

China Banking and Insurance Regulatory Commission Issues New Regulations on the Supervision and Management of Leasing Companies for Financing Purposes

China Business Solution Office
RMB Internationalization Business Promotion Office

On June 9, 2020, the China Banking and Insurance Regulatory Commission (CBIRC) announced the “Provisional Rules on Leasing Companies for Financing Purpose[s]” (Yinbaojianfa [2020] No.22, hereinafter “Circular No. 22”) which establishes new supervisory rules for finance leasing companies.

Key Takeaways

- **CBIRC will require finance leasing companies to adhere to stricter quantitative supervisory indicators.**
- **A finance leasing company wishing to make partial changes (changes in registered capital, adjustments to ownership structure, etc.) must communicate sufficiently with the provincial-level financial supervisory department in advance.**
- **A finance leasing company must, in principle, meet all the supervisory requirements in Circular No. 22 within the transition period of three years.**

1. Background of the Policy

Finance leasing is a financing method that closely integrates with the real economy. It is convenient, offers flexible repayment periods, and can improve the financial condition of lessees.

Prior to April 20, 2018, the Ministry of Commerce has managed finance leasing companies based on “Regulations on the Supervision of Finance Leasing Enterprises” (Shangliutongfa [2013] No. 337). The number of finance leasing companies rose sharply due to the lax regulatory environment, but this created many management compliance issues.

In order to strengthen the supervision and control of finance leasing companies and to lead the industry to develop in a normative and orderly manner, the General Office of the Ministry of Commerce issued a circular on May 8, 2018 concerning “Adjustments to the Responsibility to Regulate Finance Leasing Companies, Commercial Factoring Companies and Pawn Shops” (Shangbanliutonghan [2018] No.165). It established that, from April 20, 2018, the responsibility of formulating rules for conducting management and supervision of finance leasing companies would be transferred to the CBIRC.

On January 8, 2020, CBIRC solicited opinions on a public comment draft for “Interim Rules on Finance Leasing Companies” (hereinafter referred to as the “Public Comment Draft”). Circular No. 22 was officially issued after public comments were collected.

As of the end of 2019, there are a total of 11,124 finance leasing companies nationwide, of which many of them are “non-communicative companies” and “shell companies”, and some of them have been deviated from the main business. Through Circular No. 22, CBIRC aims to effect better legal compliance in the operations of finance leasing companies.

2. Main Contents of the Regulation

1) Definitions

| [Fig. 1] Definitions | |
|---------------------------------|--|
| Finance leasing company | Limited liability company or joint-stock limited company engaged in the finance leasing business (does not include financial companies that offer leasing) |
| Finance leasing business | Business in which the lessor purchases a leasing asset from a seller or leased asset(s) designated by the lessee and provides it for use to the lessee, and the lessee pays the leasing fee. |

2) Scope of business and negative list

| [Fig. 2] Scope of Business and Negative List | |
|---|--|
| Scope of business | <ul style="list-style-type: none"> ✓ Finance lease business ✓ Operating lease business ✓ Purchase, disposal and repair of leased assets related to financial lease and operating lease businesses, consultation on lease transactions, receipt of lease security deposits ✓ Transfer of finance lease or operating lease assets ✓ Fixed dividend securities investment business |
| Negative list (Prohibited activities) | <ul style="list-style-type: none"> ✓ Illegal financing or falsification in collecting deposits ✓ Financing a loan or bridging a loan ✓ Borrowing from other finance leasing companies or borrowing by impersonation ✓ Financing or asset transfer through an internet loan information intermediary or private equity fund ✓ Other businesses or activities prohibited by laws, regulations, CBIRC, or local financial supervisory departments of provinces/autonomous regions/municipalities |

3) Supervisory departments

CBIRC, provincial-level People's Governments, and provincial-level financial supervisory departments will collaborate in supervising finance leasing companies.

| [Fig. 3-1] Supervisory Departments | | |
|---|--|--|
| CBIRC | Formulate rules concerning the business operations and supervisory management of finance leasing companies. | |
| Provincial-level People's Government | <ul style="list-style-type: none"> ✓ Formulate policy measures to promote the development of finance leasing industries under the jurisdiction. Supervise finance leasing companies and manage finance leasing companies' risks. ✓ Establish detailed rules for conducting supervision of finance leasing companies, appropriately regulate the requirements for the scope of leased assets and the degree of business concentration to and inter-connectivity of the industry identified, then file reports to CBIRC. | |
| Provincial-level financial supervisory | Supervise finance leasing companies under its jurisdiction. | |
| | Off-site | Report to CBIRC on the previous fiscal year's development and status of the finance leasing company advisory under its |

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| department | | jurisdiction due no later than April 30* each year. * The deadline in the Public Comment Draft was June 30. |
| | On-site | <ul style="list-style-type: none"> ✓ Conduct on-site examinations of finance leasing companies and their relevant facilities. ✓ Make inquiries to responsible organizations or individuals for explanations concerning relevant inspection items. ✓ View and duplicate relevant materials, and conduct prior registration and storage of documents that may have been transferred, destroyed, hidden, or falsified. ✓ Conduct examinations of relevant information systems |
| | Discussions | Have discussions about advisory tasks with the board members, inspectors, and high-level management of a finance leasing company whenever it is necessary for the completion of duties, and request explanations about the essential factors regarding their business activities and risk management |
| | Significant risk alerting | <ul style="list-style-type: none"> ✓ Formulate emergency measures for significant risk events involving finance leasing companies through developing an alert system for, prevention measures against, and response methods for such risk events ✓ If any significant risk event should arise in a finance leasing company, swiftly enact the corresponding emergency measures while promptly reporting to the regional financial supervisory department, which is in charge of handling the matter immediately |
| | Disclosure of illegal activity | Build a database on illegal activity involving the finance leasing business of finance leasing companies and their major shareholders, board members, inspectors, and high-level management members. Factually record relevant illegal activity. When there is an administrative penalty, disclose information on it to the public in accordance with the law. |
| | Classified supervision | Conduct supervision of finance leasing companies applying classification according to their business scale, risk status, internal control status, etc. In accordance with its business risks and law/regulatory violation status precisely examined/confirmed from the viewpoints of financial condition and risk status, the finance leasing companies under jurisdiction are classified into the following three categories: Regular operation, irregular operation, and illegal operation (see [Fig. 3-2]). |

[Fig. 3-2] Classified Supervision

| | |
|--------------------------|---|
| Regular operation | <p>Definition: A finance leasing company operating in compliance with laws and regulations</p> <p>Supervisory actions: List the company in the supervisory listing after filing a report to CBIRC</p> |
|--------------------------|---|

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|----------------------------|--|--|
| Irregular operation | <p>Definition: A finance leasing company operating in an irregular manner, such as being a “non-communicative company,” a “shell company,” or similar.</p> <p>Supervisory actions: Strongly demand rectifications.</p> <ul style="list-style-type: none"> ✓ If the company passes an inspection after rectifications, they will be registered in the supervisory listing ✓ If the company refuses to rectify their operations, or they do not pass an inspection after attempting rectifications, they will be registered on the list of companies with irregular operation and asked to change its company name and/or scope of business, or to voluntarily deregister as a company. | |
| | Non-communicative company | <p>A company that meets any of the following conditions:</p> <ul style="list-style-type: none"> ✓ Cannot be contacted. ✓ Cannot be found in an on-site investigation of its registered location. ✓ Although the employees can be reached, the actual manager cannot be contacted. ✓ Does not report information in response to a supervisor’s request for three consecutive months. |
| | Shell company | <p>A company that meets any of the following conditions:</p> <ul style="list-style-type: none"> ✓ Fails to submit/release the previous year’s annual report via the enterprise credit information disclosure system in line with the law. ✓ Supervisory information in the last six months shows no record of its business operations. ✓ No taxation record in the last six months or no filing of tax return. ✓ No record of social insurance payment in the last six months. |
| Illegal operation | <p>Illegal operation Definition: A finance leasing company that has violated laws and/or regulations, including the rules in this document.</p> <p>Supervisory actions:</p> <ul style="list-style-type: none"> ✓ In the case where the law/regulatory violation is relatively minor and the company passes an inspection after attempting rectifications, they will be registered in the supervisory listing. ✓ In cases where the company does not pass an inspection after attempting rectifications or the violation of laws or regulations is significant, the relevant regional financial supervisory department will take legal action to punish or suppress the violation, or they will cancel the company’s business permit in coordination with the market supervisory department. Where there are suspicions of illegal/criminal behavior, investigation/punishment will be conducted without delay in accordance to the law in conjunction with the public security bureau. | |

4) Company registration

[Fig. 4] Company Registration

- ✓ The provincial-level financial supervisory department creates a framework for meetings with the market supervisory department to exercise tight control over the registration of finance leasing companies and affiliated organizations
- ✓ When attempting to change its company name, organization, company address, location of operations, registered capital, ownership structure, etc., a finance leasing company needs to secure an agreement beforehand from the provincial-level financial supervisory department through sufficient discussion.

5) Supervisory indicators

[Fig. 5] Supervisory Indicators

| | | |
|---|---|--|
| Ratio of leased assets | A finance leasing company’s ratio of finance leasing and other leased assets shall not be less than 60% of its total assets. | |
| Leverage ratio | A finance leasing company’s total amount of risk assets shall not exceed 8 times of its net assets. The total amount of risk assets is a remaining amount of total assets after subtracting cash, bank deposits, and government bonds. | |
| Fixed income securities investment | The size of a finance leasing company’s fixed income securities investment business shall not exceed 20% of its net assets. | |
| Concentration control | A finance leasing company must prevent and spread operational risks through strengthening control over major lessees and restricting its business exposure ratio to a single lessee and its affiliates. A finance leasing company must strictly comply with the following supervisory indicators: | |
| | ① Finance concentration into a single customer | A finance leasing company’s total balance of finance leasing business with a single lessee shall not exceed 30% of its net assets |
| | ② Finance concentration into a single group customer | A finance leasing company’s total balance of finance leasing business with a single lessee’s group shall not exceed 50% of its net assets |
| | ③ Finance concentration into a single affiliated company | A finance leasing company’s total balance of finance leasing business with a single affiliated company shall not exceed 30% of its net assets |
| | ④ Finance concentration into all affiliated companies | A finance leasing company’s total balance of finance leasing business with all affiliated companies shall not exceed 50% of its net assets. |
| | ⑤ Finance concentration into a single shareholder and its affiliates | The balance of financing activities to a single shareholder and all of its affiliates shall not exceed the shareholder’s amount invested in the finance leasing company, and must meet the rule of concentration into a single affiliated company stipulated in this document. |

CBIRC can adjust the above mentioned indicators according to supervisory requirements.

6) Reporting to authorities

| [Fig. 6] Reporting to Authorities | |
|------------------------------------|--|
| Reporting information | A finance leasing company must report relevant information on a regular basis to the regional financial supervisory department and the affiliated organization of the People’s Bank of China at the corresponding level. |
| Reporting essential matters | A finance leasing company needs to create a framework of reporting essential matters to the regional financial supervisory department in order to report any the following incidents within five business days: significant deals with an affiliated company, major lawsuits awaiting a ruling, arbitrations, and other essential matters requiring reports regulated by the regional financial supervisory department |

7) Leased assets

The leased asset regulations include provisions relating to the following: (1) The scope of leased assets, (2) control over allocation and official approvals of imported leased assets, (3) ownership, (4) registration, (5) purchase, (6) valuation, (7) monitoring of the asset value, (8) management of unguaranteed residual values, (9) return of the leased assets, etc.

| [Fig. 7] Leased Assets | |
|-------------------------------|--|
| Scope of leased assets | <ul style="list-style-type: none"> ✓ Fixed assets unless otherwise specified* ✓ Exclusively intended for leased assets with clear ownership, being real and profitable. A finance leasing company must not accept the following properties as the leased assets: Property on which a mortgage is already placed and of which ownership is currently contested, property seized or foreclosed upon by the judiciary authorities, or property with a defective title. <p>* Finance leasing of intangible assets is currently in a trial run in some regions such as Beijing and Shanghai. The related circulars include “The Total Implementation Plan for A Trial Run of the Service Sector’s Expanded Opening-up in the City of Beijing” (Jingzhengfa [2015] No.48), and “The Regulation of Shanghai Municipality on Advancing the Construction of a Scientific and Technological Innovation Center” (Announcement No.13 of the People’s Congress of Shanghai Municipality).</p> |

8) Management of finance lease assets

| [Fig. 8] Management of Finance Lease Assets | |
|--|--|
| Subleasing | A finance leasing company must manage subleased assets individually and establish an account for each asset. The finance leasing company must also get consent on the sublease from the lessor |
| Finance lease asset transfer | A finance leasing company must obey relevant regulations such as accounting standard rules to show the genuine actual risk status of transferring/inheriting the finance-leased assets |
| Asset quality classification and reserve fund | A finance leasing company must develop frameworks for asset quality classification and reserve funds. The company must promptly appropriate sufficient provisions for impairment loss on assets based on precise classifications to strengthen the company’s resilience against risks. |

9) Transactions Between Affiliated Companies

[Fig. 9] Transactions Between Affiliated Companies

- ✓ A finance leasing company must establish a management system for transactions between affiliated companies. Such transactions shall be independent and fairly-priced, based on the principles of commerce, without granting more favorable terms of trade than those of similar transactions with non-affiliates.
- ✓ Regarding transactions between a lessee and an affiliate company, a finance leasing company must avoid involvement with persons engaged with the affiliate company on the decision-making for the transaction. The finance leasing company's significant transactions with its affiliates must be approved by the (general) shareholder's meeting, the board of directors, or their authorized body.
- ✓ The supervisory requirements for transactions between affiliated companies regulated in this document shall not apply to transactions between a finance leasing company and its subsidiaries or project companies.

10) Transition Period

Finance leasing companies founded before this regulation must meet the requirements stipulated in this regulation, in principle, within three years of the transition period set by the provincial-level regional financial supervisory department. The department can extend the transition period as needed to accommodate the circumstances of a specific industry.

3. Impact on Companies

After the Circular No. 22 takes effect, each of the province-level financial supervisory departments will formulate the detailed rules for implementation in its region. In Beijing, the regional financial supervisory department had already announced “(Trial) Guidelines for Supervising Finance Leasing Companies in Beijing” on April 7, 2020, prior to Circular No. 22, setting stricter supervisory indicators than those in the Circular No. 22. It is expected that the detailed rules in other regions will be rolled out progressively, so close attention to the differences between Circular No. 22 and the regional rules is needed.

Upcoming tighter supervision of the finance leasing companies is expected to also bring about the following effects:

- ✓ Currently, a finance leasing company's foreign debt limit is set as ten times as much as its net assets (“Administrative Measures for Foreign Debt Registration” by the State Administration of Foreign Exchange). However, Circular No. 22 mandates that a finance leasing company's risk assets cannot total more than eight times its net assets. Attention needs to be paid to whether the finance leasing company's foreign debt limit will be affected going forward.
- ✓ Circular No. 22 also stipulates strict and quantitative indicators of, and requirements for the ratio of leased assets, degree of concentration, information reporting, etc. by finance leasing companies. While the industry is expected to develop normatively in the future, the operating costs of finance leasing companies may increase to some extent.
- ✓ As Circular No.22 prohibits the finance leasing companies from providing entrusted loans and restricts the degree of concentration into a single party, it is possible that there will be some impact on the business of finance leasing companies who were used to secure channels of foreign debt for their affiliates through utilizing their own foreign debt limit.
- ✓ In accordance with Circular No. 22, a finance leasing company attempting changes to its registered capital or ownership structure must communicate sufficiently with and obtain prior agreement from the provincial-level regional financial supervisory department. It is therefore expected that the

above-mentioned actions will require the company to allow some time for such communication as well as time to prepare for other requirements.

We will continue to follow up on relevant information and share the details as they come.

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