LONDON—Some large European banks are using cheap loans from the European Central Bank to insulate themselves from new problems that could flare up in their businesses in financially ailing European countries.

Banks including Barclays PLC, Lloyds Banking Group PLC, Crédit Agricole SA and KBC Group NV have borrowed billions of euros under the ECB's three-year-loan program through their subsidiaries in Spain, Portugal, Greece and Ireland. The goal is to make those units more financially self-sufficient.

Bank officials and outside experts say the strategy is an effort to limit the parent companies' exposure to their far-flung subsidiaries in case the local economies deteriorate further. It also would make it easier to sever ties with the subsidiaries if, in an extreme case, one of the countries were to leave the euro zone, they say.

"It doesn't signal confidence," said Philippe Bodereau, a managing director with bond-fund manager Pimco. "It's also pretty cheap self-insurance [and] helps banks disentangle themselves" from their subsidiaries.

The ECB has been doling out the three-year loans in an effort to avert a catastrophic cash crunch as European banks, locked out of traditional funding markets, struggled to repay waves of maturing debts.

The ECB offered two batches of the loans—first in December and again last week—with low 1% interest rates. Any bank based in the euro zone or with a locally incorporated business there could borrow virtually unlimited sums. In December, 523 banks borrowed €489 billion ($645.5 billion); last week, 800 banks borrowed €530 billion.

A key secondary goal of the ECB was for banks to use the funds to lend money to cash-strapped European governments, businesses and individuals. The question of what banks will do with the funds has emerged as a key uncertainty surrounding the lending program. The banks are allowed to deploy the money however they want. Their ECB borrowing strategy for the peripheral units is one indication of how the goals for the program might be difficult to attain.

A popular move among some banks has been for their subsidiaries in troubled European countries to borrow directly from the ECB. The parent companies could then stop plunking down as much of their own money to bankroll the units' daily operations.
That has at least two advantages. First, the 1% interest rate is well below what banks, especially those in countries like Greece, Ireland and Portugal, would have to pay to borrow from the markets.

More important, it allows the parent companies to distance themselves from their struggling subsidiaries, say banks and industry analysts. Some banks express worry it will be hard to extract money they plow into subsidiaries in the event of a euro-zone breakup or if the parent company decides to shut down its local business. Banks such as France's Crédit Agricole have already lent well over €10 billion to their peripheral-European arms to keep them afloat. Other banks are winding down subsidiaries and selling assets, and the ECB loans allow them to cheaply finance the businesses in the meantime.

Some experts say the tactic of using ECB loans to finance local subsidiaries has taken hold partly in response to pressure from various countries' regulators that want banks to reduce their vulnerability to further financial commitments to peripheral-European subsidiaries. Regulators in some northern European countries are imposing tougher capital and liquidity requirements on banks that don't limit exposures to those units, according to UBS analyst Alastair Ryan.

Banking experts say it isn't clear what obligations banks would face to bail out their subsidiaries if they failed to pay back the ECB loans.

The ECB borrowing strategy "may or may not shift significant risk, but if the bank's regulator thinks it does then it will have a beneficial impact on the capital and funding needs of the parent," Mr. Ryan said. "This funding transfers tail risk to the euro-system...from the private sector." He estimated that as much as 11% of the €530 billion doled out last week could be used as a substitute for parent-company funding of local subsidiaries.

Barclays said Friday that its Spanish subsidiary, which has racked up billions of euros in losses and has needed to be financially supported by its British parent, borrowed €6.2 billion from the ECB. Its Portuguese unit took €2 billion. The parent didn't borrow.

Barclays said in a statement that the money "will provide funding stability to those businesses" while they're being restructured. A person familiar with the matter said the borrowings were part of a risk-management strategy aimed at limiting fallout from any further Spanish and Portuguese losses.

Belgium’s KBC borrowed about €3 billion from the ECB last December through its Irish banking subsidiary. KBC borrowed another €5 billion last week but hasn't disclosed what parts of the international group took the money.

A KBC spokeswoman said the Irish unit borrowed last December in order "to be more self-sufficient...and to make it less-reliant on group funding."

Lloyds borrowed £11.4 billion ($18 billion) through one or more euro-zone subsidiaries. Chief Executive António Horta-Osório said last month that the bank planned to use the funds "to ring-fence noncore European assets" in Ireland, Spain and the Netherlands. The British parent company, which is trying to reinvent itself as a safer and slimmer bank, is shutting those businesses in coming years. Meantime, the ECB loans mean Lloyds won’t have to tie up its own resources in those businesses.

Crédit Agricole, one of France's biggest banks, has used ECB loans to whittle down its financial exposure to its troubled Greek subsidiary, Emporiki. After extending more than €10 billion of loans to Emporiki, Crédit Agricole last year decided essentially to cut its losses and is instead trying to get central banks to lend money to Emporiki. Due to its foreign ownership, though, the Greek central bank has barred Emporiki from borrowing from an emergency-lending facility that other Greek banks have been tapping, according to a person familiar with the matter.

But Emporiki borrowed from the ECB. At the end of December, after the ECB's first batch of three-year loans, Emporiki had borrowed €1.8 billion from the ECB, according to Crédit Agricole. Crédit Agricole, meanwhile, reduced its loan exposure to Emporiki to €5.5 billion. It is unclear how much Emporiki borrowed from the ECB.
last week.

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