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## securitization lawflash

December 17, 2014

### CSRC Issues New Provisions

*The provisions detail a new regime for privately placed, exchange-traded, and asset-backed securities in China.*

On November 19, the China Securities Regulatory Commission (CSRC) issued the long-awaited *Provisions on Administration of the Asset Securitization Business of Securities Companies and Fund Management Subsidiaries*<sup>1</sup> (together with two complementary rules regarding information disclosure and due diligence, referred to as the CSRC New Provisions), which repeals its 2013 predecessor.<sup>2</sup> It is anticipated that by removing uncertainties and providing its imprimatur to the flow of privately placed, yet liquid, securitizations, CSRC is relieving the huge sell-side backlog of working capital receivables that need to be financed throughout the Chinese economy while also catering to an increased institutional buy-side appetite to fixed-yield investments along the yield curve. Opportunities may also open up for direct or indirect participation by foreign players.

The principal thrust of the CSRC New Provisions lies in the following:

- Expanding the list of eligible issuers of asset-backed securities (ABS) and confirming their ability to rely on a special purpose vehicle (SPV) form, despite ambiguity under Chinese law
- Enlarging the scope of eligible underlying assets as limited by a Negative List
- Replacing the historical CSRC approval requirement for ABS issuance with a filing requirement with the Asset Management Association of China (AMAC)
- Reinforcing investor protection measures

#### Issuance of ABS

Securities companies and fund-management companies (and their subsidiaries) that have client asset-management businesses are bestowed, and certain other financial institutions<sup>3</sup> are eligible to seek, general CSRC approval for ABS issuance. In each case, the issuer would use an SPV (资产支持专项计划), a legal construct to which the originator would transfer the underlying assets and that would be regarded (as a matter of market practice<sup>4</sup>) as bankruptcy remote. For each such issuance, the requirement of prior approval by CSRC is no longer needed. A filing with AMAC within five working days after establishing the SPV will suffice. Unlike their brethren collateralized loan obligations offered to the public under the auspices of the China Banking Regulatory Commission (CBRC), CSRC-sponsored ABS (while eligible for trading on the exchanges) are considered

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1. Fund management companies, like securities companies, are generally permitted to act as managers of CSRC-approved securitizations; however, where the assets being securitized are not composed of bank deposits, stocks, bonds, securities investment funds, central bank notes, debt instruments of nonfinancial institutions, asset-backed securities, commodity futures, or other derivatives, a fund management company can only do so through its wholly-owned subsidiary specifically established for such purpose.

2. Provisions on the Administration of the Asset Securitization Business of Securities Companies, issued by CSRC and effective as of March 15, 2013.

3. Including (i) futures companies, securities financing companies, and other CSRC-regulated entities; and (ii) other financial institutions such as commercial banks, insurance companies, and trust companies.

4. As a strict matter of statutory interpretation, the only entities entitled to the benefits (segregation of the assets held by a trust, for the benefit of a class of third-party beneficiaries, from the claims of creditors of the transferor) of the PRC Trust Law (which is legislation enacted by the National People's Congress) are trusts managed by trust companies regulated by CBRC. The bankruptcy-remote bona fides of the SPV derive from the New CSRC Regulations, a creature of an administrative body.

privately placed securities limited at all times to not more than 200 holders.

## Qualified Underlying Assets

The underlying assets in an ABS shall satisfy certain general requirements: The assets must (a) be formed or acquired on an arm's-length basis; (b) have a clear chain of legal ownership; (c) be capable of generating independent, predictable, constant, and stable cash flow; and (d) be free from any encumbrance, including mortgage, pledge, lien, and other security interests and limitations immediately before the transfer of such underlying assets from the originator to the SPV. A Negative List, which will specify the assets that are not approved for securitization, will be promulgated by AMAC.

The prospectus of a particular ABS transaction (Prospectus) shall disclose or confirm, *inter alia*, the following information regarding its underlying assets:

- Compliance with the general requirements<sup>5</sup>
- Composition of the underlying assets
- Operation and management of the underlying assets
- Methods and effects of the risk mitigation measures
- Custodian arrangements with respect to the underlying assets

## Qualified Investors

Subject to more stringent eligibility requirements issued by the ABS trading facilities, such as exchanges, qualified investors are entities or natural persons that meet the following standards:

- Entities with proprietary net assets of no less than RMB 10 million.
- Natural persons with financial assets of no less than RMB 3 million or an average annual personal income of no less than RMB 500,000 in each of the immediately three preceding years. Financial assets for such purpose include banking deposits, stocks, bonds, fund units, asset-management schemes, banking wealth-management products, trust plans, insurance products, and futures.

The following entities and natural persons are deemed as qualified investors:

- Certain funds (e.g., pension and charitable funds) under the jurisdiction of the National Council of Social Security Fund, the Ministry of Human Resources and Social Security, the Ministry of Civil Affairs, and various local government bodies ( Regulated Social Funds)
- Corporate, partnership, and contractual investment plans registered with AMAC
- An SPV management company and its employees who invest in the ABS under their own management

The aggregate number of investors of a specific ABS product shall not exceed 200 at any time. Where the investment in ABS is directly or indirectly made through pooling funds of multiple investors in partnerships or by contract (except investment plans duly established and regulated by competent financial regulators and actively managed by financial institutions), the manager shall look through such pooling vehicles to determine whether the ultimate investor is qualified and what the number of investors is.

## Implementation Guidelines of Exchanges

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5. For underlying assets that are revolving in nature, further disclosure is required as to the volume and underwriting criteria with respect thereto. For underlying assets on which there are multiple obligors, further disclosure is required as to underwriting criteria, diversification, and obligor-specific information for any obligor the obligations of which exceed 15% or (together with its affiliates') 20% of the pool.

On November 25 and 26, two of the designated trading facilities of ABS, Shenzhen Stock Exchange (SZSE) and Shanghai Stock Exchange (SHSE), issued their guidelines for the securitization business (respectively, the SZSE Guidelines and SHSE Guidelines, collectively, the Guidelines) that implement the CSRC New Provisions.

## **Qualified Investors**

Subject to more stringent eligibility requirements in the Prospectus, the following are deemed qualified ABS investors:

- Domestic financial institutions, such as licensed banks, securities companies, fund management companies, insurance companies, and trust companies, and their respective wealth management plans, client asset-management plans, insurance investment plans, and trust plans
- Foreign financial institutions (for their own proprietary and on behalf of managed third-party accounts) approved by Chinese financial regulators, including, without limitation, Qualified Foreign Institutional Investors and Renminbi Qualified Foreign Institutional Investors
- Regulated social funds
- Privately raised funds and their managers (Private Managers) duly filed or registered with competent self-regulatory organizations (including AMAC), with the latter subject to the Minimum Net Assets Requirement (defined below)
- Other entities (including companies and partnerships) with proprietary net assets no lower than RMB 10 million (Minimum Net Assets Requirement)
- Other qualified investors in compliance with applicable CSRC rules and acknowledged by the exchanges

## **Listing, Suspension of Listing, and Delisting in the Exchanges**

### ***LISTING***

Despite the difference in wording and layout, criteria for ABS listing in SZSE and SHSE are substantively the same:

- Underlying assets and transaction structure must be compliant with relevant rules and regulations (e.g., CSRC New Provisions, Guidelines, and the Negative List).
- Issuance and filing with AMAC must be completed.
- Investor qualification eligibility must be satisfied.
- Proper and satisfactory risk control measures must be in place.
- Other requirements stipulated by the exchange must be adhered to.

Relevant issuing documents (e.g., the certificate of filing, the capital verification of issuance, transaction documents, the rating report, and the depository and custodian documents) shall be submitted to the exchange for review. Once approved, the exchange shall issue a notice regarding its consent to listing within five trading days after acceptance of the issuing documents.

Both the SZSE and SHSE Guidelines require prior consultation with the trading facility designated in the Prospectus as to whether the ABS is suitable for listing.

### ***SUSPENSION OF LISTING***

The listing of certain ABS can be suspended at the exchanges' discretion under specific events (Suspension Events):

Item	SZSE	SHSE
1	Occurrence of material events that may substantially affect the price or value of the ABS (Material Events) <sup>6</sup> .	Occurrence of Material Events, but subject to additional conditions: (a) Such Material Events have not been disclosed; and (b) The manager has applied to SHSE for suspension of listing.
2	Abnormal fluctuation of trading price of ABS.	Abnormal price fluctuation is not explicitly listed as a Suspension Event by SHSE, but can cause suspension if it falls under Item 3.
3	Other Suspension Events at the exchange's discretion.	Same as for SZSE.

Upon the cessation of the Suspension Events, the exchanges can decide to resume the listing of the ABS.

## **DELISTING**

SZSE and SHSE, pursuant to their respective Guidelines, can delist certain ABS on the occurrence of the following events.

Item	SZSE	SHSE
1	Expiry of the term of the ABS.	Two trading days immediately before the expiry of the term of the ABS.
2	Termination of the ABS according to its Prospectus before expiry.	Same as for SZSE.
3	Material adverse events occur, and SZSE considers it necessary to delist the ABS.	Other circumstances that make the manager or SHSE deem it necessary to delist the ABS.

## **Trading**

### **Spot Trading**

On the SZSE, spot trade bid and offer prices of all tranches of ABS shall take into account the accrued interest (i.e., the settlement price = the submission (bid = offer) price = (nominal price/principal + accrued interest) × negotiated discount, or Full Price Trading). On the SHSE, Full Price Trading applies only to the trading of the most junior tranche of ABS, while for the senior tranche(s), the bid and offer prices reflect views on principal value only (i.e., the settlement price = the submission (bid = offer) price + the accrued interest, or Net Price Trading).

The nominal value of each order shall be no lower than RMB 1 million and upward in increments of RMB 1 million. Both exchanges shall confirm the trading of ABS according to the sequence of declaration and shall not confirm an order if such confirmation will cause investors of the specific ABS to exceed 200.

Once matched, trading parties shall acknowledge and perform their respective delivery and payment obligations. The settlement of the trading shall be processed on a T+0 basis.

6. Material Events include (a) nonpayment of interest when due; (b) adverse adjustment of the credit rating of the ABS; (c) underlying assets suffering a loss exceeding 10% of the outstanding principal of the ABS; (d) material change in the performance of the underlying assets or their capability to generate cash flow; (e) lawsuits threatening the due distribution of interest; (f) an estimated 20% deterioration in cash flow; (g) breach of relevant ABS contracts having adverse impact to ABS investors; (h) material change in the business status, or resolutions regarding capital decrease, merger, spin-off, wind-up, or bankruptcy, of relevant parties to the ABS; (i) change, without prior consent, of relevant participating parties; (j) negative adjustment of the credit rating of relevant participating parties of the ABS; and (k) other events negatively affecting the interest of ABS investors.

Moreover, the spot trading of ABS has long been categorized as a type of bonds trading in both exchanges and, thus, the general bonds trading rules shall also apply.

## Repo

SHSE Guidelines explicitly allow repo transactions on ABS, and the general repo rules for bonds<sup>7</sup> shall apply. On the other hand, SZSE Guidelines stipulate that the business rules of ABS repo transactions will be formulated in another separate rule.

## Information Disclosure Requirement

The ongoing information disclosure requirements in the Guidelines are similar and consistent with the CSRC New Provisions:

- Manager—disclosing ((i) for the immediately previous calendar year before April 30, (ii) for each interest payment, and (iii) for other periods as may be required by CSRC, the exchange, and the Prospectus), *inter alia*, matters relating to performance of the underlying assets, performance by the respective parties of their duties under the transaction documents, performance by the originators, income and expense items, and confirmation of payment to all tranches.
- Custodian—simultaneously when the manager discloses its annual report disclosing, *inter alia*, changes to and status of the custodial assets and whether the custodian has performed its duties under the custodial agreements.
- Rating agency—disclosing (for the immediately previous year before June 30 and for other interim periods) its rating opinion and assumptions, status of and change in the underlying assets, a summary of the transaction structure of the SPV, the status of the payments on the relevant tranches of ABS, the cash flow performance of the underlying assets, and stress-test results.

## Contacts

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<sup>7</sup> Such rules include, without limitation, *SHSE Trading Rules* (revised and effective as of September 24, 2014) and *SHSE Guidelines for Risk Control in Bond Collateral Repo Trading* (effective as of February 1, 2012).