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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 Reduced to 2x Net Assets Value

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On January 7, 2021, the People's Bank of China (PBOC) and the State Administration of Foreign Exchange (SAFE) issued a circular on Adjustment to Macro-Prudential Policy Parameter for Cross-Border Financing of Companies (Yinfa [2021] No. 5, hereinafter "Circular No. 5"), in which the Macro-Prudential Policy Parameter for companies is lowered from 1.25 to 1 for the Macro-Prudential Management Model. Accordingly, companies that employ the Macro-Prudential Management Model for their foreign debt will find the maximum limit for their cross-border financing balance weighted by lending risk (hereinafter "Foreign Debt Quota") will be reduced from 2.5 to 2 times the value of their net assets, but previous foreign loan contracts could be maintained until their maturity. Circular No. 5 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 reduced from 2.5 to 2 times the value of the company's net assets. The previous foreign loan contracts could be maintained until their maturity.**
- **There is no change to the Foreign Debt Quota for companies using the Investment Gap Model.**

1. Background of the Policy

In 2017, the PBOC issued a circular on Macro-Prudential Management for Comprehensive 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 by using the Macro-Prudential Management Model. Circular No. 9 also allowed foreign invested enterprises (FIEs) and foreign financial institutions to continue using the Investment Gap Model for foreign loans during a transitional period (initially one year, but it remains in effect at the time of writing).

When entities use foreign loans employing the Macro-Prudential Management Model, their **Foreign Debt Quota** is impacted by fluctuation of the **Macro-Prudential Policy Parameter**. The PBOC makes adjustments to the **Macro-Prudential Policy Parameter** and other factors when needed, in light of macroeconomic trends, trends in the balance of payments, and other trends relating to the financial environment. (Refer to Fig. 1 for past adjustments.) The latest adjustment is considered to be primarily for easing the pressure of the stronger RMB.

[Fig. 1] Adjustment History

No	Issue Date	Circular No.	Major Adjustments	Objective
1	2020-3-12	Yinfa [2020] No. 64	✓ Raised the **Macro-Prudential Policy Parameter for companies and financial institutions** from 1 to **1.25**	✓ Make access to foreign loans easier for entities in China and reduce financing costs to prevent financial deterioration of

				companies due to COVID-19.
2	2020-12-11	Yinfa [2020] No. 301	✓ Lowered the **Macro-Prudential Policy Parameter for financial institutions from** 1.25 to **1.** ✓ Foreign deposits held in financial institutions by domestic and foreign entities are to be recorded in the institution's Foreign Debt Quota.	✓ Prevent large inflow of foreign funds in order to reduce projections of RMB appreciation and ease the pressure caused by the appreciation
3	2021-1-7	Yinfa [2021] No. 5 (This announcement)	✓ Lowered the **Macro-Prudential Policy Parameter** for companies from 1.25 to **1.**	

2. Details of the Regulation

If the Macro-Prudential Management Model is employed, the **Foreign Debt Quota** for an entity in China shall be calculated by the given formula: **Capital or Net Assets x Leverage Ratio x Macro-Prudential Policy Parameter.** The latest adjustment lowered the Macro-Prudential Policy Parameter from 1.25 to **1,** thus reducing the Foreign Debt Quota from 2.5 to **2 times** the value of a company's net assets. (Refer to Fig. 2.)

In the event that a company's foreign loans exceed the Foreign Debt Quota due to the latest parameter adjustment, foreign loan contracts made before Circular No. 5 was issued can be maintained until their maturity.

[Fig. 2] Calculation of the Risk-Weighted Maximum Balance for Cross-Border Financing (Foreign Debt Quota)

	Capital/ Net Assets	×	**Leverage Ratio**	×	**Macro-Prudential Policy Parameter**	=	**Risk-Weighted Maximum Balance for Cross-Border Financing**
Companies	**Net Assets**		**2**		Before: 1.25 **After: 1**		Before: **2.5** × Net Assets After: **2** × Net Assets
Non-Bank Financial Institutions	Capital	×	1	×	1	=	1 × Capital
Banks and Similar Financial Institutions	Tier 1 Capital		0.8				0.8 × Tier 1 Capital

Circular No. 5 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 200 by the formula above (100×2×1=200).

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 are estimates for the loan cost amount.

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-denominated foreign loan of 20: Weighted Loan Amount for Foreign Debt Quota = 20 × 1 (A) × 1 (B) = 20

Short-term RMB-denominated foreign loan of 20: Weighted Loan Amount for Foreign Debt Quota = 20 × 1.5 (A) × 1 (B) = 30

Long-term non-RMB foreign loan of 20: Weighted Loan Amount for Foreign Debt Quota = 20 × 1 (A) × 1 (B) + 20 × 0.5 (C) = 30

Short-term non-RMB foreign loan of 20: Weighted Loan Amount for Foreign Debt Quota = 20 × 1.5 (A) × 1 (B) + 20 × 0.5 (C) = 40

It must be noted that due to weighting, a foreign loan of 200 is not necessarily permitted here.

3. Effect on Companies

With the Foreign Debt Quota for companies being reduced, companies that are planning to use foreign loans employing the Macro-Prudential Management Model but have not yet registered them to SAFE are required to re-calculate their own Foreign Debt Quota and also communicate promptly with a local SAFE administrative office about their foreign loan plans. For those companies that have already made foreign loan arrangements employing the Macro-Prudential Management Model, the existing loans can be maintained until their maturity. However, available foreign loans may be more limited after the maturity date of the existing loans, so companies need to verify their cash flow plan immediately and consider switching from using foreign loans to using their own capital, loans from banks in China, and/or other arrangements. Furthermore, for those companies using loans from banks in China based on collateral outside China such as a parent company's guarantee, the amount that can be collateralized will be reduced according to the reduction in the Foreign Debt Quota. Such companies need to communicate without delay with relevant banks in China about matters such as changing loan terms.

Since Circular No. 5 has made no adjustments to the Investment Gap Model, FIEs employing the Investment Gap Model and planning to use foreign loans in the future 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 applicable policies for foreign currency control. Companies that are currently using the Investment Gap Model need to keep a lookout for whether the regulators develop any additional policies for the Investment Gap Model.

We will continue to follow up on related information and provide further updates as they come.

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