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Newsletter

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Legal Updates

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■ ■ Legal Updates

1. Overview of Foreign Debt Supervision Reforms (Author: 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.

(to be continued on the next page)

Before the promulgation of the Pilot Area Circular

Categories		The foreign debt management system before promulgation of the Pilot Area Circular	
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
		<ul style="list-style-type: none"> ➤ Filing and information reporting requirements: register with SAFE within 15 days from the signing of the foreign 	<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;

		debt contract.	<p>report to NDRC within ten days after each drawdown; register with SAFE within 15 days after the signing of the foreign debt contract.</p> <p>➤ Equally applied to RMB and foreign currency denominated financings</p>
	<p>FIEs (Except for the special types listed below)</p>	<p>➤ 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).</p> <p>➤ 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.</p> <p>➤ 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.</p>	
	<p>Foreign-funded investment enterprises</p>	<p>➤ Debt quota management:</p> <p>a.(with registered capital of no less than USD \$ 30 million) the sum of the balance of short-term debt and 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>	

		<ul style="list-style-type: none"> ➤ Special provisions for foreign RMB debt: included in the Difference as mentioned above, calculated together with other foreign currency amounts.
	Foreign-invested leasing enterprises	<ul style="list-style-type: none"> ➤ 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; ➤ Special provisions for RMB foreign debt: shall be included in the Difference as mentioned above, calculated together with other foreign currency amounts.
	Foreign-invested real estate enterprises	<ul style="list-style-type: none"> ➤ Borrowing from overseas is prohibited in principle, unless all of the following conditions are satisfied: <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		<ul style="list-style-type: none"> ➤ Enterprises in RMB foreign debt pilot areas –Suzhou Industrial Park ➤ Pilot areas for foreign debt macroprudential management, including Zhongguancun, Zhangjiagang, Qianhai, etc. ➤ Free trade zones, such as Shanghai, Guangdong, Tianjin and Fujian.

After the promulgation of the Implementing Circular

Categories		Foreign debt management system adopted after promulgation of the Implementing Circular
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
	Other financial institutions (all types of corporate financial institutions established with approval of PBOC, CBRC, CIRC or CSRC) subject to	

	management of SAFE	<p>leverage ratio (the ratio is 1 for non-banking financial institutions, 0.8 for banks) multiplied by the 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

<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.

2. Highlights of the Foreign NGO Management Law (Authors: Charles LI, Laixiang LI)

On April 28, 2016, the Standing Committee of the National People's Congress adopted the *Law of the People's Republic of China on the Management of Foreign Non-Governmental Organizations' Activities within Mainland China* (hereinafter "**Foreign NGO Law**"), which will come into effect on January 1, 2017. After more than a year of soliciting views from the public and revisions since the publishing of the second draft of the Foreign NGO Management Law (hereinafter, "**Second Draft**") in April 2015, the Foreign NGO Law has attracted widespread attention from domestic and international non-governmental organizations (hereinafter "**NGOs**"), and forms another landmark piece of legislation governing NGO activities in addition to the *Charity Law of the People's Republic of China*, which was adopted on March 16, 2016.

The Foreign NGO Law consists of 54 articles in 7 chapters, and covers aspects from NGO registration and filing to the regulation of activities, facilitation measures, supervision and management, and legal responsibility. This article outlines some of the major provisions.

Scope of Activities

The Foreign NGO Law specifies that Foreign NGOs may conduct activities beneficial to the development of social welfare in fields such as economics, education, science culture, health, sports, environmental protection and for areas such as poverty relief and disaster relief, while exchanges and collaborations between foreign schools, hospitals, natural science and engineering science research establishments or academic organizations and the domestic organizations within these same categories, is to be handled according to the relevant provisions of national law. Moreover, the Foreign NGO Law prohibits foreign NGOs from "engaging in or funding for-profit activities or political activities," and "illegally engaging in or funding religious activities" within mainland China. In order to provide guidance to overseas NGOs carrying out activities, the Foreign NGO Law requires public security authorities, together with the relevant departments, to draft catalogs of foreign NGOs' areas of activity and projects, and to publish a list of competent administrative authorities. The aforesaid catalogs and lists will be provided prior to the entry into force of the Foreign NGO Law, as confirmed at a press conference for the Foreign NGO Law ("**Press Conference**") that was held by the head of the NGO administration office of the public security department under the State Council.

Double Approval System by Registration Management Organs and Competent Administrative Authorities

The 2013 State Council-issued *Explanation of Proposals of the State Council for Institutional Reforms and Functional Transformation* states that certain social organizations, such as industry associations and chambers of commerce, technology, public welfare charities, and urban and rural community services, are subject to a system of direct registration with the civil affairs departments and that competent administrative authorities' approval is no longer required. On the on the hand,

given the complex scenarios involving political, legal or religious social organizations and foreign NGO representative offices in Mainland China, the Proposal mandates that the establishment of such organizations and offices shall be subject to approval by competent administrative authorities.

Consistent with the aforesaid State Council Proposal, the Foreign NGO Law maintains the double approval system involving registration management organs and competent administrative authorities for foreign NGOs.

- a. Registration Management Organs: The public security department under the State Council and the public security organs of provincial level people's governments are the registration management organs for foreign NGOs. It is worth noting that, in accordance with *Administrative Regulations on the Registration of Social Organizations*, *Regulation on the Administration of Foundations* and the *Tentative Regulations for the Registration of Private Non-Enterprise Entities*, the civil affairs departments are the registration management organs for three types of NGOs registered in mainland China (social organizations, foundations and private non-enterprises entities). *Regulation on the Administration of Foundations* stipulates in Article 6 that civil affairs departments are the administrative departments responsible for "representative offices established by overseas foundations located in mainland China," and, in practice, there are a number of foreign foundations' representative offices registered with civil affairs departments. Issues concerning the legal status of these representative offices are not covered by the Foreign NGO Law, but the head of the NGO administration office at the public security department confirmed at the Press Conference that the office will formulate transitional policies with civil affairs and other relevant departments, and that registration organs will handle registration in accordance with the law provided that the offices file additional documents as required by the Foreign NGO Law.
- b. Competent Administrative Authorities: The relevant departments and units under the State Council and the relevant departments and units of the provincial level people's governments are the competent administrative authorities for foreign NGOs carrying out activities within mainland China. Foreign NGOs' establishment of representative offices, modification of registration, and annual work reports for the last and the following year shall submit to registration management organs for filing or to obtain comments. The Public Security Department under the State Council and the public security organs of the provincial level people's governments, together with the relevant departments, shall publish a directory of competent administrative authorities.

Forms of Operation

The Foreign NGO Law specifies in Article 9 that there are only two methods for foreign NGOs to operate in China. They may operate through:

- a. Registered and established representative offices. Representative offices carry out activities in Mainland China. The restriction that “foreign NGOs may only establish one representative office in China” found in the Second Draft has been removed in the Foreign NGO Law.
- b. Foreign NGOs carrying out temporary activities within mainland China shall comply with the following requirements:
 - Cooperating with state organs, mass organizations, public institutions, or social organizations (hereinafter "Chinese Partner Units").
 - the Chinese Partner Unit shall follow national provisions to handle approval formalities, and file with the registration management organs responsible for the area of the proposed activity at least 15 days before the temporary activities are carried out. Where temporary activities must be carried out in emergency situations such as disaster relief or rescues, the time period for filing is not subject to these restrictions.
 - The period for temporary activities is not to exceed 1 year, and where there is truly a need to extend the period, a new filing shall be made.

Daily Operation Rules

In accordance with the Foreign NGO Law, foreign NGOs are subject to the following requirements in their daily operation:

- a. Prohibition on fundraising: Foreign NGOs and their representative offices must not raise funds within mainland China. *Regulation on the Administration of Foundations* provisions states: “representative offices of foreign funds cannot engage in fundraising in China or collect donations.” The Foreign NGO Law further clarifies that foreign NGOs cannot themselves raise funds in China.
- b. Annual Plan and Reporting: Representative offices of foreign NGOs shall send an activity plan for the following year before December 31 of each year, which includes project implementation, use of funds and other such content to competent administrative authorities. In addition, foreign NGO representative offices shall file annual work reports for the previous year to competent administrative authorities before January 31 of each year, and, after the competent administrative authorities issue comments, shall send the reports to the registration management organs before March 31 for annual inspections.
- c. Account Management: Foreign NGOs that have established representative offices shall use funds from bank accounts within mainland China that are recorded with the registration management organs. Foreign NGOs carrying out temporary activities shall use their Chinese Partner Unit's bank account to manage and use funds in mainland China, perform independent bookkeeping, and use funds only as they are allocated. Foreign NGOs, Chinese Partner Units,

and individuals must not use any other arrangement to receive and spend funds for project activities inside mainland China.

- d. Personnel Recruitment: Foreign NGO representative offices hiring employees in mainland China shall report information on employed personnel to the competent administrative authorities and registration management organs. Restrictions including “foreign staff members must not exceed 50% of a representative office’s total staff headcount” and “foreign staff members cannot concurrently work for the representative office of another foreign NGO” in the Second Draft are removed in the Foreign NGO Law. Moreover, the Foreign NGO Law does not specify volunteer recruitment issues, and deletes requirements in the Second Draft that “foreign NGO representative offices shall entrust local foreign affairs service units or other designated government departments to recruit and hire staff members or volunteers in mainland China” and “organizations operating short-term activities in China shall not directly recruit volunteers, and where there is truly a need to recruit volunteers, it shall be conducted by Chinese Partner Units.”
- e. Membership Development: Foreign NGO representative offices and foreign NGOs carrying out temporary activities must not develop, or covertly develop, membership within mainland China, except as provided for by the State Council. The exceptions, according to answers at the Press Conference, refer to membership of some foreign NGOs (mainly international scientific associations and societies), since those organizations historically recruited membership and the Chinese government encourages scientists and scholars to join foreign scientific associations.

We will keep track of the rules and regulations as well as policy developments related to the Foreign NGO Law and will continue to share with you our opinions in a timely manner.



Important Announcement

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