



Dadao Capital

Overview of Panda Bonds

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OVERVIEW OF THE PANDA BONDS

Panda bonds are a way for foreign governments and companies to venture into the Chinese Bond market, these renminbi-denominated bonds were introduced in 2005. The first entities to issue these bonds were Asian Development Bank and the International Finance Corporation. For the first decade the demand for them was not as much, but from 2016 to 2020 the Panda Bond market went through rapid expansion followed up by tightening of the market to reach a relatively stable state. The Panda Bond market is still at its nascent stages, and it could see a significant rise making it a very interesting asset class to invest. As of now, German automotive giants like the Daimler and BMW, Singapore United Overseas Bank and sovereigns like the Republic of Hungary and the Philippines.

Timeline

Even though the Panda Bonds issuance started from 2005, there have been changes and expansions done by the PBOC (People's Bank of China). The increase in Panda Bonds market can be divided into three stages.

Year	Number of Issuances	Proceeds (USD Billion)
2005 – 2009	4	0.6
2010 – 2014	2	0.3
2015 - Onwards	143	40.6

Source: Wind & KPMG

Stage 1 (2005 - 2009)

In order to open up the onshore bond market, China published the provisional administrative rules on issuing RMB bonds by International Development institutions or also called the Provisional Rules (2005). In total four Panda Bonds were issued by Asian Development Bank and International Finance Corporation, as there were restrictions placed on the proceeds of the issues Bonds.

Stage 2 (2010 - 2014)

China made some amendments to the rules that were released in 2005 and released Provisional Rules (2010). The move was to incorporate more eligible foreign issuers and allow for the proceeds to be used overseas. Despite the relaxation there was not much activity in the bond market except when a German automotive company issued a pair of Panda Bonds in 2014.

Stage 3 (2015 onwards)

In 2015, PBOC Notice (2015) was released which allowed foreign central banks, sovereign wealth funds and financial organisations to issue Panda Bonds in the CIBM (China Interbank Bond Market). This was a major step taken by the Chinese government to propel Panda Bonds market by enabling foreign government bodies and financial intuitions to participate in the China's bond market.

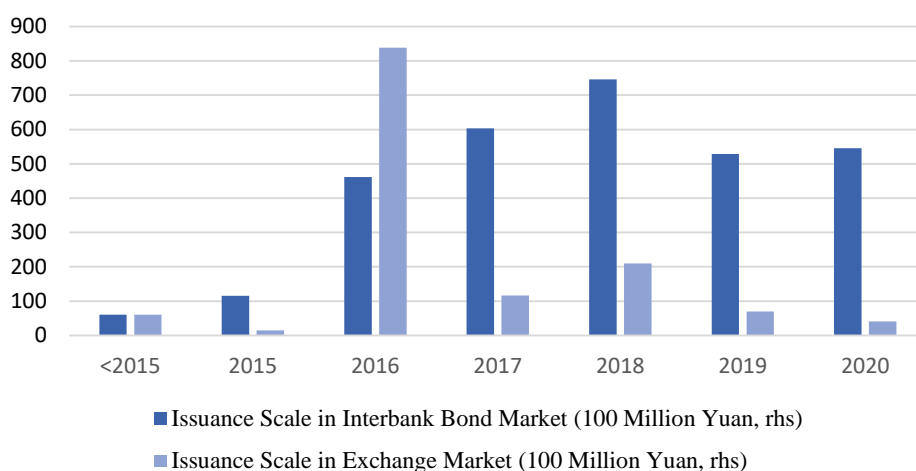
In 2016, it was announced that proceeds from on-lends Panda Bonds could be utilised to their subsidiaries in China without altering their foreign debt quota. This major development allowed companies to finance their operations in Mainland China.

Also, in the year 2016, Renminbi was included in the SDR (Special Drawing Rights) currency basket which includes USD, Euro, Japanese Yen and British Sterling Pound which shows the importance of RMB in international trade. It also provided foreign issuers with an extra option of choosing to issue SDR-denominated, RMB-settled bonds in China.

In 2018, Interim Measures were published, this gave insight into registration, application and disclosure of foreign institutions that were issuing the bonds in the CIBM, and the Provisional Rules (2010) were discarded.

In 2020, a number of policies were introduced which stipulates those overseas investors who entered the CIBM could invest in the exchange bond market directly or with the interconnection schema. It also standardized the registration for foreign investors to participate in RMB bond transaction under different channels which would alleviate the efficiency differences. Moreover, making investment were made more convenient by removing quotas and easing review procedures and also abolishing export proportion on single currency investment. In Figure 1, we have the overview of timeline and panda bond issues in exchange and interbank market. As we can see there is significant rise of bond issues after the new provisions were introduced in 2015 and in 2019 and 2020, they have been relatively stable.

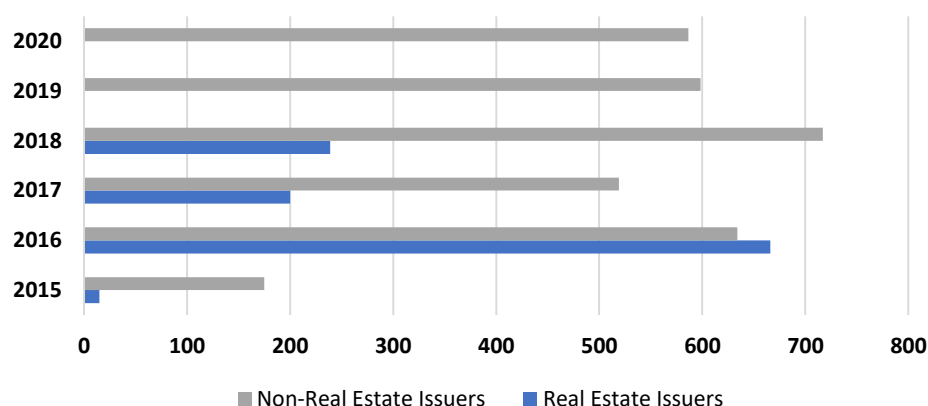
Figure 1: Panda Bond Issuance Scale in Interbank Market and Exchange Market



Source: China Chengxin International Credit Rating Co. Ltd.

In figure 2, we can see how the non-real estate bond issues have been the dominant one compared to the real estate bond issues in the years 2019 and 2020.

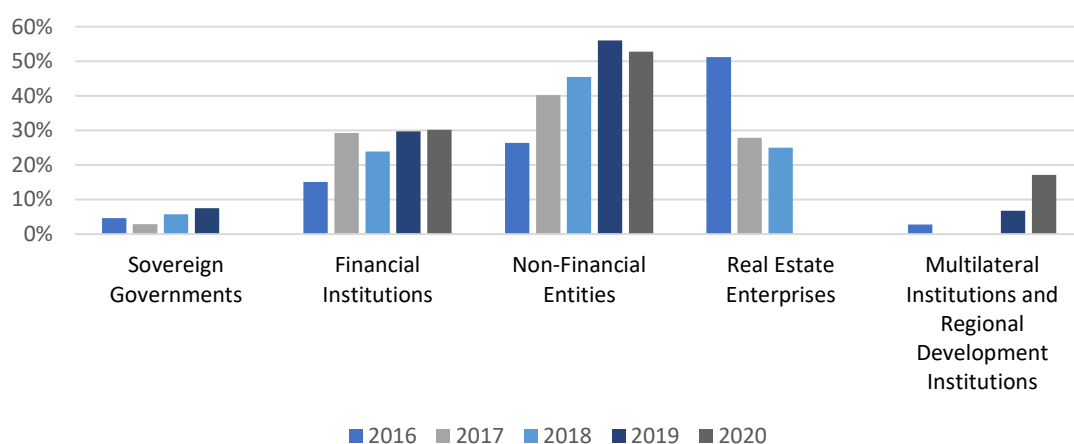
Figure 2: Panda Bond Issuance Scale (Real Estate Issuers vs. Non-Real Estate Issuers)



Source: China Chengxin International Credit Rating Co. Ltd.

Figure 3 represents the division of different issuers in the panda bond market and how non-financial entities have taken advantage of the new regulations by their increased participation in the panda bond issues.

Figure 3: Distribution of Panda Bond Issuers by Type



Source: China Chengxin International Credit Rating Co. Ltd.

As of end of 2020, the total issuance of Panda bonds was RMB435 billion, and the outstanding volume of the bonds were roughly RMB253 billion, which amounts only to 0.22% of the Chinese Bond market proving the scope for investment and growth in Panda Bonds market.

ADVANTAGES IN ISSUING PANDA BONDS

Investor diversification: Chinese bond market provides a huge opportunity for investors with potential growth especially in the panda bond market. Investor diversification is an important tenet in corporate finance, and for all foreign issuers China is a tempting market to expand the pool of creditors.

Liquidity: The onshore bond market, panda bonds in this case are perceived to be liquid compared to the offshore bond market, dim sum bonds. This helps issuers to seek for panda bonds which are more liquid compared to dim sum bonds.

Funding onshore operations: For issuers that are looking to increase operations in China, the Chinese currency RMB is the best way to lend credit. Else, the foreign issuers must convert the any currency into RMB that has relatively high transaction costs. But with panda bonds the issuers can access liquidated RMB with the help of the Panda Bonds.

Global funding: China's onshore market is equivalent to the international markets where foreign issuers can get funding in USD, EUR or GBP at a low rate by issuing panda bonds. The raised capital in RMB can be converted to these currencies by cross-currency swap.

Market Considerations: The relation between China's domestic markets and the foreign international markets have increased greatly over the past few years. Panda bonds is one of the initiatives that aids in this interconnection of domestic and foreign markets. Issuance of panda bonds by foreign institution give an insight into the operations of the issuing foreign institutions and forge trust between issuers and buyers of the domestic market. Overall, it builds a transparent and sustainable development and operations of foreign institutions in China. Moreover, panda bonds issued by sovereign countries like the Philippines build bilateral ties between both countries and help in trade and financial cooperation towards a shared goal.



STEPS OF ISSUING PANDA BONDS

Development of laws and regulations of Panda Bonds

In October 2005, International Finance Corporation and Asian Development Bank were approved to issue ¥ 1.13 billion and ¥ 1.00 billion Panda Bonds respectively in China's inter-bank bond market, which is the first batch of issued Panda Bonds. As time passed by, more and more sovereign government and international financial institutions issued Panda Bonds. The restrictions and approval procedures become more and more clearer and specific in these years.

In September 2018, Central Bank and the Ministry of Finance jointly issued the “Interim Measures for the administration of bond issuance by overseas institutions in the national inter-bank bond market”, which provide a basic restriction for Panda Bonds issued in the inter-bank market.

On February 1st 2019, China inter-bank market dealers association announced the guidelines for the business of debt financing instruments of overseas non-financial enterprises on its official website, which put forward more specific and clear requirements for overseas non-financial enterprises to issue Panda Bonds.

The approval procedures become more and more completed since 2005. The mainly approval procedures involve two parties, first is government approval and records while the second is issuers internal authorization. Overseas financial institutions issuing Panda Bonds need to perform procedures with specific regulatory authorities.

Two types of Panda Bonds issuing mode

According to regulations of issuing Panda Bonds, overseas institutions may issue Panda Bonds in full at one time or in installments within the limit in the inter-bank bond market. Overseas institutions shall meet specific conditions to issue by installments within the quota. Specifically, foreign governments, international development institutions and foreign financial institutions shall have rich experience in overseas bond issuance or have issued bonds within the territory of China and continuously disclosed information for more than one year.

Requirements of Panda Bonds accounts opening, settlement and information submission

The Interim Measures and Guidelines stipulate that the accounts, fund allocation and information submission involved in the fund-raising of Panda Bonds shall comply with the provisions of People's Bank of China and State Administration of Foreign Exchange.

Panda Bonds usage

For the usage of raised Panda Bonds, there are specific requirements illustrated in The Interim Measures and Guidelines. Overseas non-financial institutions are required to submit the plan for the usage of raised Panda Bonds to Dealers' Association at least 3 working days before the announcement of document issued in the inter-bank bond market. Also, institutions are strictly abide by the purposes of raising funds disclosed in the prospectus and perform relevant information disclosure obligations.

Information disclosure

The Interim Measures and Guidelines require overseas institutions to perform the obligation of information disclosure in accordance with the relevant provisions of the national inter-bank bond market before the issuance of bonds and during the duration of bonds. For the contents disclosed as required, it can be divided by whether the Panda Bonds is raised publicly or directly. For public raised Panda Bonds, the disclosed information include prospectus, credit rating report and tracking rating arrangement (if any), Opinions reports of lawyers', finance statements, etc. For direct raised Panda Bonds, the information disclosure objects are limited to qualified institutional investors who invest in this Panda Bond.

Case Comparison of Panda Bonds issued by Foreign Governments.

Issuer Name	Par value	Duration	Yield to maturity	Issuing date	Maturity date	Payment cycle	Issuance Scale	Rate
Poland	¥ 100.00	3 years	3.20%	2021.10.13	2024.10.15	Once per year	3 billion	AAA
Portugal	¥ 100.00	3 years	4.09%	2019.05.30	2022.06.03	Once per year	2 billion	AAA
Sharjah	¥ 100.00	3 years	5.80%	2018.02.01	2021.02.02	Once per year	2 billion	AAA
Korea	¥ 100.00	3 years	3.00%	2015.12.15	2018.12.16	Once per year	3 billion	AAA
Hungary	¥ 100.00	3 years	4.85%	2017.07.26	2020.07.27	Once per year	1 billion	AAA
	¥ 100.00	3 years	4.30%	2018.12.17	2021.12.19	Once per year	2 billion	AAA
Philippines	¥ 100.00	3 years	5.00%	2018.03.20	2021.03.23	Once per year	1.46 billion	AAA
	¥ 100.00	3 years	3.58%	2019.05.15	2022.05.20	Once per year	2.5 billion	AAA
Canada BC	¥ 100.00	3 years	2.95%	2016.01.21	2019.01.25	Once per year	3 billion	NA
	¥ 100.00	3 years	4.80%	2017.11.22	2020.11.23	Once per year	1 billion	NA

Source: Sina Finance

MACRO-ENVIRONMENT OF ISSUING PANDA BONDS

The continuous upgrading of the two-way opening of Chinese bond market and the continuous promotion of the Belt and Road Initiative will promote the further diversification of issuer structure, and it is difficult for the traditional major issuers to dominate the issuance of Panda Bonds.

Since 2019, the two-way opening-up of Chinese bond market has continued to upgrade and the Belt and Road Initiative has continued to promote the Panda Bonds market. The proportion of pure overseas issuers has significantly increased. Austria's Treasury has signed a memorandum of understanding with Chinese banks to issue Panda Bonds. In addition, Pakistan, Turkey, Georgia and other countries are also actively preparing to issue Panda Bonds. Panda Bonds have increasingly become an important embodiment of financing under the Belt and Road Initiative. The Panda Bonds market will attract issuers from more countries and regions, enrich the main structure of issuance, and further increase the proportion of pure foreign "real Panda Bond" issuance.

Interest rates on Panda Bonds are expected to continue to edge down, with refinancing needs helping to boost issuance of Panda Bonds.

Because of the Covid-19, China's economic downward pressure is still large, central bank counter-cyclical monetary policy adjustment is expected to continue increasing, for a period of time in the future the central bank is still likely to implement comprehensive fall and directional fall again, MLF interest rates are expected to fall further. The interest rate of Panda Bonds issuance is expected to continue declining slightly, which will be favorable to Panda Bonds issuance.

The reduced uncertainty of the RMB exchange rate will create a favorable environment for the development of Panda Bonds market.

There will be more factors for stabilizing the RMB exchange rate, and uncertainties are expected to decrease. Since 2018, the depreciation and sharp fluctuations of RMB exchange rate have been mainly driven by news events such as SINO-US trade frictions. But now, the escalation of SINO-US trade frictions has been eased, and the uncertainty of RMB exchange rate has been reduced. Its exchange rate clause emphasizes the transparency of exchange rate pricing, which is also conducive to enhancing the attractiveness of RMB assets to international investors and creating a favorable environment for the development of Panda Bonds market.

ISSUER TYPES OF PANDA BONDS



With the promulgation of the Interim Measures for the administration of bond issuance by overseas institutions in the national inter-bank bond market in 2018, panda bond issuers also have clearer management measures. Before the promulgation of the interim measures, foreign government institutions, overseas financial institutions and non-financial enterprise legal persons shall refer to the measures for the administration of domestic bond issuers and relevant business guidelines. After the promulgation of the interim measures, the above-mentioned entities have been clearly incorporated into the unified management as issuers, and the issuance management system of bonds issued by overseas institutions in China has also been simplified. The issuance of Panda Bonds by overseas financial institutions as legal persons in China's inter-bank bond market will be subject to the approval of the people's Bank of China. Panda Bonds issued by overseas non-financial institutions, legal persons, foreign government institutions and international development institutions in China's inter-bank bond market will be registered in advance by China inter-bank market dealers association.

The Interim Measures for the administration of the issuance of bonds by overseas institutions in the national inter-bank bond market clearly stipulates the legal persons of overseas financial institutions. First, the actual capital paid by overseas financial institutions shall not be less than 10 billion yuan or equivalent currency. Second, overseas financial institutions need to have a good corporate governance mechanism and a perfect risk management system. Third, overseas financial institutions need to have sound finance, good credit standing, continuous profit records in the last three years, experience in bond issuance and good debt solvency. Finally, overseas financial institutions need to be effectively supervised by the financial regulatory authorities of the country or region where they are located, and the main risk indicators comply with the provisions of the authorities of the financial regulatory system. The provisions for foreign government institutions and international development institutions focus on having experience in bond issuance and good debt solvency. There are no special provisions for overseas non-financial enterprise legal persons.

PANDA BONDS RATINGS

The panda bonds are rated both by foreign and Chinese rating agencies and there is a slight variation in the ratings given to the various bonds. The Chinese rating agencies and the foreign ones use a slightly different method to assign the ratings. The global ratings are on investment level whereas the domestic rating agencies assigned have a concentrated rating of AAA. Chinese rating agencies claim that their ratings are based on more comprehensive research.

Panda bond credit ratings reflects the ability and the willingness of the issuer to, in future, satisfy the financial obligations relating to the panda bonds. The ratings, in other words, is the estimated assessment of the probability of default or loss of the issuer. Initially, a foreign issuer should have a credit rating of “AA” or more from at least two rating agencies to be eligible for issuing a panda bond. After the recent regulation changes, issuers are no longer obliged to be more than “AA” but the rating agencies must make the reports from the recognized rating agencies public. China allows qualified credit rating agencies to participate in the interbank bond market. Standard & Poor’s was the first credit rating agency that entered China’s credit rating market.

It is also pertinent to understand how panda bonds operate once sold by the issuer. Once the panda bonds are sold, the issuer must register the bonds with a registration and custodian. Both the registration and custodian must be recognized by the People’s Bank of China. Foreign sovereign organisations chose Shanghai Clearing House as their custodian issued on the interbank market.



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DADAO's services includes: cross border transactions, M&A, capital raising and strategic advisory.

Our team includes hands on experienced professionals graduated from top universities. We speak fluent Spanish, Chinese and English.

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