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Significance of restart of asset securitization in China

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Executive Summary



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Resumed asset securitization is garnering attention in China. With adequate information disclosure, securitization is likely to alleviate China's shadow banking problems as a new funding channel.

Authorities pursuing efficient fund utilization

Chinese financial markets were roiled by volatility in June as short-term interest rates spiked. This episode was most notably distinguished by fact that the People's Bank of China (PBoC) refrained from supplying liquidity to the banking system. The PBoC apparently places more priority on curbing credit expansion, including growth in banks' off-balance-sheet lending, than on stabilizing interest rates. Meanwhile, with the Chinese economy in the midst of a slowdown, Chinese authorities are seeking to improve the credit mix without increasing the overall quantity of credit much. The authorities are placing priority on financing for cash-strapped SMEs and the rural economy (agriculture, rural communities and peasants).

History and current state of asset securitization in China

Against such a backdrop, the State Council issued Guidelines on Financial Support for Adjusting, Transforming and Upgrading the Economic Structure in July. The Guidelines state that China will steadily promote credit asset securitization as a routine practice to stimulate funding by financial institutions and support microenterprises' growth.

Asset securitization is thus capturing attention from the standpoint of macroeconomic management also. Broadly speaking, asset securitization in China has historically taken two forms: credit asset securitization in the interbank market and corporate asset securitization by securities firms (see table).

Securitization in the interbank market dates back to 2005, when the PBoC and China Banking Regulatory Commission (CBRC) jointly issued Administrative Rules for the Credit Asset Securitization Pilot Program. The first credit asset securitization followed

NOTE

1) China Development Bank and China Construction Bank respectively issued RMB4,177 million of ABS and RMB3,017 million of MBS on December 15, 2005.

2) Per Shanghai Clearing House. In 2005-08, 11 securitizations totaling RMB66.783 billion were issued.

3) Per Shanghai Clearing House.

soon thereafter in December 2005¹⁾. From 2009, however, asset securitizations were halted in the wake of the international financial crisis.

Credit asset securitizations resumed in May 2012, when the PBoC, CBRC and Ministry of Finance jointly issued a Notice on Matters Concerning Further Expansion of the Credit Asset Securitization Pilot Program, announcing a new pilot program with a RMB50 billion limit. As of July 24, 2013, 23 credit asset securitizations totaling RMB22,854 million have been originated²⁾.

While securitization of credit assets is currently still in the pilot phase in China, the authorities aim to make it a routine practice as noted above. Most credit asset securitizations' underlying assets are loans to large corporations, but the aforementioned Guidelines have opened the door to securitization of loans to microenterprises also.

In the interbank market, the China Interbank Dealers Association published a manual for issuing nonfinancial corporate asset-backed notes (ABN), another securitization product, in the interbank market in August 2012, thereby enabling issuance of such ABN. As of July 24, 2013, a total of 29 such ABN deals with an aggregate face value of RMB9.7 billion have been issued³⁾.

In the securities company sector of the securitization market, the first pilot corporate asset securitization took place in August 2005. There were subsequently no notable developments until March 15, 2013, when the China Securities Regulatory Commission (CSRC) issued Securities Company Asset Securitization Regulations,

Table: History of asset securitization in China

Interbank market	
Apr. 2005	PBoC and CBRC issue Administrative Rules for Credit Asset Securitization Pilot Program and launch initial pilot program with RMB15bn limit
Dec. 2005	China Development Bank issues RMB4,177mn of ABS; China Construction Bank issues RMB3,017mn of MBS
Apr. 2007	Second securitization pilot program launched with RMB60bn limit
2009	Securitized product issuance ceases in aftermath of global financial crisis
May 2012	PBoC, CBRC and Ministry of Finance issue Notice on Matters Concerning Further Expansion of Pilot Credit Asset Securitization Pilot Program and launch third pilot program with RMB50bn limit
Securities companies	
Aug. 2005	Pilot securitization program launched. First deal is CICC's securitization of China Unicom CDMA network capacity rental revenues
May 2009	CSRC issues Manual for Securities Company Corporate Asset Securitization Pilot Program
Mar. 2013	CSRC issues Securities Company Asset Securitization Regulations, upgrading asset securitization to a routine business process

Source: NRI, based on China Financial Market Development Reports, CSRC website, and media reports

4) See <http://www.nri.co.jp/english/opinion/lakyara/2013/pdf/lkr2013165.pdf>.

5) Other priorities include asset management, bond markets, pilot operation of an OTC market, organizational reforms, and corporate governance.

6) Securities companies use separate-account asset management plans as special-purpose vehicles for their asset securitizations.

which took effect immediately, as part of a deregulation initiative⁴⁾. The regulations upgraded asset securitization from a pilot program to a routine business practice, resulting in a pickup in securities firms' securitization activity. While risk management was at the forefront of this May's Conference on Innovation and Development of Securities Companies, asset securitization is one key focus of securities industry innovation in 2013⁵⁾.

As of July 2013, a total of 17 separate-account asset management plans with aggregate assets of over RMB35 billion have been originated⁶⁾. Their underlying assets include leases and rights to water treatment fee revenues. Recently, Orient Securities Asset Management Co. received CSRC approval for the Alibaba Separate-Account Asset Management Plan, China's first asset securitization product backed by microloans.

Future prospects and challenges

Resumption of asset securitization appears to be related to growth in banks' off-balance-sheet lending, which is at the core of China's shadow banking problems. While the motivation behind banks' off-balance-sheet lending is regulatory circumvention, de facto securitization techniques are often employed in such off-balance-sheet deals. The more stringently the authorities regulate on-balance-sheet or off-balance-sheet lending, the more banks devise new off-balance-sheet lending schemes. Where risks reside is consequently become less transparent. In response, the regulatory authorities likely decided that it would be better to restart legitimate asset securitizations based on thorough information disclosure.

A positive aspect of asset securitization is its likelihood of stimulating utilization of funds as intended by the authorities. In particular, it could open up a new channel of corporate finance. If the underlying assets are of high quality, companies can raise funding through securitization even if they do not have a good credit rating themselves. Securitization consequently holds promise from the standpoint of SME finance in particular, as mentioned above. For securities companies, use of separate-account asset management plans is a new way to finance companies without issuing equity or bonds. This is very significant from the standpoint of business diversification.

Negatives include that asset securitization products are currently largely illiquid and involve a high issuance costs. Additionally, securitized product investors lack diversity. They are mostly banks. However, these negatives are to some extent inevitable given

asset securitization's early stage of development in China. As issuance increases, liquidity is likely to improve. Securities firms should be able to utilize their own OTC market, likewise a new undertaking, to make markets in securitized products.

The biggest concern is ensuring that asset securitization is not utilized as a new means of circumventive finance (e.g., for local government financing vehicles) amid the regulatory clampdown on off-balance-sheet lending. Some observers are optimistic about asset securitization's prospects of helping to meet government demand for funds for urbanization projects. If information disclosure and pricing based thereon remain inadequate, the existing lack of clarity about where risk resides and how to assess it will persist. Additionally, if securitized product investors become more diverse, risk will become more dispersed. Information disclosure about securitized products' underlying assets should improve transparency in comparison to existing off-balance-sheet loan transactions.

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