China Banking and Insurance Regulatory Commission: Follow Up Questions
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SFA CEO Michael Bright met with the China Banking and Insurance Regulatory Commission (CBIRC) during a recent visit to Beijing. The CBIRC reached out to SFA for additional context on a variety of securitization-related questions. This document provides SFA’s feedback to the CBIRC. We look forward to continued productive engagement with the Chinese regulatory community.

1) 企业ABS的国际比较

Please compare enterprise ABS in China and similar products in other countries.

- It is our understanding that three platforms are used for issuing structured finance products in China. These distinctions are partly drawn based on how they are regulated, who originated the assets, and how the notes are traded.
  - Credit Asset Securitization (CAS) – mostly consumer credit like auto and housing loans, but occasionally corporate loans, e.g. CLOs;
  - Asset Backed Specific Plan (ABSP), also known as enterprise or corporate ABS, whose underlying collateral are mainly corporate cashflows or cash flows derived from commercial assets/receivables; can also include some consumer finance assets; and
  - Asset Backed Notes (ABN)

- Some of the ABS issued under the ABSP are similar to corporate/commercial asset securitizations seen in the US which include various equipment (agriculture, construction, small ticket) lease ABS, aircraft lease ABS, SMEs, premium finance, fleet leasing, and wireless towers. However, in China, the three largest asset classes - by recent issuance size - under ABSP (i.e. enterprise ABS) are supply chain finance and receivables (a large portion is for financing property companies), finance leasing, and marketplace loans. Unlike in China, where the issuance under ABSP is now more than half of the market, the issuance volume for corporate and commercial asset securitization in the U.S. is much smaller than that for consumer assets, partly because of the large role played by government agencies in the consumer debt market and the active direct market channels of financing for corporations in the US.
  - Enterprise ABS has seen ongoing discussion regarding the legal separation of assets being securitized from the sponsor and the asset/project manager. On 1 November, the Intermediate People’s Court of Wuhan City of Hubei Province issued a ruling affirming a claim by Shanxi Securities, the project manager on a lease securitization issued under the Asset Backed Specific Plan (ABSP) scheme, on the deal’s funds in escrow. The court ruled that the escrowed funds should not be subject to a freeze order because of a dispute between the deal’s originator and servicer, Rongxin Leasing Co., and one of its creditors. The ruling is
Credit positive for the Chinese structured finance sector because it signals the court’s recognition that receivables securitized by the originator are segregated from the originator’s other assets and should not be accessible to creditors.

The ruling marks the first time a Chinese court has affirmed the effective segregation of funds in an escrow account associated with a securitization transaction under the ABSP scheme. However, the court was silent on whether it recognized the true sale of securitized assets or bankruptcy remoteness in an ABSP securitization such as this and on the criteria for such recognition. While the ruling is not sufficient to clarify the many legal uncertainties in the ABSP and the Chinese structured finance sector in general, it is a step forward.

• CLOs in China are backed by loans originated by a bank and sponsored by the bank, and generally a credit (bank) ABS product, motivated by regulatory capital and funding needs. They are different from CLOs in the US, which typically source low-rated syndicated loans traded in the market from multiple lenders. See more details in a Moody’s sector comment detailing the differences between the two CLO sectors: China’s Developing CLO Sector Poses Vastly Different Credit Risks from US Market.

• It is important to note that many Chinese market features, including types of ABS, do not have one-to-one correspondence with the US market. Additional details around securitization as a funding source for China’s economy may be found here and here while details around legal and rating developments within the China securitization market may be found here.

2) 对中国ABS市场的意见和建议。信贷资产证券化在发行及交易环境、基础设施、政策支持等方面，需提升完善的空间

What suggestions will SFA make for China’s ABS market? In the scope of Credit Assets ABS in China, what are the main concerns and suggestions regarding the improvements in the issuance and trading environment, infrastructures, supporting policies and etc?

• If executed responsibly, securitization can play a vital role in the provision of credit to China’s real economy, supporting Chinese consumers and businesses by funding their borrowing in different areas including residential mortgages, credit cards, auto loans, and SMEs loans. Consumer consumption is becoming an increasingly important driver in China’s growth, and securitization can play a significant role in providing liquidity to lenders and by extension to the households. As stated in a March 2019 Moody’s report, “Securitization is playing a growing role in providing liquidity to the household sector through the issuance of RMBS and ABS on the interbank market.” Given continued migration to and expansion of urban centers, CMBS and multifamily securitization is likely to also be increasingly important.

• Continued growth of responsible securitization in China will require continued improvements in secondary market liquidity, a broader investor base with different risk appetites, and easier access for foreign investors. https://www.moodys.com/researchdocumentcontentpage.aspx?docid=PBS_1162281
In addition, many of the U.S. based ABS issuers rely on both term capital markets ABS and private committed warehouse ABS for their funding sources. We believe an important development in the China market would be the expansion of the private warehouse ABS market or ABL financing channel which would improve diversity of funding sources and also provide important liquidity for issuers. For example, many U.S. auto captive finance companies utilize private warehouse ABS facilities for liquidity purposes. Lenders under these private facilities provide committed credit lines that allow issuers to issue ABS at committed pre-determined pricing. For issuers, these ABS private facilities provide certainty of funding which they can use as backstop liquidity to protect against the risk of any disruptions in the public capital markets. We believe that such private ABS facilities would also represent an important liquidity function for non-bank financial companies in China. Another option to improve diversity of funding sources and provide more liquidity, and similar in many respects to the warehouse structures, are asset backed commercial paper (ABCP) conduits. An ABCP conduit is structured to be a bankruptcy-remote SPE that issues commercial paper which then uses the proceeds to purchase interests in different types of assets. These conduits typically receive liquidity and/or credit support from a bank lender. More information on ABCP conduits can be found in Section IV.B.7.e of our Comprehensive Guide to US Securitization.

A Moody's report in early 2019 indicated that amid strong economic growth in recent years, total US debt outstanding across the commercial real estate (CRE), corporate and consumer sectors has surpassed pre-crisis peaks. Securitization issuance has also increased, largely owing to government-backed deals, such as agency RMBS. In fact, securitization funded more than 50% of the US household debt at the end of 2018, mostly through agency RMBS. That said, private-label issuance has increased over the last two years, as the Exhibit below shows, rising to approximately 11% of total bond issuance in 2018, from 6% in 2016, driven largely by heavier volumes in private-label RMBS, consumer ABS and CLOs, and reduced issuance in agency RMBS and corporate bonds. The contribution of private-label RMBS and CLOs combined to the US capital market doubled to 6% in 2017, where it remained in 2018, from 3% in 2016.
Growth in securitization will also require an effective regulatory framework to be in place. SFA’s Comprehensive Guide to US Securitization highlights important regulations in place in the U.S. that minimize risk associated with securitization including, but not limited to, appropriate due diligence on asset quality, sufficient disclosures, risk retention where necessary, and capital and liquidity requirements. Beyond that, the paper also includes a discussion on the principles behind good regulation: principles vs rules-based; global coherence; activity-based; flexibility; focus on safety and soundness; ability to measure, etc.

Additionally, a consistent and standard securitization structuring and reporting framework is critically important to enhance comparability and transparency, thereby improving investor confidence and expanding the investor base. Also important are established disciplines from independent service providers such as those from reputable rating agencies, custodian, trustees, accounting firms. An open market with international ratings and global standards will attract more sophisticated foreign investors and allow the market to develop in a more professional and more disciplined way. A robust currency swap market and other measures to ease investment hurdle across border will also encourage foreign investors to invest in this growing market.

In addition, more detailed and transparent regulations and legal framework are critical in providing clarity in certain areas to reduce investment uncertainty. A case in example is financial lease ABS. The question whether the bankruptcy administrator will exercise its statutory power under the Enterprise Bankruptcy Law to terminate a leasing contract has confounded the industry and it’s unclear whether bankruptcy remoteness can be fully achieved for securitized assets upon a lessor bankruptcy.
3) 国外资产证券化市场与债券市场、金融市场的关联

What are the relationships between the Securitization market and the bond (or the whole financial) market in US and globally?

- Plain vanilla ABS differ from corporate bonds in terms of general structure and overall performance. In particular, senior AAA-rated ABS may be a more attractive alternative to corporate bonds, because they can offer high ratings, are secured by receivables providing stable cashflows, enjoy diversification of the underlying collateral pool, and have lower vulnerability to rising interest rates.

- Section VII in SFA’s Comprehensive Guide to US Securitization highlights the main structural differences between corporate bonds and senior, or AAA-rated, plain vanilla ABS. The above graph illustrates trends in securitization and corporate bond issuance.
4) 国外资产支持证券基础资产的政策要求，对证券化安全性的影响。

According to the regulatory framework of the ABS collateral in US and other countries, what are the influences to the industry’s security by those policies?

- In the wake of the US financial crisis, policymakers heightened regulation on the financial markets, including securitization. New regulation included enhanced disclosure requirements, risk retention requirements, greater levels of capital and liquidity, improved due diligence, and credit rating agency reform.

- An extensive overview of the US regulatory framework is included in Section VIII of our Comprehensive Guide to US Securitization, including the various regulatory agencies and their responsibilities, the regulatory response to the US financial crisis, specifics around our capital and liquidity rules, clearing and margin, and the principles around good versus bad regulation.

- Regulatory reforms, coupled with industry safeguards and a strong appreciation for risk management, protect the system and the consumers today. Those protections promote a stable economy in which capital flows freely, investors find instruments that work for their portfolio, businesses can borrow in order to grow, and consumers find a ready source of funds to finance their purchases of homes, automobiles and other needs. SFA is committed to a two-way dialogue with policy makers and the industry to collectively help ensure that our industry remains committed to the safety, soundness and growing needs of the entire economy.

- An overview of the EU Regulatory framework may be found here. As this article states, the new EU regulatory framework consolidates the patchwork of legislation governing European securitizations, and introduces the long-awaited rules for issuing simple, transparent and standardized (STS) transactions. In addition to the STS criteria, the regulation also established new risk retention rules, disclosure and due diligence requirements, banned re-securitizations and ABS backed by unverified residential loans, and set sanctions for non-compliance. Morgan Lewis recently published a report describing the way in which these U.S. and EU rules overlap but also differ in many respects.

5) 如何更好的管理资产证券化业务的相关参与方，如会计师等

Among the participants of ABS, how can the effectiveness of intermediaries supervision, such as the accounting firms and etc, be improved?

- There are regulations in place to ensure that third party providers (like accountant firms and rating agencies) are as effective as possible. One of the major accounting firms in the US, Ernst & Young, developed a Sustainable Audit Quality program in order to inspire confidence and trust across capital markets, facilitate economic growth, and serve the public interest.

- Rating Agencies have strict policies and procedures in place to manage the engagement, initial rating, and surveillance processes within their respective firms as well. While there may be substantial

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1 The only significant change to occur since the publication of this paper is that, due to a judicial decision, CLOs are no longer required to hold risk retention.
differences among the processes used by the various Rating Agencies, their goals are similar: avoid conflicts of interest; manage the interaction between the Issuer and/or Underwriter and the different contacts within the Agency (i.e., credit analysis, business relationship management); promote transparency; and provide high quality credit opinions².

6) 美国ABS市场发展的现状和趋势，最新的金融监管、金融科技、业务创新的动向。

What are the status and trends of US ABS market, as well as the latest development in financial regulations, fintech and other innovations?

LIBOR Transition

- Currently, one of the most significant issues in the global financial markets, including securitization, is the forthcoming transition away from LIBOR. Approximately $400 trillion in financial contracts worldwide are indexed to [USD LIBOR]. The official sector and industry are working together to ensure that the transition from IBORs to their respective replacement rates occurs as smoothly as possible. The LIBOR transition is one of SFA’s biggest priorities. We are members of the Alternative Reference Rates Committee, a public-private partnership convened by the Federal Reserve, and have stood up a LIBOR Task Force through which our members engage in all types of advocacy related to the LIBOR transition.

- Additional LIBOR resources:
  - SFA Libor Symposium Key Takeaways (September 2019)
  - SFA Comment on ISDA Pre-Cessation Issues for Libor and IBORs (July 2019)
  - Tax Implications of Libor Transitions (March 2019)
  - SFIG Values ICE Contributions to Libor Transition (March 2019)
  - SFIG Largely Aligned with ARRC Initial Consultation (February 2019)

Housing Finance: Qualified Mortgage/Ability to Repay Rules

- In accordance with the Dodd-Frank Act, legislation enacted in the aftermath of the financial crisis of 2007 – 2008, the Consumer Financial Protection Bureau (CFPB) implemented the Ability to Repay/Qualified Mortgage (ATR/QM) rule which states that mortgage lenders must make “a reasonable, good faith determination” of each borrower’s ability to repay the proposed mortgage loan. The ATR portion of the rule was designed to prevent borrowers from obtaining loans they could not afford; the QM portion of the rule provides legal protection from allegations that the lender failed to verify the borrower’s ability to repay the mortgage loan if certain requirements are met (also known as “legal safe harbor”). Since its inception, the ATR/QM rule has also allowed any loan eligible for purchase by a government-sponsored entity (GSE) to achieve QM status. This exemption from the rule – also called the QM Patch – expires in January of 2021 and was meant to serve as a temporary

bridging mechanism while policymakers found a long-term solution to the challenge of appropriately crafting a legal safe harbor from ATR. SFA and the rest of the industry are working to ensure that any transition away from the QM Patch can take place in a smooth and transparent manner and enhance responsible access to credit for all borrowers.

Environmental, Social and Corporate Governance

- Environmental, Social and Corporate Governance (ESG) investing has now hit the mainstream as a consideration – and increasingly a key driver – of investment approaches and analysis for individuals and institutions alike. ESG investing has its roots in what began as ‘socially responsible’ investing in the 1960s, when investors began to screen their investment opportunities based on industry involvement such as tobacco production and sales or a company’s dealings in South Africa with respect to the apartheid regime.

- Today, there is broad acceptance and interest in ESG investing with the existence of targeted mutual funds and indices as well as growing focus on data availability and analysis by ratings agencies and analytics firms. For example, Fitch has published and is now maintaining ESG Relevance Scores for its structured finance and covered bond products, which indicate how impactful a given ESG element was on our credit analysis. ESG Relevance Scores are intended to augment market transparency as well as satisfy investor demand for more thorough and robust reporting on how ESG affects credit risk.

- SFA has recently launched an effort to assess how ESG investing and reporting can be applied and accessed in the securitization market.

EU Securitization Regulation

- The EU Securitization Regulation, effective as of January 1, 2019, is also having an effect in both the EU and US securitization markets. These regulations consolidate an earlier patchwork of securitization legislation in the EU, and impose due diligence, transparency, and risk retention requirements on a broader scope of institutional investors. However, there are still a significant number of areas which require further guidance from the regulators in order for market participants to comply with such regulations.

- The following resources provide additional details around the uncertainty brought about by EU Securitization Regulations:
  - Mondaq: How Has The European Securitisation Regulation Impacted The Market?
  - Mayer Brown Q&A: The Impact of the EU Securitization Regulation on US Entities.

Fintech

- Developments within the fintech sector offer opportunities for invention and re-invention within the securitization market and the broad consumer and corporate sectors it finances. SFA previously commissioned Deloitte to examine the application of blockchain to the securitization market and
produced a white paper providing an overview of the potential use of this technology. In addition to blockchain, there are other various technologies that have the potential to be applied to securitization, including: data validation/audit trails, artificial intelligence and machine learning, cybersecurity, digital banking, digital asset custody, and cloud.

7) 美国的公司贷款资产证券化(CLO)与杠杆贷款（Leveraged Loan）的关系。

What are the relationships between CLO and leveraged Loan in the US?

- SFA is developing a CLO research paper, which we will share once it is complete. In the meantime, please see the below links for information on the CLO market:
  - [North American Loan Covenant Quality Indicator: As market pivots into bonds, loan covenants achieve best score since 2016](#)
  - [Impairment and loss rates of global CLOs:](#)
  - [CLOs – Global: In a severe downturn scenario, credit quality declines significantly, impairing junior tranches](#)
  - [From covenants to cushions: Top 10 credit](#)
  - [Nonfinancial Corporates – US: As Low-Rated Spec-Grade Universe Expands, More Rated Companies Will Likely Default Or Be Downgraded In The Next Downturn](#)
  - [Fitch Ratings: Known Risks Can Be Amplified in CLOs with High 'CCC' Limits](#)
  - [U.S. Leveraged Finance and CLO Weekly](#)
  - [Fitch Ratings: Reinvestment in Amortization Period Can Extend U.S. CLO Notes](#)
  - [Fitch Ratings: Late Cycle Risk Foremost on Minds of U.S. CLO Investors](#)
  - [Fitch Ratings: Leveraged Loan, CLO Exposures Understate Risks for Financial Institutions](#)

8) 美国关于ABS、担保贷款和其他结构化融资产品适用的监管原则和标准

What are the regulatory regimes for ABS, Covered Bonds and other structured finance vehicles in the US?

Securitization

- An extensive overview of the US regulatory framework is included in Section VIII of our [Comprehensive Guide to US Securitization](#), including the various regulatory agencies and their
responsibilities, the regulatory response to the US financial crisis, specifics around our capital and liquidity rules, clearing and margin, and the principles around good versus bad regulation.

Covered Bonds

- Covered bonds generally are issued by depositary institutions subject to supervision by banking authorities in their home countries, which ensures that regulators would step in if a safety and soundness issue were to arise. An FAQ from Morrison & Forester discusses the regulatory framework for covered bonds and compares it to the securitization framework. There is an FDIC Covered Bond Policy Statement in place to address uncertainties in the US covered bond market although the scope of transactions that this guidance covers is limited. More information on this may be found on page 9 of the FAQ.

- According to Morrison & Forester, covered bonds in the US:
  Use a synthetic structure derived from securitization techniques in order to replicate the bankruptcy protection provided by statute in Europe. Securitization structures have been a popular method of financing mortgage lending in the US since the establishment of government sponsored entities. By comparing covered bonds to the well-known securitization structure, it is easy for prospective market participants to see the similarities and differences between the two funding alternatives.

- The below chart from the FAQ compares certain aspects of covered bonds to securitizations:

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3 The only significant changes to occur since the publication of this paper is that, due to a judicial decision, CLOs are no longer required to hold risk retention and the FDIC recently issued a proposal relating to certain provisions of its securitization safe harbor rule.

9) 美国基础设施类项目能否作为ABS的基础资产，小贷公司、汽车金融公司在ABS过程中的资产出表如何处理

Does the infrastructure project meet the criteria of ABS collateral in US? What are the accounting and capital treatments for the ABS products originated by micro-credit companies and auto finance companies?

- Securitization is not typically used to finance infrastructure projects in the U.S. Public sector support (e.g., revenue and general-obligation bonds, taxes, tolls, loans, guarantees, and letters of credit) is typically necessary given the nature of infrastructure projects which tend to take a long time to complete and require special expertise for diligence. The following articles from the Milken Institute and the Bipartisan Policy Center provide more color on infrastructure finance:
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However, there are some market experts and international organizations, such as the World Bank, who are looking into securitization as a source of funding for infrastructure. The following materials from the World Bank touches on how private capital can be employed for infrastructure projects:
https://www.worldbank.org/en/topic/longtermfinance and https://pppknowledgelab.org, e.g., “Capital markets framework for long-term finance, financial innovations and regulations to mobilize institutional investors (including credit enhancement and other risk-sharing instruments) both through debt and equity markets, including the development of products through pilot transactions and the establishment of partnerships with international and domestic investors.”

As noted above a very limited number of project finance loan securitizations have been issued in the US. A recent example of one of these unique deals is the managed cash flow project finance CDO, RIN II.

In various sectors of the economy, non-banking institutions also originate and securitize loans. For example, captive finance companies such as Ford Motor Credit, originate auto loans, financing them via the securitization markets using special purpose vehicles that operate like those sponsored by banks. (Captive finance companies are wholly-owned subsidiaries that finance retail purchases from their parent companies.) Captive Finance Companies in the US, such as Ford Motor Credit Company, operate similarly to automotive non-bank financial companies in China. Non-bank sponsors and/or securitizers can also be found in the marketplace lending space, which includes several different business models operating largely in the consumer loan, student loan, mortgage, and SME loan space. Other than credit card ABS which are mainly originated by bank sponsors, most ABS are originated by non-bank sponsors. The following reports from S&P Global provides an in-depth overview of this market.

Given the growth in marketplace lending and fintech and the elevated level of regulatory risk for marketplace lending in particular, U.S. regulators have been exploring ways in which to make these markets more efficient and effective within a safety and soundness framework. For examples, these organizations can apply for Fintech Charters with the Office of the Comptroller of the Currency (OCC). The SFA has published a comment letter in support of the OCC’s FinTech charter. Additionally, the following article from PwC walks through the current status of the FinTech Charter and explores potential related regulatory developments:

It is important to note, however, that the OCC’s FinTech Charter is not without controversy. The New York Department of Financial Services has sought to block the OCC’s issuance of charters with a federal judge ruling at the end of October 2019 against the OCC, stating that the OCC does not have the power to issue a federal charter for entities that cannot take FDIC-insured deposits.