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Banking & Finance Law

Overview of Foreign Debt Supervision Reforms

Finance and Asset Management Team

Following the promulgation of the *Circular of the People's Bank of China Regarding the Expansion of Unified Cross-border Financing Macroprudential Management Pilot Areas* (“**Pilot Area Circular**”) in January 2016, the People's Bank of China (“**PBOC**”) has decided to expand the pilot program for the macro-prudential management of unified RMB and foreign currency denominated foreign debts to cover both financial institutions and enterprises nationwide. On April 29, 2016, PBOC subsequently issued the [*Circular of the People's Bank of China Regarding the Nationwide Implementation of Unified Cross-border Financing Macroprudential Management*](#) (“**Implementing Circular**”).

The Implementing Circular will bring significant changes to the existing foreign debt supervision system, with the following five aspects worthy of special attention:

- **Replacement of the Approval System with a Filing System.** According to the Implementing Circular, the previous transaction-by-transaction and quota approval mechanisms for borrowing foreign debt have been abolished. In their place, a filing mechanism shall apply to both financial institutions and corporates (*including FIEs and domestic enterprises*). Therefore, financial institutions and corporates have the discretion to take on RMB and foreign currency denominated foreign debt based upon their respective capital or net assets up to their cross-border financing limit
- **Unified management of RMB and foreign currency denominated foreign debt.** The Implementing Circular puts an end to significant uncertainty that has existed since the RMB was internationalized in 2011 by clarifying the division of duties among the different regulatory authorities with respect to RMB denominated foreign debt and by stipulating that the management of RMB denominated foreign debt quotas shall be unified with foreign currency-denominated foreign debt quotas..

- **Liberalization of overseas financing channels for domestic enterprises.** Previously, domestic enterprises were not able to borrow money from overseas unless approved by the National Development and Reform Commission ("**NDRC**") and the State Administration of Foreign Exchange ("**SAFE**"). However, as the NDRC is a separate department, its attitude towards applying the Implementing Circular still remains to be observed.
- **Cross-border financing channels for domestic and foreign real estate enterprises remain unopened.**
- **Two alternative modes for foreign-invested enterprises and foreign financial institutions.** During the transition period (subject to further separate regulations), foreign-invested enterprises ("FIEs") and foreign-invested financial institutions may choose to be subject to either the current or the new mode contemplated under the Implementing Circular for the management of foreign debt. The choice is, in principle, irrevocable once it has been made. Therefore, FIEs, including foreign-funded investment enterprises and the foreign-invested leasing enterprises can still choose to continue with the previous management mode.

In addition, we have set out a comparative summary of the previous foreign debt management mode that was in place before the date of the Pilot Area Circular and the new mode contemplated under the Implementing Circular below, in order to directly reflect the historical evolution of the management of foreign debt and to help you to better understand the cross-border financing macro-prudential management system that will be implemented.

Before the promulgation of the Pilot Area Circular

| Categories | | The foreign debt management system before promulgation of the Pilot Area Circular | |
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| Banks | Chinese Banks | <u>Short-term foreign debts</u> (with terms of one year or less): balances shall be verified by SAFE annually | <u>Medium and Long-term foreign debts</u> (with terms of more than one year): first subject to NDRC review and verification, together with relevant departments, then submitted to State Council for examination and approval |
| | | <ul style="list-style-type: none"> ➤ Filing and information reporting requirements: submit the information with respect to foreign debt through the relevant SAFE system; ➤ Special provisions for RMB foreign debt: in principle, subject to the current foreign debt management system; | |
| | Foreign Banks | <u>Short-term foreign debt:</u> balance shall be verified by SAFE each year | <u>Medium and Long-term foreign debt:</u> the amount incurred shall be verified by NDRC annually |
| | | <ul style="list-style-type: none"> ➤ Filing and information reporting requirements: the same as those applicable to Chinese banks as mentioned above; ➤ Special provisions for RMB foreign debt: the same as those applicable to Chinese banks as mentioned above; | |
| Corporates | Domestic Corporates | <u>Short-term foreign debts:</u> the balance shall be verified by SAFE (few enterprises generally have debt quotas) | <u>Medium and Long-term foreign debts:</u> subject to filing and registration with NDRC |

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| | | <ul style="list-style-type: none"> ➤ Filing and information reporting requirements: register with SAFE within 15 days from the signing of the foreign debt contract. | <ul style="list-style-type: none"> ➤ Filing and information reporting requirements: obtain a Certificate of Registration of Foreign Debts of Enterprises and subsequently handle the procedures related to the inflows and outflows of foreign debt with the settlement bank; report to NDRC within ten days after each drawdown; register with SAFE within 15 days after the signing of the foreign debt contract. ➤ Equally applied to RMB and foreign currency denominated financings |
| | FIEs (Except for the special types listed below) | <ul style="list-style-type: none"> ➤ Debt quota management: the aggregate amount of incurred medium and long-term foreign debt plus short-term foreign debt balance should be within the difference between the approved total investment and registered capital (the “Difference”) (if the registered capital is not paid up, the proportion of capital that is already paid up applies). If the borrowing amount exceeds the Difference, the total investment amount is subject to re-approval by the original approval authority (generally, MOFCOM). ➤ Registration and information reporting requirements: register with SAFE within 15 days after the execution of foreign debt contracts; with the required relevant certification documents, may directly open account, make drawdowns, pay interest and settle exchanges related to foreign debt with banks. ➤ Special provisions for RMB foreign debt: may raise debt denominated in RMB from aboard (registered capital shall be paid in full according to the schedule), together with foreign currency denominated debt, within the Difference; calculate the total debt amount based upon the amount incurred; if the debt is subject to extension, except for the first extension, all extensions shall be calculated again in the total amount of foreign debt. | |
| | Foreign-funded investment | <ul style="list-style-type: none"> ➤ Debt quota management: <ol style="list-style-type: none"> a. (with registered capital of no less than USD \$ 30 million) the sum of the balance of short-term debt and | |

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| | enterprises | <p>the incurred medium and long-term debt shall not exceed four times the registered capital that has already been paid up.</p> <p>b. (with registered capital of no less than USD \$ 100 million) the sum of the balance of short-term debt and the incurred medium and long-term debt shall not exceed six times the registered capital already paid-up.</p> <p>➤ Special provisions for foreign RMB debt: included in the Difference as mentioned above, calculated together with other foreign currency amounts.</p> |
| | Foreign-invested leasing enterprises | <p>➤ Debt quota management: the foreign debt quota for the current fiscal year for foreign-invested leasing enterprises is determined by subtracting the total amount of risk assets at the end of the previous year from the amount of ten times the net assets, based on the previous year's financial statements;</p> <p>➤ Special provisions for RMB foreign debt: shall be included in the Difference as mentioned above, calculated together with other foreign currency amounts.</p> |
| | Foreign-invested real estate enterprises | <p>➤ Borrowing from overseas is prohibited in principle, unless all of the following conditions are satisfied:</p> <ul style="list-style-type: none"> ✓ Foreign-invested real estate enterprises established before June 1, 2007 are permitted to borrow from overseas within the Difference amount in accordance with the relevant provisions. ✓ Registered capital has not been fully paid-up and a State-owned Land Use Certificate has been obtained. ✓ The capital for project development has reached 35% of the total investment amount. |
| Special management of corporates and financial institutions in free trade zones and pilot areas | | <p>➤ Enterprises in RMB foreign debt pilot areas –Suzhou Industrial Park</p> <p>➤ Pilot areas for foreign debt macroprudential management, including Zhongguancun, Zhangjiagang, Qianhai, etc.</p> <p>➤ Free trade zones, such as Shanghai, Guangdong, Tianjin and Fujian.</p> |

After the promulgation of the Implementing Circular

| Categories | | Foreign debt management system adopted after promulgation of the Implementing Circular |
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| Financial Institutions | 27 banks under unified PBOC management | <ul style="list-style-type: none"> ➤ Registration and information reporting requirements: <ul style="list-style-type: none"> ✓ If it is the first time for an institution to conduct cross-border financing, the institution must determine its cross-border financing risk-weighted balance limit (“Risk-weighted Balance Limit”) and report this to PBOC and SAFE. ✓ Institutions have the discretion to sign foreign debt contracts up to the Risk-weighted Balance Limit. Institutions are to report statistical information with respect to any RMB and foreign currency denominated foreign debt incurred during the previous month and balance fluctuations, etc. to PBOC and SAFE within five business days of the beginning of each month. ✓ After the execution but prior to the implementation of a contract, institutions are to submit information regarding the principal amount and terms of the contract to PBOC and SAFE. After drawing from the borrowing and making principal and interest payments, the institution is to report such information to PBOC and SAFE. ✓ If the relevant information changes, the institution should immediately update its information in the system accordingly. ➤ Calculation of the new foreign debt quota <p>The calculated cross-border financing risk-weighted balance (“Risk-weighted Balance,” which refers to the outstanding amounts) cannot exceed the Risk-weighted Balance Limit, i.e., the Risk-weighted Balance ≤ Risk-weighted Balance Limit.</p> ➤ Calculating the Risk-weighted Balance Limit <ul style="list-style-type: none"> ✓ The Risk-weighted Balance Limit is equal to capital or net assets multiplied by the cross-border financing leverage ratio (the ratio is 1 for non-banking financial institutions, 0.8 for banks) multiplied by the |
| | Other financial institutions (all types of corporate financial institutions established with approval of PBOC, CBRC, CIRC or CSRC) subject to management | |

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| | of SAFE | <p>macroprudential adjustment parameter of 1.</p> <ul style="list-style-type: none"> ✓ Capital or net assets: for banks, capital or net assets is calculated by using tier one capital; for non-banking financial institutions, the capital or net assets is calculated by using capital (paid-in capital or equity capital + capital reserve); the calculation is performed based upon the most recent audited financial statements. <p>➤ Calculating the Risk-weighted Balance and special provisions</p> <ul style="list-style-type: none"> ✓ The Risk-weighted Balance is equal to the sum of balance of RMB and foreign currency denominated foreign debt multiplied by the term risk conversion factor multiplied by the category risk conversion factor plus the sum of the balance of foreign currency denominated foreign debt multiplied by the exchange rate risk conversion factor. ✓ The following amounts are not considered when calculating the Risk-weighted Balance Limit: passive RMB debt, trade credit and RMB trade financing, intra-group financial transactions, foreign interbank deposits, fund flows among correspondent banks and subsidiary institutions, “panda bond” for self-use, transfers to equity and debt waivers. ✓ Special methods are used to calculate the following amounts: foreign currency denominated trade financing and off-balance-sheet financing (contingent liabilities) <p>➤ Use of funds</p> <p>May be used to supplement core capital. With SAFE approval, borrowed foreign currency funds can be used to convert to RMB.</p> |
| Corporates (not including local | General Corporates | <p>➤ Filing requirements</p> <ul style="list-style-type: none"> ✓ Report to both SAFE and PBOC: after the execution of a contract but in no case later than three business days before the drawdown date, file with the SAFE information system for capital account; the settlement bank will report the relevant information to the RMB Cross-Border Payment & Receipt |

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| <p>government financing platforms and real estate enterprises)</p> | | <p>Management Information System.</p> <ul style="list-style-type: none"> ✓ After the filing and reporting as mentioned above is complete, the settlement bank may settle the funds and report the settlement information to the relevant PBOC and SAFE systems. ✓ Each year, corporates are to timely update information regarding its foreign debt (including foreign creditor information, and loan terms, amounts and interest rates, and regarding their net assets). Corporates are required to timely amend the filing information if there are changes to information regarding audited net assets, foreign creditors, or loan terms, amounts or interest rates referred to in the financing contracts. <ul style="list-style-type: none"> ➤ Calculating the new “foreign debt quota” <ul style="list-style-type: none"> ✓ Refer to calculation methods applicable to financial institutions as mentioned above. ➤ Calculating the Risk-weighted Balance Limit <ul style="list-style-type: none"> ✓ The Risk-weighted Balance Limit is equal to net assets multiplied by the cross-border financing leverage ratio (for corporates, the ratio is 1) multiplied by the macroprudential adjustment parameter of 1. ➤ Calculating the Risk-weighted Balance and special provisions <ul style="list-style-type: none"> ✓ Refer to the calculation methods and special provisions applicable to financial institutions. ➤ Usage <ul style="list-style-type: none"> ✓ May convert to RMB on an as-needed basis; <p>The foreign debt proceeds shall be used for the corporate’s own production and business activities in accordance with the relevant regulations and with national and free trade zone industrial macro-control policies.</p> |
| <p>In free trade zones and in other local pilot innovation areas</p> | | <ul style="list-style-type: none"> ➤ There is a 1-year transition period, upon the expiration of which the free trade zones and the pilot innovation areas shall be subject to the mode contemplated under the Implementing Circular. The previous rules and regulations applicable to these areas will no longer be effective. |

● **Important Announcement**

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