ABS/China
Special Report

China Securitisation – Are SAMPs Really an Easier Way?

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Summary

The Specific Asset Management Plan ("SAMP") was introduced to the market in May 2005 under an interim rule constituted by the Chinese Security Regulatory Commission ("CSRC"). Governed by the rule, a securities firm establishes a SAMP to raise funds from investors and invests the proceeds in a specific, mostly corporate asset. The scheme provides a return to the investors through a dedicated bank account.

The SAMP structure accomplishes the same goal as a securitisation, where cash flows from the asset will be the only source of collateral for repayment of principal and interest to investors.

While the SAMP looks like a securitisation, this article addresses key issues that remain before SAMP can be a long-term financing alternative worthy of attention.

The Deal

Key features of the China Network Communications ("China Netcom") SAMP deal include:

1. 200bp interest rate savings compared with funding through traditional bank financing;
2. no approval from the China Banking Regulatory Commission ("CBRC") or People's Bank of China ("PBOC") required; and
3. a cost- and time-efficient approach to issue securitisations.

In China, small and medium-sized companies have historically not been able to access the debt capital markets easily. As a result, the majority of financing comes through bank loans. The emergence of the SAMP structure has proven to be a more cheap and efficient way for these companies to get financing. At first glance, the structure looks like a securitisation and this article considers the key features of the SAMP and how this differs from traditional securitisation.

Understanding A SAMP

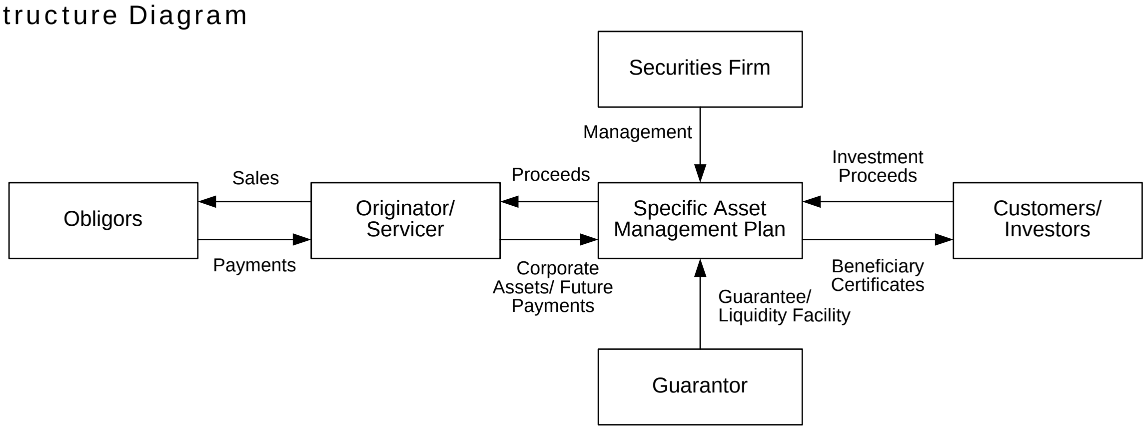
The Rule

A SAMP is established under the rule of the "Interim Administrative Measure on the Asset Management Business of a Security Company" (the "Rule"), which is constituted by the CSRC. CSRC is the sole regulator of the Rule and has the authority to review the SAMP and approve its launch.

The Programme

A SAMP is a programme that can only be set up and administered by a Chinese securities firm, to issue beneficiary certificates to domestic investors and use the proceeds to purchase specific corporate assets for investment purposes. A SAMP is usually employed as a fixed income instrument and tradable on the CSRC-regulated Shanghai/Shenzhen Stock Exchange.

Structure Diagram



Source: Fitch

The Structure

Under a typical SAMP structure, a securities firm sets up a SAMP and administers the programme's investment plan for the benefit of the investors. The corporate borrower subsequently transfers eligible assets to the SAMP in return for purchase proceeds, and usually acts as the servicer of the transferred assets.

The cash flows generated from the eligible corporate assets will first be trapped in a dedicated bank account and then passed through to SAMP investors. A qualified entity, usually a bank or sometimes a corporation, provides guarantees to ensure the SAMP's timely interest payments and principal repayment.

The Assets

The qualified underlying assets are solely corporate assets. Bank assets are excluded because they are supervised by the CBRC and PBOC. Fitch notes that the receivables of infrastructure companies (including toll roads, railways and sewers), energy companies and equipment leasing companies constitute most of the SAMP's underlying assets.

Advantages

The first advantage of using a SAMP is that Chinese corporates can significantly slash funding costs through this plan. Currently, the lending rate for bank loans for up to three years is set and dictated by the central bank at 6.03%. In comparison, the weighted-average yield of the China Netcom SAMP is 3.25% with 2.45 years of weighted-average maturity.

Another advantage of using a SAMP is that it opens up a new finance route for Chinese corporates as the Chinese debt capital market is highly regulated by the government.

A further advantage of using a SAMP is that it does not require approvals from the CSRC and PBOC, if the underlying assets are not bank assets.

The final advantage of using a SAMP is that a SAMP-style securitisation is not as complicated as Special Purpose Trust ("SPT") or Special Purpose Company ("SPC") approaches, which are commonly used in typical structured finance deals. A SAMP provides a more cost- and time-efficient approach for the originators.

■ Not Quite There...

Legal Issues

Based on the Rule, the SAMP is treated as a special-purpose vehicle ("SPV") that separates the purchased assets from the assets of the originator and the securities firm. However, unlike a common SPV in a typical westernised securitisation deal, the SAMP is not actually a legal entity, but more like an investment trust under a private fund structure.

Since the structure of the SAMP is different to that of a typical structured finance trust, which employs either an SPT or SPC approach, it is unclear whether the SAMP structure accomplishes a true sale and bankruptcy remoteness. Proponents of the structure argue that a SAMP fulfils bankruptcy remoteness because the purchased assets are valid in transfer and, therefore, are enforceable against all debtors and third parties by law.

These arguments appear to be solid and are underpinned by the Rule, which regulates the SAMP's launch. However, since the Rule is still in an interim status and no consistent regulatory system governs SAMPs, whether the SAMP can pass more severe tests to avoid the purchased assets forming part of an originator's insolvency estate is questionable. Because of this weak legal foundation, the qualified guarantee/liquidity facility plays a critical role in a SAMP deal. Fitch notes that major state-owned Chinese commercial banks currently provide a guarantee or liquidity facility to most of the listed SAMPs to date (see *Appendix 1*). The creditworthiness of the guarantee/liquidity facility provider is critical and directly linked to the rating of the transaction.

Tax Issues

For the two Chinese pilot projects, China Development Bank's collateralised loan obligation ("CLO") and China Construction Bank's residential mortgage-backed securities ("RMBS"), the State Administration of Tax, the authority for China's taxation affairs, has issued a tax ruling addressing the tax issues for securitisation deals. The ruling clearly resolves the disputes of stamp duty, VAT and income tax issues for the originator, trustee and other third parties under an SPT structure.

However, for the SAMP, no such ruling exists. It also seems highly unlikely that the State Administration of Tax would allow a SAMP to apply the tax ruling of these pilot projects. As a result, how to tax a SAMP remains uncertain, and this tax uncertainty is set to influence the SAMP's scheduled cash flows. In addition, the unclear tax status may deter originators from bringing a deal to market or investors funding a SAMP.

A guarantee/liquidity facility largely mitigates the uncertainties of a SAMP's cash flows due to its unclear tax status. The SAMP also saves the originator significant funding costs while providing investors with better yields compared with those of other fixed income instruments carrying the same rating. Therefore, the motivation and incentive to issue SAMPs remains sufficiently strong for both parties to bolster interest in this vehicle.

Fitch nevertheless believes that a clear-cut tax rule for SAMPs and other similar securitisation vehicles is necessary for the development of the Chinese securitisation market.

Structural Issues

Of the SAMPs that have come to market so far, Fitch notes that all employ a term structure to issue several tranches with different maturities. The maturity date of each tranche matches that of the collateralised assets. The prevalence of the term structure is due mainly to limited investor understanding and knowledge of an asset-backed commercial paper ("ABCP") or revolving structure. As investor knowledge of deal structures increases, Fitch believes a revolving-style SAMP will emerge in the near future.

In addition to the prevalence of term structure SAMPs, Fitch notes that SAMP arrangers employ an overcollateralisation ("OC") approach to provide internal credit enhancement for each tranche of notes to meet a specific rating level. Details of this arrangement remain unclear, however, due to the lack of transparent public information. As a result, whether a given OC level incorporates a sufficient loss reserve, dilution reserve and carrying cost reserve to sustain a specific rating level for each tranche is still questionable. Moreover, Fitch observes that there is no reserve in place to address the commingling risk of deals where the originator also acts as servicer.

Insufficient credit enhancement would create a situation where investors incurred unexpected losses, which would ultimately impair investors' acceptance of SAMPs. With these structural concerns, Fitch believes that a guarantee, once again, plays a pivotal role to mitigate a potential loss arising from insufficient credit enhancement.

■ Conclusion

Fitch has observed increasing demand from Chinese corporates for short- to medium-term financing. Most Chinese corporates have limited funding options and usually incur high funding costs due to the companies' size or governmental policies. Chinese SAMPs open up a new route for those companies that are generating solid sales but are cut off from the domestic loan or bond markets.

Fitch believes the funding cost savings and time and cost efficiencies of the SAMP review and approval procedure are the two main drivers in making SAMPs a viable funding alternative for Chinese corporates.

However, due to weak legal foundations and uncertain tax status, every SAMP has to employ a guarantee/liquidity facility to mitigate these concerns. In a SAMP deal, because of the provision of a full, unconditional guarantee, a bank actually undertakes the credit risk, which is similar to making a direct loan to a company. Therefore, the banks may raise the guarantee fee in future to compensate for their risk undertaking. This increase may offset the funding cost advantage of the SAMP and make it less attractive.

Despite the bank guarantee provision, legal and tax uncertainties remain fundamental issues for SAMPs, which are still in an interim status in the enactment of regulations. Fitch hopes to see in time a more clear-cut governing rule for SAMPs from legal and tax perspectives.

With the resolution of key legal, tax and structural issues mentioned above, Fitch believes the SAMP market can continue to mature as a financing alternative.

Appendix 1

Listed China SAMPs

SAMP Name	Underlying Assets	Tranche	Issuance Date	Arranger	Guarantor
China Unicom	Network Rental Receivables	Tranche 1 - RMB1.6bn, 175 days Tranche 2 - RMB1.6bn, 354 days Tranche 3 - RMB2.1bn, 122 days Tranche 4 - RMB2.1bn, 301 days Tranche 5 - RMB2.1bn, 421 days Total: RMB9.5bn	Tranche 1&2 - Sep 2006 Tranche 3&4 - Feb 2006 Tranche 5 - Dec 2005	CICC[2]	BOC[3]
Guangdong Toll Road	Toll Road Receivables	Tranche - RMB580m, 18 months	Dec 2005	GF Securities	ICBC[4]
China Netcom	Network Rental Receivables	Tranche 1 - RMB1.18bn, 67 days[1] Tranche 2 - RMB1.07bn, 246 days Tranche 3 - RMB1.04bn, 434 days Tranche 4 - RMB1.04bn, 611 days Tranche 5 - RMB1.02bn, 800 days Tranche 6 - RMB1.02bn, 977 days Tranche 7 - RMB1.0bn, 1163 days Tranche 8 - RMB1.0bn, 1344 days Tranche 9 - RMB0.99bn, 1528 days Tranche 10 - RMB0.98bn, 1708 days Total: RMB10.34bn	March 2006	CICC	ICBC
Huaneng Lancangjiang Hydropower	Electricity Sale Receivables	Tranche 1,2 & 3 Account for RMB1.98bn Subordinate Tranche - RMB20m Total: RMB2.0bn	May 2006	China Merchants Securities	Agricultural Bank of China
Fareastern	Equipment Leasing Receivables	Tranche A - RMB477m, 625 days Subordinate Tranche - RMB9m, 3 years Total: RMB486m	May 2006	Orient Securities	Sinochem Group

[1] China Netcom's Tranche 1 has been paid in full
[2] CICC – China International Capital Corporation
[3] BOC – Bank of China
[4] ICBC – Industrial & Commercial Bank of China
Source: Shanghai Stock Exchange, Shenzhen Stock Exchange, IFR Asia