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Update Regarding Securitization in China

China issued a notice on May 17, 2012, jointly promulgated by the People's Bank of China (PBC), the China Banking Regulatory Commission (CBRC) and the Ministry of Finance (the Notice), re-launching its pilot securitization program.¹ This *DechertOnPoint* provides a brief overview of the relaunched pilot program and updates our April *DechertOnPoint* anticipating the program's planned rollout.²

The Notice marks a milestone in the development of asset-backed securitization in the country.³ Specifically, it allows qualified and approved financial institutions to once again issue asset-backed securities, since a similar program was suspended during the global financial crisis in 2008.⁴ The first phase of the new pilot program is expected to involve up to \$7.9 billion of securitized assets.⁵ The securitization initiative comes at a time when China looks for new ways to ease the credit pressure

on Chinese banks and free up capital to support growth.⁶

The Notice is addressed directly to the China Development Bank, Postal Savings Bank of China, policy banks, state-owned commercial banks, joint-stock commercial banks, financial asset management companies, accounting firms, trust companies, financial companies and automotive financial institutions, which are encouraged to apply to the CBRC for approval to participate as issuers in the new pilot program.⁷ In addition, the new pilot program targets as eligible for securitization basic infrastructure loans, auto loans, affordable housing construction loans, loans for small and medium-size enterprises (SMEs), etc., all of which are in line with the priorities of China's 12th Five-Year Plan.⁸ Accordingly, the China Construction Bank, the Agricultural Bank of China, and the China Development Bank and other banks with high exposure to these loans are expected to participate in the program.⁹

¹ Notice on Further Expanding the Credit Asset Securitization Pilot Program, May 17, 2012.

² See our *DechertOnPoint* entitled "[Securitization in China: Recent Developments](#)."

³ See Leslie A. Pappas, [China Moves to Renew, Expand Pilot Securitization Program for Credit Assets](#), Bloomberg BNA, July 10, 2012. Reproduced with permission from BNA's Banking Report, 99 BBR 79 (July 10, 2012). Copyright 2012 by The Bureau of National Affairs, Inc. (800-372-1033).

⁴ *Supra* note 2.

⁵ See Katie Chen, *Loan Securitization Proves Positive for Chinese Banks*, Shanghai Daily, June 15, 2012, citing Moody's Weekly Credit Outlook of June 11, 2012.

⁶ See *id.* See also Ma Nan, *China to Broaden Credit Asset-Backed Securitization*, Morning Whistle, June 4, 2012.

⁷ *Supra* note 1.

⁸ *Supra* note 1; see also Chen *supra* note 5.

⁹ Chen *supra* note 5.

In structuring a securitization under the new pilot program, a financial institution will transfer credit assets to a newly formed special purpose vehicle, just as with a typical securitization transaction.¹⁰ The prescribed form of special purpose vehicle (SPV) is a special purpose trust or other institution approved by the CBRC.¹¹ It is worth noting that the Notice allows non-banking institutions, such as insurance companies, mutual funds, and social security funds, to invest in the securities.¹² An SPV will use the proceeds from the assets to pay returns on the securities.¹³ The entire issuing and trading process is supervised by the CBRC, whose approval the participating financial institutions need to qualify for the program.¹⁴

In recognition of systemic risk concerns, the new pilot program adds a number of regulatory oversight and risk control measures.¹⁵ First, two credit rating agencies will rate the securitized assets and report their findings to China's financial regulators.¹⁶ Second, an originator must retain a certain portion of the lowest class of asset-backed securities issued in a single securitization, in principle, no less than five (5) percent of the total securities of each issuance, for the duration of such securities.¹⁷ Third, any financial institution is limited to holding no more than forty (40) percent of the total issuance of any security.¹⁸ Fourth, the trustee of an SPV must periodically and publicly disclose the performance of the underlying assets.¹⁹ Finally, the securities must

have simple and clear structures. Complicated structures such as re-securitizations or synthetic securitizations are not allowed.²⁰

The potential impacts on foreign-invested banks and foreign investors remain uncertain. On the one hand, existing legal framework on bank securitization allows any eligible financial institution to apply for the CBRC's approval without explicitly prohibiting foreign-invested banks (including solely foreign-invested banks, Sino-foreign equity joint banks and branches of foreign banks) from participating in the pilot program.²¹ On the other hand, as the CBRC's approval is granted on a case by case basis, practical obstacles (which may result from the limited business of such banks in China) may have led to the lack of active participation by foreign-invested banks in the previous rounds of the program. In addition, the limited scope of the financial institutions directly addressed by the Notice may indicate that most foreign-invested banks are beyond the focus of the new pilot program.²²

The trial program has been received in the financial press as another step in China's efforts to fight a deepening economic slowdown and bolster growth.²³ As reported in the *Wall Street Journal*, China cut interest rates in June for the first time since 2008 and loosened controls on banks' lending and deposit rates.²⁴ Against this backdrop, the new program is expected to open a path for easing the pressure on Chinese banks' liquidity and boost lending to SMEs and key industry sectors.²⁵

¹⁰ Administrative Measures For the Securitization of Credit Assets, April 20, 2005, art. 2, 13.

¹¹ *Id.* art. 3, 16.

¹² Chen *supra* note 5.

¹³ *Supra* note 10. art. 2.

¹⁴ *Supra* note 1.

¹⁵ See Chen *supra* note 5.

¹⁶ Qiu Chen, *Regulators Restart Loan Securitization Program*, People's Daily, June 05, 2012, available at <http://english.people.com.cn/90778/7835886.html> (noting that the 2005 start to the pilot securitization program required only one credit rating agency).

¹⁷ *Supra* note 1. See also Gao Changxin, [Securitization to Resolve Local Governments' Debt](#), China Daily, June 05, 2012.

¹⁸ *Supra* note 1.

¹⁹ Chen *supra* note 5.

²⁰ *Supra* note 1.

²¹ *Supra* note 3; *supra* note 10; Measures for the Pilot Supervision and Administration of the Securitization of Credit Assets of Financial Institutions, November 7, 2005.

²² *Supra* note 3.

²³ See Lingling Wei, [China to Start Trial Securitization Program for Banks](#), Wall Street Journal, June 18, 2012, (subscription only).

²⁴ *Id.*

²⁵ *Supra* note 6.



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