

The introduction of a new filing and registration regime for foreign debt management in China

With a view to facilitating the utilisation of offshore capital at a lower cost, on 10 May 2015, the State Council of the People's Republic of China (PRC) announced the removal of the quota approval system of the National Development and Reform Commission (NDRC) for the issuance of foreign debt by enterprises. On 14 September 2015, NDRC crystallised the initiative by issuing the *NDRC Circular on Promoting the Reform of the Filing and Registration Regime for Issuance of Foreign Debt by Enterprises* (NDRC Circular). The NDRC Circular took immediate effect and overhauls the requirement for prior approval for foreign debt issuance, and imposes a national quota system and a reporting regime. This briefing examines the key features of the NDRC Circular, and highlights its potential impact on current and future offshore bond issuance and borrowing involving PRC enterprises and certain offshore entities.

Overview of the NDRC Circular

Scope of application

The NDRC Circular defines "foreign debts" as offshore debt instruments denominated in RMB or a foreign currency with a tenor of more than one year (i.e. mid/long-term foreign debts).¹ It is worth noting that offshore bond issuances and mid/long-term international commercial loans are specifically referred to as "foreign debts" regulated by the NDRC Circular. The NDRC Circular applies to borrowings/issuances by "enterprises" which broadly covers PRC onshore enterprises, their offshore branches and even offshore enterprises controlled by PRC onshore enterprises (Offshore Subsidiaries). From our informal communications with NDRC officials, all onshore financial institutions are also considered as onshore enterprises, and Offshore Subsidiaries may either be special purpose vehicles (SPVs) or enterprises with substantive business activities. However, according to local NDRC officials, onshore foreign-invested enterprises (FIEs) are not considered as onshore enterprises under the NDRC Circular. It should be noted that this is only based on verbal discussions with local NDRC

¹ Under the PRC foreign debt regime, debts with a tenor of more than one year is regulated as mid/long-term foreign debts, whereas debts with a tenor of one year or less are referred to as short-term foreign debts. They are subject to different regulations and mode of management.

officials and accordingly such interpretation is not necessarily binding, particularly given that there is no express language in the NDRC Circular itself that distinguishes FIEs from other PRC enterprises. In addition, it remains to be seen how NDRC would determine the threshold for what amounts to "control" in respect of Offshore Subsidiaries.

Filing replaces approval regime

The NDRC Circular replaces the previous case-by-case approval system for foreign debt with a filing system which imposes a prior registration and subsequent information reporting requirement to the NDRC. While this reform relaxes NDRC's control over PRC domestic enterprises in direct offshore bond issuance and offshore borrowing, it creates an additional administrative burden on the Offshore Subsidiaries which previously were not subject to NDRC regulation regarding their bond issuance or borrowing activities. NDRC has now effectively established one integrated framework that will allow it to monitor foreign debts of both onshore enterprises and their Offshore Subsidiaries.

One pending issue, however, is how foreign debts taken by FIEs would be regulated in China. Unlike domestic enterprises, FIEs are allowed to incur foreign debts within their "borrowing gap"² without the need for any approval or filing procedures with NDRC. Since the NDRC Circular does not differentiate between PRC domestic enterprises and FIEs, it remains to be seen if the new system under the NDRC Circular would override this "borrowing gap" regime. From our informal inquiries with local NDRC officials, it appears that the application of the NDRC Circular will not extend to FIEs (but note the comment above that such feedback is not necessarily the official interpretation by NDRC). Hence, the current "borrowing gap" regime and the calculation of the "Wai Bao Nei Dai" quota for FIEs are likely to remain in place.³

Prior registration with NDRC

Under the new regime, enterprises must register with NDRC before each bond issuance or the taking out of each loan facility. Eligible issuers/borrowers must satisfy certain criteria, such as having a good credit record, sound corporate governance and risk-control systems, as well as the ability to repay debt without default under their existing bonds or other debts. An application along with an issuance plan setting out the currency, volume, interest rate, tenor, proposed use of proceeds and remittance must be filed with NDRC. NDRC has implied that this filing system is not a de facto approval, although it remains to be tested in practice as to what extent NDRC would exercise its discretion in reviewing the application materials.

NDRC is also introducing an annual national quota to regulate the overall amount of foreign debt. Currently the size of such national quota has not been made publicly available. It remains to be seen whether NDRC would take a liberal approach to satisfy the financing demands of the enterprises. Since the NDRC Circular intends to facilitate offshore financing and to support the growth of the real economy, NDRC is likely to set the annual national quota regime at a reasonable level. However, the existence of this national quota system, together with the Circular's clear support of key industries, sectors and projects (a specific list of which is yet to be

² The borrowing gap of an FIE refers to the difference between its total investment and registered capital as approved by PRC authorities. An FIE may borrow foreign debt (including mid/long-term debt and short-term debt) up to its borrowing gap without additional approvals/filings. An FIE's mid/long term foreign debt is calculated based on its cumulative borrowed amounts, while its short term foreign debt is calculated on an outstanding balance basis.

³ "Wai Bao Nei Dai" refers to a scenario where both the borrower and lender are PRC onshore entities while the guarantor is an offshore entity. An FIE, as the onshore borrower, may incur foreign debt where the guarantee is enforced. In that case, the outstanding principal of the FIE may not exceed the aggregate of the FIE's net assets of the previous year and its borrowing gap. It remains to be seen whether the NDRC Circular will affect the calculation and/or function of the borrowing gap in the context of "Wai Bao Nei Dai".

announced), may give rise to uncertainty as to whether foreign debt registration would be effected, especially when the issuer is not viewed as engaging in an encouraged industry, sector or project.

The NDRC Circular states that foreign debt registration certificates would be issued within 12 working days and will be valid for one year. This certificate is important as it facilitates the conduct of foreign exchange-related formalities such as proceeds repatriation. It is expected that the State Administration of Foreign Exchange (SAFE) would issue supporting regulations to provide further detail on the procedures relating to foreign debt registration. Currently, discussions with SAFE regarding repatriation is taking place on a case by case basis.

Subsequent reporting requirements with NDRC

The NDRC Circular requires the borrowers/issuers to report their foreign debts to NDRC by completing and submitting a standard form within 10 working days of the drawdown/issuance of the foreign debt. The foreign debt registration and information reporting requirements will allow NDRC to collect information regarding foreign debts, so as to effectively supervise cross-border capital flow and to control risks relating to foreign debts. It appears that NDRC is encouraging issuers to plan at the beginning of each year the total amount of foreign debt that it wishes to incur and register the same amount with NDRC. Once this is done, an issuer only needs to promptly notify the NDRC that an issuance within the registered amount has taken place. The implementation of the NDRC Circular appears to require PRC enterprises, especially those with significant offshore operations, to better centralise planning of their offshore debt raising activities.

Repatriation and use of proceeds

The NDRC Circular allows both onshore and offshore use of proceeds based on the needs of enterprises. This seems to signal a relaxation on the existing regime on proceeds repatriation and usage. However, in reality, it is SAFE and the People's Bank of China (PBOC) rather than NDRC that regulate proceeds repatriation and utilisation in respect of foreign currency and RMB-denominated debt. Since neither of these regulators has issued rules consistent with the content of the NDRC Circular, restrictions on remitting proceeds of foreign debt for utilisation within China may still apply in the meantime.⁴ Moreover, the NDRC Circular remains to be reconciled with the SAFE's general prohibition on the repatriation of proceeds under the "Nei Bao Wai Dai" structure.⁵ So far it is unclear how SAFE/PBOC views the proposed repatriation and information regarding the use of proceeds on foreign debt registration certificates as reviewed by NDRC in its prior registration. At the moment, issuers and borrowers are approaching SAFE on a case by case basis to discuss repatriation. Given that NDRC is the leading upstream regulator on foreign debt management in China, SAFE and/or PBOC may issue separate rules to facilitate proceeds repatriation. Since NDRC aims to ensure that proceeds from foreign debts are used to develop key industries, sectors and projects in China, it will be interesting to see what rules SAFE and/or PBOC would issue to achieve this target.

Impact on loan and bond issuance structures

Before the issuance of the NDRC Circular, the borrowing of an offshore loan by an Offshore Subsidiary from a foreign lender would not generally be subject to PRC regulations. The most significant exception was that if the

⁴ For example, generally speaking, PRC domestic company borrowers cannot convert foreign debt proceeds into RMB, and foreign debt proceeds cannot be converted into RMB to repay existing onshore RMB loans.

⁵ "Nei Bao Wai Dai" refers to the scenario where both the borrower and lender are offshore entities while the guarantor is a PRC onshore entity. Under current SAFE regulation, unless specifically approved by SAFE, the offshore borrower may not directly or indirectly remit any financing proceeds under the "Nei Bao Wai Dai" structure back to China.

PRC parent of the Offshore Subsidiary provided a guarantee for the offshore financing incurred by the Offshore Subsidiary, the arrangements would be covered by SAFE regulations concerning "Nei Bao Wai Dai", so that the proceeds of the offshore financing could not be remitted into the PRC. However, since the NDRC Circular came into effect, the act of offshore lending by the Offshore Subsidiary (irrespective of whether its PRC parent provides a guarantee) would, on the face of the NDRC Circular, be subject to the NDRC filing requirement.

In respect of offshore bond issuances, in light of the SAFE regulations concerning "Nei Bao Wai Dai" which restrict the remittance of the proceeds of offshore bond issuances into the PRC (as referred to above), market participants have often used keep-well structures so as to be able to bring bond proceeds onshore. Under a keepwell structure, the PRC parent of the offshore issuer provides liquidity support and keep-well undertakings (instead of a cross-border guarantee) to support the offshore bond financing. Well-structured keep-well arrangements are generally outside the scope of the "Nei Bao Wai Dai" regulations, meaning the remittance of the bond issuance proceeds into PRC would not be caught by the restrictions under the "Nei Bao Wai Dai" regulations. However, it should be noted that under the NDRC Circular, if the issuer is an Offshore Subsidiary of a PRC enterprise, the bond issuance will be subject to the NDRC registration and filing requirement and NDRC will review the usage of the bond issuance proceeds even if the PRC parent only provides keep-well undertakings. Through this process NDRC is technically able to accept or reject the registration of issuances. In addition, since direct offshore issuance and borrowing is now facilitated by the NDRC registration, potential issuers will be actively considering whether they should do a direct issuance instead of using a keep-well structure or cross-border guarantee structure. In particular, ratings agencies have generally rated issuances with a keepwell structure slightly lower than the direct issuance or cross-border guarantee structure, which in turn may result in issuers having to pay a higher coupon/interest on their bonds.

Potential consequences of breach

The NDRC Circular is silent on the consequence of potential breach for failing to attend to registration. Pursuant to the *Interim Measures on Foreign Debt Management* issued by SAFE effective as of 1 March 2003, which was jointly issued by NDRC, SAFE and the Ministry of Finance, foreign loan contracts are not legally binding if the borrowers fail to obtain the necessary approvals or fail to attend to the required registrations. Further clarifications are required to determine whether such failure would render the direct issuance/borrowing invalid, unenforceable, or affect the repatriation and use of proceeds. Irrespective of whether non-compliance would adversely affect the validity or enforceability of the underlying loan obligations, reputational issues are also relevant and we would expect market participants to seek to comply with the NDRC Circular.

Conclusions

The introduction of the new filing and registration regime is aimed at simplifying the administrative procedures on foreign debt and to provide a framework to regulate direct issuance/ borrowing activities by PRC onshore enterprises. Notwithstanding, further clarification by and coordination among the relevant regulators is still required to ensure that in practice the access to offshore financing channels by PRC enterprises can be facilitated.

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500986-4-7584-v0.6

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