

# NDRC replaces approval regime with filing regime for foreign debt control and other legal updates from China

Recent legal updates from China demonstrate a shift in the government's policies to further liberalise the market and encourage the development of the Chinese leasing industry: (1) on 14 September 2015, the National Development and Reform Commission (NDRC) of the People's Republic of China (PRC) issued the Circular on Promoting the Reform of the Filing and Registration Regime for Issuance of Foreign Debt by Corporate Entities (Circular 2044), replacing the previous approval system with a national quota and filing regime for foreign debts; (2) a series of recent circulars and policies allow onshore operating lease rentals to be denominated in a foreign currency; and (3) on 31 August 2015, the State Council issued the Guidance Opinion on Encouragement of the Development of the Financial Leasing Industry (Guidance).

## NDRC's reform in the administration of foreign debts<sup>1</sup>

### ■ A national quota and filing regime in substitution of an approval regime

Circular 2044 relaxes NDRC's control on mid/long-term<sup>2</sup> foreign debts of PRC companies by replacing its existing case-by-case approval system with a national quota and filing system. A comparison of the regime pre-Circular 2044 and post-Circular 2044 is summarised as follows:

	<b>Pre-Circular 2044</b>	<b>Post-Circular 2044</b>
<b>PRC domestic companies as borrowers</b>	<ul style="list-style-type: none"> <li>- mid/long term debt: NDRC approval required</li> <li>- short term debt: State Administration of Foreign Exchange (SAFE) approval required</li> </ul>	<ul style="list-style-type: none"> <li>- mid/long term debt: NDRC approval no longer required (it is replaced by a national quota system and pre-incurrence filing with NDRC)</li> <li>- short term debt: SAFE approval required</li> </ul>

<sup>1</sup>Circular 2044 deals with "foreign debt" that is defined as offshore debt denominated in RMB or a foreign currency with a maturity term of more than one year, which is borrowed by a PRC onshore entity, an offshore branch of a PRC onshore entity or the offshore entities controlled by a PRC onshore entity, and such "foreign debt" includes offshore bond issuances and mid/long term international commercial loans.

<sup>2</sup> A mid/long term debt has a maturity term of more than one year and a short term debt has a maturity term of one year or less.

<b>Foreign-invested enterprises (FIEs) as borrowers</b>	"borrowing gap" regime <sup>3</sup>	- it remains to be seen how FIEs are affected <sup>4</sup> - "borrowing gap" regime is likely to remain
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■ **Highlights of Circular 2044**

- (1) It requires the issuer/borrower to register certain information with NDRC prior to incurring a foreign debt. Documents to be submitted to NDRC include an application report and a plan setting out the currency, size, interest rate, term, purpose of the debt and remittance details.
- (2) It imposes a standard timeframe for reviewing the pre-incurrence filing applications<sup>5</sup>.
- (3) Eligible issuers and borrowers are required to meet certain requirements such as having a good credit track record and a sound corporate governance and risk-control system.
- (4) When the aggregate registered foreign debt reaches the stipulated annual national quota, NDRC will make a public announcement stating that the filing of foreign debts will no longer be accepted for that year.
- (5) It requires the issuer/borrower to report foreign debts to NDRC in the form attached to Circular 2044 within 10 working days of the drawdown/issuance of the foreign debt.

■ **Uncertainties and challenges**

Uncertainties and challenges remain in relation to Circular 2044:

- (1) It does not eliminate the current requirement of registering foreign debts with SAFE<sup>6</sup>.
- (2) It does not override the current restrictions on utilisation of foreign debt proceeds prescribed by SAFE<sup>7</sup>.
- (3) It remains to be seen if NDRC will take a restrictive or a liberal stance when determining the annual national quota for foreign debts.
- (4) It is unclear whether the pre-incurrence filing system will be a procedural matter or will involve any discretionary review.

<sup>3</sup> An FIE is allowed to borrow up to the difference between its total investment and registered capital (as approved by the PRC Ministry of Commerce under the foreign investment legal regime). Mid/long term debt is calculated based on cumulative borrowed amounts and short term debt is calculated based on outstanding amounts.

<sup>4</sup> Circular 2044 does not differentiate PRC domestic companies from FIEs.

<sup>5</sup> Within 5 working days of receipt of the pre-incurrence filing application, NDRC will decide whether to accept the application. A certificate of the filing of the foreign debt will be issued within 7 working days from the date that application is accepted.

<sup>6</sup> Corporate entities are required to complete the registration within 15 working days of signing the loan agreement.

<sup>7</sup> For example, generally speaking, foreign debt proceeds cannot be converted into RMB for PRC domestic company borrowers, and foreign debt proceeds cannot be converted into RMB to repay existing onshore RMB loans.

- (5) It has included offshore subsidiaries and branches controlled by PRC entities as part of PRC entities for the purpose of the new foreign debt pre-incurrence filing regime.
- (6) It does not differentiate between PRC domestic companies (invested by PRC entities) and FIEs and how this would affect the current total investment/registered capital regime of FIEs remains to be seen.
- (7) There is no grandfathering provision in Circular 2044, and it does not consider how the new requirements will apply to deals that have already been agreed on and how the borrower can comply with Circular 2044 before the pre-incurrence filing system is established.

## Liberalisation of domestic rental currency denomination

### ■ History and developments

Historically, due to restrictions on foreign exchange, payments between PRC parties could only be denominated and settled in RMB.

In 2012, SAFE's Reply on China Banking Regulatory Commission (CBRC)-approved Leasing Companies to Receive Foreign Exchange Denominated Finance Lease Rentals (Circular 80) permitted financial leasing companies approved by CBRC to receive rental payments denominated in foreign currencies under domestic leases, provided that the financial leasing company in question complied with the "50% requirement" (see details below).

After the Shanghai Free Trade Zone (Shanghai FTZ) was established in 2013<sup>8</sup>, SAFE's Shanghai branch issued Circular on the Implementation Rules of Foreign Exchange within Shanghai Free Trade Zone (Circular 26), extending the scope of Circular 80 to foreign-invested leasing companies and domestic-funded (non-CBRC) leasing companies on the condition that they are registered in the Shanghai Free Trade Zone.

In August 2015, SAFE issued Circular 12, which allows operating lease rentals to be denominated in a foreign currency in the Tianjin Free Trade Zone (Tianjin FTZ). Circular 12 has a trial period of two years.

### ■ Eligibility requirements

Set out below is a summary of the key eligibility requirements under the various circulars.

	<b>Circular 80</b>	<b>Circular 26</b>	<b>Circular 12</b>
<b>Eligible lessors</b>	CBRC-approved leasing companies or their project companies in the FTZs	Leasing companies incorporated in Shanghai FTZ	Leasing company incorporated in Tianjin FTZ
<b>Eligible lease type</b>	Finance lease	Not clear <sup>9</sup>	Operating lease

<sup>8</sup> Please see our client briefing "Offshore Financing in Shanghai Free Trade Zone Liberalised" at [http://www.cliffordchance.com/briefings/2015/04/clifford\\_chance\\_clientbriefingoffshor.html](http://www.cliffordchance.com/briefings/2015/04/clifford_chance_clientbriefingoffshor.html)

<sup>9</sup> The eligible lease type is not clearly identified in Circular 26.

<b>Conditions</b>	At least 50% of the purchase price is financed with money borrowed in a foreign currency from offshore or onshore lenders (the <b>50% requirement</b> )	50% requirement	Either (a) the 50% requirement is satisfied; or (b) the underlying asset is leased from an offshore lessor and the foreign currency rental payments are required to be paid to the offshore lessor
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## State Council's Guidance to encourage the development of financial leasing industry

The State Council sets out in its Guidance a comprehensive plan for the development of the financial leasing industry. Highlights include:

- (1) Subsidiaries of a financial leasing company are no longer subject to a minimum registered capital requirement.
- (2) It emphasises the innovation by promoting cooperation between financial leasing companies and other financial institutions such as banks, insurance companies, trusts and funds.
- (3) It encourages financial leasing companies to engage in cross-border leasing activities denominated in RMB.

Detailed implementation rules are expected to be published in the future.

## Conclusion

The liberalisation of the currency denomination of lease rentals protects lessor in the Tianjin FTZ from costs and risks associated with currency conversion. These efforts of the PRC regulators, combined with the reform of foreign debt control regime under Circular 2044 and SAFE's reform of cross-border security/guarantee in 2014<sup>10</sup>, will provide an increasingly liberal and transparent environment for Chinese lessors in raising capital in the international market.

The recent developments summarised in this briefing note reflect the Chinese government's increasingly liberal attitude towards foreign exchange matters, as well as its determination to open international financing opportunities to PRC companies and to develop its burgeoning financial leasing industry. These will have a positive effect on the long term development of PRC leasing companies and Tianjin FTZ lessors invested by foreign leasing companies alike.

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<sup>10</sup> Please see our client briefing "China relaxes controls on cross-border security: implications for structuring cross-border asset finance transactions " at [http://www.cliffordchance.com/briefings/2014/07/china\\_relaxes\\_controlsoncross-bordersecurity.html](http://www.cliffordchance.com/briefings/2014/07/china_relaxes_controlsoncross-bordersecurity.html)

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