

Research on Accounting Issues of Financial Asset Securitization in China

Daimeng Yang^{1,a,*}

¹*Beijing Language and Culture University, Beijing, 100083, China*

a. 13203597777@163.com

**corresponding author*

Abstract: In recent years, China's financial market has witnessed a growing maturity, with asset securitization gradually emerging as a pivotal approach for enterprises to reduce financing costs and improve the efficiency of capital utilization. However, asset securitization, as a very complex financial innovation tool, may also expose enterprises to greater risks. This study aims to explore the issues of financial asset securitization in terms of accounting treatment, providing an all-encompassing depiction of its definition, development, practice, and accounting treatment. By utilizing China's asset securitization market as an example case study, this research analyzes prospective challenges and novel aspects in terms of accounting and financial reporting that may arise in the future for financial asset securitization. In addition, this paper discusses cutting-edge developments in the field of asset securitization, such as the impact of technological advances on accounting treatment, and puts forward some suggestions for risk management and prevention of its accounting. An examination of the accounting treatment surrounding financial asset securitization aids in enhancing the transparency and accuracy within financial reporting systems, thereby fostering investor trust in the financial market while bolstering overall stability.

Keywords: Asset securitization, Accounting treatment, Risk.

1. Introduction

Asset securitization is the activity of issuing asset-backed securities by using the future cash flows of the underlying assets as the basis for repayment. Financial asset securitization is a subset of asset securitization and is specifically aimed at securitizing financial assets. This approach helps financial institutions reduce capital costs and risks, provides investors with diversified investment options, and accordingly promotes the deepening and development of financial markets. However, financial asset securitization also brings a series of accounting issues and risks, including “information asymmetry, accounting estimation and recognition, and accounting disclosure” [1]. These challenges present considerable obstacles for the financial industry, accounting practices, and regulatory policies, thereby exerting a negative impact on the stability and long-term viability of financial markets. Consequently, it is imperative to thoroughly investigate and examine these issues when engaging in asset securitization.

In order to explore the accounting issues in the process of financial asset securitization, this study adopts the methods of literature review and case study. Through reviewing relevant literature, the definition, operation mechanism, accounting treatment, and accounting risk of financial asset

securitization are systematically elaborated. Secondly, taking the asset securitization market in China as a case study, this research analyzes the risks and challenges posed by the accounting issues of financial asset securitization. Finally, the findings are summarized and generalized to present development prospects and policy recommendations for the field of asset securitization.

The significance of this study is to promote the healthy and sustainable development of China's financial market by conducting research and analysis on the accounting aspects of financial asset securitization. This will provide enterprises and investors with valuable insights and guidance.

2. Overview of Financial Asset Securitization

2.1. Definition

Financial asset securitization is a structured financing activity in which the proceeds of asset-backed securities are paid out of the cash flows generated by the financial assets [2]. It consists of the following steps:

- Firstly, financial institutions such as banks or general enterprises screen out from the various financial assets they hold (e.g., residential loans, credit card receivables, etc.) assets or asset portfolios that are less liquid but have expected stable future cash flows as the object of securitization.
- Second, the financial institution will set up a specific purpose vehicle (SPV), which is independent of the financial institution, with the primary purpose of purchasing the underlying assets and issuing the securities. In order to improve the credit rating of the asset-backed securities and attract investors, the SPV will improve the credit rating of the securities through third-party guarantees, insurance, or internal credit enhancement (e.g., senior/subordinated structure). Backed by the cash flows generated by the underlying assets, the SPV will issue bonds or other types of securities to the investors and will be responsible for the management of the underlying assets and the recovery of principal and interest to pay back principal and interest to the holders of the securities.

This process not only improves the liquidity of the assets but also helps financial institutions optimize their asset-liability structure, diversify risks, and improve returns. After issuance, asset-backed securities can be freely traded in the financial market, providing investors with more investment choices and opportunities for risk diversification.

2.2. Current Status

China's financial asset securitization market started late but has developed rapidly, and with the support of policies and institutions, it has achieved remarkable results and become an important part of the financial market. In recent years, the government has been actively promoting financial market reforms, and asset securitization has experienced remarkable development, covering real estate, infrastructure, and corporate debt.

According to *Asset Securitization Development Report 2023*, as of 2023, China's asset securitization market operated smoothly, with a total of 184.814 billion yuan of various types of asset securitization products issued throughout the year. The year-end market stock stood at 435.1685 billion yuan, a year-on-year decline of 7% (Figure 1) [3]. Despite a slight decline in the scale of issuance, the overall market structure was relatively stable, and the issuance interest rate also showed a trend of decreasing and then increasing.

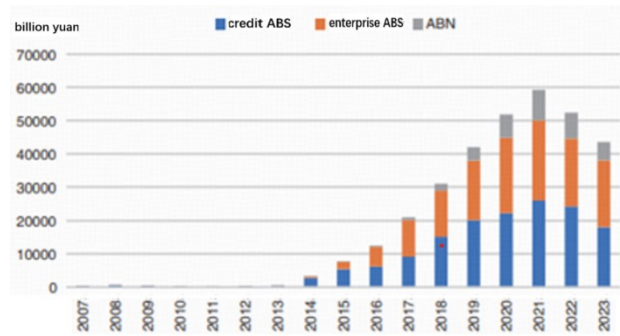


Figure 1: Asset-backed securities custody volume, 2007-2023 [3].

However, China's asset securitization market still faces a number of problems and challenges, such as market mechanisms and business standards still need to be improved and updated, professional ratings as well as supporting intermediary services are not yet sound, and assets are more volatile and face the challenge of complex risk overlays [4].

3. Basic Principles of Accounting Treatment

3.1. Accounting Standards

Asset securitization, or ABS, is a financial instrument that converts specific assets into securities. For accounting purposes, this process is mainly carried out with reference to *ASBE No. 23—Requirements for the Transfer of Financial Assets*, which is a standard that elaborates in detail on how to identify and measure transfers of financial assets and provides standardized guidelines for handling the accounting matters related to asset securitization.

In financial transactions, the key is to understand the actual transfer of equity, not just apparent compliance. When accounting for the transfer of assets, even if the change of ownership at the legal level has been completed, if the related risks and benefits have not been substantially transferred to the new holder, the asset should still continue to be credited to the original holder, which helps to safeguard the financial information disclosed reflects economic substance and enhances the accuracy of and reliance on financial reporting [5]. This treatment helps to ensure that the disclosed financial information reflects the economic substance and enhances the accuracy and reliance of financial reporting.

In the case of a transfer of a financial asset, the key is to assess whether the principal risks and rewards have been fully transferred to the recipient, and once it has been determined that the recipient has assumed the vast majority of those risks and rewards, the transferor should cease to account for the asset in its financial statements, a process that involves projecting and evaluating the future cash flows to ensure that they have been transferred to the recipient in substance; however, if the risks and benefits are not fully transferred, the transferor is still required to continue to recognize the asset in its books.

Control is a key indicator of whether a financial asset has been successfully transferred. The transfer of control involves not only the transfer of risks and rewards but also the transfer of the right of use and domination [6]. An asset securitization transaction can only be considered successful if control is fully transferred. If the transferor has relinquished control over the financial assets, this should normally be considered a sale, and conversely, if he retains some control, the situation is usually categorized as financing.

3.2. Comparison with International Standards

There are both similarities and certain differences in the treatment of asset securitization between Chinese accounting standards and International Financial Reporting Standards (IFRS). With the increasing integration of global financial markets, the differences between Chinese accounting standards and IFRS are gradually narrowing, and enterprises should be keenly aware of these changes in order to promote international financial reporting comparability and transparency.

4. Key Issues in Accounting Treatment

The accounting treatment of asset securitization in China mainly has the following problems: applicability and perfection of accounting standards, incompleteness and lagging of laws and regulations, complexity and uncertainty of accounting treatment, adequacy and transparency of information disclosure, and incompleteness of supporting services.

Although China has issued a number of accounting standards, such as *AS 22 - Recognition and Measurement of Financial Instruments* and *AS 23 - Transfer of Financial Assets*, which provide guidance on the accounting treatment of asset securitization to a certain extent, the updating and improvement of accounting standards still lags behind compared with the rapidly developing domestic financial market and continuously innovative asset securitization products in China. Meanwhile, there are some specific applicability problems in the application of Chinese accounting standards in the field of asset securitization. For example, how to accurately define the boundaries between "true sale" and "secured financing," and how to reasonably recognize the transfer of risk-reward materiality in complex transaction structures are all challenges that the current accounting standards need to face.

Although China has introduced a series of laws and regulations related to asset securitization, the overall legal system is still unsound. The lack of special securitization regulations makes it difficult to find a clear legal basis for some specific problems encountered in the accounting process [7]. In addition, in the process of implementing laws and regulations, there are cases of lax and unfair implementation in some regions and departments. This may lead to interference and disruption of the market order and affect the fairness and effectiveness of accounting treatment.

Asset securitization transactions often involve multiple participants and complex transaction structures, which increase the complexity and difficulty of accounting treatment. In the process of accounting treatment, it is necessary to accurately identify and differentiate the rights and obligations of different participants, as well as the risks and rewards of different transaction segments, for example, how to judge the divestiture and control of assets under different circumstances. In addition, fair value is an important concept in the accounting treatment of asset securitization, and the choice of its measurement method will have an impact on the accounting treatment of securitization of assets. However, the efficiency level of China's capital market is still lower than that of other developed capital markets, and the determination of fair value is often characterized by greater uncertainty and subjectivity. Coupled with the asymmetry of market information and the limitations of valuation techniques, the determination of fair value may be challenged by a variety of factors, resulting in the reliability and relevance of accounting information being questioned [8].

Although China has stipulated mandatory disclosure of information on asset securitization, such as risks, financial impacts, and transparency of the structure of the transaction, in practice the exhaustiveness and transparency of such information need to be further enhanced, especially for those special non-standardized asset securitization products, whose published information often fails to satisfy investor requirements for details and timeliness. In addition, because the format and content of disclosed information vary among institutions and products and the quality varies, it is difficult for

investors to compare and assess them effectively, a situation that seriously affects market clarity and investor trust.

Lastly, China's asset appraisal and credit rating industry is relatively backward and has yet to form a perfect appraisal system and rating standards. The behavior of some intermediary service providers in the asset securitization business is not standardized enough, and there are problems such as unfair competition and double charging. This has increased the level of confusion in the market and affected the fairness and effectiveness of accounting treatment.

5. Future Development Trends and Recommendations

China's asset securitization market has now entered a stage of standardized development after experiencing piloting, stagnation, and recovery and will show positive trends in terms of market size, policy environment, participating entities, and technological advancement in the future. Despite the year-on-year decrease in corporate ABS issuance in the first half of 2024, the asset securitization market is still undergoing structural adjustment. Consumer finance ABS issuance rose steadily, green ABS developed rapidly, and the types of underlying assets became more and more diversified [9]. Held real estate ABS gradually became a new direction for the market to explore, and insurance asset management company ABS products also began to debut in the market, bringing new vitality to the market. With the continuous maturity of the market and technological advancement, the asset securitization market is expected to provide more diversified and efficient financing channels for the real economy and play an important role in promoting economic development and social progress. However, the market still needs to enhance transparency, optimize the investor structure, enrich the types of underlying assets, strengthen the risk assessment and monitoring of asset securitization products, and improve laws, regulations, and regulatory policies to promote healthy and sound development. At the same time, it is necessary to summarize the successful experience of international asset securitization and explore the asset securitization model suitable for China's national conditions, taking into account the actual situation of the Chinese market.

With the rapid development of technology, enterprises have undergone fundamental changes in dealing with the accounting affairs of asset securitization. First, modern IT technology has improved the speed and accuracy of data processing, enabling companies to analyze cash flows and risks in greater detail, and thus more accurately assess the value of their products. Second, changes in accounting processes have dramatically simplified day-to-day operations, with many complex manual tasks now being performed by automated tools, such as financial statement generation and risk assessment. In addition, emerging technologies such as blockchain have increased the transparency of accounting disclosures, making the recording and sharing of key information such as deal structure, risk details, and cash flow projections more reliable [10]. These technological changes have placed higher demands on the capabilities of accounting professionals, and modern accountants need to have solid financial knowledge and be proficient in the use of various types of accounting software.

6. Conclusion

This paper focuses on the complexities faced in the accounting treatment of financial asset securitization. First, the study reviews the basic concept of financial asset securitization and clarifies its importance in risk management and liquidity enhancement. Then, the paper discusses in detail the applicability of relevant accounting treatments. By systematically analyzing the domestic accounting standards, the paper points out the limitations of the current accounting standards in dealing with financial asset securitization, especially the deficiencies in fair value measurement and risk disclosure. The main conclusion lies in the fact that clarifying and unifying the accounting treatment principles

of financial asset securitization is crucial to enhancing the quality of accounting information, protecting investors' interests, and promoting the stable development of financial markets. Relevant professionals and organizations must strengthen the research and revision of relevant accounting standards to ensure that they are better adapted to the rapid development and changes in China's financial market. However, there are some shortcomings in this paper. First, in terms of content, with the continuous innovation of the financial market and the emergence of new securitization products, this article is unable to cover the details of the accounting treatment of all types of products. Future research can be further expanded into emerging areas such as green asset securitization. Second, in terms of methodology, this paper mainly adopts literature review and case study analysis, which can be combined with empirical research in the future to verify the theoretical assumptions through the data model and improve the scientific and persuasive nature of the research. Looking ahead, the research on accounting issues of financial asset securitization will show a diversified and in-depth trend, which deserves our continuous attention.

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