

Finance

# China Bulletin

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## In This Issue...

- SAFE's New Rule Simplifies and Clarifies Foreign Debt Registration



Welcome to the June issue of White & Case's China Finance Bulletin. This bulletin is a regular update on the PRC finance sector ensuring you stay up to date with the latest legal, regulatory and practice developments.

## SAFE's New Rule Simplifies and Clarifies Foreign Debt Registration

On April 28, 2013, the State Administrative of Foreign Exchange ("**SAFE**") issued "The Administrative Measures for the Registration of Foreign Debt" (entitled "The Operational Guidelines for the Registration of Foreign Debt") (Hui Fa [2013] No.19) (collectively, the "**No. 19 Circular**")<sup>1</sup>. The No. 19 Circular came into effect on May 13, 2013.

The No. 19 Circular is a major milestone in foreign exchange administration, as it combines and integrates the existing departmental regulations, and clarifies approval principles in a systematic way.

The key changes made by the No. 19 Circular are:

### Clarification of preconditions to an FIEs' incurrence of foreign debt

The No. 19 Circular has reinstated that the amount of foreign debt that can be borrowed by foreign invested enterprises' ("**FIEs**") shall not be higher than its "borrowing headroom" which is the difference of its total investment and registered capital. Another precondition is that capital injection to an FIE should be "completed". Prior to issuance of the No. 19 Circular, it was not clear what constituted "completion of capital injection", in particular in the case of capital injection made in instalments. In practice, different local branches of SAFE had different interpretations of "completion of capital injection". The No. 19 Circular has clarified that foreign shareholders of an FIE should at least make the first instalment of its capital injection prior to any borrowing of foreign debt by that FIE. The No. 19 Circular also explicitly allows FIEs to borrow an amount of foreign debt which is in proportion to the ratio of the actual paid-in capital contributed by its foreign shareholders to total capital agreed to be contributed by the foreign shareholders.<sup>2</sup>

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<sup>1</sup> The Chinese version of the No. 19 Circular can be found at [http://www.gov.cn/zwqk/2013-05/03/content\\_2395170.htm](http://www.gov.cn/zwqk/2013-05/03/content_2395170.htm).

<sup>2</sup> Paragraph 2 of the "application principles" column in Annex 1 of the No. 19 Circular.

### A breakthrough in an FIEs' borrowing headroom

Before the No. 19 Circular became effective, an FIE's borrowing headroom would be permanently reduced by the cumulative amounts of medium-to-long term foreign debts that the FIE incurred, in other words, any subsequent repayment of such foreign debt would not result in a corresponding increase of its borrowing headroom. The No. 19 Circular explicitly provides that any extension or refinancing of an FIE's medium-to-long term foreign debt would not take up any additional borrowing headroom of that FIE, as long as there is no increase in the outstanding amount of the medium-to-long term foreign debts and that FIE does not convert any foreign currency into Renminbi.<sup>3</sup>

### Treatment of certain FIEs as Domestic Enterprises

The No. 19 Circular provides that certain types of enterprises with foreign investment shall, for the purpose of foreign debt administration, be treated as Chinese-funded enterprises which are subject to even more stringent restrictions on incurrence of foreign debt. Those enterprises are (a) Chinese-funded enterprises domestic enterprises with foreign investment of less than 25 percent (the "**Domestic Enterprises**"), (b) FIEs whose total investment and registered capital are equal, and (c) FIEs without a clear total investment amount.

### Abolishment of certain SAFE approvals

The No. 19 Circular has abolished approvals by SAFE of the following matters:

- (a) Conversion by FIEs of foreign debt proceeds into Renminbi.<sup>4</sup> However, if an FIE intends to apply foreign debt proceeds towards refinancing of its existing debts, it is not allowed to convert such proceeds into Renminbi<sup>5</sup>. Such restriction can effectively prevent FIEs from using foreign debt proceeds to refinance its Renminbi loans.
- (b) Opening of foreign debt accounts. Non-bank borrowers may open accounts for withdrawal and repayment of foreign debts as long as the foreign debt has been registered with SAFE.
- (c) Verification of repayments of foreign debt. A bank can now verify repayment of foreign debt directly.

### Clarification of the permitted usage of foreign debt proceeds

The No. 19 Circular confirms that proceeds of foreign debt borrowed by FIEs and Domestic Enterprises may be applied towards trade and services within its own business scope and towards eligible financial transactions. For financial transactions, the No. 19 Circular sets up certain restrictions. Among other things, if the foreign debt proceeds will be used towards refinancing existing debt, such proceeds cannot be converted into Renminbi.<sup>6</sup>

### Domestic debt with foreign security

Before the No. 19 Circular was issued, only Domestic Enterprises in pilot program areas could take advantage of security or guarantee granted by offshore entities securing or guaranteeing loans extended by onshore lenders, as once the debt was paid off by the offshore security provider or guarantor, there was an actual debt owed by the Domestic Enterprise to its offshore security provider or guarantor which constitutes a foreign debt of that Domestic Enterprise. Pursuant to the No. 19 Circular, once certain conditions are satisfied, such deal structure is now available to Domestic Enterprises that have been granted with a quota by the local SAFE. SAFE's requirements for granting such quota include, without limitation (a) such Domestic Enterprise being in sectors encouraged by the government, (b) being in good standing, (c) having a net asset to total asset ratio of no less than 15 percent, and (d) having an aggregate foreign debt and external guarantee amount not exceeding 50 percent of its net assets.<sup>7</sup>

### Summary

Generally speaking, after the No. 19 Circular became effective, save for the registration of a loan agreement evidencing a foreign debt with SAFE, which remains the biggest hurdle, most other procedures, such as foreign-debt account opening, conversion of foreign debt proceeds into Renminbi and repayment of foreign debts, can be handled by banks.

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3 Paragraph 3 of the "application principles" column in Annex 1 of the No. 19 Circular.

4 Clause 14 of the No. 19 Circular.

5 Paragraph 5(1) of the "notes" column in Annex 3 of the No. 19 Circular.

6 Paragraph 5 of the "notes" column in Annex 3 of the No. 19 Circular.

7 The "application principles" column in Annex 8 of the No. 19 Circular.

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