

Introduction to Bond Defaults and Risk Management in China

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Abstract: While the bond market is continuously developing and growing, the risks behind them are becoming more and more prominent. Since the bond market broke the rigid payment in 2014, the amount and quantity of bond defaults have been increasing. The decline is to show the characteristics of high credit rating, state-owned background enterprise, and multi-industry diffusion. The occurrence of bond defaults has brought different degrees of damage to related entities. This has a great risk for the bond market. Therefore, in this context, how to effectively deal with the impact of bond default risks on enterprises and conducts empirical analysis on the basis of this is a major problem. This article analyzes the causes of bond default from the perspective of breach of contract, and according to the reasons, the solution to risk management is proposed, including macroeconomic regulation and specific measures.

Keywords: bond defaults, risk management, China

1. Introduction

The bond market is an indispensable part of a country's financial system. A unified and mature bond market can provide low-risk investment and financing tools for investors and funders in the whole society; the yield curve of bonds is the benchmark for all financial commodities in society and economy. Therefore, the bond market is also an important carrier for conducting central bank monetary policy. The development of the bond market is also crucial for China. However, in the current bond market development process, too many bond defaults have hindered the normal development of the bond market and negatively affected the investment and financing behavior [1]. First, bond defaults to increase the risk of financing costs. In the environment of bond default, investors have increased the requirements for risk premiums, driving bond interest rates to rise, leading to rising physical financing costs. The occurrence of breach of contract will directly lead to a significant increase in the issuance price of first-level market bonds, which is particularly obvious in industries that have a relatively large production capacity in default. Secondly, the concentrated incident of breach of contract will also cause upward pressure on the yield of credit bonds in the secondary market. The rate of yields will further promote the cost of issuing debt issuance in turn. Considering the alternative of bonds and other debt financing instruments, the increase in interest rates in the bond market will eventually be transmitted to other debt financing markets. Second, bond defaults to push up and re-financing risks. The occurrence of breach of contract may increase the pressure on market reinstatement. Third, bond defaults may cause regional credit risk fermentation. Once a company defaults, the capital needs of many relevant enterprises will increase immediately, and corporate assets may be frozen,

thereby a trigger possibility of regional credit risk will also increase significantly. Fourth, bond defaults may increase financial stability and hidden dangers of financial security. Thus, how to better reduce default risk and strengthen risk management is still the future direction of the bond market.

2. Current Situation

2.1. Current Situation of Bond Defaults in China

In 2022, against the backdrop of macroeconomic pressure and a weakened financing environment, the credit risk exposure in China's bond market shifted from substantial defaults to extensions. Specifically, eight new defaulting issuers were added to the bond market, involving a total of 45 maturity default bonds with a total maturity default amount of approximately RMB 23,262 million, and a total of RMB 101,576 million in 2021, all of which were significantly reduced year-on-year [2]. Since 2014, the amount of new bond defaults in China has shown a rising trend, but the scale of new bond defaults from 2020 compared to 2019 has slightly decreased and started a downward trend, but from the current social environment impact, bond defaults still belong to the economic issues that should be closely watched.

2.2. Disposal Related to Bond Defaults in China

As the technical legal construction is not yet perfect, there is a disconnect between the current law and the market, and the disposition varies significantly for different types of bonds. Creditors often can only rely on traditional bankruptcy, contract, corporate and tort laws to claim remedies. In addition, there is a lack of legal basis for the courts to deal with complex creditor dispute cases.

3. Problems

3.1. Early Termination of Investment

Firstly, the frequent occurrence of bond defaults may reduce investors' confidence and lead to early termination of investment, which may put pressure on the bond issuer to make payments. Secondly, the default of one bond may lead to the early maturity of other bonds of the company, resulting in a series of defaults.

3.2. Increase Credit Risk

The outbreak of default will cause a decline in market risk appetite and make refinancing more difficult. At the same time, many listed companies' share prices fall sharply, while bank credit continues to contract, the market's refinancing ability is limited, further increasing credit risk.

3.3. Causing Serial Defaults

Issuers that have already defaulted are highly likely to default again. As business activities continue to deteriorate, once the company's cash flow is insufficient, it will be under greater pressure to pay off the bonds that are about to mature, resulting in frequent defaults on various debts. As bond defaults reflect poor corporate performance, the shares of defaulting listed companies tend to underperform. A fall in share prices can also increase the likelihood of bond defaults. Bank asset quality may be at risk. Bond defaults can reinforce loans, creating the potential for serial defaults [3]. Although bond defaults do not directly result in non-performing loans on the bank's balance sheet, companies that default on their bonds are often extremely cash-strapped and have reduced financing capacity, and once they default on their bonds, the risk will inevitably be transmitted to their loans, affecting their

ability to repay them. At the same time, once a defaulting company is in debt crisis, it will also have a significant impact on the financing products or projects it participates in, leading to a higher probability of indirect default. Defaulted bonds can also cause losses to investors by reducing the net value of bond funds.

4. Reasons for Existence of Risks

4.1. Insufficient Information Construction and Risk Prevention Awareness

In the current trading process of bond activities, the information technology construction is not perfect, and some information platforms do not fully grasp the process of dry-related bond activities, which makes it difficult to effectively carry out risk prevention work. At the same time, within some business entities, no attention is paid to the application of modern information management technology, and no perfect information platform and system is established according to the needs of bond activities, thus leading to the inability of information management and data analysis capabilities to meet the development needs of business entities, resulting in the implementation of development strategies being hindered [4]. At the same time, during the current trading activities in the bond market, some of the managers of the relevant operating entities still rely on traditional management concepts and adopt traditional management models to carry out internal management, which not only leads to low management efficiency, but also makes it difficult to avoid bond risks. Some of the management teams of the operating entities have not established a correct awareness of risk prevention and have not established a perfect risk prevention system and risk prevention mechanism within the enterprise, resulting in the enterprise's risk prevention ability not meeting its own development needs, which has a negative impact on the development of the enterprise [5].

4.2. Risk Monitoring Policies and Risk Revealing Ability

The lack of implementation of relevant policies is the main reason affecting the risk of default in the bond market. In the current development of the bond market, the relevant bond risk default policy is not sound, and does not effectively protect the rights and interests of investors, and the supervision of bond defaults is insufficient to effectively protect the smooth development of the bond market. The risk-revealing ability of rating agencies has an important impact on the governance of default risk in the current bond market. In some parts of China, due to factors such as the level of development, there are rating agencies with insufficient risk-revealing capabilities, making it difficult to effectively carry out default risk prevention work [6]. The development of rating agencies is a key element in the development of the bond market.

4.3. Dispersion and Disposal Channels and the Risk-sharing Function

Firstly, investors lack financial instruments to diversify risks before the risk of bond default occurs. However, compared with mature markets, China's credit derivative market is still in the exploratory stage and the supporting mechanisms of the relevant legal system, credit environment, transaction settlement, accounting and taxation system are not yet sound, resulting in insufficient pricing ability of financial institutions for credit mitigation instruments [7]. Secondly, after the risk of bond default. Investors lack a specialized transfer market to dispose of the risk. At the same time, those investors who focus on non-performing asset investment outflows are also unable to buy low in the market to obtain the investment strategy of late returns and participate in the default disposal of credit bonds. These will inevitably increase the disposal cycle of defaulted bonds, increase the difficulty for bondholders to realize, and are not conducive to the improvement of the efficiency of the disposal of defaulted bonds.

5. Risk Management Strategies

5.1. Formulate Stable Macroeconomic Policies and Monitor Bond Risks Dynamically

Through the formulation of macroeconomic policies, bond risks can be effectively monitored, and the steady development of the bond market can be ensured. Therefore, government departments need to formulate scientific macroeconomic policies according to the development needs of the bond market, enhance the ability to monitor bond risks dynamically and promote the steady development of bond activities. Firstly, the government needs to clarify the current risk issues in the development of the bond market and improve the relevant economic policies according to the specific bond default risks to reduce the risk of bond defaults and ensure the steady development of the bond market [8]. Secondly, government departments need to strengthen implementation, ensure effective implementation of supervision work, ensure the steady development of bond activities through scientific, standardized and rigorous supervision mode, punish violations and promote the steady development of the bond market. Finally, in the process of formulating macroeconomic policies, it is necessary to continuously optimize them according to the development of the bond market to ensure that economic policies are fully in line with the development needs of the bond market and to promote the steady development of China's economic construction.

5.2. Improve Credit Guarantee System and Provide Effective Credit Enhancement Measures

As the current bond market lacks a scientific credit guarantee system, the bond market needs to focus on the construction of a credit guarantee system. The credit guarantee system is the key to effectively clarifying the credit rating of the transaction subjects of bond activities, enabling the relevant business entities to clarify the creditworthiness of the counterparties, and through a sound credit guarantee system, the scientific control of bond activities can be effectively carried out, and the risk of default on the relevant bonds can be managed and prevented [9]. Therefore, China needs to fully clarify the significance of the construction of a credit guarantee system for the bond market, promote the steady implementation of bond activities through scientific construction planning, and guarantee the steady development of the Chinese bond market.

5.3. Strengthen the Supervision of Intermediaries and Enhance Information Symmetry

On the one hand, the regulatory authorities should continuously strengthen the supervision of bond issuance and underwriting, and urge intermediaries such as underwriters, trustees and guarantors to conscientiously perform their duties, and do a good job in risk prevention and control in terms of due diligence, information disclosure and continuous supervision, so as to ensure the legitimate rights and interests of investors in accordance with the law [10]. On the other hand, investors should make rational investments, strengthen the observation of investment objects, pay attention to the allocation of investment portfolios, stay away from investment products of listed companies with high gearing ratios and weak short-term solvency, and also treat the phenomenon of default objectively, and take correspondingly high risks while obtaining high returns [11].

5.4. Raise Investors' Risk Awareness and Improve Investor Protection Mechanism

By raising investors' risk awareness and improving the investor protection mechanism, we can effectively prevent the risk of default in the bond market and promote the steady development of investment activities. Firstly, government departments need to strengthen publicity and education to reinforce investors' risk awareness and ensure that investors' risk prevention awareness is enhanced to avoid bond default risks damaging investors' rights and interests. Secondly, the government needs to

learn from advanced experience, improve the investor protection mechanism, fully protect the basic rights and interests of investors, prevent investors from suffering losses in bond activities, and ensure the steady development of the bond market. Finally, government departments need to fully improve the bond market management system, optimize the process of bond activities through scientific management measures, protect the rights and interests of investors and promote the steady development of the bond market.

6. Conclusion

The current default issues in my country's bond market need to be resolved urgently. During the development of the Chinese bond market, due to insufficient information construction, insufficient awareness of risk prevention, insufficient relevant risk monitoring policies, insufficient ability to disclose the risk disclosure of rating agencies, and the construction of the credit guarantee system is not complete for reasons, the risk of bond defaults frequently, which seriously damages the interests of relevant investors. Therefore, relevant institutions need to fully clarify the negative impact of bond default risks on the development of the market at the same time, in the process of curbing the breach of contract, we must pay attention to the protection of the interests of bond investors. Supervision and improvement of laws and regulations are carried out. By formulating stable macroeconomic policies, dynamic monitoring bond risks, improving the ability of rating companies to reveal risks, enhancing the power and level of the issuer, improving the Chinese credit guarantee system, providing effective credit increase measures, improving investor risk awareness, and improving investor risk awareness. Improve investor protection mechanisms and other means, optimize market development, reduce the risk of bond default, promote the steady development of the Chinese bond market and the financial market on the basis of protecting the rights and interests of investors, and the steady development of China's social and economic construction.

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