costs of financial standards conversion and audit. As the first general regulatory framework introduced for the Panda Bond market, the Measures has laid a good foundation for the long-term normative development of the Panda Bond market, but as of this stage, there is still a lack of clearer guidance in specific implementation.

In order to improve the management of the registration and issuance of Panda Bonds, the National Association of Financial Market Institutional Investors ("NAFMII") promulgated *Detailed Rules for the Administration of Tiered Management of Debt Financing Instruments of Overseas Non-Financial Enterprises* (the "Detailed Rules") and *Form Requirements for Registration Documents for Debt Financing Instruments of Overseas Non-Financial Enterprises* (the "Form Requirements") in September 2020. Based on the requirements set in the Detailed Rules, overseas non-financial enterprises shall distinguish whether they can be classified as overseas seasoned enterprises according to their own market recognition at home and abroad, operating performance, financial status, transparency of information disclosure, bond repayment history, and so on. Overseas seasoned enterprises could make uniform registration of multiple products, whereas registration quota at the registration stage is not required, and elements such as the product to be issued in each phase and the issuance scale could wait to be determined in the issuance stage. According to the Detailed Rules, if an overseas seasoned enterprise that originally adopted the sub-product registration model switches to a unified registration model, it should submit unified registration documents to NAFMII before the first three issues to notify the changes made in provisions and use of proceeds, and this setting would somehow prolong the processing time and increase issuance costs. In the long run, the Detailed Rules could bring effective facilities for overseas seasoned enterprises such as unified registration of multiple varieties, the mechanism of main underwriters, shortened pre-evaluation, and flexible setting in the number of main underwriters. At the same time, the landing of these rules highlights the integration at home and abroad, and the improved Panda Bond business becomes more consistent with domestic bond practices in processing mechanism, thus becoming more attractive to CIBM members. Likewise, the Form Requirements caters to the international requirements of information disclosure and fits better with the differentiated disclosure needs.

In December 2020, NAFMII issues *Guidelines on Bond Issuance by Foreign Governmental Agency and International Development Institution Issuers* (the “Guidelines”), which further clarifies the arrangement for registration process, information disclosure and requirements for intermediary agencies, a move designed to facilitate issuance. This system setting encompasses the particularity of the two types of entities in terms of financial statement disclosure and disclosure time, and also takes into account the international practices along with the needs for investor protection. To wrap it up, the two regulatory rules introduced in 2020 have further completed the regulatory framework, which would help simplify the issuance process in the long run and benefit overseas seasoned enterprises with real RMB financing needs, despite a limited effect in boosting the market in the short term.

**Figure 9: Policy Overview**




Source: public information, edited by CCXI

### (II) Significant Opening-up on the Investment side

**In recent years, multiple measures to improve the investment channels for overseas entities were adopted, such as unifying regulatory rules, removing quota restrictions, facilitating settlement and so on, which positively impacted the development of the Panda Bond Market.**

Since the regulatory documents were released in February 2016 to allow overseas institutional investors to directly enter the CIBM through application, open-up on the investment side of the Chinese bond market has entered the fast lane. In 2020, a number of policies were issued to smooth investment channels for overseas entities. Among them, the three ministries jointly issued *the announcement on matters related to the Investment of Foreign Institutional investors in China's Bond Market (draft for soliciting opinions)* (the "Announcement") in September 2020, which unifies the regulatory rules for all kinds of overseas institutional investors to invest in China's bond market. The Announcement stipulates that overseas investors who have entered the CIBM could invest in the exchange bond market either directly or through the interconnection scheme. It has also standardized in a uniform way the registration application, investment scope, fund custody, and information registration for overseas investors to participate in RMB bond transactions under different channels, which would help mitigate the efficiency differences. In addition, advancement in the QFII and RQFII systems in 2020 manages to provide more convenience in making investments by removing quota restrictions and simplifying review procedures, while also clarifying issues such as fund transfer and abolishing the limit on export proportion of single currency investment.

The significant expansion of overseas investors under the Bond Connect arrangement has also brought more vitality to the Panda Bond market. Panda Bonds - particularly those issued by sovereign institutions - manage to draw medium- and long-term high-quality overseas investor to participate in the CIBM, a trend that is manifested by the constantly increasing number and average daily trading volume of overseas issuers through Bond Connect. In terms of the number of institutions, a total of 625 overseas entities had entered the CIBM through Bond Connect by the end of 2020, among which more than 120 were new entrants, a number that is significantly higher than that in 2019. Among them, Panda Bond has also become a key attraction for foreign investors through Bond Connect. For instance, of the sovereign Panda Bonds issued by the Republic of the Philippines in March 2018, the proportion of foreign investors subscribed through Bond Connect accounted for 88% of the total. Likewise, overseas investors accounted for nearly half of subscription for the RMB bonds (Bond Connect) issuance made by the New Development Bank in February 2019, as compared with its 2016 issuance that was almost entirely subscribed by domestic investors. With the rapid advancement of Bond

Connect, the expansion of overseas investors would help to reduce the Panda Bond issuance cost and attract more high-quality overseas issuers, thus effectively fostering the market.

# Part III. Panda Bond Rating

The Panda Bond market is positioned to attract highly qualified foreign institutions with real needs for RMB financing. So far, the global scale ratings of the issuers are investment level, while the local scale ratings are concentrated in AAA. Difference exists in Panda Bond ratings by Chinese and foreign rating agencies, given the variation in rating framework and local rating practices. More abundant domestic samples and more comprehensive views from Chinese rating agencies may provide a relatively reasonable benchmark and effectively bridge the information discrepancies between investors and issuers.

## (I) Market Dominated by High-Credit-Level Issuers

**The global scale ratings of the issuers are investment level, while the local scale ratings are concentrated in AAA.** From the perspective of local scale ratings, all of the public offering issuers in the interbank market were assigned AAA ratings, while the exchange public offering market liberated along the way and saw the first AA+ rated public issuer in 2017. There has been only 4 AA+ issuers in the public market so far. In 2017, China Auto Rental Ltd. and Skyworth Digital Holdings Co., Ltd. successively issued Panda Bonds in the exchange market, marking a major breakthrough. From 2018 to 2020, Beijing Enterprises Clean Energy Group Limited and Capital Environment Holdings Limited have become new AA+ rating issuers in the public offering exchange market. Meanwhile, the majority of the public offering issuer have the investment grade in the global scale, with roughly 60% of the ratings in the BBB range. Despite continuous opening up, the Chinese bond market is still a market subject to strict regulation with few defaults ever happened, and the investor protection mechanism remains to be enhanced. In that way, although we're looking forward to witness a more diversified issuer pool, the basic credit tone for this market are not expected to change in the short run.

## (II) The Value of Chinese Domestic Rating

**With abundant rating samples and global perspective, Chinese rating agencies can provide more accurate benchmarks when measuring the credit risk of Panda Bonds, and effectively bridge the information discrepancies between investors and issuers.** The Chinese market is too big to be ignored. First, having a Panda Bond rating could be a stepping stone for foreign institutions to access the Chinese market. A Panda Bond rating would help the issuer gain higher market recognition and more business opportunities in East Asian area. In addition, the problem of information discrepancies is more prominent due to the regional differences between issuers and investors in the Panda Bond market. This is primarily reflected in the fact that, different judgments of sovereign risks made by Chinese and foreign rating agencies may lead to underestimation of the issuer and restrain their willingness to issue RMB bonds due to the limitation of sovereign ceilings on Panda Bond issuance. In addition, it is necessary to make horizontal comparisons between global and local issuers. It follows that the Chinese rating agencies have more abundant domestic samples and more complete local series, thus can effectively bridge the information discrepancies between investors and issuers, providing a relatively reasonable benchmark for investors.

**There is no direct mapping relationship between global scale rating and the local rating, especially between different rating agencies.** In the view of CCXI, Panda Bond rating should make better alignment of the local and global scale credit rating methodologies. Foreign issuers except for sovereigns and MDBs should be compared with local players in the same industry, from both basic credit assessment and support level. Likewise, a global view is needed as the evolvement and relative ranking of industries may vary across countries. It follows that investment-grade issuers (global scale) could have different local ratings.

## Part IV. Panda Bond Market Outlook

The Panda Bond market is faced with challenges and opportunities more than ever in the post-pandemic era. As most economies slide into recession and international communications and bilateral cooperation gets largely restricted under Covid-19, the intention of new overseas issuers to enter the Panda Bond market is temporarily suppressed, while issuance plans of long-term issuers are subject to limited impact. The signing of RCEP[5] and CAI[6] together with the promotion of Green Panda Bond issuance would foster the market, providing opportunities for new players to enter. However, uncertainty may continue to cloud the market in the short run considering the recurrence of the pandemic and the volatility of the China-US yield spread.

**The China-US interest rate spread would be volatile, and is likely to narrow in the second half of the year.** The Chinese economy displayed strong resilience and high growth potential in the turbulent global environment in 2020, boasting steady fundamentals of its growth path. Generally, the Chinese economy will stay in the recovery path in 2021. However, downward pressure remain for global economy in the light of constant spread of the COVID-19 epidemic, coupled with China-US trade frictions and renewed geopolitical risks. The RMB exchange rate would fluctuate, while the pressure for currency depreciation and capital outflow is relatively low given China's strong economic fundamentals, waning dollar index and more predictable policy framework of the Biden Presidency. The interest rate in China are expected to rise gradually, and the yield may fall in the second half of the year as the pace of recovery slows down. Meanwhile, the US interest rate may rise under the projection for massive stimulus plan and economic recovery over our forecasting horizon. Volatility in the China-US interest rate spread would sustain, and the spread is likely to narrow in the second half of the year, while subject to the pace of economic recovery and policy stance in both countries.

**Strategic significance of the BRI would be more prominent in the post-pandemic era. The signing of RCEP and CAI would foster the market, providing opportunities for new players to enter.** The pandemic

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5 Regional Comprehensive Economic Partnership

6 EU-China Comprehensive Agreement on Investment

will reshape the global political and economic landscape, which would further highlight the strategic significance of the Belt and Road Initiative. The signing of RCEP and CAI will create more opportunities for investment flows between China and relevant areas, thus propelling new overseas entities to issue RMB bonds. More overseas institutions would consider Panda Bond as a financing channel when they enter the Chinese market with the advancement and implementation of RCEP and CAI. Under RCEP, the automotive industry, banking and insurance, together with biotechnology would be the major fields for EU investment, which would promote potential issuers from certain industries to enter the RMB bond market. For instance, Daimler AG and BMW Automotive are prominent players in the Panda Bond market, pointing to foreign automakers' long-term plan in asset and business in China. ASEAN's investment in China is focused on finance, real estate, leasing, logistics, etc., which is likely to bring potential issuers from the related fields.

**Promoting the issuance of Green Panda Bonds is in line with the green and sustainable development of the BRI in the post-pandemic era, which is also conductive to the development of the domestic Green Bond market and the Panda Bond market.** The pandemic weighed heavily on most of the economies along the Belt and Road, spurring external financing needs for economic recovery due to limited fiscal space. The follow-up financing of projects under construction also face challenges. Green Panda Bond will become an option for institutions along the Belt and Road to establish long-term financing channel. On the other hand, with rising demand for green and sustainable infrastructure after the epidemic, issuing green panda bond will propel the green and sustainable development of the BRI, which also fits with the aim of Chinese government in the post pandemic era. During that process, more foreign governments and international development institutions along the Belt and Road are encouraged to issue green, social and sustainable Panda Bonds, given their exemplary role in promoting green and sustainable development. Moderate relaxation of the restrictions on issuer qualification and the use of proceeds should be considered, which would be beneficial to both the expansion of domestic Green Bond market and the Panda Bond market.

**Looking forward, the Panda Bond market still has huge space for growth.** As of the end of 2020, the total issuance scale of Panda Bond is around RMB435 billion, and the outstanding volume of the Panda Bond market is roughly RMB253 billion, accounting for merely 0.22% of the overall Chinese bond volume. In the medium-to-long term, further opening-up and liberalization of the Chinese financial market, the acceleration of RMB internationalization, the advancement of the BRI and the sequential landing of more guidance documents would continue to boost the market.

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