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# Alibaba Microfinance's asset securitizations

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## Executive Summary



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*Asset securitization is garnering renewed attention as the Chinese government attempts to revitalize existing financing channels in response to an economic slowdown. Against such a backdrop, Orient Securities and Alibaba have issued China's first securitized product backed by microloans.*

### China's first microloan securitization

With Chinese economic growth slowing, the Chinese government, led by Premier Li Keqiang, has adopted a policy of stimulating the economy by revitalizing existing financing channels without resorting to large-scale fiscal stimulus. Guidelines on Financial Support for Adjusting, Transforming and Upgrading the Economic Structure issued by the State Council on 1 July state that the government plans to promote credit asset securitization as a routine practice to stimulate funding by financial institutions and support microenterprises' growth. Asset securitization has since been garnering renewed attention in China.

Asset securitization in China can be divided into two broad categories: credit asset securitization in the interbank market and corporate asset securitization by securities firms<sup>1)</sup>. In recent years, both types of securitization deals slowed to a trickle until May 2012, when asset securitization resumed in the interbank market on a pilot basis. In March 2013, regulators designated asset securitization as a routine business for securities firms<sup>2)</sup>. On July 26, 2013, the China Securities Regulatory Commission (CSRC) announced that it had approved 17 securitized products originated by eight securities firms and was reviewing seven additional products. Many of the products are securitizations of physical assets' income streams.

With the government focusing on financing for microenterprises as a policy priority, Orient Securities Asset Management received CSRC approval for the Alibaba Separate-Account Asset Management Plan on June 25, 2013. The plan's underlying assets are unsecured microloans. The Alibaba plan is China's first securitization of microloans by a securities firm. Although loans to SMEs had previously been securitized<sup>3)</sup>, the Alibaba plan is significant in that its underlying assets' scope was

#### NOTE

1) See "Significance of restart of asset securitization in China" (<http://www.nri.com/global/opinion/lakyara/2013/pdf/lkr2013176.pdf>).

2) Securities firms were previously permitted to securitize assets on a pilot basis from August 2005.

3) Zheshang Bank's First SME Loan Securitization Trust (originated in 2008).

**Exhibit 1. Orient Securities/Alibaba's first securitized issue**

Tranche	Maturity	Rating	Projected return (p.a.)	Par value per bond (RMB)	Total par value (mn RMB)
Senior	Oct. 28, 2014	AAA	6.2%	100	375
Mezzanine	Oct. 28, 2014	Unrated	11.0%	100	75
Junior	Oct. 28, 2014	Unrated	Undisclosed	100	50
Total					500

Source: NRI, based on information from Orient Securities Asset Management's website

broadened to encompass loans to microenterprises and sole proprietors.

The Alibaba plan consists of 10 separate issues, each with RMB200-500 million of asset-backed securities maturing in 1-2 years. The issues' senior tranches will be sold to ordinary investors while the junior tranches will be purchased by Alibaba. The senior securities' projected yield is 6.2%. The senior-most securities will have a AAA rating, better than privately issued bonds' average rating (AA) (Exhibit 1). Interest rates on the securitized microloans are estimated at 18-21%<sup>4)</sup>.

4) Per media reports.

Orient Securities Asset Management announced that the securities issued in the Alibaba plan's first issuance will trade on a Shenzhen Stock Exchange trading platform launched on July 29.

## Alibaba Microfinance

For Alibaba, the plan is an important financing source that will increase its lending capacity.

Alibaba's e-commerce platforms (Alibaba (B2B), Taobao Marketplace (C2C), and Tmall (B2C)) are used mainly by microenterprises and individuals operating businesses. Microenterprises and individuals' inability to obtain bank financing to expand their businesses is a constraint on Alibaba's growth. In response, Alibaba founder Jack Ma founded Alibaba Microfinance to provide small loans to microenterprises and individuals, vowing that Alibaba would change banking if banks themselves refuse to change.

In April 2010, Alibaba Microfinance began providing "Taobao Loans" to Taobao.com and Tmall.com merchants. It subsequently set up a microlending subsidiary in Zhejiang Province in June 2010 and another in Chongqing in June 2011, the same

**Exhibit 2. Alibaba Microfinance**

	Eligible borrowers	Geographic scope	Credit screening	Max. loan (RMB)	Max. term
Taobao Loans	Taobao/Tmall merchants	Nationwide	Online	1mn	12mo
Alibaba Loans	Alibaba merchants	Shanghai, Beijing, Tianjin; and Zhejiang, Shandong, Jiangsu and Guangdong Provinces (as of August 13, 2013)	Online + in person	1mn	12mo

Source: NRI, based on information from Taobao Loan and Alibaba Loan websites

month that it began offering "Alibaba Loans" to Alibaba.com merchants. For Taobao Loans, Alibaba Microfinance checks prospective borrowers' credit history and the state of their businesses. It processes loan applications online and offers unsecured loans to Taobao.com merchants throughout China. For Alibaba Loans, by contrast, Alibaba Microfinance personnel sometimes visit the borrower's place of business as part of the credit screening process. Alibaba Loans' availability is limited to certain cities and provinces (Exhibit 2).

On July 12, Alibaba Microfinance announced that as of June 30, 2013, it had extended a cumulative total of over RMB100 billion of microloans to over 320,000 microenterprises and individuals. The default rate on its microloans is 0.87%.

5) Per the Alibaba Group's website.

As of year-end 2012, 11.3 million companies had set up shop as Alibaba.com merchants<sup>5)</sup>. How to meet these companies' heavy demand for funding is a major issue for Alibaba. Due to leverage restrictions imposed by the China Banking Regulatory Commission (CBRC) and People's Bank of China's Guidance on Microloan Companies' Pilot Operations<sup>6)</sup>, microfinance companies' lending capacity is constrained by their capital. Alibaba Microfinance's securitizations will be an important means of increasing its lending capacity through securitization of microloans and rollover issuance of securitized products.

6) Issued on May 4, 2008. Microloans companies' bank borrowings are prohibited from exceeding 50% of their capital. The aforementioned Alibaba Microfinance subsidiaries in Zhejiang Province and Chongqing have capital of RMB600 million and RMB1 billion, respectively.

### Microloan securitization's future prospects and challenges

One key issue facing microloan securitization is risk control. Microloans are characterized by easy accessibility and repayment. They can be taken out and repaid at any time. Loan terms are consequently relatively short, generally ranging from a few days to several months. In other words, microloan securitizations' underlying assets could vary substantially due to borrower behavior. Alibaba Microfinance's securitizations received CSRC approval presumably because the Alibaba Group is

6) Unified taxation of financial income, effective from 2016, could reduce foreign-currency money market funds' advantage over foreign-currency deposits.

able to manage risk and maintain its credit rating by virtue of its large size and financial strength. Few other companies are able to imitate Alibaba.

A second issue is development of a regulatory framework for microlending. China has not yet established regulations for online microlending by the likes of Alibaba. In August 2013, the State Council formed a research team to study online finance's development and state of regulatory supervision. The team comprises representatives from seven regulatory agencies, including the People's Bank of China, CSRC, CBRC, and Ministry of Public Security. The government is apparently preparing to regulate microlending by first ascertaining its current state through the research team.

In addition to Alibaba, other major e-commerce companies (e.g., Jing Dong, Suning) have also successively launched microlending businesses in pursuit of higher profits. Securing funding is a key issue for these companies also. If the government laws and regulations governing microloans and existing concerns about risk control and other matters are resolved, microloan securitizations are likely to increase in prevalence.

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