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Doubled Foreign Debt Quota for Cross-border Financing

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On 13 January 2017, the People's Bank of China (hereinafter "PBOC") promulgated the "Circular on Implementing Macro-prudential Management of Comprehensive Cross-border Financing"[1] (Yinfa [2017] No.9, hereinafter "the New Circular"). With the objectives of facilitating financing for domestic enterprises and encouraging utilization of overseas funds, the New Circular doubled the foreign debt quota under the Macro-prudential Management Model. The New Circular has come into force since the date of its promulgation.

BACKGROUND

Piloted in the 4 Free Trade Zones, the Macro-prudential Management Model allows the covered enterprises to raise overseas funds within their own net assets and enjoy a restorable debt quota when repayment is made, no matter whichever the currency or tenor is chosen. Only three months after the launch of the pilot scheme, application of the Macro-prudential Management Model has been expanded nationwide since the promulgation of "Circular on Implementing Macro-prudential Management of Comprehensive Cross-border Financing Nationwide"[2] (Yinfa [2016] No.132, hereinafter "Circular No.132") on 29 April 2016.

Based on the statistics released by PBOC, the aggregate amount of foreign debts increased by USD 42.7 billion compared to the figure as of the end of June, and went up to USD 1.432 trillion by the end of September 2016. Such an increase in outstanding foreign debts not only reversed the falling trend since 2015, but also reflected the increasing financial needs for overseas funds. The present situation has triggered the authority to implement measures to satisfy the financial needs of domestic enterprises.

Following the structure of Circular No.132, the New Circular doubles the cross-border financing leverage ratio in order to further facilitate financing and encourage capital inflow.

HIGHLIGHTS

Changes comparing to Circular No.132 regarding foreign debts will be highlighted as follows:

Increase in foreign debt quota

Macro-prudential management means a dynamic model which calculates the foreign debt quota based on enterprises' net assets. To be specific, the maximum amount that an entity can borrow shall be calculated by

[1] PBOC (13 Jan 2017). Retrieved from:
http://www.pbc.gov.cn/zhengwugongkai/127924/128038/128109/3241310/2017012210515624976.pdf

[2] Details could be referred to New Focus No.6 2016 published by BTMU, Hong Kong Branch.
http://rmb.bk.mufg.jp/files/topics/337_ext_02_en_0.pdf

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multiplying the entity's net assets or capital by cross-border financing leverage ratio and policy parameter.

According to the New Circular, the cross-border financing leverage ratio is adjusted from 1 to 2. Hence, the foreign debt quota for eligible entities has been doubled, which equals to 2 times of its' net assets under the given formula. The ratio remains unchanged for non-banking financial institutions and banks at 1 and 0.8 respectively.
Formulas for calculating the foreign debt quota are listed as follows:

	Enterprises	Non-banking Financial Institutions	Banks
Capital / Net Assets	Net Assets	Capital (paid-in capital/shares + capital reserves)	Tier-1 Capital
Cross-border Financing Leverage Ratio	2	1	0.8
Policy Parameter	1	1	1
Foreign Debt Quota	Net Assets × 2	Capital × 1	Tier-1 Capital × 0.8

Discretionary conversion of foreign currency

The New Circular has reiterated that discretionary conversion of foreign currency-denominated funds[3] is allowed.

Calculation of foreign debt balance

The New Circular further clarifies that the trade credit incurred from cross-border trade is excluded from foreign debt balance.

In addition, the counted amount of funds obtained from "onshore guarantees for offshore loans" (loans granted to overseas enterprises guaranteed by domestic enterprises or financial institutions) will be lessened from 100% to 20% in the balance.

Unification of regional foreign debt policies

Different regional cross-border financing management models implemented in different pilot areas shall all be unified and governed by the New Circular since 4 May 2017.

Selection of financing model

The New Circular granted some flexibility for foreign-invested enterprises (hereinafter "FIEs") and foreign-funded financial institutions in cross-border financing models selection. They can choose between the existing model (Investment Gap Model)[4] and the Macro-prudential Management Model within the transitional period, which is 1 year from the effective date of the New Circular. After the transitional period, the choice of management models for FIEs shall be decided by the authority based on the overall implementation progress of the New Circular while the New Circular shall be automatically applied to all foreign-funded financial institutions.

COMMENTS

By expanding the quota of foreign debts, the Macro-prudential Management Model provides more flexibility for domestic enterprises in optimizing financial management as well as promoting more capital inflow to stabilize the capital market.

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[3] Details could be referred to New Focus No.8 2016 published by BTMU, Hong Kong Branch. http://rmb.bk.mufg.jp/files/topics/351_ext_02_en_0.pdf

[4] Foreign debt quota under such model is calculated by the gap between total investment and registered capital. Other than the short-tern foreign currency-denominated ones, the quota for other foreign debts is not restorable after repayment.

It is worth noting that all existing regional pilot schemes implemented by the authority shall be unified and governed by the New Circular since 4 May 2017. In case the enterprises have outstanding foreign debts raised from regional pilot schemes which exceed the quota calculated by the given formula in the New Circular, capital arrangement shall be made in advance.

From operational aspects, include but not limited to registration information, application requirements and procedures, and transition between the two management models, are said to be under supervision of the authority, enterprises are advised to pay close and persistent attention to relevant policy.

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