

## THE AIRCRAFT LEASING SECTOR IN CHINA: REGULATORY REGIME CHANGES AND OTHER DEVELOPMENTS

### REFORM OF CHINA'S FINANCIAL LEASING INDUSTRY REGULATORY REGIME

In March 2018, the thirteenth National People's Congress of the People's Republic of China ("PRC") approved the institutional reform proposal submitted by the State Council. Among other things, this proposal contemplates that the China Insurance Regulatory Commission ("CIRC") will be merged with the China Banking Regulatory Commission ("CBRC") and form a single commission under the direct supervision of the State Council. On 8 April 2018, the China Banking and Insurance Regulatory Commission ("CBIRC") came into existence.

Following the establishment of CBIRC, the Ministry of Commerce of the PRC ("MOFCOM") published the *Circular on the Supervisory Duties on Financial Leasing Companies, Commercial Factoring Companies and Pawn Shops*<sup>1</sup> ("Circular 165") on 8 May 2018, officially announcing that its administrative authority over financial leasing companies was handed over to CBIRC. Circular 165 took effect on 22 April 2018.

#### Two parallel regulatory regimes

Currently, there are two major types of financial leasing companies in the PRC: ordinary<sup>2</sup> financial leasing companies approved by MOFCOM (in Chinese, *Rongzi Zulin Gongsi* (融资租赁公司), "MOFCOM FLCs") and special financial leasing companies approved by CBRC (in Chinese, *Jinrong Zulin Gongsi* (金融租赁公司), "CBRC FLCs").

CBRC FLCs are non-banking financial institutions and their establishment and operations are subject to CBRC regulations, principally the *Administrative Measures on Financial Leasing Companies* (effective from 13 March 2014, the "2014 CBRC Measures") and the *Implementing Measures on Administrative Licensing Matters for Non-banking Financial Institutions* (effective from 5 June 2015) (together with the 2014 CBRC Measures, the "CBRC Regulations").

Only certain types of institutional investors specified by CBRC are eligible to set up or otherwise invest in CBRC FLCs. Such institutional investors include domestic or non-PRC commercial banks with an independent legal personality, domestic large-scale enterprises with a core business of producing goods

#### Key issues

- Reform of China's Financial Leasing Industry Regulatory Regime
- Other Developments
- Conclusion

<sup>1</sup> For details, please visit MOFCOM's official website at <http://ltfzs.mofcom.gov.cn/article/smzx/201805/20180502743009.shtml>.

<sup>2</sup> "ordinary" and "special" are not terms of art but are used merely to differentiate the two types of FLCs.

suitable to be traded in financial lease transactions, foreign registered financial leasing companies and other entities accepted by CBRC.

MOFCOM FLCs<sup>3</sup> are mainly regulated by the *Administrative Measures on Supervising Financial Leasing Enterprises* issued by MOFCOM on 18 September 2013 (the "**2013 Regulations**"). In addition, historically, foreign invested MOFCOM FLCs must also comply with the provisions provided by the *Administrative Measures on Foreign Invested Leasing Industry* issued by MOFCOM on 28 October 2015 (the "**MOFCOM Regulations**"). In contrast to CBRC FLCs, the eligibility requirements provided under the MOFCOM Regulations are less stringent.

Generally speaking, MOFCOM FLCs are subject to a less stringent regulatory regime compared with CBRC FLCs.

### **Abolition of the MOFCOM Regulations**

On 22 February 2018, MOFCOM promulgated the *Decision on the Abolition and Amendment of Certain Regulations*<sup>4</sup>. This Decision abolished the MOFCOM Regulations, among others. As a result, the eligibility requirements of foreign investors and other specific supervisory requirements regarding foreign-invested MOFCOM FLCs provided for in the MOFCOM Regulations no longer apply. Nevertheless, MOFCOM FLCs, whether foreign invested or purely domestic, are still subject to the continuing supervision of MOFCOM in accordance with the 2013 Regulations as well as the supervision of CBIRC as a result of Circular 165 (this is subject to the uncertainties discussed below).

### **Change of regulator: uncertainties**

Pursuant to Circular 165, CBIRC is intended to replace MOFCOM as the regulator of financial leasing companies and, as a result, to formulate relevant operational regulations. Although Circular 165 is explicit on the authority hand-over, it is unclear as to its implementation or the scope and intention of the operational regulations.

Currently, there are key differences between CBRC FLCs and MOFCOM FLCs as to investor eligibility, registered capital, sources of funding, governmental regulation and intervention and approval processes.

In the absence of further guidance from either MOFCOM or CBIRC, the following queries remain unanswered:

- (i) How will MOFCOM FLCs established prior to Circular 165 be regulated? Will they be subject to the CBRC regulatory requirements with respect to CBRC FLCs or will they continue to be regulated by the 2013 Regulations?
- (ii) Going forward, will there be a unified regulatory regime for all leasing companies established in China? What would be CBIRC's requirements as to eligibility requirements for different types of investors in the leasing industry? Will there be a tiered regulatory regime catering to the needs of different types of investors?

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<sup>3</sup> MOFCOM FLCs are not financial institutions but ordinary enterprises in the PRC.

<sup>4</sup> For details, please visit MOFCOM's official website at: <http://www.mofcom.gov.cn/article/b/c/201803/20180302718134.shtml>.

CBIRC is now working with local governments to establish a registration system<sup>5</sup> with respect to MOFCOM FLCs and will require each local MOFCOM FLC to register with this system. It is reported that the specific regulations as to financial leasing companies are expected to be published by CBIRC sometime soon in 2018.

## OTHER DEVELOPMENTS

### NDRC Circular 11: to file or not?

On 26 December 2017, NDRC promulgated the *Administrative Measures for the Outbound Investment by Enterprises* ("**Circular 11**") which took effect on 1 March 2018.

Pursuant to article 32 of Circular 11, an investor is required to obtain the approval of or filing with NDRC before the implementation of any outbound investment activities prescribed by Circular 11.

It is worth noting that Circular 11, although presumably regulating equity investment by PRC companies outside of the PRC, includes a reference to a PRC company or a non-PRC company controlled by it conducting outbound investment "through providing financing or a guarantee in order to obtain overseas ownership, control rights, business management rights and other related equities" in the definition of the regulated outbound investment activity<sup>6</sup>. Such provision can be interpreted broadly to include financing or a guarantee provided by a PRC company (or a non-PRC company under its control) to facilitate the acquisition of offshore assets such as aircraft and vessels. PRC lessors may need to be aware of such NDRC requirement and to check with NDRC or its local counterparts with respect to any outbound financing or guarantee provided in relation to any asset (such as aircraft) acquisition.<sup>7</sup>

### Foreign debt issues

On 14 September 2015, NDRC issued the *Circular on Promoting the Reform of the Filing and Registration Regime for Issuance of Foreign Debt by Corporate Entities* ("**Circular 2044**") which relaxed NDRC's control on mid/long-term foreign debts of PRC companies by replacing its case-by-case approval system with a national quota and filing system.<sup>8</sup>

<sup>5</sup> See news link at <http://www.cbrc.gov.cn/chinese/newShouDoc/765E8ED7669048CA9704D6BEC36E9FC6.html>

<sup>6</sup> Article 2 of Circular 11 provides that "outbound investment refers to the investment activities conducted by an enterprise located within the territory of the People's Republic of China (hereinafter referred to as "investor") either directly or via an overseas enterprise under its control through making investment with assets and equities or providing financing or a guarantee in order to obtain overseas ownership, control rights, business management rights and other related equities".

<sup>7</sup> For details of the filing procedures and required materials, please refer to NDRC's official website at: <http://services.ndrc.gov.cn:8080/ecdomain/portal/portlets/bjweb/newpage/guide/guidService.jsp?idseq=a85cb67f2a5f4b45b3e13ba3f35292b4>.

<sup>8</sup> For details, please refer to our client briefing at: [https://www.cliffordchance.com/briefings/2015/09/ndrc\\_replaces\\_approvalregimewithfilingregim.html](https://www.cliffordchance.com/briefings/2015/09/ndrc_replaces_approvalregimewithfilingregim.html).

A point worth noting for Chinese leasing companies is that the mid/long term loans incurred by their offshore subsidiaries (which are fairly common for the leasing industry) are captured by Circular 2044.

In June 2016, NDRC initiated a pilot program whereby certain selected entities (including financial institutions and local governmental investment and financing vehicles) were granted an annual total quota for offshore bond issuances and debt borrowings (the "**Annual Quota**"). Within the Annual Quota, each selected entity (and its group companies) may issue offshore bonds or borrow medium/long term debts at any time or frequency at its discretion within the prescribed year.

Offshore bond issuances and debt borrowings regulated under the pilot program do not require case-by-case prior registration with NDRC (which would otherwise be required pursuant to Circular 2044). Instead, upon closing of the transaction, the selected entity is required promptly to report the relevant information regarding the foreign debt to NDRC. In 2017, twenty-two companies were granted an Annual Quota. However, up until the date of this article, no such quota has been announced as being granted to any company by NDRC in 2018.

NDRC is likely to strengthen its control and supervision as to 2044 NDRC filings in respect of mid/long term offshore loans and it is advisable for PRC companies to consult with the relevant local counterparts of NDRC as to the details and requirements for completing such filings.

## **CONCLUSION**

These regulatory changes are indicators of the PRC government's efforts in streamlining the administration of the leasing industry and strengthening the control of cross-border borrowings. Certain issues remain to be clarified. Navigating through the ever-changing regulatory environment, Chinese lessors should not only watch out for these continuing developments but also factor the changes into their business planning.

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