13. CREDIT RATINGS IN CHINA

WINNIE P. H. POON

1. INTRODUCTION

The total amount of outstanding corporate bonds in China is relatively low in comparison to other major Asian financial markets. According to PR Newswire (2003), the total outstanding amount in China was RMB\(^1\)133 billion (about US$16 billion) in 2002, which represents about 1.3% of the country’s GDP compared to at least 10% of the respective GDP in other Asian markets. Although the corporate bond market in China is very underdeveloped, its potential for growth is substantial because the market demand for bond investment is increasing. The considerable growth potentials of the market and surging trends in corporate bonds are substantiated by the research findings from the Shenzhen Stock Exchange, China as in February 2003 (PR Newswire, 2003). The findings of this research report by Shenzhen Stock Exchange indicate that, the demand from institutional investors could go up to RMB94 billion (over US$11 billion). On the supply side, corporations would consider raising RMB140 to 279 billion (about US$19.9 to 33.7 billion) from the bond market.

In addition, Thomson Financial believes that China is a potentially lucrative market with vast unfilled funding needs (Lunsford, 2004). Until January 2004, the international rating agencies have rated fewer than 100 Chinese firms when there are more than eight million corporations and over 100 banks desiring capital with which to expand (Baglole, 2004; and Lunsford, 2004). If the Chinese regulatory authorities allow foreign credit agencies to rate their domestic bonds and open up the rating industry for more competition, then the opportunity for credit rating business will be huge. At present, Chinese bonds that are offered only to the domestic market do not require international credit ratings, unless they intend to raise capital from international capital markets or to cross-list on a foreign
stock exchange. For example, China Petroleum & Chemical Corp. and Huaneng Power International Inc., which are listed on the New York Stock Exchange, have requested credit ratings from Standard and Poor’s Ratings Services (one of the four “Nationally Recognized Statistical Ratings Organizations” (NRSROs) in the U.S.). Moreover, none of the foreign credit ratings are officially recognized by the regulatory bodies in China.

The World Bank has recommended that China develop a sophisticated bond market to make use of its large amount of private funds and reduce its dependence on infrastructure projects in the State budget (China Daily, 1998b). Rating agencies perform an important role in the development of bond markets. One of the major problems that has hindered the growth of the Chinese bond market is the absence of “authentic” issuer ratings on bonds (China Daily, 1998a). There seems to be a general consensus among Chinese practitioners about the growing need for “authentic” credit ratings for issuers in China’s rating industry (China Daily, 1998b).

Kennedy (2003) believes that the domestic credit rating agencies in China have not had any effect on the decisions of investors of Chinese corporate bonds, and he attributes that to Chinese government control of the corporate bond market. Investors do not seem to pay attention to their ratings, and even an AAA rating is of little value to some speculators (Kennedy, 2003). Some investors may ask whether or not a bond issue is guaranteed by the government or not, but are not concerned about its credit rating. If most investors fail to take credit ratings seriously, the development of the rating industry will be slow or even impeded (China Daily, 1998b).

The main purpose of this paper to present an in-depth study of the credit ratings in China because they are very crucial to the potentially lucrative, but underdeveloped, Chinese bond market. Section 2 provides the regulatory framework for the bond market and the credit rating industry in China. Their recent developments are reviewed in Section 3. Section 4 describes the major domestic rating agencies, and Section 5 contrasts the long-term issuer ratings that are assigned by local and international rating agencies. The significant issues of the credit ratings in China are discussed in Section 6. The conclusions and recommendations are given in Section 7.

2. REGULATORY FRAMEWORK

The regulatory framework for the bond market and the credit rating industry in China are described in this section. Figure 1, which is based on EIU (2003), provides an overview of China’s financial system. In addition, Standard and Poor’s (2003) provides a thorough discussion of China’s market infrastructure, legal infrastructure, regulatory framework, and informational infrastructure in its country governance study of China. The State Council has ultimate and overruling authority over all regulatory bodies in the financial sector. The National Development and Reform Commission (NDRC), which is supervised by the State Council, is responsible for the research into and overseas implementation of nationwide strategic planning. Companies that raise capital from domestic or overseas financial markets must obtain approval from the NDRC (S&P’s, 2003).

Since 1983, the People’s Bank of China (PBOC), the central bank, has served dual roles as the regulator of the financial industry, especially the banking regulator, and the manager of monetary policy. The State Council set up the China Banking Regulatory Commission (CBRC) in March 2003 following a decision by the National People’s Congress standing