

Stricter Rules on Outbound Loan

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On 29 November 2016, the People's Bank of China (hereinafter the "PBOC") promulgated the "Circular on Further Clarifying the RMB-denominated Outbound Loan Business of the Domestic Enterprises" (Yinfa [2016] No.306, hereinafter the "Circular"). The Circular specifies that with effect from the issuance date, accumulated balance of the outbound loans in foreign currencies (hereinafter "FCY") and RMB made by a domestic enterprise to its overseas related entities, should always be within the outbound loan quota which equals to 30% of the domestic enterprise's owner's equity. Besides, pre-registration at the local branch of the State Administration of Foreign Exchange (hereinafter the "local SAFE") becomes necessary.

BACKGROUND

While the rules in relation to FCY-denominated outbound loan were issued in 2009 and the related restrictions had been relaxed afterwards, rules regarding the RMB-denominated outbound loan were mentioned for the first time in the "Circular on Simplification of Process of Cross-border RMB Settlement and Improvements on the Relevant Policies" (Yinfa [2013] No.168, hereinafter the "No.168 Circular") which was released by the PBOC in July 2013. According to the No.168 Circular, eligible domestic non-financial enterprises are allowed to carry out the RMB-denominated outbound loan business through the RMB pooling scheme.

With the aim to further encourage transactions and capital flows to be denominated in RMB to facilitate RMB internationalisation, the Chinese government has set the rules on RMB-denominated outbound loan far looser than those of the FCY's¹. Considering the flexibility and convenience of the governing rules, RMB-denominated outbound loan is widely used for cross-border financing for multinational companies with the purpose of transferring surplus funds out of China.

However, the differences between the RMB and FCY rules might be used for arbitrage by some of the companies. Moreover, due to ambiguity in the guidance, there might be different operational standards in different regions. For example, the quota for RMB-denominated outbound loan might follow the rules on FCY and be set as 30% of the owner's equity in some of the regions, while there could be no limitation at all in some other regions. In order to resolve such problems, standardisation and unification of the management measures are considered essential.

HIGHLIGHTS

The Circular, which took effect since 29 November 2016, was issued with the aim to standardise the RMB-denominated outbound loan business to achieve a sustainable development of the cross-border RMB settlement.

¹ Details could be referred to the APPENDIX.

Lender and Borrower

Domestic enterprise (lender) is allowed to lend RMB-denominated loan to its overseas group company (borrower) through the settlement bank. According to the Circular, lending in the form of entrusted loan by the group's finance company is also allowed.

- The domestic enterprise, as the lender, should be a non-financial enterprise registered in the Mainland China (excluding Hong Kong, Macau and Taiwan) for at least 1 year.
- The overseas group company, as the borrower, should be a related entity of the domestic enterprise.

Macro-prudential Management

Same as the rules on FCY, macro-prudential management will be applied to the RMB-denominated outbound loan. Accumulated balance of the FCY and RMB-denominated outbound loans should always be kept within the outbound loan quota, which is at present set at 30% of the domestic enterprise's owner's equity according to the formula.

Outbound Loan Quota = Owner's equity × Macro-prudential coefficient²

Outbound Loan Balance = Σ Outbound loan balance
+ Σ Prepayment amount × (1 + number of days prepaid/contract period)³
+ Σ FCY-denominated outbound loan balance × Currency conversion factor⁴

Among which, macro-prudential coefficient and the currency conversion factor are determined by the PBOC based on the macro-economic environment as well as the cross-border capital movements.

Implementation Procedures

As stipulated in the Circular, pre-registration of the RMB-denominated outbound loan at the local SAFE is also required.

Generally speaking, implementation procedures of the outbound loan, no matter in RMB or FCY, can be shown as follows:



Detailed Requirements

Comparing to the No.168 Circular, the Circular specifies the regulations on loan term, roll-over and interest rate, etc., and emphasises that authenticity check shall be conducted strictly by the settlement bank.

Account	■ An RMB special deposit account must be opened solely for the use of RMB-denominated outbound loan business.
Loan Term	■ The loan term shall be set within 6 months to 5 years in principle . ■ In case the loan term is 5 years or above, record-filing at the PBOC should be conducted.
Roll-over	■ Roll-over is allowed only once for each RMB-denominated outbound loan in principle.

² Macro-prudential coefficient is currently set as 0.3.

³ Quota consumed due to prepayment will be recovered every 5 years.

⁴ Currency conversion factor is currently set as 0.

Interest Rate	<ul style="list-style-type: none"> ■ The interest rate can be fixed based on agreement of the two parties conforming to commercial principle within a reasonable scope, but must be set greater than 0.
Source of Funds	<ul style="list-style-type: none"> ■ Personal loan or money obtained from debt financing cannot be used for outbound lending.
Usage of Funds	<ul style="list-style-type: none"> ■ The funds can be used based on actual needs. Authenticity and rationality of the usage will be checked by the settlement bank stringently.
Backflow of Funds	<ul style="list-style-type: none"> ■ The loan must be collected by the RMB special deposit account. ■ The amount of total backflow shall not exceed the sum of the loan amount and interests, income tax and relevant expenses.

Special Cases

If the outbound loan business is conducted frequently in a short-term, a statement explaining the reasons will be required by the settlement bank. New outbound loan business will be stopped in case of the following conditions:

- A) Non-compliance activities are found;
- B) The current balance has already exceeded the quota;
- C) The borrower fails to repay on time, while the lender refuses to give explanations or the explanations are not rational enough (the relevant situation will be reported to the local PBOC).

COMMENTS

The PBOC has been intervening massively to prevent a sharp RMB depreciation. The once ballooning forex reserves in China, peaking at US\$3.99 trillion in June 2014, fell to US\$3.05 trillion in November 2016 with a 23.6% decrease, hitting the lowest level since 2011. On the other hand, in face of the capital outflow situation due to the declining RMB, several control policies and measures have been implemented since the third quarter of 2015, limiting outflows with stricter oversight on outbound transactions and overseas direct investments.

Previously in the No.168 Circular, there are no specific stipulations on quota and usage of funds for the RMB-denominated outbound loan, approval from the authorities is not required. Such loophole has made it a way of capital flight as a result. By integrating the management methods of the cross-border RMB and FCY, it is expected that prevention of excessive speculative arbitrage can be achieved.

Besides, from the formula to calculate the outbound loan balance, it can be presumed that prepayment is not encouraged, as it may cause possible abnormal short-term cross-border capital flows and rising potential risk of arbitrage. In addition, standardisation of the outbound loan is also in line with the requirements of the anti-money laundering and counter-terrorist financing programs. Therefore, it is expected that stricter regulations under capital account on enterprises trying to circumvent capital controls and take funds offshore will be enforced in the future.

The rules may affect the multinational companies' financing plans and arrangements for cross-border use of corporate funds. While the impact should be limited for funds transferring with true background, it may be procedurally more complex since complete supporting documents must be provided to the settlement bank for authenticity checking. Also, it may be more time consuming as registration at the authorities is necessary. Enterprises are recommended to discuss with the settlement bank thoroughly to ensure a smooth process for outbound loan.

APPENDIX: Comparison between the FCY and RMB-denominated Outbound Loan

	FCY-denominated Outbound Loan	RMB-denominated Outbound Loan	
		No. 168 Circular (Superseded)	The Circular
Lender	<ul style="list-style-type: none"> Domestic non-financial enterprise 	<ul style="list-style-type: none"> Domestic non-financial enterprise 	<ul style="list-style-type: none"> Domestic non-financial enterprise registered for at least 1 year
Borrower	<ul style="list-style-type: none"> Overseas related entity of the lender 	<ul style="list-style-type: none"> Overseas related entity of the lender 	<ul style="list-style-type: none"> Overseas related entity of the lender
Account	<ul style="list-style-type: none"> Special account 	<ul style="list-style-type: none"> RMB special deposit account 	<ul style="list-style-type: none"> RMB special deposit account
Registration at the local SAFE	<ul style="list-style-type: none"> Required 	<ul style="list-style-type: none"> No specific stipulations 	<ul style="list-style-type: none"> Required
Outbound Loan Quota	<ul style="list-style-type: none"> Accumulated outbound loan balance in FCY shall not exceed 30% of the owner's equity Advanced approval from the local SAFE is necessary in case of quota exceeding 	<ul style="list-style-type: none"> No specific stipulations 	<ul style="list-style-type: none"> Accumulated outbound loan balance in RMB and FCY shall not exceed 30% of the owner's equity Quota exceeding is not allowed
Loan Term	<ul style="list-style-type: none"> Based on agreement of the two parties conforming to commercial principle within a reasonable scope 	<ul style="list-style-type: none"> Based on agreement of the two parties conforming to commercial principle within a reasonable scope 	<ul style="list-style-type: none"> Within 6 months to 5 years in principle Record-filing at the PBOC should be conducted in case the loan term is 5 years or above
Roll-over	<ul style="list-style-type: none"> No specific stipulations 	<ul style="list-style-type: none"> No specific stipulations 	<ul style="list-style-type: none"> Allowed only once in principle
Interest Rate	<ul style="list-style-type: none"> Based on agreement of the two parties conforming to commercial principle within a reasonable scope 	<ul style="list-style-type: none"> Based on agreement of the two parties conforming to commercial principle within a reasonable scope 	<ul style="list-style-type: none"> Based on agreement of the two parties conforming to commercial principle within a reasonable scope, but must be set greater than 0
Source of Funds	<ul style="list-style-type: none"> FCY capital funds Bank loans Current account funds Funds converted into FCY from RMB FCY funds obtained from the pool or entrusted loan 	<ul style="list-style-type: none"> No specific stipulations 	<ul style="list-style-type: none"> Lending in the form of entrusted loan by the group's finance company is allowed Personal loan or money obtained from debt financing cannot be used for outbound loan lending
Usage of Funds	<ul style="list-style-type: none"> No specific stipulations 	<ul style="list-style-type: none"> Based on agreement of the two parties conforming to commercial principle within a reasonable scope 	<ul style="list-style-type: none"> Based on actual needs Authenticity and rationality of the usage will be checked by the settlement bank stringently

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