

Special Topic 11 Results of the Central Bank Rating of Financial Institutions

For the purpose of fulfilling its responsibilities of macroprudential regulation and systemic risk prevention, and evaluating the operation management and risk profiles of financial institutions in a scientific and reasonable manner, the PBC, on the basis of previous exploration and experience, further consolidated available resources effectively and began to conduct the Central Bank Rating of Financial Institutions in 2018.

I. About the Central Bank Rating of Financial Institutions

In 2018, the PBC conducted the Central Bank Rating of Financial Institutions quarterly, covering banking institutions such as development banks, policy banks, commercial banks, village and township banks, rural cooperative banks and rural credit cooperatives, and non-banking financial institutions such as finance companies of corporate groups, financial leasing companies, auto financing companies and consumer finance companies. The rating indicator system combines mathematical models with professional judgment, and focuses on evaluation of corporate governance, internal control, capital management, asset quality, market risk, liquidity, profitability, information system and financial ecosystem. Moreover, the final rating results also take into account live

information that is collected during the process of off-site monitoring, stress testing and on-site investigations. The rating results span 11 levels, including level 1 to 10 and level D. The higher the level, the riskier it is. Level D refers to institutions that go bankrupt, are taken over or revoked. Financial institutions rated level 8~10 and level D are identified as high-risk institutions.

II. Results of the Central Bank Rating of Financial Institutions

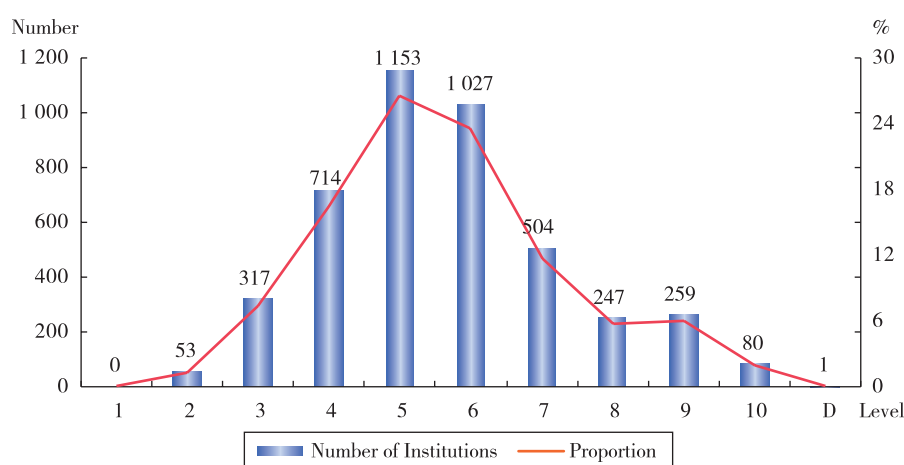
The fourth quarter rating of 2018 covered 4 379 banking institutions, including 24 large banks and 4 355 small and medium-sized institutions (including 3 990 small and medium-sized banks and 365 non-banking institutions). Among the 24 large banks, 1 was rated level 1, 11 were rated level 2, 7 rated level 3, 3 rated level 4, 1 rated level 6 and 1 rated level 7. Among the 4 355 small and medium-sized institutions, 370 were rated level 1~3, accounting for 8.5 percent; 3 398 were rated level 4~7, accounting for 78 percent; and 586 were rated level 8~10 and 1 rated level D, accounting for 13.5 percent (Figure 3.1), which were mainly rural small and medium-sized financial institutions.

By institution type, foreign-funded banks and private banks were rated with comparatively

good results, with 35.7 percent and 22.2 percent rated level 1~3, respectively. Village and township banks, city commercial banks and rural commercial banks followed, with 88.9 percent, 75.6 percent and 73.2 percent rated level 4~7, respectively. Rural credit cooperatives and rural cooperative banks were

rated worse, with 43.3 percent and 32.7 percent of the institutions, respectively, rated level 8~10. Broken down by district, in Xiamen, Shenzhen, Shanghai, Zhejiang, Fujian, Qingdao, Jiangsu and Beijing, institutions rated Level 2~5 took up more than 70 percent.

Figure 3.1 Distribution of Rating Results for Small and Medium-sized Institutions



Source: The PBC.

In general, small and medium-sized financial institutions operate stably, and in recent years, 164 institutions exited the high-risk list after certain early corrective measures were taken. Some small and medium-sized financial institutions are rated risky, on one hand because that Chinese economy is slowing down and small and medium-sized financial institutions are more sensitive and liable to economic changes, and on the other hand, partly because of strengthening of banks' risk management. The classification of non-performing assets of banking institutions is now more prudent and banks are setting aside more loan loss provisions, which may result

in decrease of some regulatory indicators and impact the rating results.

III. Application of the Results of Central Bank Rating of Financial Institutions

The Central Bank Rating of Financial Institutions lays the foundation for macroprudential regulation and systemic risk prevention by the PBC. The rating results provide an important basis for differentiated management, including the Macroprudential Assessment, approval of bond issuance by financial institutions and the central-bank

lending, and determination of the differentiated deposit insurance premium. In 2018, the rating results were adopted in many aspects, playing an important role in risk mitigation and prevention.

Information about high-risk institutions was provided to relevant authorities regularly.

The PBC sent risk warning letters to certain local governments regularly, warning them about the high risk of some local financial institutions, and asking them to take tailored measures, considering the specific risk sources of these institutions, to defuse risks in a targeted way. This will help the local governments to fulfill their responsibilities of risk mitigation and resolution based on the principle of territoriality, and help to develop the benign financial ecosystems for their own districts. The PBC also provided information about high-risk institutions for related regulatory authorities, making suggestions about regulatory responsibilities in risk mitigation and resolution, and how relevant parties should work and cooperate on the basis of clearly-defined responsibilities, so as to make joint efforts in defusing the risks of high-risk institutions in a proper manner.

Rating results were fed back to financial institutions, and early corrective measures were taken for high-risk institutions.

The PBC informed the rated institutions one by one of their rating results as well as main risks and problems, and put forward suggestions for rectification. The PBC also reviewed the rectification plans of some financial institutions, inquired about their opinions and suggestions about Central Bank Rating, and observed their rectification effects. The PBC, together with other authorities, sent out warnings about high-risk institutions, and according to their risk characteristics and causes, took specific early corrective measures, including replenishing capital, reducing non-performing assets, restraining asset growth, lowering leverage, controlling large credit extension and trading, checking shareholder dividends, replacing the senior management, improving corporate governance and internal control, etc., in order to put right these institutions' irregular or even illegal activities and behaviors that were not in line with macroeconomic policies. In this way, high-risk institutions could be guided to make self-recovery and improvement of resilience against risks.