Research Update:

Standard Chartered Bank Affirmed At 'A', SCBHK At 'A+'; Various Positive Actions Taken On Hong Kong Hub Entities

August 7, 2019

Overview

- Standard Chartered group announced on Aug. 1, 2019, that it has partially completed its planned restructuring to form SCBHK into a regional hub and has assumed the ownership of SCB China.
- SCBHK is also to assume the ownership of SCB Taiwan and SCB Korea, pending regulatory approvals.
- The group expects the restructuring of the hub to deliver up to US$300 million in improved net interest income for the group by 2021.
- We are affirming our ratings on SCB and SCBHK with stable outlooks. SCB will remain a core subsidiary of the group while SCBHK's strengthened capital base will help compensate for its higher economic risks after inclusion of China.
- Benefiting from the higher ratings on SCBHK, we are raising our issuer credit rating on SCB China to 'A+' from 'A'. We are also placing our 'A-/A-2' ratings on SCB Korea on CreditWatch positive, pending regulatory approval to become a subsidiary of SCBHK.

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Rating Action

On Aug. 7, 2019, S&P Global Ratings affirmed its 'A/A-1' ratings on U.K.-based main operating entity Standard Chartered Bank (SCB) and its 'A+/A-1' ratings on Standard Chartered Bank (Hong Kong) Ltd. (SCBHK).

At the same time, we raised our rating on Standard Chartered Bank (China) Ltd. (SCB China) to 'A+' from 'A', and placed our 'A-/A-2' ratings on Standard Chartered Bank Korea Ltd. (SCB Korea) on CreditWatch with positive implications. The ratings on Standard Chartered PLC (SC PLC; BBB+/Stable/A-2), the nonoperating holding company of the group, are unaffected.

Rationale

The rating actions follow the group's results announcement on Aug. 1, 2019, at which it indicated it has partially completed its announced internal restructuring to form SCBHK as a regional hub. SCBHK has become a wholly owned subsidiary of SC PLC, the listed holding company of the group, and has assumed the ownership of SCB China. The group is also seeking regulatory approval to move SCB Taiwan and SCB Korea under SCBHK's direct ownership.

Our affirmation of the ratings on SCB reflects our view that it will remain a core subsidiary upon the completion of the restructuring. We note that Standard Chartered group has an international universal banking franchise with commercial banking at its core. We expect the group to give critical importance to both the U.K. and Hong Kong regional hubs. SCB will remain the larger part of the group, accounting for around 60% of total group equities, income, and assets as of June 30, 2019. Its financial performance, particularly profitability, will likely remain weaker than that of SCBHK, but we do not expect this to be an ongoing problem partly noting that SCB carries higher booking and relationship management costs while significantly contributing to SCBHK's corporate and institutional banking revenue.

For SCBHK, we affirmed our issuer credit rating and maintained the existing stand-alone credit profile (SACP) on the bank. In our view, economic risks surrounding the bank will likely gradually increase, given higher exposure to China. At the same time, we expect SCBHK to have a strong capital base once the legal entity restructuring is completed, given our expectations of moderate loan growth, fairly high dividend payouts, and broadly stable profitability.

Our upgrade of SCB China follows the entity becoming a core subsidiary of SCBHK and that it benefits from the latter's higher ratings and our view that the Hong Kong government would extend support to SCB China if required. We have assigned a core group status to SCB China due to its importance to the group's growth strategy for both Hong Kong and China, among the group's most important markets.

The placement of the ratings on SCB Korea on CreditWatch positive reflects our expectation that the entity will become a highly strategically important SCBHK subsidiary, pending regulatory approval. SCB Korea is likely to benefit from the higher ratings on SCBHK once it has become a subsidiary of SCBHK.

Our key assumptions include:

- It is highly likely the group will complete the reorganization of SCBHK as a regional hub as planned.
- The reorganization will lift the group's net interest income by up to US$300 million by 2021.
- SCB will continue to account for more than half of revenue, equities, and assets post restructuring.
- SCB China will grow faster, albeit modestly, within SCBHK given higher growth prospects of China and better utilization of funding that it would be receiving from SCBHK.
- SCBHK's key funding and metrics would not likely deteriorate significantly and the group will continue impose tight internal controls and measures on funding and liquidity conditions not only on SCBHK, but also on other Standard Chartered entities. That said, we could view a potential weakening of funding and liquidity profiles of SCBHK as a sign of a weakening of the overall group's funding and liquidity profile.
- SCBHK will focus on managing risks rather than aggressive growth opportunities, leading to a

modest deterioration in asset quality despite challenging economic conditions characterized by a slower economic growth outlook in China and Hong Kong, modest increase in credit losses, and sustained profitability backed by rising net interest margins.

- We expect our risk-adjusted capital ratio for SCBHK to remain at 10.5%-11.5% in the coming 18-24 months. We assume about 7%-8% loan growth a year during 2019-2021, about a 50% dividend payout ratio, and 0.7%-0.8% return on assets during 2019-2021.

For SCBHK, we foresee some geographic, revenue, and portfolio diversification as SCBHK enhances its market presence within north Asia. However, we expect overall profitability to decline modestly, given weaker profitability of the group's China, Taiwan, and Korea subsidiaries.

We expect SCBHK to strengthen its capital upon completion of the restructuring. We have therefore changed our assessment of capital and earnings from adequate to strong.

Given the higher economic risks that we now incorporate into the anchor rating, we can now compare SCBHK with peers that face slightly higher economic risks. That said, we are maintaining the existing risk position score at adequate mainly because key metrics such as impairment loss rate and nonperforming loan ratios do not suggest a significantly stronger risk position based on a peer comparison, including peers in Hong Kong.

For liquidity, we also expect SCBHK to remain predominately retail-deposit funded. We also note that SCBHK and the group may be using excess liquidity not necessarily for new business growth opportunities, but also use to replace relatively expensive funding at other Standard Chartered entities.

We also expect SCBHK to maintain high systemic importance. Our assessment of the bank's systemic importance reflects its significant deposit market share, its role as one of the three note-issuing banks in Hong Kong, and its meaningful role to the Hong Kong economy. SCBHK remains designated as one of the six domestic systemically important banks in Hong Kong by the Hong Kong Monetary Authority (HKMA). We also expect core and highly strategic subsidiaries to benefit from Hong Kong government support.

We also do not expect any major change in the group's resolution strategy, especially in relation to the HKMA's loss-absorbing capacity requirements and down-stream planning from the group to material subsidiaries.

Outlook

SCB

The stable outlook on SCB reflects our view that the group will maintain strong capitalization and funding and liquidity profiles in the next 12-24 months. We also expect the group to maintain satisfactory asset quality in line with other geographically diverse globally systematic important banks. We expect SCB to remain a core subsidiary of the group upon completion of the restructuring.

The stable outlook also reflects our view that the group is unlikely to: (1) accumulate additional loss-absorbing capacity (ALAC) that warrants a second notch of ALAC support; and (2) sustainably improve profitability over the next 12-24 months to make its creditworthiness more clearly in line with that of peers we rate 'A+'.

Downside scenario

We would lower the ratings on SCB if the group's capitalization deteriorates along with weaker asset quality or its funding or liquidity weakens. However, the potential for a downgrade would be limited if the group accumulates 8.5% ALAC on a sustainable basis at such time.

Upside scenario

We would most likely raise the rating on SCB if the group demonstrates a business model that is diverse and well positioned for the changed regulatory and economic environment, and accumulates over 8.5% ALAC on a sustainable basis. This would likely be exemplified in the situation where the group has much improved and stabilized its earnings such that its credit strength is comparable to that of 'A+' rated peers.

SCBHK

The stable outlook reflects our expectation that SCBHK will maintain its robust business stability, strong capitalization, healthy asset quality, and strong funding and liquidity profile over the next 12-24 months. We expect SCBHK's solid business and risk profile to help the bank offset any potential headwinds from prevailing economic uncertainties. We also anticipate that the bank will maintain its high systemic importance in Hong Kong, and believe the Hong Kong government will be able to provide extraordinary support in case of need.

Downside scenario

We could downgrade SCBHK if the group's credit profile deteriorates or if SCBHK's SACP weakens. The SACP could come under downward pressure due to: (1) weakening capitalization such that the bank's risk-adjusted capital ratio sustainably falls below 10%; (2) weakening of funding and liquidity profiles; or (3) the bank's asset quality significantly weakens more than the industry average, as indicated by metrics such as a rise in credit costs.

Upside scenario

We believe an upgrade of SCBHK is unlikely over the next two years.

SCB China

The stable outlook on SCB China reflects our outlook on the bank's immediate parent, SCBHK. We expect the bank to remain a core subsidiary of SCBHK over the next two years. The ratings on SCB China would move in tandem with those on the parent.

Upside scenario

We believe an upgrade is unlikely over the next two years.

Downside scenario

We could downgrade SCB China if we downgrade SCBHK.

CreditWatch

SCB Korea

We expect to resolve the CreditWatch positive on SCB Korea when the entity receives regulatory approval and becomes a subsidiary of SCBHK, which could occur in the next 90 days. We see a high likelihood for SCB Korea to become a highly strategically important subsidiary of SCBHK and benefit from SCBHK's higher ratings upon regulatory approval of the restructuring.

We could raise the rating on SCB Korea if the entity has obtained regulatory approval and becomes a subsidiary of SCBHK.

We could affirm the current ratings and remove them from CreditWatch if SCB Korea fails to become a subsidiary of SCBHK.

Ratings Score Snapshot

	To	From
SCBHK		
Issuer Credit Ratings	A+/Stable/A-1	A+/Stable/A-1
SACP	a	a
Anchor	bbb+	a-
Business position	Adequate (0)	Adequate (0)
Capital and earnings	Strong (+1)	Adequate (0)
Risk position	Adequate (0)	Adequate (0)
Funding and liquidity	Above-average and Strong (+1)	Above-average and Strong (+1)
Support		
ALAC Support	(0)	(0)
GRE Support	(0)	(0)
Group Support	(0)	(0)
Sovereign Support	(+1)	(+1)
Additional Factors	(0)	(0)
Economic Risk	4	3
Industry Risk	1	1

Related Criteria

- General Criteria: Hybrid Capital: Methodology And Assumptions, July 1, 2019
- General Criteria: Group Rating Methodology, July 1, 2019
- Criteria - Financial Institutions - General: Methodology For Assigning Financial Institution Resolution Counterparty Ratings, April 19, 2018
- Criteria | Financial Institutions | General: Risk-Adjusted Capital Framework Methodology, July 20, 2017
- General Criteria: Methodology For Linking Long-Term And Short-Term Ratings, April 7, 2017
- General Criteria: Guarantee Criteria, Oct. 21, 2016
- Criteria | Financial Institutions | Banks: Bank Rating Methodology And Assumptions: Additional Loss-Absorbing Capacity, April 27, 2015
- General Criteria: Principles For Rating Debt Issues Based On Imputed Promises, Dec. 19, 2014
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- Criteria | Financial Institutions | Banks: Banking Industry Country Risk Assessment Methodology And Assumptions, Nov. 9, 2011
- Criteria | Financial Institutions | Banks: Banks: Rating Methodology And Assumptions, Nov. 9, 2011
- General Criteria: Use Of CreditWatch And Outlooks, Sept. 14, 2009
- Criteria | Financial Institutions | Banks: Commercial Paper I: Banks, March 23, 2004

Related Research

- Standard Chartered PLC (Holding Co.); Standard Chartered Bank (Lead Bank), July 24, 2019
- Fed Likely To Cut Rates This Year As Trade Headwinds Blow Harder, June 12, 2019
- United Kingdom Ratings Affirmed At 'AA/A-1+'; Outlook Remains Negative, April 26, 2019
- Banking Industry Country Risk Assessment: Hong Kong , April 4, 2019
- Standard Chartered Is Progressing On A Long Road To Strengthening Its Creditworthiness, Feb. 28, 2019
- Countdown To Brexit: Rating Implications Of A No-Deal Brexit, Feb. 6, 2019
- The 2019 Outlook For U.K. Banks Hinges On Brexit, Jan. 10, 2019
- Asia-Pacific Banking Outlook 2019--Headwinds Are Picking Up, Dec. 4, 2018
- Everyone Passed: Stress Tests Highlight Growing Resilience Of U.K. Banks, Nov. 29, 2018

Ratings List

Ratings Affirmed		
Standard Chartered Bank		
Issuer Credit Rating	A/Stable/A-1	
Certificate Of Deposit	A/A-1	
Standard Chartered Bank (Hong Kong) Ltd.		
Issuer Credit Rating	A+/Stable/A-1	
Standard Chartered Bank (Hong Kong) Ltd.		
Senior Unsecured	A+	
Subordinated	A-	
CreditWatch		
	To	**From**
Standard Chartered Bank Korea Ltd.		
Issuer Credit Rating	A-/Watch Pos/A-2	A-/Stable/A-2
Upgraded; Ratings Affirmed		
	To	**From**
Standard Chartered Bank (China) Ltd.		
Issuer Credit Rating	A+/Stable/A-1	A/Stable/A-1

Certain terms used in this report, particularly certain adjectives used to express our view on rating relevant factors, have specific meanings ascribed to them in our criteria, and should therefore be read in conjunction with such criteria. Please see Ratings Criteria at www.standardandpoors.com for further information. Complete ratings information is available to subscribers of RatingsDirect at www.capitaliq.com. All ratings affected by this rating action can be found on S&P Global Ratings' public website at www.standardandpoors.com. Use the Ratings search box located in the left column.