

# China's TLAC Debuts:

## The Road Ahead

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Financial Services Ratings

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*This report does not constitute a rating action*



# Key Takeaways

- Industrial and Commercial Bank of China Ltd. has issued the first ever total loss-absorbing capacity (TLAC) bonds in China. This will likely widen the financing channels of China's global systemically important banks (G-SIBs) in meeting the TLAC requirement. The final pricing is low at 2.25%-2.35%.
- China's TLAC-eligible noncapital bonds are less risky than Tier 2 bonds.
- We expect Chinese G-SIBs to receive pre-emptive support from the government. We consider such support in our ratings of the Tier 2 bonds issued by Chinese G-SIBs.
- S&P Global Ratings rates TLAC-eligible senior bonds differently across markets, reflecting our views on government support and the structuring of subordination.
- China's G-SIBs will likely prefer the onshore market when issuing TLAC bonds, given the current low domestic funding cost; domestic institutional investors are likely to be the main buyers. It's also worth monitoring the cross-holding of TLAC bonds by G-SIBs, given the grace period for capital deduction compared with Basel rules.

# China's TLAC Eligible Bonds Are Less Risky Than T2

TLAC-eligible bonds rank higher than regulatory capital instruments  
 Claims hierarchy for Chinese G-SIBs

Hierarchy of claims	Loss absorption	Default risk (cumulative from sr. claims)	Likelihood of extraordinary govt support to G-SIB
1 Senior unsecured and other senior claims	Liquidation	Issuer credit risk	
2 TLAC-eligible senior debts	Resolution	Subordination	Extremely high/very high
3 Tier 2	Gone concern	PONV	
4 Additional tier 1	Going concern	Coupon nonpayment	No support notching
5 Common equity tier 1			

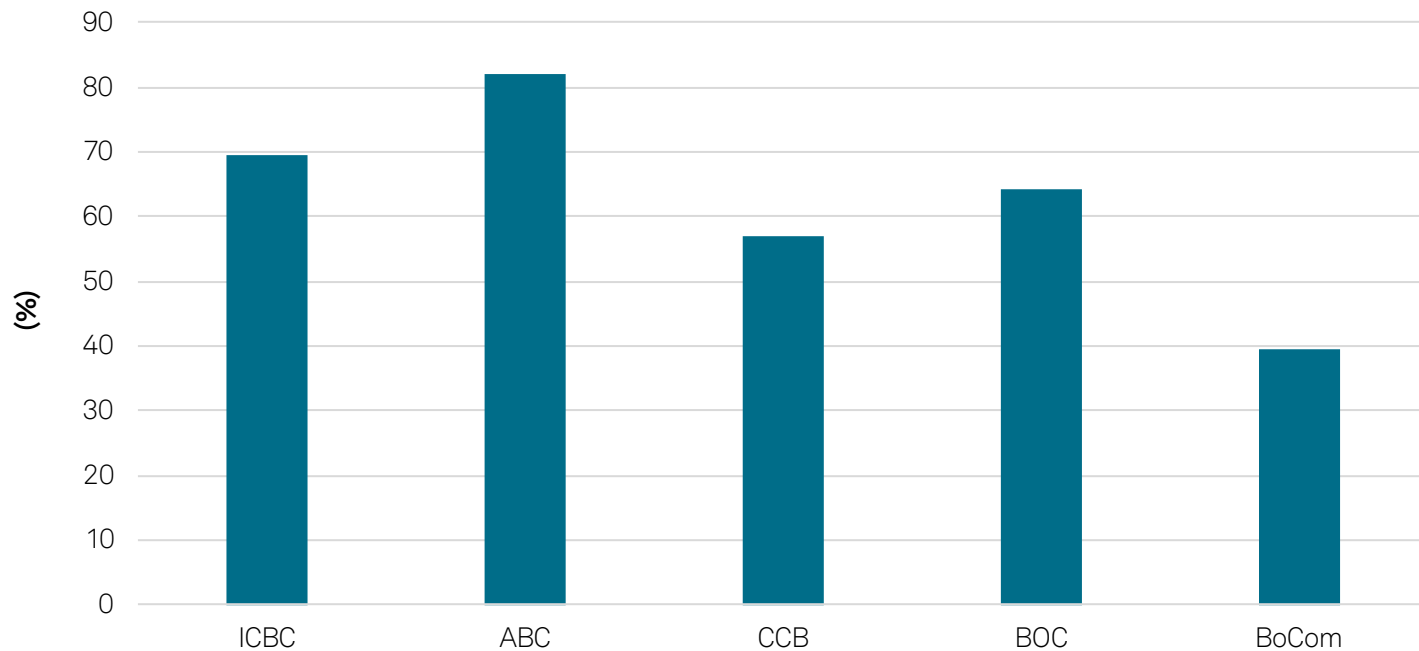
- These bonds shall rank higher in priority to the regulatory capital instruments such as additional Tier 1 and Tier 2 capital instruments.
- The Chinese financial regulator can require the mandatory writedown of all or a portion of the TLAC bonds when the issuer enters resolution and has already written down or converted into equity all its Tier 2 capital instruments.
- We rated Chinese G-SIBs' Tier 2 bonds at two notches below their long-term issuer credit ratings. The notching reflects subordination risks and a principal writedown feature at the point-of-nonviability.

\*The government support for Bank of Communications is very high and extremely high for the other four Chinese GSIBs. G-SIBs--Global systemically important banks. TLAC--Total loss-absorbing capacity. PONV--Point of nonviability. Source: Company announcements, Financial Stability Board, S&P Global Ratings.



# China's G-SIBs Likely To Receive Pre-emptive Government Support

Government ownership is high for Chinese G-SIBs  
Government ownership (2023)



ICBC--Industrial and Commercial Bank of China Ltd. ABC--Agricultural Bank of China Ltd. CCB--China Construction Bank Corporation. BOC--Bank of China Ltd. BoCom--Bank of Communications Co. Ltd. Source: Company announcements, S&P Global Ratings.

- Given financial stability concerns and the strong ties between G-SIBs and the central government, we expect G-SIBs to receive pre-emptive government support to prevent these banks from triggering a systemic crisis. We consider such support in our ratings on the Tier 2 bonds by Chinese G-SIBs.
- In our view, the Chinese government is highly supportive of the domestic banking system, and we expect high regulatory discretion in managing troubled banks.
- This does not mean every troubled Chinese bank would be bailed out by the government. We do expect the authority to allow bank failures, where contagion risk is manageable and unlikely to trigger a financial crisis.

# Issue Ratings On TLAC Issuances In Other Markets

TLAC-eligible senior bonds are rated differently across markets  
 Selected TLAC issuances of GSIBs in other jurisdictions

Bank Name	Starting Point	Notching Down	Subordination	Jurisdiction
Royal Bank of Canada	OpCo SACP	One Notch Below SACP	Contractual	Canada
Sumitomo Mitsui Financial Group, Inc.	NOHC ICR	On par with the NOHC	Structural	Japan
BNP Paribas SA	OpCo SACP	One Notch Below SACP	Contractual	France
Banco Santander, S.A.	OpCo SACP	One Notch Below SACP	Contractual	Spain
Deutsche Bank Aktiengesellschaft	OpCo SACP	One Notch Below SACP	Statutory	Germany

OpCo--Operating company. NOHC--Non-operating holding company. SACP--Standalone credit profile. ICR--Issuer credit rating.  
 Source: Company announcements, S&P Global Ratings.

- Starting points to rate the TLAC-eligible senior debt:
  - Issuer credit rating (ICR) for Japanese G-SIBs. This incorporates our expectation of pre-emptive government support to the G-SIBs in distress.
  - Stand-alone credit profile in the U.S. and Europe. This reflects uncertainty of such government support.

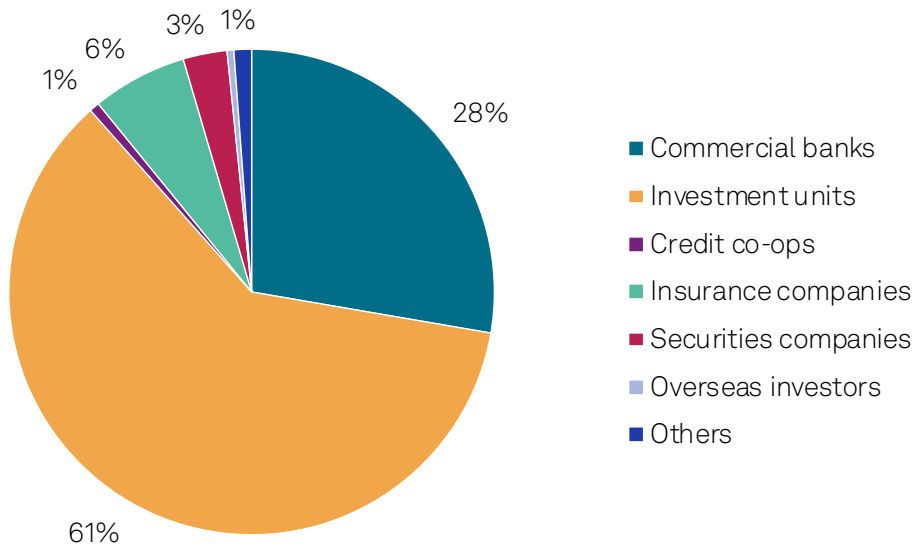
Notching down:

- Typically, one notch below the starting point, reflecting the subordination risk.
- No notching down in Japan because the ICRs on the holding companies of Japanese banking groups are one notch below those on the group's core operating banks. This reflects the structural subordination risk.

# Domestic Institutional Investors Likely Be The Main Investors

- Given cheaper funding costs, the banks will likely prefer the onshore market before significant rate cuts by the U.S. Federal Reserve.
- Domestic institutional investors are likely to be the main holders of TLAC bonds.
- Cross-holding by G-SIBs is also worth monitoring, given the grace period for capital deduction compared with Basel rules.

## Investment units hold most commercial bank bonds Investor base of financial bonds by banks (Mar. 2024)



Source: China Bond, S&P Global Ratings.

## China has a grace period for the capital deduction clause

Investments	FSB/Basel	Chinese TLAC Rule
G-SIBs' cross-holding of TLAC instruments.	Deduct from own regulatory capital if it exceeds the 10% threshold; amounts not deducted are risk-weighted.	Same, but with a grace period until Dec. 31, 2029. Before then, TLAC investments are risk-weighted, with the risk weight being the same as that of Tier-2 capital (currently 150%) under the standardized approach.
Non-GSIBs' investment in TLAC.	Deduct from own regulatory capital if exceeds the 10% threshold; amounts not deducted are risk-weighted.	Risk weighted, with the risk weight being the same as that of Tier-2 capital (currently 150%) under the standardized approach.

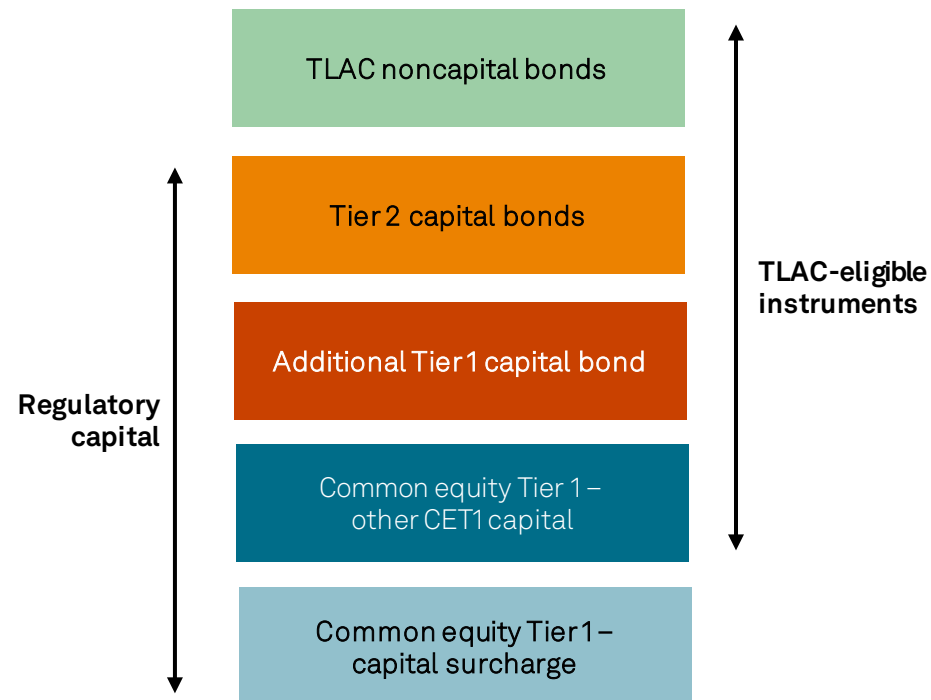
FSB—Financial Stability Board.

Source: S&P Global Ratings, Financial Stability Board

Source: Company reports, S&P Global Ratings.

# Breaking Down The Rules On TLAC

The TLAC requirement is built on regulatory capital requirements



BoCom--Bank of Communications Co. Ltd. Source: Company announcements, Financial Stability Board, S&P Global Ratings.

- The FSB’s TLAC rules add to minimum regulatory capital requirements.
- For China’s four state-owned megabanks, the TLAC requirement is at least 16% of risk-weighted assets (RWAs) as from Jan. 1, 2025, and at least 18% as from Jan. 1, 2028.
  - BoCom was only added to the G-SIB list in 2023 with a transition period of three years to meet the above targets.
- Tier 1 and Tier 2 capital may also count toward the TLAC requirement. This requirement excludes any applicable regulatory capital buffers, which must be met in addition to the TLAC RWA minimum.
  - In China, these buffers include a 2.5% capital conservation buffer and a 1.5% of G-SIB add-on buffer (for the mega four and 1% for BoCom).

# Related Research

## Commentary

- [Realigned Capital Rules To Cut China Banks' TLAC Needs, March 7, 2024](#)
- [China's New Capital Rules Will Ease Strain On Banks Ahead Of TLAC Rollout, Nov. 10, 2023](#)
- [China's Tightening Capital Rules To Hit Aggressive Banks, Feb. 22, 2023](#)
- [China's Major Banks Still Have An RMB3.7 Trillion Shortfall On TLAC Requirement, Jan. 18, 2023](#)
- [FAQ: How Are China's Big Four Banks Addressing The RMB6 Trillion TLAC Gap? Aug. 26, 2020](#)
- [FAQ: Rating Japanese Banks' TLAC-Eligible Senior Debt, Feb. 25, 2016](#)

## Rating Action

- [Royal Bank of Canada's Up To C\\$2 Billion Senior Resolution Notes Rated 'A', Sept. 24, 2018](#)
- [Banco Santander's Inaugural Second Ranking Senior Notes Rated 'BBB+', Jan. 27, 2017](#)
- [BNP Paribas' Proposed Debut Senior Nonpreferred Notes Rated 'A-', Jan. 3, 2017](#)
- [Deutsche Bank Upgraded To 'A-' On Increased ALAC Buffer; Outlook Negative; Senior Subordinated Debt Lowered To 'BBB-', March 29, 2017](#)
- [Japan-Based Sumitomo Mitsui Financial Group's Notes With TLAC Feature Assigned 'A-' Ratings, March 2, 2016](#)



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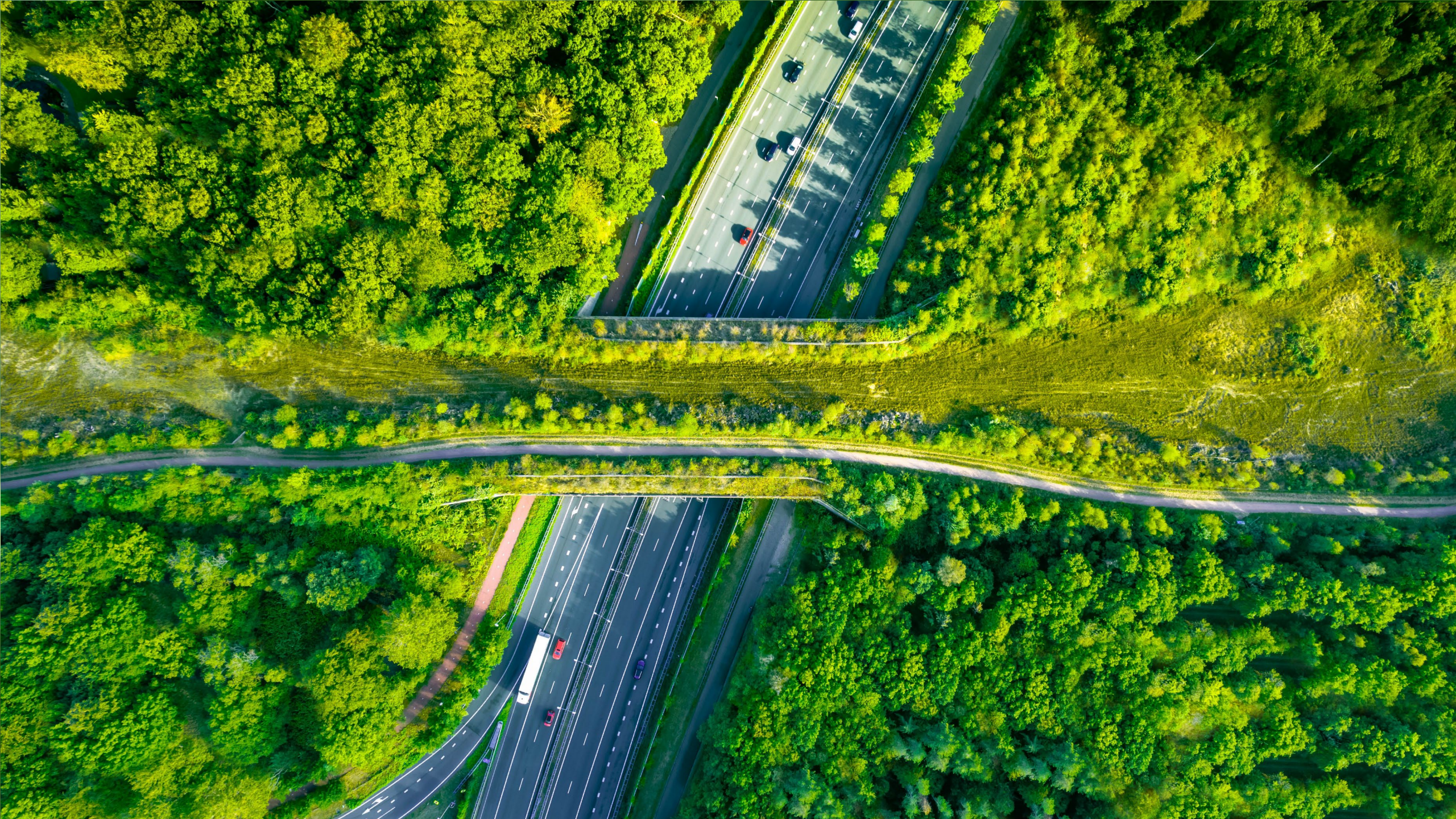
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