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Latest CBRC rules encourage development of financial leasing companies

On 13th March 2014, the China Banking Regulatory Commission (CBRC) promulgated a new set of *Administrative Measures on Financial Leasing Companies* (the New CBRC Measures) aimed at promoting the financial leasing industry. The New CBRC Measures replace, as from such date, previous measures issued by the CBRC in 2007 (the 2007 CBRC Measures).

The New CBRC Measures send a positive signal by encouraging investments in financial leasing companies and by widening their business scope.

Regulatory background

Currently, investors may choose to invest in two major types of financial leasing companies: ordinary financial leasing companies ("*Rong Zi Zu Lin*" or "**MOFCOM FLCs**"), which are regulated by the Ministry of Commerce (**MOFCOM**), and special financial leasing companies ("*Jin Rong Zu Lin*" or "**CBRC FLCs**"), which are regulated by CBRC. CBRC FLCs are set up as non-banking financial institutions and are generally subject to more stringent regulatory requirements than MOFCOM FLCs.

The key changes

The New CBRC Measures only apply to the formation and operation of CBRC FLCs and not MOFCOM FLCs. The key changes include:

A more diversified pool of eligible promoters: Under the 2007 CBRC Measures, only four types of entities were eligible to act as a "principal capital contributor" of a CBRC FLC: (1) foreign or domestic-incorporated commercial banks, (2) foreign or domestic-incorporated leasing companies, (3) domestic-incorporated large-scale enterprises (LSE) which manufacture products that are suitable for finance leasing[1] and (4) other financial institutions approved by CBRC. The principal capital contributor must be the applicant in the formation of the CBRC FLC and must contribute no less than 50% of the equity investment in the CBRC FLC. All other investors are classified as "ordinary capital contributors".

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[1] Both the 2007 CBRC Measures and the New CBRC Measures define "products that are suitable for finance leasing" as fixed assets.

The New CBRC Measures no longer differentiate between the principal and the ordinary capital contributors. Instead, they focus on which entities are eligible to be investors of a CBRC FLC. The New CBRC Measures have introduced a concept of promoters which are essentially the initial capital contributors. Other investors which are not promoters are also subject to the same eligibility requirements as promoters.

In addition to the four types of entities above, qualified domestic entities and foreign financial institutions may now also act as promoters. In particular, a foreign financial institution includes entities other than commercial banks or leasing companies that are incorporated in the jurisdiction in which the financial regulators have entered into a cooperative regulatory mechanism with CBRC.

However, the New CBRC Measures require that at least one promoter of a CBRC FLC must fall within the original categories, that is, it must either be a foreign or domestic-incorporated commercial bank, a foreign-incorporated leasing company or a domestic LSE. Such a promoter must contribute no less than 30% of the registered capital of the CBRC FLC.

This change allows a more diversified scope of entities to invest in CBRC FLCs. In particular, domestic companies and non-banking financial institutions may benefit from the New CBRC Measures as for the first time, CBRC are specifically sanctioning domestic companies or foreign financial institutions to invest in CBRC FLCs.

In addition, the New CBRC Measures reflect the PRC regulator's continued focus on maintaining the stability of CBRC FLCs. By prohibiting investors from, among others, (a) making contributions through borrowed funds or (b) transferring their shares in the relevant CBRC FLC within five (5) years of its formation or (c) creating any security interest over such shares within five (5) years of its formation, the New CBRC Measures are likely to attract primarily long-term investors to CBRC FLCs, rather than investors seeking potential "trading" opportunities. It is worth noting that promoters are required to undertake in the constitutional documents of the CBRC FLC that (a) if the CBRC FLC is in difficulties of meeting its payment obligations, the promoters shall provide liquidity support; and (b) if the losses of the CBRC FLC erode the registered capital of the company, the promoters shall contribute further capital in a timely manner[2].

Broader Business Scope: The New CBRC Measures extend the permissible business scope of CBRC FLCs to include purchasing and transferring rental receivables from their leased assets to any entity (and not only to commercial banks as required under the 2007 CBRC Measures), accepting deposits from non-bank shareholders for not less than three (3) months tenor (instead of only accepting deposits for more than one (1) year tenor as required under the 2007 CBRC Measures), and investing in fixed income security products.

CBRC has also adopted a two-tier regime to regulate the business scope of CBRC FLCs. This regime distinguishes between the basic business and the "additional business" of the CBRC FLC and essentially allows more operational and funding flexibility for CBRC FLCs. Basic business refers to the business of a CBRC FLC that is closely related to financial leasing activities, such as financial leasing, accepting security deposits from lessees and borrowing from financial institutions, etc. In terms of the "additional business", subject to the

[2] This is literal translation and although it is not entirely clear what it means, it appears to mean that if due to operating losses the amount of shareholders' equity is less than the amount of the company's original registered capital, the promoters shall contribute further capital to make up the shortfall in a timely manner. Such requirement on contributing further registered capital appears to be a special requirement on CBRC FLCs as compared to other general types of companies in China. CBRC has not provided further details as to how such a requirement will be implemented.

approval of the CBRC, a CBRC FLC that "operates well and has a sound internal control system" may be allowed to engage in the business of issuing bonds, originating asset-backed securitisation (ABS) business, setting up SPVs in domestic free trade zones and providing guarantees for their subsidiaries or SPVs, all of which activities should offer more operational and funding flexibility for CBRC FLCs.

Subsidiaries or branches permitted: The New CBRC Measures provide that a CBRC FLC may set up subsidiaries or branches if approved by the CBRC. Relevant implementing rules will be issued by CBRC in due course.

At the moment, CBRC FLCs generally run their leasing business involving different industries on one consolidated platform and it is likely that the provision on allowing subsidiaries and branches to be set up under the New CBRC Measures could encourage CBRC FLCs to set up subsidiaries to focus on specific industries such as aviation, shipping and other big-ticket items of equipment.

Conclusion

The New CBRC Measures are a step forward in implementing the long-term objective of the PRC regulator to promote the financial leasing industry. It is hoped that when the implementing rules on subsidiary and branch formation are published, the regulatory regime on CBRC FLCs would become more transparent. While the potential effect of the New CBRC Measures remains to be tested, the signs for the leasing industry are promising.

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