
CHAMBERS GLOBAL PRACTICE GUIDES



Securitisation 2023

Definitive global law guides offering
comparative analysis from top-ranked lawyers

China: Trends & Developments

Wen Li, Xin Zhang, Harold Shen and Wenyi Piao
Global Law Office

Trends and Developments

Contributed by:

Wen Li, Xin Zhang, Harold Shen and Wenyi Piao

Global Law Office see p.6

The Direction of China's Securitisation Market

China's economy continues to be heavily affected by COVID-19 in 2022. Accordingly, enterprises are faced with multiple difficulties, especially those in the real estate industry. As the risks taken by the real estate industry have been exposed speedily, the industry built around asset-backed securities (ABS) has been significantly affected. Compared with the previous year, the deal volume and size of both credit ABS issued by financial institutions and ABS issued by non-financial institutions declined sharply in 2022. In these circumstances, a series of regulatory measures for financial leasing and factoring business have been promulgated by Chinese financial regulators in the past three years, which had an increasing influence on the ABS industry. Meanwhile, in early 2022, the Supreme People's Court issued the Provisions of the Supreme People's Court on the Adjudication of Civil Compensation Cases Involving the Tort of Misrepresentations in the Securities Market which imposes great legal risks on underwriters, lawyers, accountants and rating agencies. How judges determine civil liability for misrepresentations of ABS has begun to attract a great deal of attention from investment banks and other advisors.

Credit asset securitisations

China's credit asset securitisation sector made its debut in 2005, was suspended in 2008 due to the financial crisis and restarted in 2012. In the past decade, the credit asset securitisation market has developed into the most significant component of China's asset securitisation market, under a regulatory framework with the People's Bank of China (PBC) and the China Banking

and Insurance Regulatory Commission (CBIRC) as the core regulators. So far, there are six types of products in the credit asset securitisation market, namely, residential mortgage-backed securities (RMBS), auto loans ABS, consumer loan ABS, small and micro-enterprise loans ABS, credit card receivables ABS, and non-performing loan ABS (NPL ABS). A total of 1,150 credit ABS were issued from 2011 to 2021, with the aggregated issuance scale over RMB5 trillion. Among them, RMBS and auto loans ABS are the largest securitisation products issued in terms of the issuance scale, thanks to the support from regulators.

The issuance scale of RMBS decreased rapidly in 2022, as a result of continued strengthening of financial policies in the real estate area in the first half of this year. RMBS issuance is expected to return to normal in 2023 as a set of new policies supporting sound development of real estate enterprises were introduced. Compared to RMBS, auto loan ABS remained solid in 2022, becoming the top product in terms of issuance scale. In particular, green ABS based on new energy vehicle loans have not only received strong support from financial regulators, but also attracted attention from international investors. In addition, in order to accelerate the resolution of problems derived from non-performing loans, NPL ABS have become the key task of the asset securitisation departments of Chinese commercial banks and achieved a new record of issuance. In the context of the issuance in 2022, in addition to credit card receivables non-performing assets, non-performing personal residential mortgage loans represent an increasing propor-

tion of the underlying assets in non-performing asset securitisations. This is primarily because of the seriously adverse impacts on borrowers' repayment ability caused by COVID-19 in the past three years. As for corporate loans securitisation products, only a small number of small and micro-enterprise loans ABS were issued in 2022, including non-performing small and micro enterprise loans ABS.

Business asset securitisation

The securitisation market in China consists of two separate markets: the market for ABS traded on the Shanghai and Shenzhen Stock Exchanges, and the market in asset-backed notes (ABN) traded in the China Interbank Bond Market. In the past five years, some of the exchange-traded ABS failed to pay principals or interests at maturity. Whether underlying assets are remote from bankruptcy of originators under the current structure of the deal in a Chinese securitisation is highly valued by the regulators. For instance, the Shanghai Stock Exchange further emphasises the principle of "true sale and bankruptcy remoteness" in its ABS Rules (draft for comments) recently released on 2 December 2022.

Green ABS

Under the influence of regulatory policy on real estate and local government debt, exchange-traded ABS trading decreased sharply in 2022. Financial leasing assets have become the most important type of underlying asset. Meanwhile, commercial mortgage-backed securities (CMBS), whose underlying assets are commercial mortgage loans, developed rapidly. In addition to the high quality of the target property, the determination of a "green" label is one of the most important reasons for the regulators to support CMBS. With the policy of "carbon dioxide emission and carbon neutrality", China's economy is entering a period of deepening green

development, and financial regulators intend to guide funds to support the development of the green economy. In addition, it is worth noting that in the past five years, financial leasing companies and factoring companies have acted as originators in a large number of ABS while the real financiers were actually real estate enterprises and urban investment companies controlled by local governments. Therefore, when the central government makes adjustments to real estate policy or local government debt policy, the asset securitisation market is bound to fluctuate accordingly. In the authors' opinion, it is likely that China's asset securitisation market will develop rapidly under such policies in the next two years.

Asset-backed commercial paper and quasi-REITs

The National Association of Financial Market Institutional Investors (NAFMII) launched its scheme for asset-backed commercial paper (ABCP) in June 2020. The issuance scale of ABCP in the China Interbank Bond Market increased greatly in 2022. However, unlike the US market where the originator of ABCP is a commercial bank, the originator of Chinese ABCP is a non-bank commercial enterprise. While these enterprises own the relevant underlying assets according to ABCP regulatory requirements, they can quickly raise funds through simpler financing instruments. Therefore, the outlook for China's ABCP market remains to be seen. NAFMII also gave major support to quasi-real estate investment trusts (quasi-REITs) and commercial mortgage-backed notes (CMBNs). Any enterprise that owns utility infrastructure, transportation infrastructure, warehousing and logistics, industrial parks or commercial real estate can raise funds through a quasi-REIT or CMBN, as long as it is in line with major national strate-

gies and policy requirements, especially green economy policies.

Infrastructure securities investment funds (Infrastructure REITs)

In China, REITs are deemed as securitisation of real estate and constitute a component of the asset securitisation market. Currently, the only type of REIT that can be publicly offered and traded on the stock exchange for public investors is the infrastructure REIT. Any issuance of infrastructure REITs must first obtain approval from the National Development and Reform Commission (NDRC) on whether the target infrastructure assets are compliant with the regulatory criteria, before an application for issuance can be made to the China Securities Regulatory Commission (CSRC) and then an application for listing on the stock exchange. The NDRC has been actively promoting the participation of local governments and state-owned enterprises in infrastructure REIT applications in the first half of 2022, and further clarified that private enterprises participating in REIT pilots should also be encouraged. The infrastructure assets that can be issued as REITs have been expanded to affordable rental housing assets and new energy assets such as wind power and hydroelectric facilities. Meanwhile, in order to lower the tax risk of REITs, the Ministry of Finance (MOF) and the State Taxation Administration (STA) issued the Announcement on Tax Policies for the Pilot Programme of Real Estate Investment Trusts in the Infrastructure Sector on 29 January 2022, which, to some extent, clarified the taxation standards for some REITs. However, given the complex legal structure of current China-REITs, the tax risks around REITs cannot be fully resolved in a short period of time.

The outlook for regulation

Although the 2019 revision of the Securities Law of the People's Republic of China placed asset-backed securities under the regulation of the Securities Law, there are still no uniformly applicable legal rules for the entire asset securitisation market, including without limitation rules on special purpose vehicles and asset sale. It is still the regulatory rules set by the CSRC, PBC and CBIRC that have the greatest impact on asset securitisation.

CBIRC

On 28 November 2022, CBIRC officially released the Notice of Issues Concerning Strengthening the Compliance Regulation of the Financial Leasing Business of Financial Leasing Companies on its website, which had already been practice since February 2022. The Notice clearly requires financial leasing companies to abandon the “quasi-credit” business concept, but to focus on the function of “leasing assets” in a manner complementary with traditional banking business. It is strictly prohibited to include the following in the scope of leased objects: roads, municipal pipelines, water pipelines, bridges, dams, weirs, waterways, holes, non-equipment property under construction, and structures which are suspected of increasing local government hidden debts or which may affect the normal supply of public services after being disposed of. Although the notice is aimed at financial leasing companies, it will certainly affect other leasing companies which are not of a financial nature in the securitisation market. Moreover, CBIRC is expected to soon require other leasing companies to abandon the “quasi-credit” concept. Therefore, in the near future, the structured financial products of “quasi-credit” assets can no longer label themselves as a type of “asset securitisation” in the Chinese market.

Stock Exchanges and NAFMII

The Shanghai and Shenzhen Stock Exchanges released the Asset-Backed Securities Rules (draft for comments) on their respective official websites, on 2 December 2022, under the unified arrangement by CSRC. One of the main purposes of the stock exchanges rules is to “further strengthen the asset credit and bankruptcy remoteness system and enhance investor protection”. The formulation of the new rules crystallises the regulatory experience since the CSRC relaunched the asset securitisation market in 2014, for example, defining which institutions are information disclosure obligors in the practice of asset securitisation. It will certainly have a positive effect on clarifying the duties and legal responsibilities of each participating institution in asset securitisation.

NAFMII may also revise its asset securitisation rules in conjunction with experience in the practice of ABCP.

The Supreme People’s Court

The Supreme People’s Court released the Interpretation of the Supreme People’s Court on the Application of the Part on Contracts of the Civil Code of the People’s Republic of China (Draft for Comments) on 4 November 2022. The judicial interpretation aims to further clarify some specific issues involved in the transfer and assignment of contractual rights and obligations, in particular the effectiveness of assignment notice for claims. For example, Article 50 of the draft judicial interpretation provides that “if the assignee sues the debtor to perform the obligation, but has no evidence to prove that the creditor or the assignee has notified the debtor [of the assignment], the people’s court shall support the claim that the notice of assignment is effective when the copy of the statement of claim is served.” If the above provision is retained in the final version of the judicial interpretation, it will certainly play a positive role in properly resolving the issue of notice in relation to the transfer of underlying assets in asset securitisation transactions.

Contributed by: Wen Li, Xin Zhang, Harold Shen and Wenyi Piao, Global Law Office

Global Law Office (GLO) dates back to the establishment of the Legal Consultant Office of China Council for the Promotion of International Trade (CCPIT) in 1979. It was the first law firm in China to take an international perspective on its business, fully embracing the outside world. With more than 500 lawyers practising in the Beijing, Shanghai, Shenzhen and Chengdu offices, it is known as one of the leading Chinese law firms and continues to set the pace as the PRC's most innovative legal practitioner. Since China's first IPO, GLO has assisted numerous companies to gain finance from the domestic

and overseas capital markets. Its securitisation team consists of over 40 partners who are experienced in handling highly complex, structured transactions, advising underwriters and issuers in both debt and equity capital markets. Areas of expertise include domestic and overseas IPOs, offering and listing of conventional and structured fixed-income products, post-IPO financings, mergers and acquisitions of listed companies, restructuring and reorganisation of listed companies, and compliance and corporate governance of listed companies.

Authors



Wen Li is a partner at Global Law Office based in Beijing. His practice covers capital markets, M&A, structured finance and securitisation, financial investment, and VC and PE. In

the area of capital markets, Mr Li has participated in the IPOs of Chinese enterprises on both the Shanghai and Shenzhen Stock Exchanges. In the area of securitisation, Mr Li's representative clients include Agricultural Bank of China, Shanghai Pudong Development Bank, China Development Bank and other Chinese financial institutions. Mr Li is a member of the Securitisation and Structured Finance Committee and the Legal Committee of the National Association of Financial Market Institutional Investors of the PRC.



Xin Zhang is a partner at Global Law Office based in Beijing. He provides legal services for Chinese and international banks and investors in relation to banking and finance, M&A, FDI

and overseas investment, with extensive coverage of the financing, energy, power, real estate and natural resources sectors. In the area of banking and finance, Mr Zhang has represented most of the Chinese and international banks, international financial institutions and ECAs active in the Chinese market and advised on syndicated loans, project financing, structured trade financing, vessel and aircraft financing, export credit loans and financial derivatives.

CHINA TRENDS AND DEVELOPMENTS

Contributed by: Wen Li, Xin Zhang, Harold Shen and Wenyi Piao, Global Law Office



Harold Shen is a partner at Global Law Office based in Shanghai. His practice areas include capital markets, mergers and acquisitions, private equity and venture capital and FDI.

Harold has participated in numerous public offerings of Chinese enterprises on both domestic and international stock exchanges, and has provided legal services to clients from incorporation to public offerings, and subsequent acquisitions and daily operations. His client portfolio covers a diverse sector range including pharmaceuticals, financial services, education, consumer products, real estate, energy, logistics, retail and media. Harold has also represented foreign and domestic PE/VC firms in their investments in China in various sectors.



Wenyi Piao is a partner at Global Law office based in Beijing and specialises in securitisation and structured financing. Wenyi Piao is deeply involved in the field of corporate

asset securitisation and is familiar with various types of basic assets. Wenyi Piao has successfully handled more than 200 cases in the securitisation projects of assets including real estate, supply chain, infrastructure, consumer finance, accounts receivable and trust beneficiary rights, with a total project scale of more than RMB500 billion. Wenyi Piao has served several representative projects in the development of China's securitisation market.

Global Law Office

15&20/F Tower 1, China Central Place
No. 81 Jianguo Road Chaoyang District
Beijing 100025
China

Tel: +86 10 6584 6688
Fax: +86 10 6584 6666
Email: global@glo.com.cn
Web: www.glo.com.cn



环球律师事务所
GLOBAL LAW OFFICE

CHAMBERS GLOBAL PRACTICE GUIDES

Chambers Global Practice Guides bring you up-to-date, expert legal commentary on the main practice areas from around the globe. Focusing on the practical legal issues affecting businesses, the guides enable readers to compare legislation and procedure and read trend forecasts from legal experts from across key jurisdictions.

To find out more information about how we select contributors, email Katie.Burrington@chambers.com