



# PBOC PROMOTES NEW CROSS BORDER FINANCING RULE THROUGHOUT CHINA

On April 29th, 2016, the People's Bank of China ("PBOC") issued the Notice on *Implementing Nationwide the Macro Prudential Management of Cross Border Financing in Full Aperture* ("PBOC Notice") (《中国人民银行关于在全国范围内实施全口径跨境融资宏观审慎管理的通知》) which was implemented on May 3rd, 2016<sup>1</sup>.

Coming after the *PBOC Notice Regarding the Expansion of the Pilot Scheme for Macro Prudential Management of Cross Border Financing* ("Pilot Notice") (《中国人民银行关于扩大口径跨境融资宏观审慎管理试点的通知》) implemented in four free trade zones only three months later, the PBOC Notice extends the implementation of macro prudential management of cross border financing to all non-financial enterprises established in China (excluding government financing vehicles and real estate enterprises) ("Enterprises") and various legal person financial institutions whose incorporation are approved by the PBOC, the China Banking Regulatory Commission, the China Securities Regulatory Commission and the China Insurance Regulatory Commission ("Financial Institutions"). It shows a clear determination of Chinese government to encourage inflow of capital in proportion to the assets scale of Enterprises and Financial Institutions, and liberalize, to some extent, PRC domestic institutions in financial arrangements. The management regime under the PBOC Notice is very different from the current foreign debt quota regime, the key features include:

## 1. Macro Prudential Management Policies

"**Cross Border Financing Risk Weighted Outstanding**" ("Financing Outstanding") and "**Upper Limit of Cross Border Financing Risk Weighted Outstanding**" ("Financing Limit") constitute two main features of the new cross border financing policies. Financing Outstanding refers to the aggregate amount of the outstanding debts in RMB and foreign currency after multiplying the risk weight. Financing Limit is the product of net assets (or the capital), cross border financing leverage ratio and the macro prudent adjustment parameter. The Financing Outstanding shall not exceed the Financing Limit.

### Financing Outstanding

**Financing Outstanding** =  $\sum$  RMB & Foreign currency financing balance \* tenor risk ratio \* category risk ratio +  $\sum$  foreign currency financing balance \* exchange rate risk ratio

**Tenor risk ratio** is set at 1 for mid-to-long term debts (with tenor exceeding 1 year) and at 1.5 for short-term debts (with tenor of or less than 1 year).

**Category risk ratio** is set at 1 if it is an "on balance sheet" financing. For "off balance sheet" financing (or a contingent debt), the ratio is also temporarily set at 1.

**Exchange rate risk ratio** is set at 0.5

All risk ratios might be adjusted by PBOC from time to time.

Specifically, in relation to foreign currency trade financing, 20 % of it shall be taken into account in the calculation of the Financing Outstanding, and the tenor risk ratio is set at 1 uniformly.

<sup>1</sup>The PBOC Notice has set a one-year transforming period for pilot scheme of macro prudential management of cross border financing implemented in four free trade zones in China, which means that the PBOC Notice will be implemented in said districts since May 3rd, 2017.

In relation to “off balance sheet” financing (or a contingent debt) of Financial Institutions, including the domestic guarantee provided by Financial Institutions for overseas loans, overseas contingent debt incurred by Financial Institutions due to providing derivatives based on the needs of true cross-border transactions and hedge management service for assets and liabilities currency risk and term risk, and the contingent debt incurred by Financial Institutions due to participating in international financial market transactions in their self needs of hedge management for currency risk and term risk, the fair value of “off balance sheet” financing (or a contingent debt) shall be taken into account in the calculation of the Financing Outstanding.

In general, fund borrowed by the Enterprises and Financial Institutions in both RMB and foreign currency from non-resident enterprises or individuals, including both on-balance-sheet debts and off-balance-sheet debts, must be calculated for the Financing Outstanding, but some categories are expressly eliminated from the calculation, including:

- Passive debt in RMB incurred by Enterprises and Financial Institutions from offshore entities’ investing to domestic bond market; RMB deposit of foreign entities in the Financial Institutions
- Trade credit of Enterprises incurred from true cross-border trade (including both payables, and receivables in advance) and RMB trade financing obtained from offshore financial institutions; various kinds of RMB trade financing generated due to conducting settlement for true cross-border trade by Financial Institutions
- Overseas debts of Enterprises incurred under cross-border cash pooling arrangements (which are established for the management of cash flow of legal business operations and industrial investments) duly filed by the authorities
- Overseas debts incurred by Financial Enterprises due to overseas deposit taking of interbank, inter-branch account and affiliate transfer
- RMB bonds issued in China by offshore parent companies of Enterprises to fund their onshore subsidiaries; and
- Any amount of cross-border debts of Enterprises or Financial Institutions converted into equity or is exempted.

### Financing Limit

**Financing Limit** = Net assets or Capital \* Cross border financing leverage ratio \* Macro Prudent Adjustment Parameter

**Net assets or Capital** refers to the net assets of Enterprises, tier one capital of banking Financial Institutions and capital (paid-in capital or capital stock + capital reserve) of non-banking Financial Institutions, which shall be calculated according to the latest audited financial report of the Enterprises and Financial Institutions.

**Cross border financing leverage ratio** is set at 1 for Enterprises and non-banking Financial Institutions, and at 0.8 for banking Financial Institutions.

**Macro Prudent Adjustment Parameter** is set at 1.

The ratio and parameter might be adjusted by PBOC from time to time.

## 2. Flexible Filing Procedure

Under the original regime, Enterprises shall apply for foreign debt registration before relevant Administration for Foreign Exchange (“SAFE”) within 15 business days after the signing of the offshore loan contract. In accordance with the PBOC Notice, pre-record filing and registration is not required. Enterprises could have more flexibility by making filing with SAFE’s capital information system no later than 3 business days before the drawdown.

Financial Institutions are required to file the details of the calculation of their Financing Outstanding and Financing Limit with PBOC or SAFE before making their first cross-border financing transaction, and thereafter to report to PBOC or SAFE before the drawdown of the loan or issue of the bonds if a cross-border financing agreement is signed.

### 3. Parallel Cross Border Financing Regimes

Under the original management regime, foreign-invested enterprises (“FIEs”) could obtain offshore financing within the difference of the total investment and the registered capital, while the outstanding short-term foreign debt and total amount incurred for mid and long term foreign debt of foreign-invested financial institutions are subject quota limit set by National Development and Reform Commission (“NDRC”) and SAFE respectively every year. The new management policies does not prevent FIEs and foreign-invested financial institutions from continuously adopting the existing foreign debt quota regime, although how long the parallel regimes will last is not clearly interpreted by the PBOC Notice. In any case, FIEs and foreign-invested financial institutions could only adopt one regime and file the same before PBOC or SAFE. If they decide to adopt the macro prudential management regime, it could not revert to the existing foreign debt quota regime unless approved by PBOC or SAFE.

### Other Issues to be Further Clarified by the Authorities

1. The PBOC Notice stipulates that the fund transfer in the cross border financing can be handled under the general domestic and foreign currency account, which hints that the Enterprises could convert the borrowed foreign exchange at will for the current SAFE policies allow the foreign exchange under the general domestic and foreign currency account to be converted into RMB freely. However, it further regulates that the Enterprises could convert the foreign exchange funds into RMB upon its actual need for its own manufacturing and operation, which according to current practice shall provide contract, invoice or other evidence before the banks to certify the existence of actual need. The contradiction of foreign exchange conversion shall be further clarified by SAFE.
2. Under the existing regime, mid and long term foreign debt of domestic-funded enterprises are subject to quota control of NDRC, and filing at NDRC before borrowing is required. The PBOC Notice does not address whether the NDRC regime is still applicable to domestic-funded enterprises, and if SAFE will still require applicants to submit relevant NDRC filing documents for fulfilling SAFE registration. Said issue shall be further clarified by SAFE and NDRC.
3. The PBOC Notice does not stipulate how the overseas debts that Enterprises incurred due to domestic guarantee for overseas loans and overseas guarantee for domestic loans will be calculated for Financing Outstanding, which shall also be further explained by SAFE.

### Conclusion

The promulgation of this new cross border financing rules seems to show a tendency for adopting a more loose supervision towards the in-flow of capital in China. Under this new regime, domestic entities are generally granted with more autonomy in raising money from cross border financing. They can choose to raise money from the domestic market or from offshore markets to decrease the financing cost.

For the FIEs, before making the final decision of choosing which regime, it is suggested to evaluate the pros and cons of two cross border financing regimes based on its financial status.

In addition, we will keep close eyes on the practice and the implementation measure to be promulgated by SAFE and/or NDRC and keep you posted.

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