Call for a healthier bond market

China must ease debt issue approvals and let players manage risks based on actual market situation, says Chengxin

By Jeff Pao
Interview

China should ease approval procedures for corporate bonds and allow issuers and investors to manage default risks based on market-driven ratings, China Chengxin (Asia Pacific) Credit Ratings Co. Ltd. (CCXAP) said.

"There has not been a single case of bond default in China in the past two decades," said Philip Li, managing director of CCXAP, a unit of China Chengxin Credit Management Co. Ltd. "Why can't we have defaults in the bond market?"

The unwritten principle of zero default in the Chinese bond market has created a moral hazard. Investors tend to think the government will ultimately bail out their bond investments in case of default, Li said. They underestimate the risks when buying corporate bonds.

Also, tight regulatory standards have created a bottleneck in the bond market, limiting investor choices, he said. Investors rush to subscribe to new issues in the hope of getting up to 8 percent return on their investment.

"It is not a healthy situation," Li told the Hong Kong Economic Journal's EJ Insight.

Some unscrupulous credit rating service providers have sold ratings for profit. A triple A rating could fetch 2 million yuan (US$326,264), Li said.

Such malpractice is one reason the National Development and Reform Commission (NDRC) suspended corporate bond issues in May, he said.

On May 23, the NDRC directed all relevant parties including issuers, underwriters, accounting firms, credit rating agencies and other intermediaries to thoroughly examine the financial records of issuers.

The top planning agency will launch random inspections based on the results of the internal vetting.

Lack of transparency in urban construction debt securities issued by financing vehicles on behalf of local governments is another reason for the suspension of bond issues, Li said.

"Due to loose post-sale monitoring by regulators, some urban construction investment and development companies have poor transparency and incomplete financial data," he said. "Some money has gone missing, instead of being used for the planned public projects."

Assets offered as collateral for the securities are often inflated and some are double-pledged, Li said.

China's bond market is jointly regulated by the NDRC, the People's Bank of China and the China Securities Regulatory Commission, leading to a cumbersome approval process and weak post-issue oversight, Li said.

A single authority to handle all regulatory matters could solve the problem and improve efficiency, he said.

Established in 1992, China Chengxin Credit Management is the first Chinese credit rating agency. Over the past 20 years, it has rated more than 9,000 corporations, banks and financial institutions in China.

In 2006, it established China Chengxin International Credit Rating Co. Ltd. with Moody's which owns 49 percent of the joint venture. The unit provides a full range of credit rating services to corporations and institutions in the Chinese domestic credit market.

Last year, China Chengxin Credit Management set up CCXAP in Hong Kong, offering rating services for dim sum bonds, Hong Kong's renminbi-denominated debt securities.

Other major Chinese rating agencies include Dagong Global Credit Rating Co. Ltd., China Lianhe Credit Rating Co. Ltd. and Shanghai Brilliance Credit Rating & Investors Service Co. Ltd.

jeffpao@hkej.com

■ Full report at www.ejinsight.com

Philip Li, managing director of China Chengxin (Asia Pacific) Credit Ratings, says the unwritten principle of zero default in China's bond market has posed a moral hazard. HKEJ