

People's Bank of China and State Administration of Foreign Exchange Issue Circular on Adjustment to Macro-Prudential Policy Parameter for Cross-Border Financing Corporate Foreign Debt Quota to Be Raised to 2.5x Net Assets Value

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On March 12, 2020, the People's Bank of China (PBOC) and the State Administration of Foreign Exchange (SAFE) issued a circular on an adjustment to the Macro-Prudential Policy Parameter for cross-border financing (Yinfa [2020] No. 64, hereinafter "Circular No. 64"), in which the Macro-Prudential Policy Parameter has been raised from 1.00 to 1.25 in the Macro-Prudential Management Model. Accordingly, **companies that employ the Macro-Prudential Management Model for their foreign debt will find their risk-weighted maximum balance for cross-border financing (hereinafter "Foreign Debt Quota") raised from 2.0 to 2.5 times the value of their net assets.** Circular No. 64 entered effect on the day it was issued.

Key Takeaways

- The Foreign Debt Quota for companies that employ the Macro-Prudential Management Model will be raised from 2.0 to 2.5 times the value of the company's Net Assets.
- There is no change to the Foreign Debt Quota for companies using the Investment Gap Model.

1. Background of the Policy Change

Severely affected by the spread of the new coronavirus, many entities in China, especially small- and medium-sized companies, have been faced with difficulties in financing and rise of financing costs when they resume business. Circular No. 64 is intended to reduce financing costs in the real economy by increasing the Foreign Debt Quota for entities in China and further encouraging the use of foreign investment.

In 2017, the PBOC issued a circular on macro-prudential management for cross-border financing (Yinfa [2017] No. 9, hereinafter "Circular No. 9") in order to allow companies and financial institutions in China to access foreign loans. Circular No. 9 also allowed foreign invested enterprises (FIEs) and foreign financial institutions to continue using the Investment Gap Model to borrow foreign loans during a transitional period (initially one year, but it remains in effect at the time of writing).

Circular No. 64, however, raises the Foreign Debt Quota only for companies using the Macro-Prudential Management Model and makes no adjustments for those that use the Investment Gap Model.

2. Details of the Regulation

If an entity in China employs the Macro-Prudential Management Model, its **Foreign Debt Quota shall be calculated by the given formula: Capital or Net Assets × Leverage Ratio × Macro-Prudential Policy Parameter.** Circular No. 64 increases the **Macro-Prudential Policy Parameter** from 1.00 to **1.25**, thus raising the Foreign Debt Quota from 2.0 to **2.5 times** the value of a company's **Net Assets**.

【Fig. 1】 Calculation of the Risk-Weighted Maximum Balance for Cross-Border Financing (Foreign Debt Quota)							
	Capital/ Net Assets	×	Leverage Ratio	×	Macro-Prudent ial Policy Adjustment Parameter	=	Risk-Weighted Maximum Balance for Cross-Border Financing
Companies	Net Assets		2.0		Before Circular <u>No. 64:</u> 1.00 After Circular <u>No. 64:</u> 1.25		Before: 2.0x Net Assets After: 2.5x Net Assets
Non-Bank Financial Institutions	Capital	×	1.0	×			Before: 1.00x Capital After: 1.25x Capital
Banks and Similar Financial institutions	Tier 1 Capital		0.8				Before: 0.8x Tier 1 Capital After: 1.0x Tier 1 Capital

Circular No. 64 has made no adjustments in the Foreign Debt Quota for entities using the Investment Gap Model.

Example: The Foreign Debt Quota for a company with Net Assets of 100 will be 250 by the formula above ($100 \times 2.0 \times 1.25 = 250$).

Additionally, Circular No. 9 requires companies to calculate the Weighted Loan Amount for the Foreign Debt Quota factoring in the currency and term of the loan (using specific conversion factors shown below). As a result, the Weighted Loan Amount might exceed the actual contract amount of a foreign loan.

Below is trial balance.

Reference: Calculation of the Weighted Loan Amount for the Foreign Debt Quota

Preconditions:

Long term: over one year. Short term: within one year

A: Conversion factor for term-based risk, B: Conversion factor for category-based risk, C: Conversion factor for exchange risk

Long-term RMB-dominated foreign loan of 20: Weighted Loan Amount for Foreign Debt Quota = $20 \times 1.0(A) \times 1.0(B) = 20$

Short-term RMB-dominated foreign loan of 20: Weighted Loan Amount for Foreign Debt Quota = $20 \times 1.5(A) \times 1.0(B) = 30$

Long-term non-RMB foreign loan of 20: Weighted Loan Amount for Foreign Debt Quota = $20 \times 1.0(A) \times 1.0(B) + 20 \times 0.5(C) = 30$

Short-term non-RMB foreign loan of 20: Weighted Loan Amount for Foreign Debt Quota = $20 \times 1.5(A) \times 1.0(B) + 20 \times 0.5(C) = 40$

Although a company with Net Assets of 100 has a Foreign Debt Quota of 250 in accordance with Circular No. 64, it must be noted that a foreign loan of 250 is not necessarily permitted due to weighting.

3. Effect on Companies

By increasing the Macro-Prudential Policy Parameter, which raises the Foreign Debt Quota through the Macro-Prudential Management Model, the PBOC and SAFE have provided additional financial capacity to small- and medium-sized companies in particular. This is intended to help such companies cope with deteriorated cash flows in light of the current status of the macro-economy and international trade balance.

Since Circular No. 64 has made no adjustments to the Investment Gap Model, FIEs employing the Investment Gap Model need to compare the two management methods for the Foreign Debt Quota to see which one is a better choice. If a company finds that the Macro-Prudential Management Model will allow them to use a higher amount of foreign loans, they can switch to the Macro-Prudential Management Model in compliance with local policies for foreign currency control. Companies that are currently using the Investment Gap Model are encouraged to keep on the lookout for developments by the regulators in additional policies for the Investment Gap Model.

We will continue to provide updates as soon as relevant information becomes available.

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