
**A BRIEF ANALYSIS OF THE BASIC ASSETS OF ASSET-BACKED
BILLS**

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Abstract

In recent years, asset-backed bills have been continuously innovated and developed, effectively helping enterprises to achieve low-cost and low-risk financing. As an important part of the asset-backed notes, the underlying assets play an important role in the process of the asset-backed notes. How to reasonably construct the asset pool, fully activate the basic assets, and effectively control the risks related to the basic assets is a subject worthy of further study. Combined with the current national policy orientation, the current asset-backed bill market situation and investors' preferences, the author studied the common basic assets in the market. In this paper, from the formation conditions and function characteristics of the underlying assets, as well as the financing needs of most enterprises with low threshold, low cost, low risk and flexibility, combined with cases, in-depth analysis of the underlying asset risk of asset-backed bills, and put forward feasible and constructive countermeasures and suggestions for the underlying asset risk in the asset-backed bills.

Index Terms— Asset-backed Notes, Underlying Assets, Financing Innovation

I. INTRODUCTION

1.1. Background Analysis

Asset-backed bills have developed rapidly and have a good development prospect. In recent years, China's bond market has been developing steadily, with abundant bond varieties and rapid growth in issuing scale. In 2020, asset-backed notes (ABN) maintained rapid development. A total of 448 products were issued in the whole year, with a total issuance size of 510.838 billion yuan (76.779 billion USD). Both the issuance number and the size of ABN increased significantly compared with that of 2019. As for the secondary market, by the end of 2020, the stock scale of ABN products reached 706.096 billion yuan (106.126 billion USD). The annual trading volume in the secondary market was 306.185 billion yuan (46.02 billion USD), an increase of 72.30% compared with that in 2019. The number of transactions was 2,017, with an average value of 152 million yuan (22.8456 million USD), indicating a significant increase in transaction activity. In terms of credit performance, the overall credit quality of ABN products in 2020 is good. Policy, market dealers association members developed Guidelines on Due Diligence for Asset Backed Bills Business of Non-Financial Enterprises (Trial), standardizing and guiding the asset-backed paper due diligence investigation behavior, putting forward more specific requirements on business operation itself. The gradual improvement of the system construction is conducive to the sustainable and healthy development of the asset-backed bill market. As the ABN market continues to become more international, it is moving towards a broader and deeper level.

ABN's basic asset types have constantly enriched. The 2016 Guidelines on Asset Backs for Non-financial Enterprises (Revised Edition) expanded the scope of the definition of the underlying assets. The underlying assets of ABN were gradually expanded on the basis of the property rights of the original enterprise, such as accounts receivable, lease claims and beneficial rights of trusts. In 2018, the underlying assets were mainly receivable claims and lease claims, with 34 and 27 issues respectively, and the issuance amount was 41.367 billion yuan (6.217 billion USD) and 32.168 billion yuan (4.835 billion USD) respectively. 17 bills were issued, accounting for 24.40% of the amount issued; With the introduction of the transaction structure innovation mechanism of trust as a vehicle for specific purpose in the Guidelines (Revised), 7 pieces of beneficial trust claims were issued, accounting for 8.77% of the issued amount of 11.027 billion yuan (1.657 billion USD), becoming the fourth category of basic assets.

1.2 Value Analysis

At present, China's asset-backed bills are still in the development stage, with a wide variety of products and uneven quality of underlying assets. Due to the low quality of the underlying assets, some ABN products in the market failed to issue or failed to generate stable cash flow as expected after the successful issue, which resulted in the loss of investors' rights and interests. This paper aims to deeply analyze the related risks of ABN's underlying assets, and put forward feasible and constructive countermeasures and suggestions on how to better select the underlying assets and increase the quality assurance of the underlying assets.

1.3 Literature Review

On the Development of Asset-backed Instruments. The development of domestic asset-backed securities is relatively late. Despite the late start, domestic scholars also actively and effectively devote themselves to the research of asset securitization and make their own contributions to the diversity of financing in the domestic market. Zuo Liren (2015) made a comprehensive analysis of the current situation of China's financial market and relevant regulatory laws, combined with the development experience of foreign capital markets, and concluded that China's capital market can learn from foreign development models, actively promote the process of asset securitization, promoting the stable and coordinated development of the domestic capital market. [1]. Gao Ming (2017) made an in-depth study on the status quo of asset securitization in China and pointed out that securitization, as an innovative financing tool, had injected fresh blood into the financial market. In view of the obstacles existing in the development of China's securitization, he proposed to strengthen the construction of securitization laws and regulations as well as develop asset securitization in a diversified way [2]. Lv Huaili and Lin Yanyan (2017) compared domestic and foreign asset securitization products and proposed that the country should actively encourage financial market innovation and promote the development of multi-level capital market [3]. Lv Duan quin (2019) pointed out that in accordance with the principle of "real sale and bankruptcy isolation", the Guidelines on Asset-Baked Notes for Non-financial Enterprises revised in 2016 introduced specific purpose vehicles (SPV), continuously expanded the scope of underlying assets, clarified the transaction structure and the responsibilities of participating institutions, established and refined the supporting form system, and improved the relevant information disclosure standards, which really have played an important role to protect investors, vigorously promote the development of the Chinese ABN code. [4]

Study on the Underlying Assets. Tao Tao (2013) believed that the main risk of enterprise asset securitization comes from the risk of underlying assets, which should be paid attention to [5]. As an innovative financing tool, asset securitization also has a variety of risks. Ma Yuping (2020) pointed out that external enhancement mainly plays a positive role in asset securitization by means of third-party purchase of secondary securities of enterprises, acquisition of redundant underlying assets, redemption guarantee provided by sponsors, replacement of substandard underlying assets and other methods. [6]. Ma song (2020) studied the securitization of trust beneficial right assets and found that the principle of credit enhancement not only guaranteed investors' funds, but also met the needs of issuers and other aspects. [7] Lv Binbin (2017) conducted a large number of studies on the circular purchase mechanism of securitized products and concluded that the circular purchase structure can effectively solve various problems such as the term of receivables as the underlying asset and the repayment in advance. However, compared with the static underlying asset pool, the circular purchase structure is more difficult to design, and the requirements for the underlying asset into the pool are higher. At the same time, Lu Binbin also analyzed the purchase frequency of underlying assets and the design of early repayment, and believed that at the beginning of the issuance of asset securitized products, the product term should be set first, followed by the cyclic purchase period and amortization period of underlying assets [8].

II. Overview of the underlying assets

The underlying assets refer to the assets on which the exchange of derivative financial instruments depends. In the case of asset-backed instruments, it refers to the property, property rights or the combination of property and property rights that comply with the provisions of laws and regulations, have clear ownership, can be transferred according to law, and can generate sustained, stable, independent, predictable cash flow and can be specified.

A. Conditions for the Formation of ABN Underlying Assets

ABN is a securitized financing instrument based on underlying assets. The underlying assets that can be included in ABN shall meet two basic conditions: first, the issuer shall have real, legal and complete ownership of the underlying assets, and the underlying assets can be attached with any rights restrictions such as pledge and guarantee on the premise that they can remove the burden of property and have no impact on the subsequent issuance and payment of ABN; Second, the time and amount of future cash inflow generated by the underlying assets are independent, clear, stable, predictable and sustainable, and the corresponding rights and interests can be legally transferred.

B. The Role of ABN Underlying Assets

ABN is a financing tool supported by income from the stable cash flow continuously generated by the underlying assets in the future, and this cash flow can meet the requirements of paying returns to investors by means of principal and interest service within a certain period of time as agreed, thus reducing investors' investment risks. The financing scale of the enterprise is determined by the expected cash flow of the underlying assets and is not subject to the 40% limit of the enterprise's net assets.[9] Besides, it can fully revitalize the stock assets of enterprises, improve the utilization efficiency, and optimize the structure of assets and liabilities. In addition,

enterprises can independently decide the use of funds raised, which means the use of funds is more flexible.

C. Current Status of ABN's Underlying Assets

Distribution of Types of Underlying Assets. In 2019, ABN products with consumer finance creditor's rights, small and micro loan creditor's rights, receivable creditor's rights and lease creditor's rights as the basic assets occupied 61.84% market share. Consumer finance creditor's rights and small and micro loans creditor's rights products issued 74 single products in the whole year, the scale of which reached 95 billion yuan (14.279 billion USD), accounting for 32.91% of the total issued in the whole year. The issuing scale and the issuing number both exploded, significantly increasing by 14.83 times and 13.80 times respectively compared with the same period last year. The development of debt receivable products was relatively stable. A total of 45 products were issued throughout the year, with a total issuance amount of 42.236 billion yuan (6.348 billion USD), accounting for 14.63% of the total issuance of the year. The issuance share of debt leasing products accounted for 14.30% of the total issuance in the whole year. A total of 32 units were issued in the whole year, with a total issuance scale of 41.263 billion yuan (6.202 billion USD), an increase of 5 units and an increase of 9.095 billion yuan(1.367 billion USD).

ABN Products for New Underlying Assets. After the official launch of ABN, the Association of Dealers has been actively exploring and innovating based on the reality of China's market, and has successively launched various innovative projects. On January 30, 2019, "Beijing Cultural Science and Technology Financial Leasing Co., Ltd., 2019 Phase I asset-backed notes" was successfully issued, with an amount of 770 million yuan (115.731 million USD) and a term of 3 years. The basic assets included intellectual property rights such as patent right and copyright. With Beijing Culture and Technology Financial Leasing Co., Ltd as the initiator, the project innovatively carries out the financial leasing business with intangible assets as leases. On June 6, 2019, the country's first tuition-earning right "the first phase of 2019 asset backed notes of Aquila Education Investment Management Co., Ltd." was successfully issued, with a product size of 620 million yuan (93.186 million USD) and AAA rating. On December 26, 2019, the first based on the highway of advertising business profit of assets "QiLu culture tour group co., LTD. 2019 the first issue asset-backed paper" issued successfully, and issuance of 170 million yuan (25.551 million USD), including 160 million yuan (24.048 million USD) in priority, and won the AAA credit rating. The project can successfully issued to provide enterprises with similar foundation assets financing model and new ideas. In October 2020, Dezhou Branch of Zheshang Bank issued the first financial leasing company blockchain receivables ABN in China, with an amount of 144 million yuan (21.6432 million USD). By issuing instalment receivables through the receivables chain platform, we have successfully explored a low-cost and direct financing path for all parties in the industrial chain.

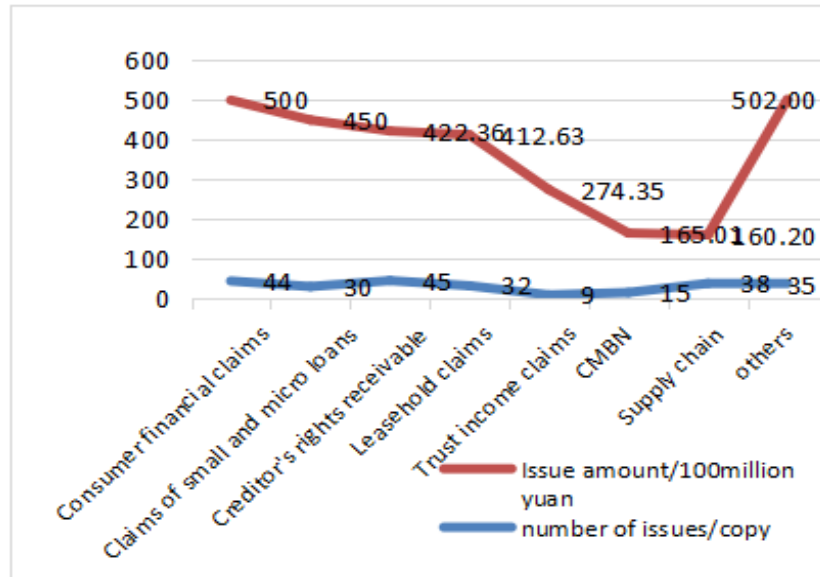


Fig1.ABN product released in 2019
Data Source: CNABS

III. RISKS RELATED TO UNDERLYING ASSETS

3.1. Solency Risk.

The solvency risk refers to the risk that ABN products fail to repay the principal and interest to investors within a certain period as agreed due to the deterioration of the cash flow of the underlying assets or the large deviation of the cash flow of the underlying assets from the predicted value. This kind of risk mainly comes from the insufficient quality assessment of the underlying assets and the insufficient prediction of the future cash flow when selecting the underlying assets. In the analysis and evaluation of the underlying assets, the following aspects are mainly discussed: the debtor's own situation and type distribution, the regional concentration degree of the underlying assets, the quality of the underlying assets within the cycle purchase period, etc. The degree of debtor concentration is closely related to the risk of the underlying assets. For example, China Huaneng Group has a high concentration of debtors from Liaoning and Inner Mongolia, which is prone to regional homogenization and other problems. Any adverse change in regional policies may have an adverse impact on the creditworthiness of the asset-backed notes. However, all the debtors in the receivables asset-backed notes of Jiuzhou-Nantong are in public hospitals set up in China. That is, the industry concentration of debtors is too high, which does not meet the requirements of the dispersed allocation of basic assets under normal circumstances. In this case, all risks in the hospital industry may affect the safety of trust property.

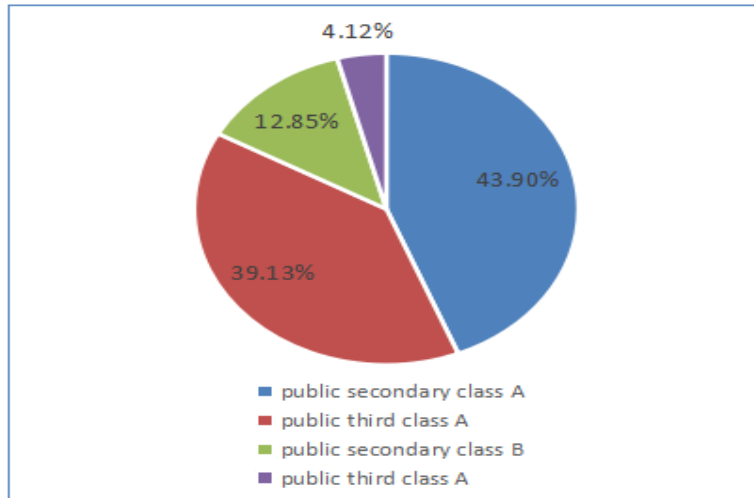


Fig2.Distribution of debtor types

Data Source: Prospectus for the first issue of trust asset-backed notes of JiuzhouTong in 2016

3.2. Credit Risk.

The credit risk of ABN's underlying assets comes from whether the underlying assets are really sold, whether the funds are idle or used to buy secondary underlying assets, whether the interest during the cycle purchase can be transferred in time, etc. If the underlying assets are not actually sold, the original owner's ownership of the assets is not cut off. Once the original equity owner has operational risks or the company goes bankrupt and liquidated, the unsold assets will still be included in the asset liquidation. Both the original equity owner and the investor will face huge risks, which will seriously affect the credit rating of the product. In order to improve the grade of basic assets, enterprises usually adopt circular purchase. However, once the remaining cash flow after paying the principal and interest during the purchase period cannot purchase new high-quality basic assets, some funds are idle or used to purchase secondary basic assets. This situation is likely to damage the interests of a negotiable instrument. In addition to the cycle purchase structure, there is a cycle purchase period, as well as a principal and income amortization period. During the cycle purchase period, the cash flow generated by the underlying assets only partially pays the relevant costs and interests of the current period of the project, and the rest is used for the cycle purchase of new underlying assets. However, the actual basic situation during the operation of the project determines whether the enterprise will purchase and what kind of assets to enter the pool. Therefore, during the amortization period of the project, the purchase of new underlying assets should be stopped and the cash flow generated should be paid to the investors as agreed and the principal should be returned. Otherwise, the credit risk of the product will be increased.

3.3. Role and Risks of Third Parties.

In the process of bill issuance, enterprises and investors generally rely on the services provided by the issuing carrier, issuing carrier management agency, trustee, asset service agency, rating agency, credit extension agency, service provider and other third parties. Admittedly, these third-

party services can also be a separate risk. If the issuing vehicle manager has to expand its business due to its own size constraints, and the trust program usually lasts for a long time, the person in charge of the project in the issuing vehicle may take on multiple businesses during the duration, and thus do not have enough energy to pay attention to the potential risk and other details of the asset-backed paper. Another example is that the asset-backed bills involve a large number of relevant participants, and the frequent collection and transfer of project recovery funds may easily cause the cash flow generated by the self-owned funds of the asset service institutions to be confused with the project cash flow. In the event of a bad asset service institution and a credit crisis, the mixed funds will be difficult to distinguish between the losses that lead to the interests of investors.

3.4. Other Risks.

Including tax risk, force majeure risk, etc. Tax risk refers to the fact that the holder of the asset-backed bill may pay certain taxes for the income distribution during the holding period, but the underlying asset also paid certain taxes when the income was obtained, so there is a situation of double taxation in the tax payment. And the change of tax policy in the future is also unknown, so the holders may face tax risks. Force majeure risks refer to policies, economic changes and natural disasters occurring during the period of existence that may cause greater risk exposure to the products and thus adversely affect the assets and earnings of the trust plan. In particular, the establishment of the legal system of ABN of various underlying assets in China is not perfect, and the asset-backed bill is still in the development stage, which may face various legal and policy risks in the future.

IV. SUGGESTIONS ON THE UNDERLYING ASSETS OF ABN PRODUCTS ARE GIVEN

4.1. Choose Your Underlying Assets Carefully.

Determining the underlying assets and building the underlying asset pool is often the first step to implement the asset-backed notes. High-quality and low-risk underlying assets can not only be predicted to have stable cash flow in the future, but also be the driving force for asset-backed bills to continue to be popular with market investors, which fully reflects that qualified and high-quality underlying assets are the absolute foundation for the success of asset-backed negotiable instrument projects. The risk of underlying assets is not only affected by uncontrollable factors such as national macroeconomic policies and industry fluctuations, but also the factors of the assets themselves. Therefore, in order to control risks more reasonably and effectively, the most direct way is to improve the pooling standard of underlying assets and eliminate the possibility of all kinds of non-performing assets being pooled. The most important and basic condition of the underlying assets is to comply with the legality of the law, that is, the creditor's right or the earnings right really has the legal effect, and is the reasonable and legal assets of the sponsor enterprises. In addition, high-quality assets should also have the following characteristics:

4.1.1. Dispersion. The assets of the asset pool should be dispersed as far as possible in terms of region and debtor type distribution. If there are uniform characteristics in some respects, such as

all assets in the pool are infrastructure toll rights, then the other characteristics should be as different as possible and the correlation of the other aspects should be minimized.

4.1.2. Scale. The scale of the underlying assets in the asset pool determines the level of cost and expense, and the two are inversely proportional. Generally speaking, the management fee of project intermediary service agency, such as accounting fee, custodian fee and plan management fee, is a relatively high fixed fee. When the financing scale of the enterprise is larger, the unit cost of capital will be lower.

4.1.3. Predictability. In the process of asset pool construction, the pooled assets should be selected in strict accordance with the rules and standards to ensure that the pooled underlying assets can generate stable and sustainable cash flow predictably in the future. Only when the cash flow can be expected, the security of capital can be guaranteed, the transaction risk can be accurately estimated and the risk can be reasonably dispersed. According to the comparable data of the same period in 2018 in the Wind database, a statistical analysis of the projects issuing asset-backed bills shows that high-quality underlying assets have a significant impact on the issuing cost of asset-backed bills and investors' purchase willingness, which is the key to effectively reducing financing costs and successfully issuing bills.

4.2. Invite a Professional Third-party Asset Service Agency.

The independence and professionalism of the basic asset service institutions are very important in the whole process of issuing bills. In order to better carry out the project, the professional third party plays an important role. For example, the operation and management level of the asset service institution will directly affect the total amount and quality of cash flow collection. However, in the actual operation of project issuance, in order to save financing costs, the asset service institution is usually assumed by the affiliated enterprises of the initiating institution. This is easy to create a mix of capital risk and credit risk. The professional third-party asset service can effectively reduce the risk of capital confusion and realize risk isolation. At the same time, from the perspective of risk management, the enterprise should set up an internal risk prevention and control team to manage the assets of the foundation pool and the assets of the enterprise in different categories. The main task of the risk prevention and control team is to develop a feasible and effective risk early warning mechanism, find out abnormal risks in time, issue risk reports on time, and protect the underlying assets and the interests of investors from being infringed.

4.3. Use Circular Purchase to Solve the Maturity Mismatch of the Underlying Assets.

This is mainly for accounts receivable ABN products. Most of the enterprises in the market have a relatively short age of some receivables, so the receivables billing will lead to a shorter duration of the project. But market investors generally prefer notes with relatively long maturities. Through the circular purchase mode, the receivables entered into the pool are constantly increased to properly solve the problem of maturity mismatch and improve the returns of investors. In the circular purchase mode, the recovered cash flow is not completely used for the payment of principal and interest of investors, but the remaining cash flow is used for the purchase of new underlying assets. On the premise that a series of expenses such as related audit

fee, credit rating fee and trust fee must be paid, if the structural design of the traditional static asset pool is maintained, the average unit cost of financing will be higher, while the circular purchase method can amortize these costs with the increase of the assets in the pool, thus achieving the effect of reducing the average financing cost.

4.4. Make Up for the Lack of Credit of Underlying Assets through Internal and External Credit Enhancement.

Compared with traditional financing methods, the main difference of asset-backed notes is that they rely on the stable cash flow generated by the underlying assets to guarantee the financing. However, not all the credit ratings of the underlying assets in the market can meet the needs of investors, and the implementation of internal and external credit enhancement measures can supplement the deficiency of the underlying assets and reduce the default rate of the asset-backed bills. In the choice of internal and external credit enhancement, we should fully consider the limitation of financing cost. Since external credit enhancement will involve other units or products, it is likely to increase the financing cost and issuing cost of the issuing company. The company needs to combine the quality and risk of the underlying assets, weigh the advantages and disadvantages according to the issuing cost of the internal budget, and design an effective internal and external credit enhancement method. Through the organic combination of internal rating enhancement and external credit enhancement, the quality of asset-backed bills can be improved and the signal of safety can be conveyed to the market, which can not only win the favor of more potential investors, but also reduce the capital cost of enterprises, minimize the cost of rating enhancement and maximize the benefits of bills.

V. CONCLUSION

To sum up, with the development of asset securitization in China, the range of underlying assets has been continuously expanded, and the types of domestic ABN underlying assets have become increasingly rich. The risks faced by ABN products have become more complex and variable, among which the primary risk is the risks related to various underlying assets inside and outside the asset securitization structure. Enterprises can ensure the safety of cash flow of basic assets by screening high-quality basic assets from the source, employing professional third-party asset service agencies for specific operations, adopting circular purchase and increasing credit from inside and outside, so as to ensure the smooth issuance of ABN products and continue to be popular with market investors, and effectively help enterprises overcome various difficulties such as narrow financing channels, high financing threshold, high financing cost and high financing risk. It can be predicted that with the strong support of the state, asset-backed bills will achieve innovation and prosperity in more fields and have a more vigorous future.

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