

# China's new cross-border financing rules: potential impact on aircraft financing structures

China, as a country with foreign exchange controls, closely monitors and administers its cross-border financings. On 29 April 2016, the People's Bank of China (**PBoC**) issued the *Circular on Implementing Overall Macro-prudential Management System for Nationwide Cross-border Financing* (the **New Circular**) which introduces a system (the **MP System**) to track financings provided to PRC on-shore entities by offshore financiers in RMB or foreign currencies.

The New Circular came into force on **3 May 2016** and the MP System now applies to all enterprises incorporated in China, including both foreign invested enterprises (**FIEs**) and Chinese domestic companies, but excluding real estate enterprises and government financing platforms (collectively, **PRC Enterprises**).

## Potential impact on cross-border aircraft financing structures

- **Pre-approval and post-signing foreign debt registration no longer required**

The National Development and Reform Commission (**NDRC**), PBoC and the State Administration of Foreign Exchange (**SAFE**) have, historically, acted as co-governing authorities with respect to cross-border financings. Generally speaking, under the previous regime, the allocation of their roles with respect to cross-border financings has been as follows<sup>1</sup>:

- (a) NDRC approval has been required for the mid/long-term foreign debts<sup>2</sup> of Chinese domestic companies;

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<sup>1</sup> This is a high level overview only of the foreign debt administration regime. Please note that specific/additional restrictions and requirements have been applicable for certain kinds of borrowers (largely depending on the industry of the relevant borrower).

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

- (b) SAFE approval has been required for the short-term foreign debts of Chinese domestic companies. SAFE has also been responsible for monitoring the foreign debts of FIEs under the so-called "borrowing gap regime"<sup>3</sup> and for the administration of post-signing foreign debt registrations (for both Chinese domestic companies and FIEs); and
- (c) PBoC has been responsible for monitoring cross-border financings denominated in RMB and overseeing the overall administration of China's foreign exchange system.

Key recent steps in the gradual reform of China's cross-border financing regulatory regime have been as follows:

- (a) in September 2015, NDRC issued a circular (**Circular 2044**) which relaxed NDRC's administration of mid/long-term foreign debts. Circular 2044 essentially replaced a case-by-case approval system with a national quota and filing system with respect to the mid/long-term debts of Chinese domestic companies<sup>4</sup>; and
- (b) the New Circular has alleviated PBoC's and SAFE's administration of a PRC Enterprise's borrowings by removing any quota or case-by-case approval requirement with respect to foreign debts within the administration of PBoC and SAFE. In addition, SAFE no longer issues any foreign debt registration certificate which had been a feature of the old regime.

- ***Calculation of foreign debt limit under the New Circular***

If a PRC Enterprise intends to borrow funds from an offshore entity, it is now required to calculate its borrowing limit based on a risk-weighted methodology under the MP System: i.e. its "risk-weighted cross-border financing balance" (**Balance**) cannot exceed its "risk-weighted cross-border financing limit" (**Cap**).

The New Circular sets out complicated formulae for the calculation of the Balance and the Cap. Essentially:

- (a) the Balance is calculated on the basis of the outstanding amount of the onshore borrower's cross-border financings (subject to adjustments based on the specific tenor, type and currency of the financings); and
- (b) the Cap is calculated on the basis of the onshore borrower's capital or net assets (subject to adjustments based on leverage ratios and other parameters).<sup>5</sup>

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<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> Please see our earlier Clifford Chance client briefing - *NDRC replaces approval regime with filing regime for foreign debt control and other legal updates from China* (September 2015) via this link: [http://www.cliffordchance.com/briefings/2015/09/ndrc\\_replaces\\_approvalregimewithfilingregim.html](http://www.cliffordchance.com/briefings/2015/09/ndrc_replaces_approvalregimewithfilingregim.html)

<sup>5</sup> For a more detailed explanation on the formulae, please see our earlier Clifford Chance client briefing - *PBoC*

- **Filing/reporting requirements under the New Circular**

Although there is no longer a requirement to register foreign debt with SAFE, pursuant to the New Circular, the MP System imposes new filing and reporting obligations on PRC Enterprises, which require (among other things):

- (a) **non-financial enterprises**<sup>6</sup> to file with SAFE each cross-border financing after execution<sup>7</sup> and no later than three business days before funds drawdown<sup>8</sup>; and
- (b) **financial institutions**:
  - to file with PBoC and SAFE their methodology for calculating their Balance and Cap prior to conducting their first MP System cross-border financing transaction; and
  - thereafter, to report to PBoC and SAFE relevant transaction information after the execution, and before the performance of, each cross-border financing agreement.<sup>9</sup>

- **Options available to FIEs**

Significantly, FIEs may elect to follow the new MP System or maintain the methodology for calculating their foreign debt which applied prior to the introduction of the new system.

This means that a foreign-invested leasing company may elect to continue using the existing foreign debt regime in cases where it would allow more flexibility in obtaining offshore financing.<sup>10</sup>

Any such election made by an FIE must be filed with PBoC and SAFE in advance. Once filed, it will, in principle, remain the methodology for calculating that FIE's foreign debt.

Note that this election option is only available for a "transitional period" (after which it is likely

*Implements Nationwide Macro-prudential Management on Cross-border Financing* (May 2016) via this link: [http://www.cliffordchance.com/briefings/2016/05/pboc\\_implements\\_nationwidemacro-prudentia.html](http://www.cliffordchance.com/briefings/2016/05/pboc_implements_nationwidemacro-prudentia.html).

<sup>6</sup> Non-financial enterprises are companies which are not licensed as financial institutions in China.

<sup>7</sup> The New Circular has not provided details as to the scope of documents to be disclosed and filed.

<sup>8</sup> No further guidance has yet been issued by SAFE as to whether any informal document (for example, a receipt) will be issued to the applicant making the filing; this issue is expected to be clarified in the implementing rules to be issued by SAFE.

<sup>9</sup> For a more detailed explanation of the filing/reporting requirements, please see our earlier Clifford Chance client briefing referred to in footnote 5 above.

<sup>10</sup> Prior to the MP System, the quota of foreign debt that could be borrowed by a foreign invested leasing company (which is a different from the "borrowing gap regime" applicable to general FIEs as explained in footnote 3) from an offshore entity in each year was calculated using the formula  $B - A$ , in which :

- (i) A stands for total amount of its risk assets in the preceding year according to its audited financial statement of the previous year, and
- (ii) B stands for 10 times the value of its net assets based on its audited financial statement of the previous year.

It appears that the resulting calculation based on this formula is, in most circumstances, greater than the result calculated based on the risk-weighted method under the new MP System but parties should take specific and separate advice on such calculations.

the FIEs will need to follow the MP System)<sup>11</sup> - the New Circular is unclear as to the length of the "transitional period".

- **Uncertainties**

- (a) NDRC filing

As mentioned above, Circular 2044 reformed NDRC's administration and supervision of mid/long-term foreign debts by instituting a national quota and filing system.

It remains uncertain as to how the New Circular interacts with Circular 2044. The New Circular is silent on this and no further clarifying guidance has yet been issued by the PRC authorities.

- (b) Off-balance-sheet-financing/contingent debts

The MP System introduces a new concept of "offshore-balance-sheet-financing /contingent debt" (**Off-balance sheet Debt**). Off-balance sheet Debt counts towards the Balance and thus reduces the total cross-border financing amount allowed to be borrowed by a PRC Enterprise.

However, the New Circular is not clear as to what constitutes Off-balance sheet Debt.

## Conclusion

The new MP System is a significant transition from the previously fragmented regulatory approach to a more consolidated regime. In addition, foreign-invested leasing companies now have options when calculating their foreign debt limits.

Nevertheless, it remains to be seen how the New Circular will impact aircraft financing deals, in particular those involving leasing entities set up in free trade zones:

- (a) where the individual borrower is established by a foreign-invested leasing company, it remains unclear as to how that borrower's foreign debt limit interacts with the foreign debt limit of its FIE parent; and
- (b) where the borrower is established by a financial leasing company approved by the China Banking Regulatory Commission (**CBRC**)<sup>12</sup>, it remains unclear whether the borrower must comply with the new filing/reporting requirements as a non-financial enterprise or as a financial institution.

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<sup>11</sup> However, it is not entirely clear under the New Circular which regime applies to the FIEs after the transition period.

<sup>12</sup> Such a leasing company is a non-banking financial institution.

## Contacts



**Paul Greenwell**

**Partner, Hong Kong**

**T: +852 2825 8857**

**E: [Paul.Greenwell@CliffordChance.com](mailto:Paul.Greenwell@CliffordChance.com)**



**Katherine Ke**

**Counsel, Shanghai**

**T: +86 212320 7248**

**E: [Katherine.Ke@CliffordChance.com](mailto:Katherine.Ke@CliffordChance.com)**

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Clifford Chance, 40th Floor, Bund Centre, 222 Yan An East Road, Shanghai 200002, People's Republic of China

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