

ClientAlert

China Bank Finance

May 2014

SAFE Cross-Border Security Rules Finally Released

The State Administration of Foreign Exchange of the PRC ("**SAFE**") formally released on 19 May 2014 the *Foreign Exchange Administration Rules on Cross-border Security* (《跨境担保外汇管理规定》) together with its operation guidelines (the "**New Rules**"). The New Rules will come into effect on 1 June 2014. The New Rules reform the regulatory regime for outbound and inbound security. We issued a client alert in March 2014 commenting on the final draft of the New Rules (See our [China Bank Finance Client Alert issued in March 2014](#)).

From 1 June 2014, PRC companies will be able to provide guarantee/security in favour of an offshore entity ("**Outbound Security**") without the need to obtain any approval or quota from SAFE. Any Outbound Security is still subject to the requirement that it must be registered with SAFE within 15 days of its execution, but such registration will no longer be a condition to the validity of the security interest being created.

The New Rules removed the restriction set out in the final draft of the New Rules for the aggregate amount of Outbound Security provided by a financial institution not to exceed "50% of the audited amount of its net assets". In the New Rules, this is now a matter subject to the discretion of the relevant industry regulators (e.g. for commercial banks, People's Bank of China and China Banking Regulatory Commission).

However, the "No Flow-Back of Loan Proceeds" restrictions remain. Unless special approval from SAFE is obtained, proceeds of an offshore loan supported by Outbound Security cannot be used for (1) equity investment or shareholder loan into PRC entities, (2) refinancing existing debt which was originally used for equity investment or shareholder loan into PRC entities, (3) acquisition of an offshore company/group which has more than 50% of its assets in the PRC, or (4) initial payment for a trade transaction in respect of goods or services to a PRC entity which (x) is more than US\$1,000,000 and exceed 30% of the total price for such goods or service, and (y) is made at a time more than 1 year earlier than the date of delivery of goods or services.

We will issue further updates once the New Rules are implemented.



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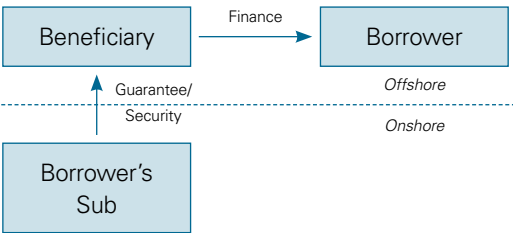
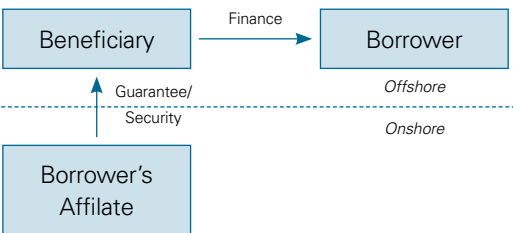
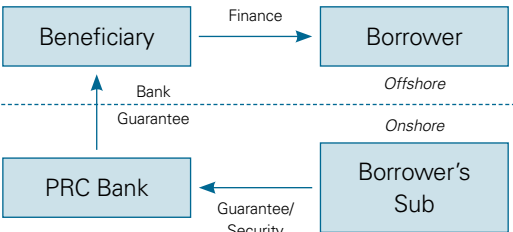
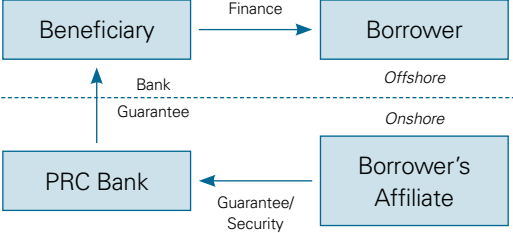
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Appendix: Basic Financing Structures Before and After 1 June 2014

Structures	Before 1 June 2014	After 1 June 2014
Corporate Structures (USD or other foreign currencies)		
<p>1) Offshore Finance with USD Upstream Outbound Corporate Security</p> 	<ul style="list-style-type: none"> ■ Generally impermissible 	<ul style="list-style-type: none"> ■ Permissible ■ No approval or ratio or quota restrictions for offshore "Loans" (however impermissible for "Bonds" which must have an "offshore sub & onshore parent" structure) ■ No Flow-Back of Loan Proceeds
<p>2) Offshore Finance with USD Non-Upstream Outbound Corporate Security</p> 	<ul style="list-style-type: none"> ■ Permissible but not practical ■ Some large SOEs subject to SAFE approved quota ■ The others subject to SAFE approval on a case-by-case basis which can be very difficult and time-consuming to obtain ■ In general, must be an "offshore sub & onshore parent" structure ■ No Flow-Back of Loan Proceeds 	<ul style="list-style-type: none"> ■ Permissible ■ No approval or ratio or quota restrictions (however "Bonds" must have an "offshore sub & onshore parent" structure) ■ No Flow-Back of Loan Proceeds
Bank Structures (USD or other foreign currencies)		
<p>3) Offshore Finance with USD Upstream Outbound Bank Guarantee</p> 	<ul style="list-style-type: none"> ■ Permissible ■ Subject to SAFE approved quota ■ No Flow-Back of Loan Proceeds 	<ul style="list-style-type: none"> ■ Permissible ■ Subject to the rules of industry regulatory (if any) ■ No Flow-Back of Loan Proceeds
<p>4) Offshore Finance with USD Non-Upstream Outbound Bank Guarantee</p> 	<ul style="list-style-type: none"> ■ Permissible ■ Subject to SAFE approved quota ■ No Flow-Back of Loan Proceeds 	<ul style="list-style-type: none"> ■ Permissible ■ Subject to the rules of industry regulatory (if any) ■ No Flow-Back of Loan Proceeds

Structures	Before 1 June 2014	After 1 June 2014
RMB Structures		
<p>5) Offshore Finance with RMB Outbound Corporate Security (Upstream or Non-Upstream)</p> <pre> graph TD subgraph Onshore BA[Borrower's Affiliate] B[Beneficiary] end subgraph Offshore BO[Borrower] end BA -- "Guarantee/ Security" --> B B -- "Finance" --> BO </pre>	<ul style="list-style-type: none"> ■ Permissible ■ No approval or ratio or quota restrictions according to PBOC rules (which however is in conflict with SAFE rules) 	<ul style="list-style-type: none"> ■ Permissible ■ Difference between PBOC rules and SAFE rules is much less significant ■ Application of the “No Flow-Back of Loan Proceeds” rules not entirely clear
<p>6) Offshore Finance with RMB Outbound Bank Guarantee (Upstream or Non-Upstream)</p> <pre> graph TD subgraph Onshore PRCB[PRC Bank] B[Beneficiary] BOA[Borrower's Affiliate] end subgraph Offshore BO[Borrower] end BOA -- "Guarantee/ Security" --> PRCB PRCB -- "Bank Guarantee" --> B B -- "Finance" --> BO </pre>	<ul style="list-style-type: none"> ■ Permissible ■ No approval or ratio or quota restrictions according to PBOC rules 	<ul style="list-style-type: none"> ■ Permissible ■ No approval or ratio or quota restrictions ■ Application of the “No Flow-Back of Loan Proceeds” rules not entirely clear
Individual Structures		
<p>7) Offshore Finance with PRC Individual Outbound Security</p> <pre> graph TD subgraph Onshore PI[PRC Individual] B[Beneficiary] end subgraph Offshore BO[Borrower] end PI -- "Guarantee/ Security" --> B B -- "Finance" --> BO </pre>	<ul style="list-style-type: none"> ■ Permissible but not practical ■ Only if the such security is granted together with a PRC company for an outbound acquisition ■ Subject to SAFE approval which must be obtained for the individual and corporate security as one package and time-consuming and difficult 	<ul style="list-style-type: none"> ■ Permissible ■ No approval or ratio or quota restrictions ■ No Flow-Back of Loan Proceeds
Alternative Structure		
<p>8) Offshore Finance with Onshore Placeholder Loan (i.e. two parallel loans onshore/offshore loans stapled together with an ICA)</p> <pre> graph TD subgraph Onshore OB[Onshore Banks] OBorrower[Onshore Borrower] end subgraph Offshore OFB[Offshore Banks] OFBorrower[Offshore Borrower] end OB -- "Finance" --> OBorrower OFB -- "Finance" --> OFBorrower OBorrower <--> ICA OFBorrower </pre>	<ul style="list-style-type: none"> ■ Permissible ■ Onshore/offshore separate security packages must be separate ■ ICA requires careful drafting so as not to breach any SAFE regulation 	<ul style="list-style-type: none"> ■ Permissible ■ More flexibility to structure the security package and ICA

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