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ASSESSING THE ROLE OF BANKS IN THE PRIVATE CREDIT SECTOR: EVIDENCE FROM BANK LOANS PROVIDED TO PRIVATE CREDIT LENDERS

Key points:

- *The private credit (PC) sector has grown significantly in the past decade, developing intricate connections with the broader financial system. From the perspective of financial stability, a key concern is the increase in bank loans to PC lenders, which are subsequently channelled to financially vulnerable companies through the PC sector. This linkage could expose banks that fund PC lenders to significant credit risks.*

- *To examine this concern, we analysed a large sample of bank loans provided to PC lenders. Our results reveal that the total outstanding amount of these loans has grown at an average rate of 10% per annum over the past decade. However, the contagion risks emerging from these loans have remained low thus far, as they only accounted for a median of 0.2% and a maximum of 4.4% of a bank's total assets in our sample.*

- *That said, three emerging trends related to the interconnections between banks and the PC sector warrant closer monitoring, as further evolution may amplify the transmission of shocks from the PC sector to the banking sector:*

    - *<u>Larger participation of less capitalised banks</u>: Whilst banks providing credit to PC lenders in our sample were usually well capitalised, we find that the participation of less capitalised banks has increased considerably. In specific, these banks have accounted for 12% of bank loans to PC lenders in 2023, up from 6% a decade earlier. Less capitalised banks will be less able to absorb potential losses if associated PC lenders default on bank loans during periods of stress, with potential ramifications for the wider financial system.*

- *Loosened underwriting standards of PC lenders: PC lenders' underwriting standards have loosened considerably, as their portfolio share of new PC provided to financially vulnerable companies with high leverage or a weak debt servicing ability has increased. Importantly, banks' exposure to these risk-prone PC lenders has increased substantially, accounting for half of all bank loans to PC lenders in 2023, up from 37% a decade earlier. This shift may increase banks' exposure to credit risks.*

- *Rising spillover risks to Asia-Pacific (APAC)-based banks: Although observations indicate a concentrated risk of PC in the Americas, we find that APAC-based banks have accounted for 14% of bank loans to PC lenders in 2023, up from 6% a decade earlier. As most loans are directed towards PC lenders based in the Americas, this trend may increase the risk of shock transmission from the PC sector to banks across regions.*

- *Finally, our analysis may not capture all bank loans to PC lenders, which partly reflects the inherent opacity of the PC sector. Although our sample size is comparable to some market estimates, readers should interpret our results with caution due to potential data gaps.*

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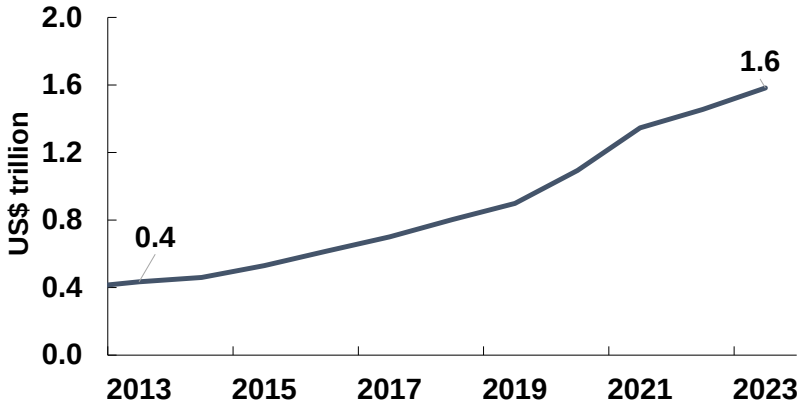
1. INTRODUCTION

The private credit (PC) sector has grown considerably in the past decade, with an annual growth rate of 10% (Chart 1), and has developed intricate connections with the broader financial system. From the perspective of financial stability, a key concern is the increase in bank loans to PC lenders, which are defined as loans to PC-focused investment companies, their affiliated funds and business development companies (BDCs), as these loans are subsequently channelled to financially vulnerable companies through the PC sector. This channel could expose banks that fund PC lenders to substantial credit risks.

Chart 1: Global PC assets (US$ trillion)



Note: The curve depicts the total assets under management by PC-focused funds and BDCs.

Source: Preqin Ltd.

However, the inherent opacity of the PC sector poses significant challenges to a comprehensive assessment of contagion risks arising from its connections with the banking sector. To bridge this data gap, we constructed a large sample of bank loans provided to PC lenders, sourced from several commercial databases and regulatory filings. Although our sample may not capture all bank loans provided to PC lenders, it is comparable in size to some market estimates, and encompasses PC lenders whose combined PC assets accounted for about 85% of the aggregate at the end of 2023.

Based on the available data, our results reveal a 10% annual increase in global bank loans provided to PC lenders over the past decade, a shift that is closely aligned with the expansion of the PC sector during the same period. However, the contagion risks emerging from these loans have remained low thus far, as they only accounted for a median of 0.2% and a maximum of 4.4% of a bank's total assets in our sample. That said, our results point to three emerging trends related to the interconnections between banks and the PC sector that warrant closer monitoring as they may amplify the transmission of shocks from the PC sector to the banking sector if they continue to evolve.

This paper is structured as follows. Section 2 provides an overview of our novel dataset. Section 3 analyses the contagion risks arising from bank loans provided to PC lenders. Section 4 highlights three emerging trends related to the interconnections between banks and the PC sector that warrant closer monitoring. Section 5 concludes the study.

2. DATA AND METHODOLOGY

This study relied on a combination of four datasets: (1) PC lender-level data, (2) PC borrower-level data, (3) bank loan-level data, and (4) bank-level data. The construction and limitations of each dataset are discussed in the following sub-sections. Due to varying coverage across these datasets, readers should interpret the analytical results presented in Sections 3 and 4 with caution.

2.1 PC lender-level and PC borrower-level data

Using data from Preqin Pro[2], we began to construct our datasets by compiling a list of 2,877 PC lenders that have underwritten PC to companies through their PC-focused funds and/or BDCs, as well as their geographical information. We also compiled a list of 11,284 companies that sought credit from these PC lenders between 2014 and 2023, referred to as PC borrowers.

Next, we retrieved PC borrowers' geographic and balance sheet data from S&P Capital IQ. We manually matched the borrowers' names across both databases, as these names often vary between the two databases. To improve accuracy, we matched the names not only based on their similarity but also by ensuring that each borrower's geographic and industrial information were consistent across both databases.[3] Overall, we successfully matched the names of approximately 60% of the sampled PC borrowers and collected their geographic and balance sheet data.

2.2 Bank loan-level data

We manually searched for loans borrowed by each PC lender and its PC-focused funds and/or BDCs in two commercial databases, Bloomberg and DealScan, as well as the Form 10-K search engine. To ensure a comprehensive search, we also searched the databases for loans borrowed by special purpose vehicles (SPVs) set up by these PC lenders, as these lenders may borrow from banks through their respective SPVs rather

[2] Preqin Pro is a comprehensive data and analytics platform that offers users access to a vast array of information on the PC sector. Its data have been widely used to determine the size of the PC sector by regulators and market participants, such as IMF (2024), IOSCO (2023), Lynam of BlackRock (2023), Blackstone (2020) and Goldman Sachs Asset Management (2024).

[3] This approach has been applied in the literature; for example, see IMF (2024) and Wong, et al. of the Hong Kong Monetary Authority (2024).

than directly.[4] All of the loans borrowed by PC-focused funds, BDCs, and SPVs were consolidated into their respective PC lenders. During this manual search, we identified 1,220 outstanding loan tranches provided to 122 PC lenders by either banks or non-bank financial intermediaries (NBFIs) from 2013 to 2023.[5] Within these loans, we identified 821 direct loans and 283 syndicated loans provided by 250 banking groups[6] to 118 PC lenders,[7] using the identification process as detailed in Section 2.3.

Our bank loan-level data appear to offer broad coverage of PC lenders, as these 118 PC lenders accounted for 85% of the total PC assets managed by the 2,877 PC lenders at the end of 2023 according to Preqin Pro. The remaining 15% may be partly attributable to the zero leverage of some PC lenders,[8] although data gaps may also be present. In addition, our sample size seems to be comparable to some market estimates. To the best of our knowledge, Moody's Ratings pioneered the estimation of the total outstanding amount of bank loans provided to PC lenders in 2023, with estimates ranging from US$131 billion for loans provided to PC-focused funds and BDCs to US$326 billion for loans provided to PC-focused funds, BDCs, and SPVs. We estimate the total outstanding amount of bank loans provided to PC lenders in our sample during the same period to be US$268 billion, which falls within the range estimated by Moody's Ratings.[9,10]

2.3 Bank-level data

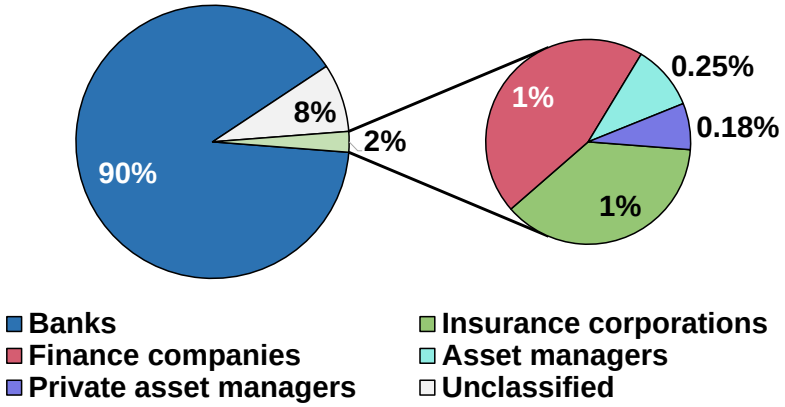
As mentioned in Section 2.2, we identified loans that were solely provided or syndicated by banks to PC lenders with reference to S&P Capital IQ. We elaborate this process below.

First, we matched lenders' names across the loan databases and S&P Capital IQ, as names often differ between sources to varying degrees. We were able to match 92% of the lenders' names in terms of the outstanding amount of loans. Next, we downloaded entity types, geographic data, and balance sheet data for the matched lenders from S&P Capital IQ. These lenders included both banks and NBFIs. For loan tranches jointly syndicated by both banks and NBFIs, we assumed that each lender

[4] See IOSCO (2023).
[5] These loans are committed by bank or non-bank lenders and can be fully or partially drawn by PC lenders at any time within the period specified in the loan agreements accepted by both sides.
[6] The 250 banking groups provided loans to PC lenders between 2013 and 2023, and 178 continued to extend loans to PC lenders at the end of 2023.
[7] The 118 PC lenders borrowed from banks between 2013 and 2023, and 76 remained liable to banks at the end of 2023.
[8] See Block et al. (2024), whose survey of a sample of PC lenders indicated that 5% of PC lenders in the United States and 67% in Europe did not use leverage in 2021.
[9] See Abdel Massih et al. of Moody's Ratings (2024).
[10] Fitch Ratings estimated that the total outstanding amount of subscription facilities and net asset value facilities provided by banks to private capital funds (including PC funds, private equity (PE) funds and real estate funds) reached US$750 billion in 2022 (Fayvilevich et al., 2023) and US$100 billion in 2023 (Fayvilevich et al., 2024), respectively.

contributed equally to the loan amount. Using this approach, we estimated that approximately 90% of the loans were provided by banks (blue portion, Chart 2). Meanwhile, 2% of the loans were extended by NBFIs (light green portion), including insurance corporations (green portion), finance companies (red portion), asset managers (aqua portion), and private asset managers (purple portion). The remaining 8% of the loans were provided by unclassified lenders (grey portion).

Chart 2: Share of loans provided to PC lenders at the end of 2023, by lender type (%)



Note: Each share is expressed as a percentage of the total outstanding amount of loans provided to PC lenders at the end of 2023.

Sources: Bloomberg, DealScan, Form 10-K, S&P Capital IQ, and HKMA staff estimates.

For banks, the availability of balance sheet data varies according to their hierarchical level. At the bank branch level, balance sheet data in terms of the total outstanding amount of bank loans are available for 80% of the branches; the remaining bank branches are unlisted and hence not required to disclose their balance sheets. In contrast, at the banking group level, which consolidates all branches into their respective parent companies, balance sheet data are available for 99% of the banking groups, as nearly all of the banking groups are listed and required to disclose their balance sheets. We therefore analysed balance sheets at the banking group level, unless specified otherwise.

3. CONTAGION RISK ASSESSMENT

This section examines the implications of bank loans provided to PC lenders from the perspective of financial stability. Section 3.1 provides a detailed overview of these loans. Section 3.2 evaluates whether these loans currently expose the banking sector to substantial contagion risks.

3.1 Overview of bank loans provided to PC lenders

We find that the total outstanding amount of bank loans provided to PC lenders has grown substantially over the past decade at an annual rate of 10%, rising from only US$100 billion in 2013 to US$268 billion in 2023 (Chart 3). This growth is strongly correlated with the expansion of the PC sector during the same period. Recently, the growth of these loans has accelerated significantly. Specifically, our analysis of the cumulative growth of these loans between 2014 and 2023 reveals that around 81% of the growth occurred over a relatively short period between 2021 and 2023 (Chart 4).

Chart 3: Total outstanding amount of bank loans to PC lenders (US$ billion) and total number of new bank loans

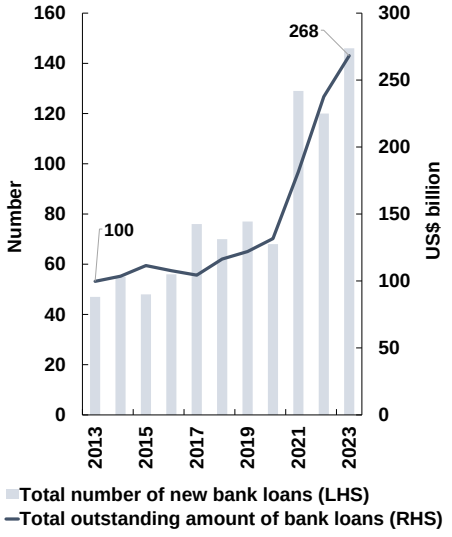
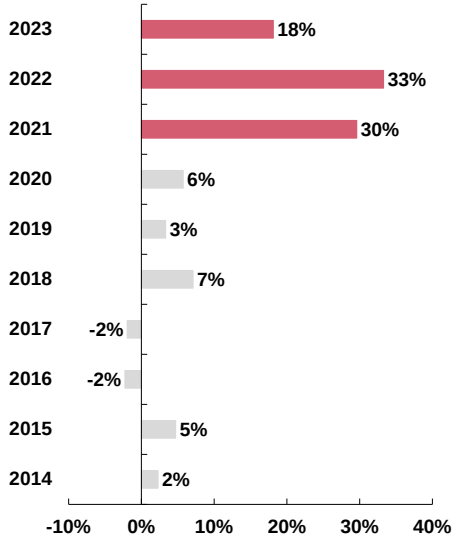


Chart 4: Proportion of the cumulative growth of bank loans to PC lenders, by year (%)



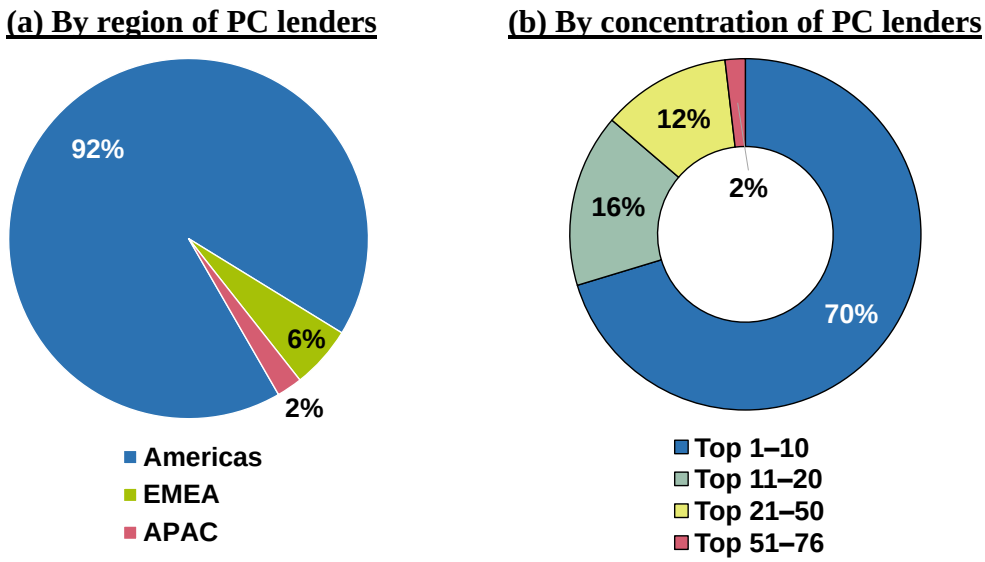
Note: In Chart 3, the curve represents the total outstanding amount of bank loans provided to PC lenders. The bars denote the total number of new bank loans in each the year. In Chart 4, each bar represents the proportion of cumulative growth of the total outstanding amount of bank loans provided to PC lenders occurring in each year between 2014 and 2023.

Sources: Bloomberg, DealScan, Form 10-K, S&P Capital IQ, and HKMA staff estimates.

Our analysis also indicates that some types of PC lenders and banks are more actively engaged in the loan market than others, as they have extended and borrowed the majority of loans to date.

a) **PC lenders**: In terms of geographical region, PC lenders based in the Americas are the main borrowers, accounting for approximately 92% of the outstanding bank loans provided to PC lenders in 2023 (Chart 5a). Such loans are concentrated in a handful of PC lenders: the top 10 PC lenders that borrowed the most from banks accounted for about 70% of the outstanding loans at the end of 2023 (Chart 5b).

Chart 5: Share of PC lenders at the end of 2023
(% of total outstanding amount of bank loans provided to PC lenders)



Note: The sample includes 76 PC lenders that were liable to banks at the end of 2023. In Chart 5a, each colour represents the share of PC lenders per indicated region. In Chart 5b, each colour represents the share of PC lenders in descending order by their total outstanding amount of bank loans.

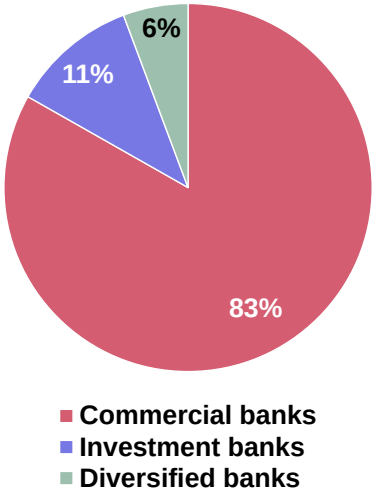
Sources: Bloomberg, DealScan, Form 10-K, S&P Capital IQ, and HKMA staff estimates.

b) **Banks**: Commercial banks are the largest sources of loans provided to PC lenders, representing about 83% of outstanding bank loans in 2023 (Chart 6a). Any defaults on these loans could lead to adverse spillover effects on bank depositors. In terms of geographical region, Americas-based and Europe, the Middle East, and Africa (EMEA)-based banks accounted for about 62% and 24% of the aggregate, respectively, in 2023 (Chart 6b).[11] Such loans are concentrated in large banks, with the top 10 bank lenders providing 47% of all outstanding loans to PC lenders at the end of 2023 (Chart 6c).[12]

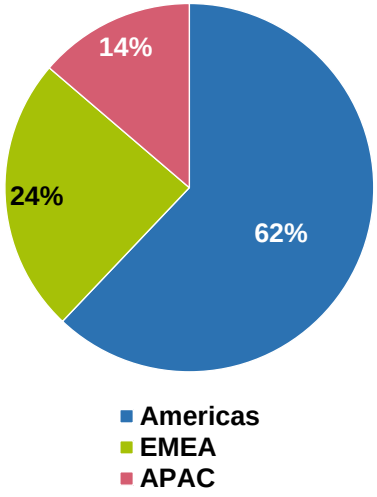
[11] Bank branches in Hong Kong have rarely extended loans to PC lenders according to the available data.
[12] These findings remain robust when expressed at the bank branch level.

Chart 6: Share of banks at the end of 2023
(% of total outstanding amount of bank loans provided to PC lenders)

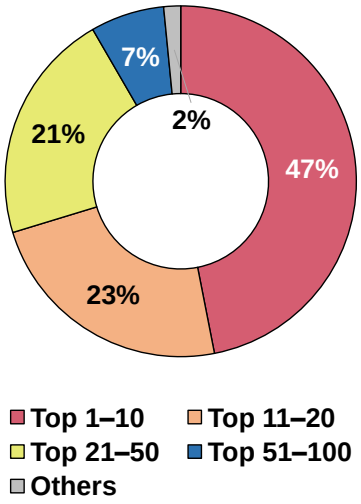
(a) By type of banks



(b) By region of banks



(c) By concentration of banks

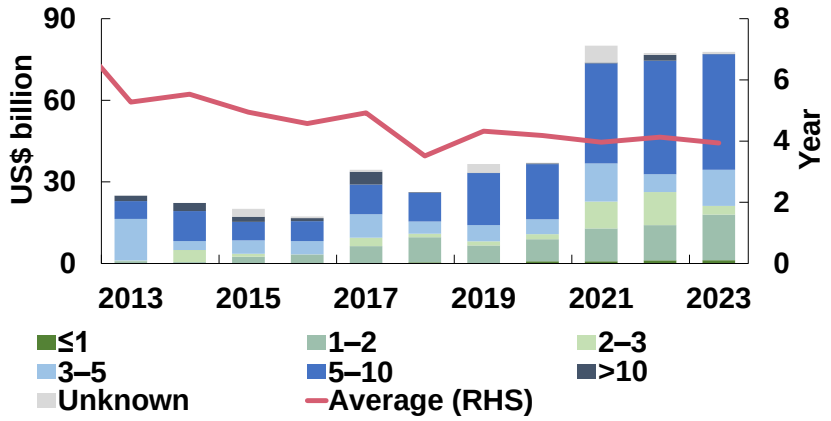


Note: The sample encompasses 178 banking groups that had extended loans to PC lenders at the end of 2023. In Chart 6a, each colour represents the share of the respective bank type. With reference to S&P Capital IQ, we classified a bank as a commercial bank if it accepts deposits from the public; as an investment bank if it specialises in raising capital for companies and does not accept deposits; or as a diversified bank if it operates both business lines. In Chart 6b, each colour represents the share of banks based in a given region. In Chart 6c, each colour represents the share of banks in descending order by the total outstanding amount of their loans provided to PC lenders.

Sources: Bloomberg, DealScan, Form 10-K, S&P Capital IQ, and HKMA staff estimates.

The average maturity of bank loans provided to PC lenders in our sample during the past decade ranges from 4 to 6 years (Chart 7), which is consistent with the average maturity of PC assets reported by some financial regulators and credit rating agencies.[13] This congruence suggests that most of these loans are used by PC lenders to provide credit in the PC sector.

Chart 7: Total amount of new bank loans provided to PC lenders by maturity (US$ billion) and their average maturities (years)



Note: Each coloured bar represents the total amount of new bank loans provided to PC lenders within the respective maturity in a given year. The curve depicts the average maturity of new bank loans provided to PC lenders, weighted by the amount of these loans.

Sources: Bloomberg, DealScan, Form 10-K, S&P Capital IQ, and HKMA staff estimates.

One possible limitation of our sample is that some PC lenders may borrow bank loans not only to facilitate their PC provision, but also to fund their PE acquisition, given their multiple investment focuses. In the remaining sections, we present our assessment of contagion risks based on the full sample of PC lenders. To ensure robustness, we then restricted our sample to a subset of PC lenders whose PC assets comprise a relatively high proportion of their overall portfolios and re-examined the consistency of the results across different sample selection criteria. Although we do not report the results of robustness tests for brevity, they indicate that our contagion risk assessment remains largely robust when using a sub-sample of PC lenders whose PC assets exceed 16% and 45% of their total assets under management; these percentages correspond to the lower quantile and median in our sample, respectively.

[13] The average maturity of PC assets observed by Cai and Haque of the Federal Reserve Board (2024) and Gunter et al. of S&P Global Ratings (2024) ranges from 4 to 5 years, which is largely consistent with the average maturity of bank loans observed in our sample. The trends in all of these samples recently decreased to about 4 years. Peirce of the United States Securities and Exchange Commission (2024) observes that the typical maturity of PC assets is around 5 years.

3.2 Contagion risks from bank loans provided to PC lenders

The possibility of defaults on bank loans provided to PC lenders are a potential source of contagion risks. Such defaults could lead to substantial credit losses on the balance sheets of affected banks. The severity of these contagion effects is directly correlated with banks' level of exposure to such loans, such that greater exposure is likely to be associated with more severe contagion effects.

Despite the rapid growth of these loans as shown in Section 3.1, our findings indicate that the contagion risks emerging from these loans have remained low thus far, as they only accounted for a median of 0.2% and a maximum of 4.4% of a bank's total assets in 2023 (Chart 8). These banks were usually well capitalised, with a Common Equity Tier 1 (CET1) capital ratio of at least 8.1%, compared to the minimum requirement of 4.5% under the Basel III framework (Chart 9).[14]

Chart 8: Distribution of bank loans to PC lenders (% of bank assets)

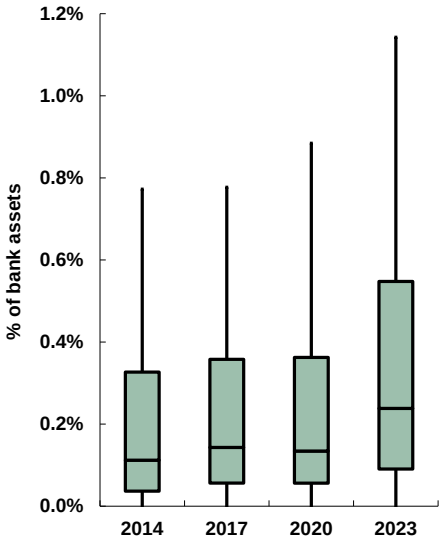
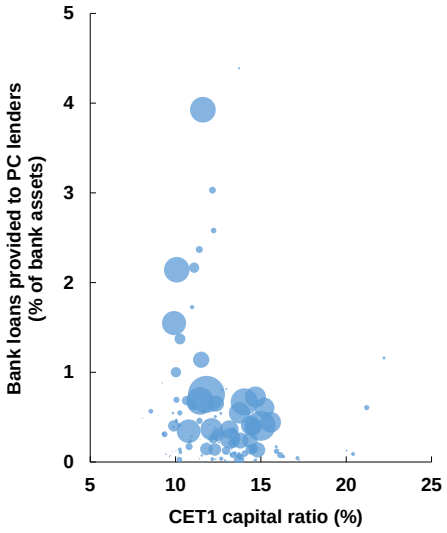


Chart 9: Bank loans to PC lenders (% of bank assets) and CET1 capital ratio



Note: In Chart 8, each boxplot denotes the distribution of bank loans provided to PC lenders, expressed as a percentage of total bank assets in the given year. Each box represents the lower quantile to upper quantile range, with the horizontal line within the box indicating the median. The upper and lower end points of the thin vertical lines represent the 90th and 10th percentiles, respectively. In Chart 9, each dot represents a bank extending loans to PC lenders at the end of 2023. The x-axis and y-axis respectively represent banks' CET1 capital ratio and loans provided to PC lenders, expressed as a percentage of their total assets in the same period. The size of each dot is proportional to the market share of the respective bank in the loan market during the same period.

Sources: Bloomberg, DealScan, Form 10-K, S&P Capital IQ, and HKMA staff estimates.

[14] In addition to the minimum requirement, many jurisdictions impose additional regulatory requirements on banks, including the capital conservation buffer, the countercyclical capital buffer, and systemically important global and domestic bank buffers. In major economies, the CET1 capital requirements were around 10% on average in 2023 (ECB, 2023; Federal Reserve Board, 2023).

4. EMERGING TRENDS WARRANTING CLOSER MONITORING

Although the contagion risks emerging from the provision of loans by banks to PC lenders have remained limited, three emerging trends related to the interconnections between banks and the PC sector may require closer monitoring: the larger participation of less capitalised banks, loosened underwriting standards of PC lenders, and rising spillover risks to APAC-based banks. These trends may increase the risk of shock transmission from the PC sector to banks across regions. We discuss each of these trends in detail in Sections 4.1 to 4.3.

4.1 Larger participation of less capitalised banks

For analysis, we categorised banks with a CET1 capital ratio lower than 10% in the previous year as less capitalised; all others were categorised as more capitalised. The threshold was determined based on the average capital requirement for banks in major economies in 2023.[15]

Using this classification, we find that the less capitalised banks have increasingly engaged in lending to PC lenders in recent years. The total outstanding amount of loans provided by less capitalised banks to PC lenders has grown significantly by 19% annually over the past decade, compared with merely 10% growth for their more capitalised counterparts (Chart 10). As a result, these less capitalised banks have accounted for 12% of bank credit to PC lenders in 2023, up from 6% a decade earlier (Chart 11).[16]

This emerging trend may increase the potential severity of shock transmission from the PC sector to the banking sector if it continues to evolve. As less capitalised banks hold relatively thin capital buffers, they would be less able than their more capitalised counterparts to absorb potential losses if associated PC lenders default on bank loans during periods of stress. Although most banks that provide credit to PC lenders remain well capitalised, as mentioned in Section 3.2, we should be aware of this nascent development.

[15] Large banks in the United States were required to maintain their CET1 capital ratio at an average level of 9% in 2023 (Federal Reserve Board, 2023). In the European Union, the overall capital requirements and guidance in CET1 capital ratio were about 11% during the same period (ECB, 2023). We took the simple average of both levels, 10%, as a threshold for classifying banks as more or less capitalised.

[16] If the CET1 capital ratio threshold is replaced with either 9% (i.e. the average regulatory level in the United States) or 11% (i.e. the average regulatory level in the European Union), the estimated market share of less capitalised banks increases significantly to 10% or 26% in 2023, up from 4% or 15% a decade earlier, respectively.

Chart 10: Annualised growth in bank loans to PC lenders from 2014 to 2023, by type of banks

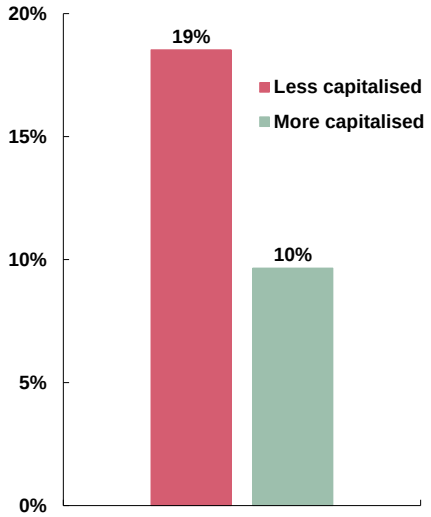
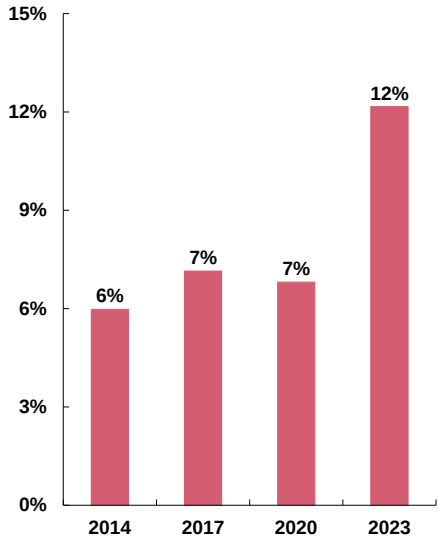


Chart 11: Share of bank loans provided by less capitalised banks to PC lenders (%)



Note: In Chart 10, each bar represents the annualised growth in the total outstanding amount of bank loans provided by less capitalised (red bar) and more capitalised banks (green bar) to PC lenders between 2014 and 2023. In Chart 11, each bar represents the total outstanding amount of loans provided by less capitalised banks to PC lenders, expressed as a percentage of the total outstanding amount of bank loans provided to PC lenders.

Sources: Bloomberg, DealScan, Form 10-K, S&P Capital IQ, and HKMA staff estimates.

4.2 Loosened underwriting standards of PC lenders

Second, our analysis reveals that PC lenders have significantly loosened their underwriting standards, as indicated by the increased portfolio shares of new PC extended to financially vulnerable companies. These companies are characterised by (a) a debt-to-EBITDA ratio (DER) above 6 (indicating high leverage) or below 0 (indicating a negative EBITDA), or (b) an interest coverage ratio (ICR) below 1 (indicating an inability to fully cover interest expenses with net earnings). Among the PC lenders borrowing from banks, the proportion of new PC extended to these companies has increased substantially, from only 7% in 2014 to 31% in 2023 (Chart 12). This trend may make these PC lenders more prone to potential defaults.

Importantly, this trend has increased banks' exposure to these risk-prone PC lenders. Specifically, the total outstanding amount of bank loans provided to these risk-prone PC lenders has increased substantially. Such loans accounted for half of all bank loans to PC lenders in 2023, compared with 37% a decade earlier (Chart 13). This growing exposure of banks to risk-prone PC lenders may increase their credit risks even further. These risks appear to be partly factored into the interest rates on the related bank loans, which have already surpassed the bond yields for companies at the margin of falling into the range of speculative grades (Chart 14). As a result, banks face visible

credit risks due to their connections with risk-prone PC lenders, which may warrant closer scrutiny in the future.

Chart 12: Share of new PC to financially vulnerable companies (%)

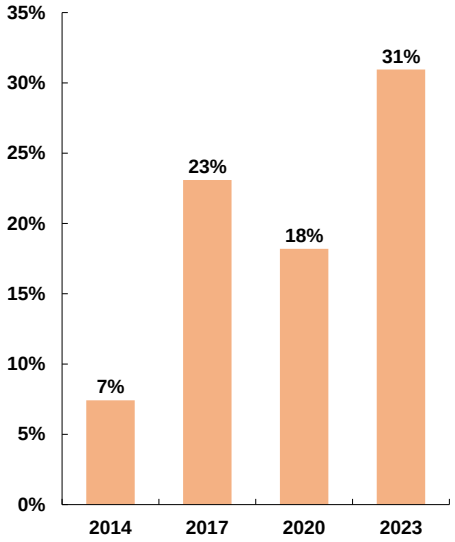
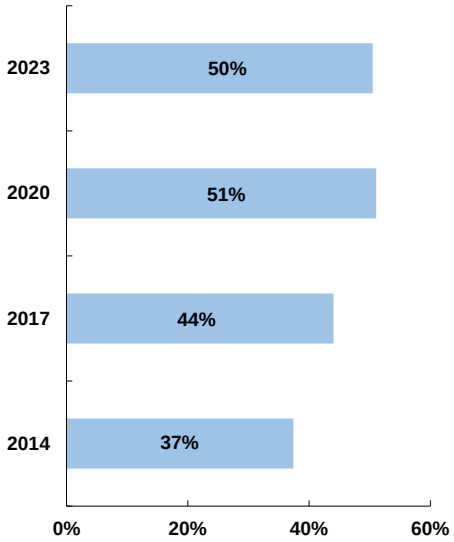


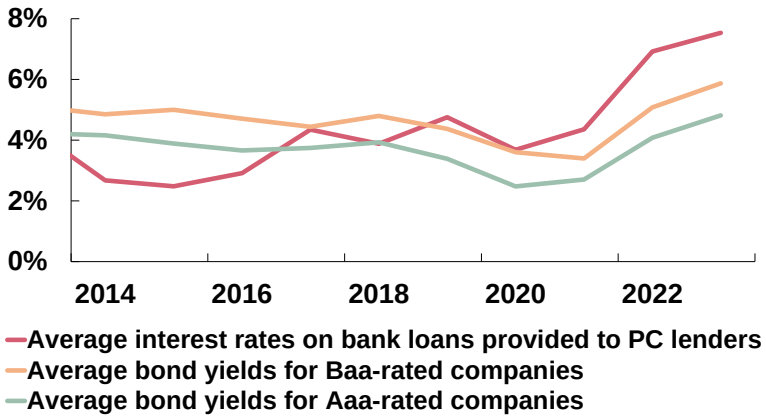
Chart 13: Share of bank loans to risk-prone PC lenders (%)



Note: In Chart 12, each bar represents the total amount of new PC extended by bank-indebted PC lenders to financially vulnerable companies in the indicated year, expressed as a percentage of the total amount of new PC extended by these lenders. In Chart 13, each bar represents the total outstanding amount of bank loans provided to these risk-prone PC lenders in the respective year, expressed as a percentage of the total outstanding amount of bank loans to all PC lenders.

Sources: Bloomberg, DealScan, Form 10-K, S&P Capital IQ, and HKMA staff estimates.

Chart 14: Average interest rates on new bank loans provided to PC lenders, and bond yields for Aaa-rated and Baa-rated companies (%)



Note: The red curve represents the average interest rate on new bank loans provided to PC lenders, weighted by the amount of loans. The orange and green curves indicate the bond yields charged on companies with a Baa grade (lowest investment grade) and an Aaa grade (highest investment grade), respectively.

Sources: Bloomberg, DealScan, Form 10-K, S&P Capital IQ, Federal Reserve Economic Data, and HKMA staff estimates.

4.3 Rising spillover risks to APAC-based banks

Lastly, our analysis shows that APAC-based banks, the majority of which are based in Japan, have increased their lending to PC lenders across regions. These banks have accounted for a larger share of bank loans to PC lenders, which rose from only 6% in 2014 (red bands, Chart 15a) to 14% in 2023 (red bands, Chart 15b). This gain in market share occurred primarily at the expense of their EMEA-based competitors (green bands). A substantial portion of the loans extended by APAC-based banks were directed towards Americas-based PC lenders (thicker red band, Chart 15b).

This trend may have considerable implications with respect to potential shock transmission from the PC sector to banks. The increase in market share held by APAC-based banks suggests that potential defaults on loans extended to PC lenders may no longer be confined to banking systems in the Americas. Conversely, APAC-based banks may now be increasingly vulnerable to the propagation of shocks induced by the PC sector. This situation may warrant increased cross-jurisdiction collaboration in regulatory monitoring.

Chart 15a: Share of bank loans provided to PC lenders at the end of 2014, by regions of banks and PC lenders (%)

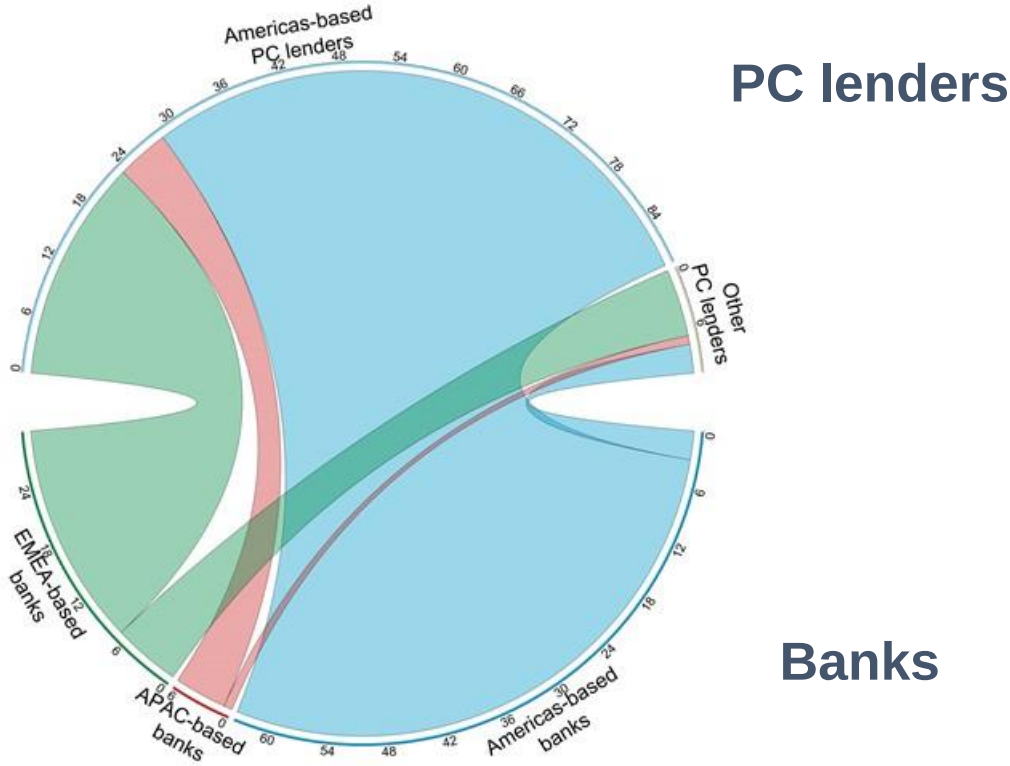
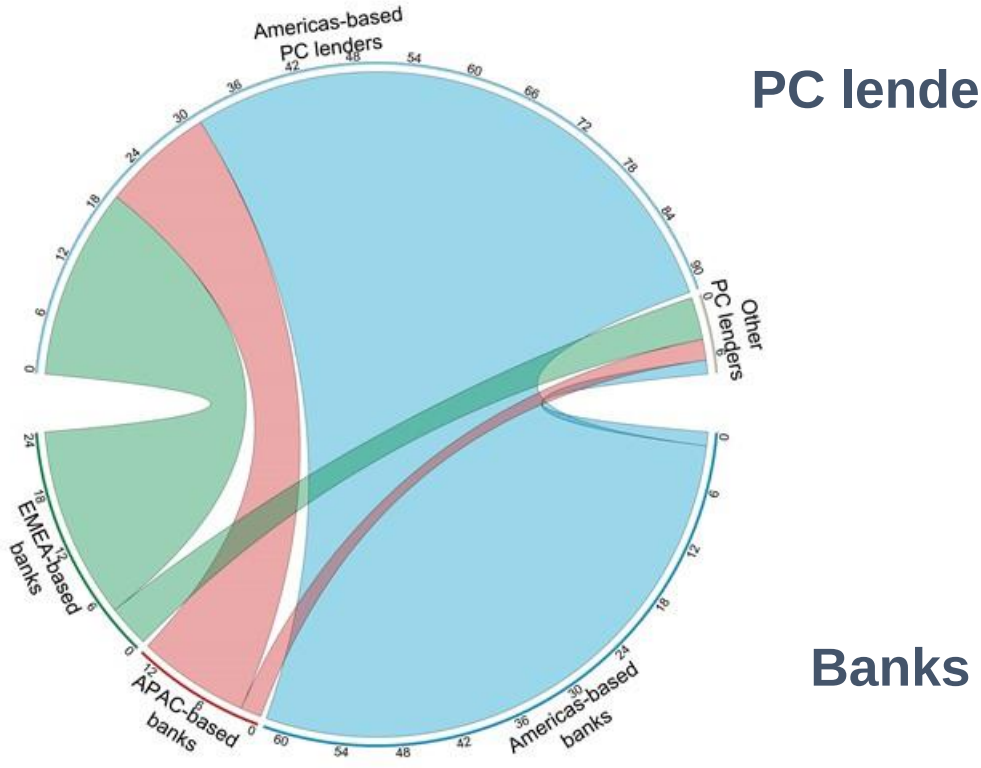


Chart 15b: Share of bank loans provided to PC lenders at the end of 2023, by regions of banks and PC lenders (%)



Note: The upper and lower halves of the circles represent PC lenders and banking groups, respectively. The circumference and thickness of each band is proportional to the total outstanding amount of loans provided by banks based in the indicated region to PC lenders in the indicated region. The colour indicates the region where banks are based.

Sources: Bloomberg, DealScan, Form 10-K, S&P Capital IQ, and HKMA staff estimates.

5. CONCLUSION

In conclusion, our analysis explores the inherently opaque interconnections between banks and the PC sector using a large sample of bank loans provided to PC lenders. Overall, our results suggest that banks currently face low contagion risks due to their loans provided to PC lenders, despite the sector's rapid growth over the past decade.

From the perspective of financial stability, however, some developments warrant closer monitoring. From our findings, we identify three emerging trends related to the interconnections between banks and the PC sector: (a) the larger participation of less capitalised banks, (b) loosened underwriting standards of PC lenders, and (c) rising spillover risks to APAC-based banks. These trends may amplify the transmission of shocks from the PC sector to the global banking sector if they continue to evolve.

Finally, partly due to the inherent opacity of the PC sector, our analysis may not have been able to capture all bank loans provided to PC lenders. Although our sample size is comparable to some market estimates, readers should interpret our results with caution due to potential data gaps.

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