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Cross-border Financing Management Measures To Be Implemented Nationwide

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The People's Bank of China (hereinafter "PBOC") promulgated a "Circular on Implementing Macro-prudential Management of Comprehensive Cross-border Financing Nationwide" (hereinafter the "New Circular")[1] on 29 April 2016. The New Circular specifies that with effect from 3 May 2016, non-financial enterprises and financial institutions established in China are allowed to raise funds from overseas within the foreign debt quota calculated by the given formula. In addition, prior regulatory approval from the authorities is no longer required.

BACKGROUND

Piloted in the Shanghai, Guangdong, Fujian or Tianjin Pilot Free Trade Zones (hereinafter the "FTZs"), the macro-prudential management of comprehensive cross-border financing policy (hereinafter the "FTZs Policy")[2] has been effective since 25 January 2016. It is said that several pilot entities in the FTZs had benefited from the broadened funding channels as well as the lowered funding costs, boosting cross-border financing activities as a result. Smooth running of the FTZs Policy has made it ripe for further expansion, and now the New Circular covers the whole country after only three months of the introduction of the FTZs Policy.

HIGHLIGHTS

Increased Covered Entities

Non-financial enterprises (excluding real estate enterprise and finance platform of the local government) and financial institutions established in China are covered under the New Circular. Among which, 27 designated banks[3] will be supervised by the PBOC, while financial institutions other than the 27 designated banks and all the enterprises will be supervised by the State Administration of Foreign Exchange (hereinafter "SAFE").

Broader Funding Channels

Covered entities are allowed to borrow RMB and/or FCY-denominated offshore funds within the foreign debt quota, and the formulas remain the same as stated in the FTZs Policy. While the foreign debt quota might be lessened comparing to some of the existing special foreign debt policies implemented in some pilot regions, the New Circular has offered broader funding channels for enterprises with insufficient foreign debt quota, especially for foreign-invested enterprises which can only apply to the "Investment Gap Model"[4] previously. Eligible entities are allowed

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1 PBOC (29 Apr 2016). Retrieved from:
http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3056127/index.html

2 Details could be referred to New Focus No.2 2016 published by BTMU, Hong Kong Branch.
http://rmb.bk.mufg.jp/files/topics/306_ext_02_en_0.pdf

3 For financial institutions, only 27 designated banks are covered in the FTZs Policy.

4 Foreign debt quota under such model is calculated by the gap between total investment and registered capital. Other than the short-term FCY-denominated ones, foreign debt quota for other foreign debts is unrecoverable after repayment.

to select either the existing model or the one in the New Circular. However, once the implementation model is determined, reselection is not available in principle.

Formulas for calculating the borrowing amount and the foreign debt quota are listed as follows:

<table>
<tr><th>Borrowing Amount</th><td>∑Balance of foreign debts × Risk factor by tenor × Risk factor by category of financing + ∑Balance of FCY-denominated foreign debts × Risk factor by foreign exchange
<table>
<tr><th>Risk Factor</th><th>Category</th><th>Number</th></tr>
<tr><td rowspan="2">By tenor</td><td>Short-term loan (≤ 1 year)</td><td>1.5</td></tr>
<tr><td>Medium to long-term loan (>1 year)</td><td>1</td></tr>
<tr><td rowspan="2">By category of financing</td><td>On-balance financing</td><td>1</td></tr>
<tr><td>Off-balance financing</td><td>1</td></tr>
<tr><td colspan="2">By foreign exchange</td><td>0.5</td></tr>
</table>
</td></tr>
<tr><th>Foreign Debt Quota</th><td>
<table>
<tr><th>Entity</th><th>Formula</th></tr>
<tr><td>Enterprise</td><td>Net assets × 1 × Macro-prudential coefficient[5]</td></tr>
<tr><td>Bank</td><td>Core capital × 0.8 × Macro-prudential coefficient</td></tr>
<tr><td>Non-bank financial institution</td><td>Capital[6] × 1 × Macro-prudential coefficient</td></tr>
</table>
</td></tr>
</table>

<u>Simplified Procedure</u>[7]
The borrowing entities are allowed to sign the borrowing agreement with the offshore counterparty without obtaining prior regulatory approval from the PBOC or the SAFE.

<u>Integration and Unification of the Foreign Debt Policies</u>
Other regional pilot areas implementing RMB and/or FCY-denominated cross-border financing shall all be governed by the New Circular after 1 year from the effective date of the New Circular. In case enterprises are willing to apply to the existing special foreign debt policies during the period, prior discussion with the authorities shall be conducted.

COMMENTS

By offering broader funding channels, the New Circular is considered to be a great move for both the non-financial enterprises and financial institutions nationwide. Moreover, integration of the management measures of the RMB and FCY-denominated foreign debts all over the country, as well as the cancellation of the prior regulatory approval, which makes the rules clearer and simpler, is expected to further lead to increasing initiatives of offshore funding and improved utilization efficiency of foreign capital.

5 Macro-prudential coefficient is determined by the PBOC based on the macro-economic environment. Current coefficient is set as 1.

6 Equals to (paid-in capital/share capital + capital reserves).

7 Implementation guidance will be issued by the SAFE later on.

APPENDIX: Comparison between the Existing Models and the New Circular

	Investment Gap Model	FTZs Policy	New Circular
Area	Nationwide	Shanghai, Guangdong, Tianjin, Fujian FTZs	Nationwide
Object	1) Foreign-invested enterprise	1) Non-financial enterprise registered in the FTZ (excluding real estate enterprise and finance platform of the local government) 2) 27 designated banks registered in the FTZs	1) Non-financial enterprise established in China (excluding real estate enterprise and finance platform of the local government) 2) Financial institutions established in China
Currency	FCY and RMB	FCY and RMB	
Account	FCY: Special account RMB: General account	FTA or general account	
Usage	Within the scope of business	For the use of operating activities or project constructions, conversion of funds is allowed based on actual needs of the enterprise	
Balance Management	Managed by balance (Recoverable after repayment) ➢ Short-term FCY-denominated foreign debts Managed by amount (Unrecoverable) ➢ Long-term FCY-denominated foreign debts ➢ RMB-denominated foreign debts	Managed by balance (Recoverable after repayment) Formula: ∑Balance of foreign debts × Risk factor by tenor × Risk factor by category of financing + ∑Balance of FCY-denominated foreign debts × Risk factor by foreign exchange	
		* Risk factor: ➢ By tenor: 1.5 for short-term loan (≤ 1 year); 1 for medium to long-term loan (>1 year) ➢ By category of financing: 1 for on-balance financing; 0.2 or 0.5 for off-balance financing ➢ By foreign exchange: 0.5	* Risk factor: ➢ By tenor: 1.5 for short-term loan (≤ 1 year); 1 for medium to long-term loan (>1 year) ➢ By category of financing: 1 for on-balance financing; 1 for off-balance financing ➢ By foreign exchange: 0.5
Foreign Debt Quota	For enterprise: Total investment - Registered capital	** Macro-prudential coefficient: currently as 1* For enterprise: Net assets × 1 × Macro-prudential coefficient	For bank: Core capital × 0.8 × Macro-prudential coefficient
			For non-bank financial institution: (Paid-in capital/Share capital + Capital reserves) × 1 × Macro-prudential coefficient