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# Corporate Bond Market in China

# : Its Present Situation and Prospect

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## ＜Summary＞

- China's bond market has been rapidly expanding in recent years, especially corporate bond[1] have a big presence in the market. The size of the Chinese bond market (excluding Hong Kong), a total of corporate bond and financial bond other than the government bond ranked the top in Asia in 2012, overriding Japan. The bond market is largely divided into interbank market and exchange market. According to the People's Bank of China (PBOC), the former is dominant in terms of both issuance and outstanding, accounting for more than 90% of respective amounts.
- The corporate bonds consist of listed corporate bonds, enterprise bonds, CPs, MTNs and others. Especially increasing rapidly are CPs and MTNs. It seems they are increasing because they can be issued on a relatively simple term. Chinese corporate bonds are supervised by different agencies according to the kinds of securities, and traded on a different market. In each category of securities the state owned enterprises are the biggest issuer. Recently the

[1] In this article corporate bonds refer to the corporate debenture bonds as the Peoples' Bank of China describes, (namely, enterprise bonds, corporate bonds, and other financing tools like CPs and MTNs).

small and medium-sized enterprises (SMEs) have begun to join them, but their issuances are rather limited. They are also under a separate agency of supervision and subject to different terms by the kind of issuing securities

- Commercial banks and funds hold a greater share of securities in the interbank market where the majority of corporate bonds are traded[2]. Securities in the interbank market are mostly held until maturity while the bond market takes on an aspect of modified bank loan market.
- As is the case with other Asian countries, where fostering corporate bond market is an important agenda, China also has big problems such as an excessive presence of banks in the securities market and a lag in the diversification of bond issuers and investors. Most characteristic in China, however, is its separation of markets based on the supervisory agencies. From the side of issuers and investors, these separated markets and differing supervisory agencies are not user-friendly, but from the viewpoint of supervising authorities one can say this is a very convenient system in which the authorities can authorize the bond issues depending on their policies and needs for funds.
- The government authorities are aware of the problems such as implicit guarantees for the securities and distorted interest rate formation which hinder the sound development of the market, and promise the reforms of the securities market. The reforms, however, will not be broad and bold enough to bring a big change in the bond market; there will continue to remain controlled transactions in each market.

## ＜Text＞

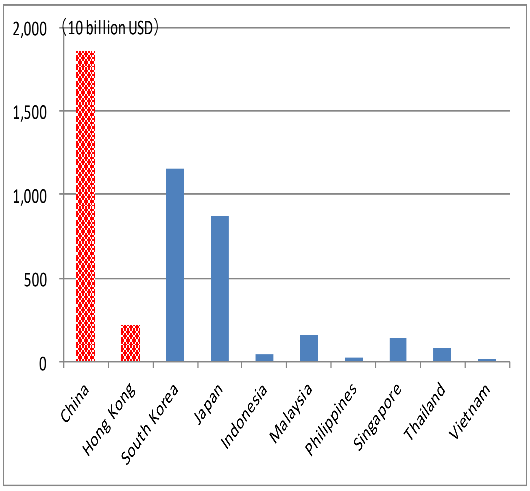
1. Bond market in China and corporate bonds

According to the statistics by the BIS, the size of securities markets in the world amounted to $90 trillion (approx. 9,450 trillion yen) at the end of December, 2013 and China (excluding Hong Kong) ranked the 6th in the world after increasing by almost 9 times in the last decade to about $4 trillion. The Asian Bonds Online reports that the amount of securities issued in China other than government bonds (i.e., the total of corporate bonds and financial bonds) overtook Japan in 2012 to become the largest in Asia. As is shown in chart 1-2, corporate bonds have a big presence in the recent China bond market.

2 No data is available for the shares of bond holders in the exchange market.

Chart1-1: Bonds Markets in East Asia

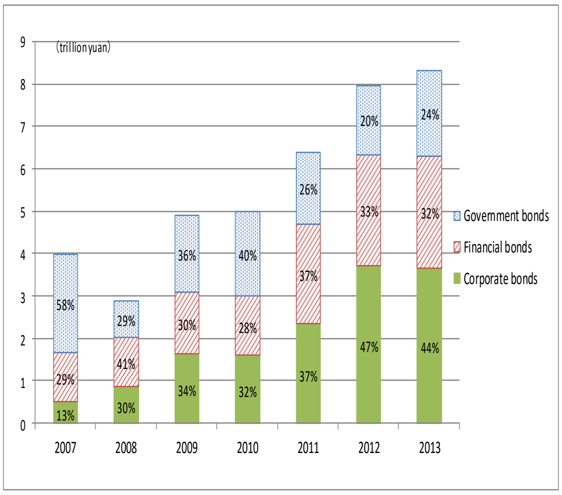
（Total of financial and corporate bonds）




Source：Asian Bonds Online（as of end December, 2013）

※$2.2 billion for Vietnam

Chart 1-2：Bond Issuance in China[3]




Source：PBOC, China Bond Com

※Numbers show the share of each security in the total issuance

## 2. Characteristics of Chinese corporate bond market

Securities market in China is largely divided into an interbank market and an exchange market, but more than 90% of securities are traded in the interbank market[4]. It is also true with the corporate bonds and only 11% of corporate bonds were issued on the exchange market[5]. Chart 2 shows the representative corporate bonds traded in China, which include CPs (commercial papers) for short-term financing, SCPs (super short-term commercial papers) for shorter financing, and MTNs for medium-term, and listed corporate bonds and enterprise bonds for a long term financing.

They are supervised by a different agency and traded in a different market.

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[3] Only enterprise bonds for 2011 and earlier(owing to a statistical change by the PBOC)

[4] According to the China Financial Stability Report 2014 issued by the PBOC, transactions in the interbank market accounted for 91% for bond issuance in 2013 and 94% for the bond outstanding.

[5] The shares of corporate bonds registered at China Securities Depository and Clearing Corporation (CSDCC).

Chart 2: Representative bonds in China

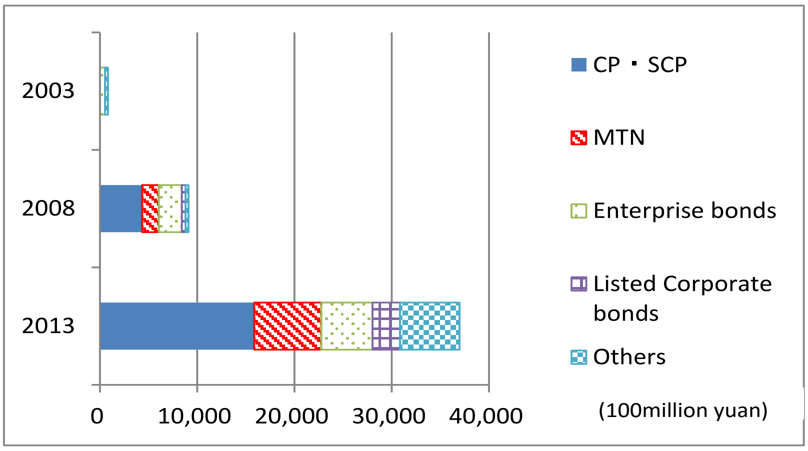
| | Super short-term Commercial Paper(SCP) Commercial Paper(CP) Medium-term Notes(MTN) | Listed Corporate Bonds | Enterprise Bonds |
|---|---|---|---|
| Competent Authority | People's Bank of China(PBOC), National Asscociation of Financial Market Institutional Investors(NAFMII) | China Securities Regulatory Commission(CSRC) | National Development and Reform Commission(NDRC) |
| Approval | Registration system | Verification and approval system | |
| Size of Fund Raised | The accumulated balance cannot exceed 40% of the net assets of the company | | Satisfying the approved size by the State Council, and the accumulated balance cannot exceed 40% of the net assets of the company |
| Determination of Issuing Rate | Tender issuance or book building | Determined through market inquiry by issuers and sponsors | Determined by the enterprise according to the actual market condition, but subject to the approval of the regulatory body |
| Bond Maturity | The maturity for SCP is no longer than 270 days, for CP no longer than 1 year, for MTN is usually no longer than 10 years | No restricitions | No restrictions, normally long-term bonds with maturities lonager than 5 years |
| Main Trading Places | Inter-bank Bond Market | Exchange market | Cross-market trading, but are mainly traded in the Inter-bank Market |
| Registration and Settlement Institutions | China Central Depository and Clearing Corporation Limited（CCDC）<br>Shanghai Clearing House（SHCH） | China Securities Depository and Clearing Corporation Limited （CSDCC） | China Central Depository and Clearing Corporation Limited（CCDC）<br>China Securities Depository and Clearing Corporation Limited（CSDCC） |

Source：Compiled by the IIMA based on ASEAN+3 Bond Market Guide Volume1

※The majority of enterprise bonds is traded in the interbank market.

Corporate bond market has expanded along with a new incorporation of CPs in 2005, of listed corporate bonds in 2007, and of MTNs in 2008 and as of 2013 CPs and MTNs jointly accounted for 62% of the total issuance. This shows that more funds have been raised by means of financing tools similar to bond issuance rather than by issuing bonds themselves.

Chart 3: Bond issuance in China




Source：Shanghai Clearing House, China Central Depository & Clearing Co., Ltd (CCDCC)、CSDCC

※Figures for Others for 2013 include PPNs (a kind of financing tools) amounting to RMB566.8 billion.

Issuers of category of corporate bonds show that the small numbers of issuers dominate the corporate bond market and the State Owned Enterprises (SOEs) account for a larger part of corporate bonds.

Chart 4: Top 30 issuers of local currency corporate bonds (2013)

| | |
|---|---|
| Total local currency corporate bonds（billion yuan） | 8,505 |
| Total Top30 local currency corporate bonds（billion yuan） | 4,135 |
| SOE issuers of top 30 | 3,569 |
| Top 30 as % of Total local currency corporate bonds | 48.6 |
| SOE issuers as % of Top30 local currency corporate bonds | 86.3 |

Source：AsianBondsOnline

Thus, while big companies centering on SOEs dominate the bond issuance market, there are some frameworks for bond issuance by the SMEs, the scale of the latter is rather limited and their supervisory agencies and issuance terms also differ depending on the kind of the securities issued.

Chart 5-1：Securities issued by the SMEs

| | SME collective notes | SME collective bonds | SME private placement bonds |
|---|---|---|---|
| Competent Authority | National Asscociation of Financial Market Institutional Investors(NAFMII) | National Development and Reform Commission(NDRC) | China Securities Regulatory Commission(CSRC) |
| Approval Method | Registration system | Verification and approval system | notification system |
| Issuing method | Issued by 2 to 10 SMEs who collectively design and issue a single note with the same credit enhancement arrangements and the same redemption plan | Issued by several SMEs who collectively design and issue a single note with the same credit enhancement arrangements and the same redemption plan | Usually single SME issues for single private placement bond, but jointly issuing by several SMEs is also permitted |
| Size of Fund Raised | One company cannot exceed 200million yuan and 40% of the net assets of the themselves. Total amount of one note cannot exceed 1 | The accumulated balance cannot exceed 40% of the net assets of the respective company | No restricitions |
| Determination of Issuing Rate | Determined through market | Determined through the process of verification of PBOC | Within 3 times of the bank lending base rate |
| Main Trading Places | Inter-bank Bond Market | Exchange market | Exchange market |

Source：Compiled by the IIMA based on the information by Shanghai Clearing House, China Bond Com and others

※SME private placement bonds are classified as listed corporate bonds, and SME collective bonds as enterprise bonds respectively.

Chart 5-2: Issuance of securities by SMEs

| | SME collective notes | | SME collective bonds | | SME private placment bonds | |
|---|---|---|---|---|---|---|
| | number of securities | issuing amout (100million yuan) | number of securities | issuing amout (100million yuan) | number of securities | issuing amout (100million |
| 2009 | 4 | 12.65 | 0 | 0 | 0 | 0 |
| 2010 | 19 | 46.57 | 2 | 5.83 | 0 | 0 |
| 2011 | 17 | 52.34 | 3 | 14.18 | 0 | 0 |
| 2012 | 34 | 70.87 | 5 | 14.81 | 73 | 76.53 |
| 2013 | 3 | 5.17 | 15 | 17.03 | 217 | 285.23 |

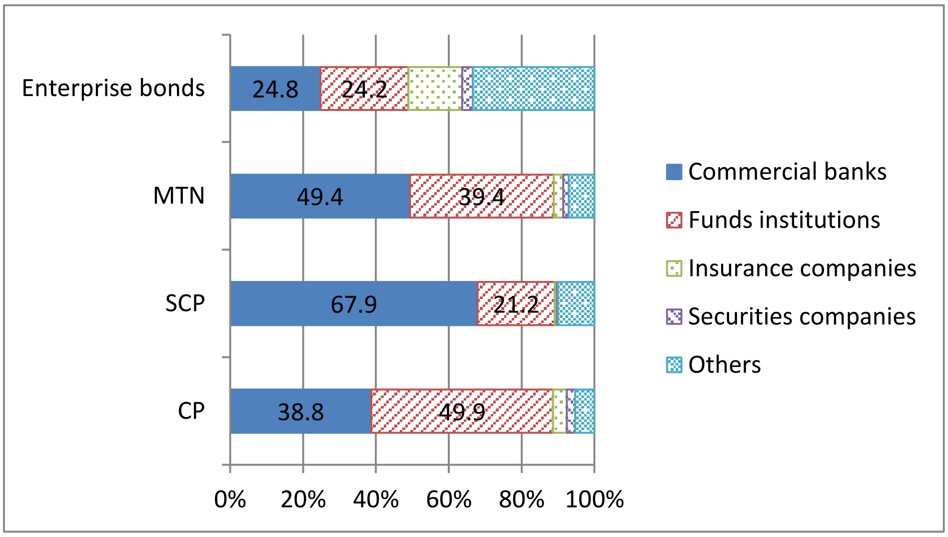
Source：China Bond Com, CCDCC

Next, let's see the investors of corporate bonds in China. As was noted above, the great majority of corporate bonds are traded in the interbank market, and commercial banks and funds have a great share respectively[6]. Chart 7 shows that in recent years the turnover ratio has been low for both government bonds and corporate bonds, suggesting that most of the purchased

[6] According to Asset Management Association of China, the assets managed by the funds amounted to RMB4.2 trillion at the end of 2013, of which publicly-offered funds accounted for RMB3.1 trillion. Publicly offered funds include stock type, mixed type, bond type, and currency type, of which bond type accounts for about 10% and mixed type for 19%.

bonds tend to be held until maturity.

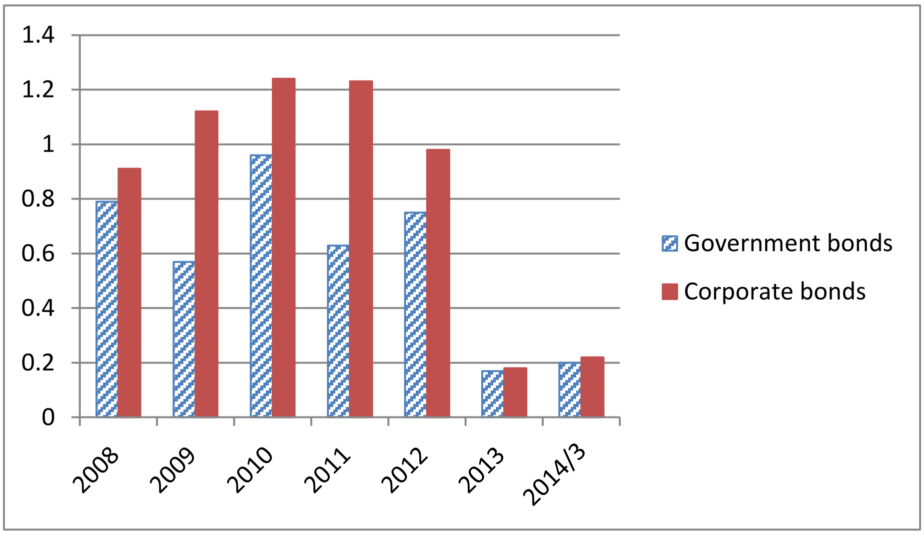
Chart 6: Holders of corporate bonds traded in the interbank bond market (2013)




Source : Compiled by the IIMA based on the information of China Bond Com and Shanghai Clearing House

※ The Exchange holds 26%of enterprise bonds attributed to Others (33.4%)

Chart 7: Bonds Turnover ratios in China




Source : Asian Bonds Online

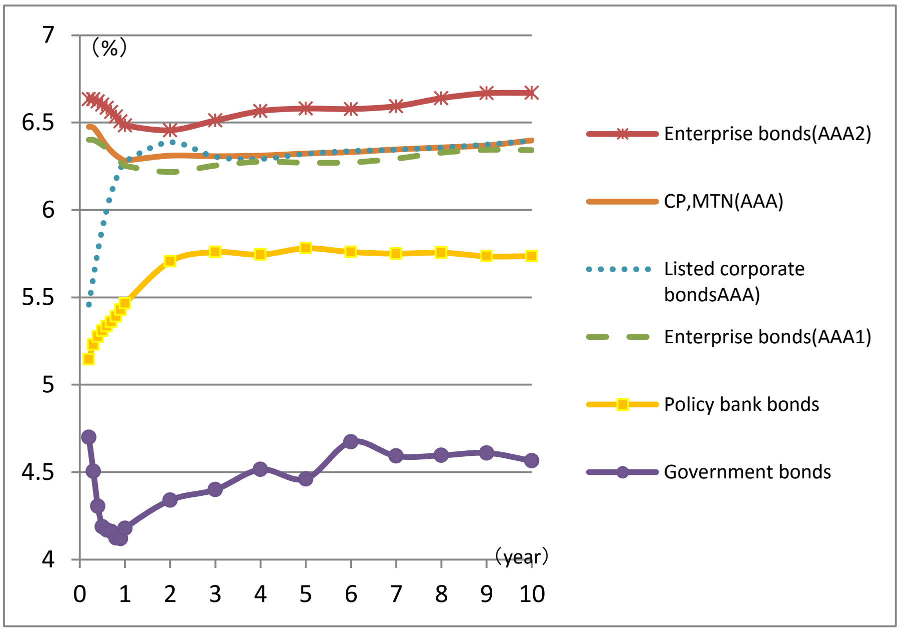
※Bonds turnover ratio equals value of bonds traded divided by Average amount of bonds outstanding.

To sum up, it can be said that i) recent expansion of China's corporate bond market reflects the growth of diversified financing tools, ii) main issuers of these bonds including financing tools are the SOEs iii) taking into account the large corporations with banks accounting for about a half of subscriptions and the low turnover ratio, the corporate bond market in China in large part serves as a transformed bank lending market.

As Chart 8-2 shows (as of the end of June, 2014), yield curves have been formed based on the policy bank bond as a benchmark, with those for corporate bonds and enterprise bonds showing higher curves in the order. Also Chart 8-1(as of the end of 2013) depicts the influence on the bond market of the jump of short-term interbank interest rates triggered by the fears for failure of shadow banking or concerns for a possible tapering of the US quantitative easing. Since then, the interest rates have generally tended to stabilize, although there was the first default of Chinese corporate bond market in March 2014. According to the PBOC, even after the removal of regulation on floor rate of lending to liberalize the loan rates in July 2013, more than 90% or so of the RMB loans have been made at higher rates than the benchmark rates (current benchmark rate for 1year loans is 6%). As Chart 8-2 shows, all of the final yields of the bonds register less than 6%, thus the corporations are enjoying a merit of reduced cost of procurement of funds in the bond market. On the other hand, even the AAA rated corporate bonds have a spread of more or less than 200bp against the interest rate of the government bond. Chart 9 shows that this is very big compared to those in Japan and Korea. According to a report by Shanghai Brilliance Credit Rating & Investors Service Co., Ltd., one of the major rating agencies in China, most of issuers of corporate bonds in 2013 enjoyed the rating of AA or higher[7], but the spreads noted above indicate that the corporate bonds are judged to have large risks.

[7] Issuers rated lower than AA ratings account for 6.6% for CPs, 0.4% for medium-term notes, and 0% for listed corporate bonds and enterprise bonds.

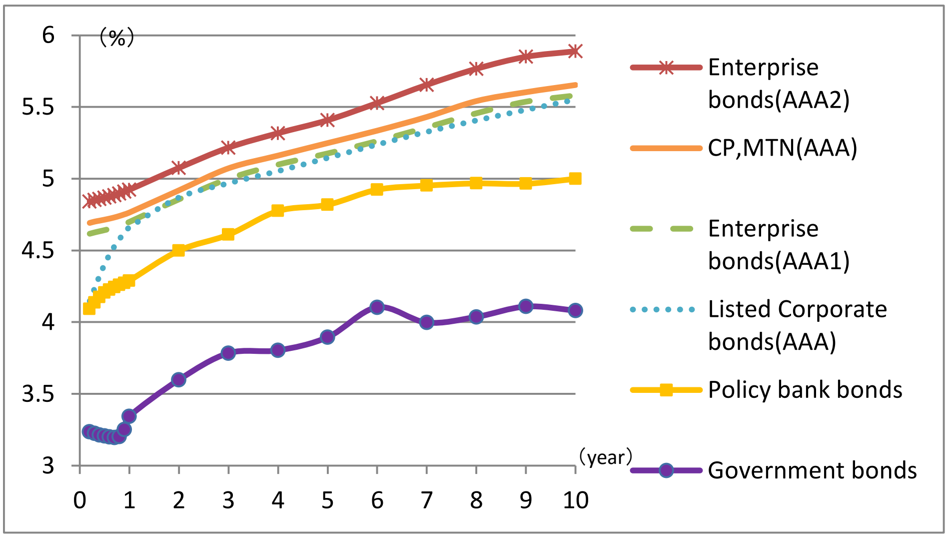
Chart 8-1: Yield curves for corporate bonds, government bonds, and policy bank bonds (as of end of 2013)




Source：China Securities Index Co., Ltd.

※Enterprise bonds refer to those traded in interbank bond market. Figures in parentheses show the ratings.

Chart 8-2: Yield curves for corporate bonds, government bonds, and policy bank bonds (as of end of June, 2014)




Source：China Securities Index Co., Ltd.

※Enterprise bonds refer to those traded in interbank bond market. Figures in parentheses show the ratings.

Chart 9: Spreads between corporate bonds and government bonds (as of the end 2013, in bps)

| | Corporate bonds（AA）vs Government bonds | | | Corporate bonds（AAA）vs Government bonds | | |
|---|---|---|---|---|---|---|
| | 1 year | 3 year | 5 year | 1 year | 3 year | 5 year |
| China | 296.8 | 294.1 | 313.9 | 205.8 | 183.1 | 182.9 |
| South Korea | 21.0 | 42.0 | 42.0 | 17.0 | 38.0 | 38.0 |
| Japan | 11.9 | 18.1 | 16.4 | 0.0 | 0.0 | 0.0 |

Source：Asian Bonds Online

※According to the Thomson Reuters, Spreads between Japan's corporate bonds (AAA) and government bonds (as of the end 2013) are 3-year bonds for -0.001(0.1bp), 5-year for 0.124(12.4bp). No data is available for 1 year.

3. Issues for China's corporate bond market

As is the case with other Asian countries where fostering corporate bond market is an important agenda, China also has problems such as an excessive presence of banks in the bond market, and lagged growth and diversification of corporate bond issuers and investors. What is the most characteristic of China's bond market is the separation of market by separate supervision for separate securities. Namely, each market is regulated by separate supervisory agencies and the market participants are also limited according to the kind of securities. This is very inconvenient to the issuers as the issuing procedures vary according to the supervisory agencies. Investors also have a restriction on the products to invest, for instance, like the individual investors cannot access[8] the interbank bond market which accounts for the majority of bond trading. The market is not convenient to use for both issuers and investors. On the other hand, it can be said this is a convenient system for the regulators since they can authorize the bond issuance in line with their policy needs and purpose of the funds.

Long-term corporate bonds in China consist of listed corporate bonds mainly issued by private companies and enterprise bonds mainly issued by the SOEs, and the latter has a bigger presence with twice as large size as the former. As was shown in Chart 2, the two have a different concept of management as they are under separate supervisory agencies. Listed corporate bonds are disclosed in the bond market at a time of their issuance and after, while enterprise bonds are subject to less disclosures as more emphasis is placed on the assessment at

[8] The bonds which individual investors can buy on the counter of banks are Treasury Bonds and Savings Bonds (Electronic).

a time of issuance with less controls after the issuance[9].

As seen above, China's bond market represents rather a specific circumstance. In a liberalized free bond market, the bonds are accepted through the judgment of the market, and those that the market judges should default must exit from the market. Present bond market in China, however, provides the government with the framework to meet the needs for national policies. This framework, on the other hand, has tended to limit the sound development of the market, by bringing about a distortion in the interest rate formation, as the market recognizes that the government has given positive commitments to the bond issuance, thus giving the bond an implicit government guarantee.

In forecasting the future, it is important to give special attention to the movements of enterprise bonds.

As is shown in Chart 4, the great majority of the enterprise bonds have been issued by the SOEs, most of which are located in the rural areas. It is believed that the urban construction bonds (those issued to finance infrastructure projects) account for a large part of the enterprise bonds. As China has achieved an investment-driven economic growth, there has been a growing concern for an excessive investment in real estates. If at some point some of them should default, its impact on the bond market should be enormous since many of the enterprise bonds have a similar background of issuance.

It is most likely that the national policies continue to be reflected in the process of issuance for the enterprise bonds that are supervised by the National Development and Reform Commission. So even if they will have a strict assessment at the time of issuance, a strong incentive will work on the government who is promoting urbanization for approving large procurements of funds on the bond market to secure the needed funds. Unless there is a big change in their policy making, the issuance of enterprise bonds will surely continue to be on the rise.

[9] Based on the explanation in the website of Finance Office of the People's Government of Cixi City.

4. Future Prospect

The government is aware of the problems in the corporate bond market and says it is willing to promote the reform of the bond market, declaring its policies, as in the decision of the Third Plenary Session of 2013, to let the market play a decisive role in the distribution of resources and leave to the market whatever securities the market can mark a price on. However, it is difficult to think, at least in a short run, that the government will move to a comprehensive liberalization of the market and therefore restricted transactions will continue to remain in a foreseeable future.

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