

Legal Update

China: New Foreign Debt Regulation Regime Takes Effect on 10 February 2023

China's new foreign debt regulation regime will take effect on 10 February 2023.

The regime was promulgated by the National Development and Reform Commission ("NDRC") on 10 January 2023 under the *Administrative Measures for the Review and Registration of Mid- to Long-Term Foreign Debt of Enterprises* (《企业中长期外债审核登记管理办法》) ("Administrative Measures").

Upon taking effect, these replace the NDRC's 2015 *Circular on Promoting the Reform of the Filing and Registration Regime for Issuance of Foreign Debt by Enterprises* (NDRC Circular 2044/2015) (《关于推进企业发行外债备案登记制管理改革的通知》(发改外资[2015]2044号)) ("Circular 2044").

Compared to Circular 2044 (and related questions and answers published by the NDRC from time to time ("NDRC Q&A Guidance")), key changes in the Administrative Measures are:

1. Both direct and indirect borrowing are subject to foreign debt regulation

The Administrative Measures cover both (a) direct borrowing by any PRC enterprise or any non-PRC enterprise or branch controlled by a PRC enterprise and (b) indirect borrowing by any PRC enterprise.

(a) **Direct borrowing**

The Administrative Measures clarify the meaning of "control" (控制) for direct borrowing by any PRC enterprise or any non-PRC enterprise or branch controlled by a PRC enterprise as follows (this term is not defined in Circular 2044):

"Control" of an enterprise means:

- (i) ownership, directly or indirectly, of over half of the voting rights in that enterprise; or
- (ii) although not owning over half of the voting rights in that enterprise, having the ability to direct important matters of that enterprise, including but not limited to its business, financial matters, human resources and technology.

(Article 2 of the Administrative Measures)

(b) Indirect borrowing

The Administrative Measures include a new article on indirect offshore borrowing by a PRC enterprise, which covers the issuance of offshore bonds or borrowing of offshore commercial loans etc. by an offshore enterprise where:

- (i) the enterprise's main business activities are within the PRC;
- (ii) the borrower/issuer is an enterprise incorporated outside the PRC; and
- (iii) the borrowing/issuance is based on the equity interests, assets, revenue or other similar rights of PRC enterprises.

(Article 33 of the Administrative Measures)

This article covers offshore debt of enterprises with a "red chip" structure and offshore enterprises controlled through variable interest entities by onshore enterprises (previously covered by Q31 and 34 of the NDRC Q&A Guidance).

However, it is unclear how "having its **main business** activities in the PRC" and "borrowing/issuance **based on** the equity interests, assets, revenue or other similar rights of PRC enterprises" would be interpreted.

In addition, it is not clear on the shareholding or control requirements between the borrower/issuer and the PRC enterprise(s). This article may extend the scope of the foreign debt regulation regime to enterprises not controlled by PRC enterprises or individuals, but have their main business activities in the PRC if the borrowing is based on the equity interests, assets, revenue or other similar rights of PRC enterprises.

2. Clarification on debt instrument types subject to foreign debt regulation

The Administrative Measures refine the scope of debt instruments (债务工具) covered, including but not limited to senior debts (高级债), perpetual bonds (永续债), capital debentures (资本债), medium term notes (中期票据), convertible bonds (可转换债券), exchangeable bonds (可交换债券), finance leases (融资租赁) and commercial loans (商业贷款). *(Article 2 of the Administrative Measures)*.

Compared to Circular 2044 and the NDRC Q&A Guidance, the Administrative Measures expressly cover medium term notes (中期票据), exchangeable bonds (可交换债券) and finance leases (融资租赁), and do not cover preferred stocks (优先股).

3. Clarification on the usages of foreign debt

The Administrative Measures propose a positive list and a negative list – one setting out encouraged usages of foreign debts, and the other setting out prohibited usages of foreign debts.

The following table sets out usages of foreign debts in the positive and negative lists set out in Circular 2044 (and the NDRC Q&A Guidance) and the Administrative Measures respectively:

	Circular 2044	Administrative Measures
Positive List	<p>Proceeds under foreign debts shall be used for the following:</p> <ul style="list-style-type: none"> • supporting the "One Belt, One Road" initiative; • supporting coordinated regional development of Beijing, Tianjin and Hebei; • supporting the Yangtze River Economic Belt initiative; and • supporting international cooperation of production capacity and equipment manufacturing and other major construction projects and key areas of investment. <p><i>(Article 6 of Circular 2044).</i></p> <ul style="list-style-type: none"> • focusing on essential business operations; and • supporting implementation of national strategies and development of the real economy. <p><i>(Q47 of the NDRC Q&A Guidance).</i></p>	<p>Proceeds under foreign debts shall be used for the following:</p> <ul style="list-style-type: none"> • focusing on essential business operations; and • supporting implementation of national strategies and the development of the real economy. <p><i>(Article 7 of the Administrative Measures)</i></p>
Negative List	<p>Use of proceeds under foreign debts shall not:</p> <ul style="list-style-type: none"> • violate any PRC laws and regulations; • threaten or be detrimental to the national interests and economic security of the PRC; • contravene the goal of the PRC's macroeconomic regulation and control; • contravene the PRC's development and industrial policies; or • be used for restoring losses and non-productive expenses or (except for banking/financial institutions) be lent to others. <p><i>(Q47 of the NDRC Q&A Guidance).</i></p>	<p>Use of proceeds under foreign debts shall not:</p> <ul style="list-style-type: none"> • violate any PRC laws and regulations; • threaten or be detrimental to the national interests, economic, information and data security of the PRC; • contravene the goal of the PRC's macroeconomic regulation and control; • contravene the PRC's development and industrial policies; • increase local government's hidden debts; or • be used for speculative purposes or (except for banking/financial institutions) be lent to others (other than any circumstance which has been stated in the application materials and approved). <p><i>(Article 8 of the Administrative Measures)</i></p>

Compared to the NDRC Q&A Guidance, the Administrative Measures require that foreign debt proceeds shall not be used to threaten information and data security, increase local government's hidden debts, or be used for speculative purposes.

These new requirements echo domestic legislations and regulatory measures implemented in recent years.

Other changes include removing reference to "restoring losses" (弥补亏损) from the negative list, and, in relation to on-lending of proceeds, a carve-out has been incorporated for any circumstance stated in the application materials and approved.

The Administrative Measures also specify that actual uses of proceeds raised by foreign debts should be consistent with the *Certificate for Approval and Registration of the Borrowing of Foreign Debt by Enterprises* (Certificate of Approval and Registration) and proceeds shall not be used for purposes not specified therein (*Article 25 of the Administrative Measures*).

4. Tighter requirements for borrowing foreign debts

The Administrative Measures further tighten requirements on the condition of enterprises for borrowing foreign debts.

Each controlling shareholder and de facto controlling person of an enterprise is required to (1) not have any criminal records relating to corruption, bribery, embezzlement or misappropriation of assets or other criminal offences that may impede the order of the socialist market economy, and (2) not be the subject of lawful investigation for criminal offences or breach of major laws or regulations, in each case, within the past 3 years (*Article 9(4) of the Administrative Measures*).

5. Standard approval and registration procedures

The Administrative Measures rank higher in legislative hierarchy than Circular 2044.

This is for the purpose of implementing the Notice by the General Office of the State Council of Fully Implementing the List-based Management of Administrative Licensing Items (General Office of the State Council 2/2022) (《国务院办公厅关于全面实行行政许可事项清单管理的通知》(国办发[2022] 2号)), which stipulates that approval of medium and long-term foreign debt of enterprises shall require state-level license administration, which cannot be regulated by a normative document.

In addition, under the new regime the management of foreign debt by way of "approval and registration" replaces the "filing and registration" regime implemented under Circular 2044.

Such change may mean that applications for approval of medium and long-term foreign debt may be subject to substantive review and increased oversight by government bodies.

The application and reporting procedures of foreign debt adopted in Circular 2044 have been followed in the Administrative Measures, with additional requirements set out below.

At the application stage, the following should be noted:

- (a) The Administrative Measures expressly clarify that an enterprise must obtain a Certificate of Approval and Registration before borrowing of foreign debt (i.e. before issuance of the bonds or (as the case may be) making the first utilisation under the foreign commercial loans) (*Article 10 of the Administrative Measures*).

- (b) The Administrative Measures adopt a more stringent approach, compared to Circular 2044. A Certificate of Approval and Registration is required for enterprises to carry out relevant procedures including SAFE registration, account opening, as well as receipt, payment and exchange of proceeds and use of proceeds (*Article 17 of the Administrative Measures*).
- (c) The Administrative Measures state that the approval and registration authority will inform the applicant within 5 working days after the date of receipt of application materials if the application report or documents are incomplete, deviate from the prescribed format or are not within the scope of management of the authority. If no notice is given by then, the application is treated as accepted for processing from the date of receipt. Notice of whether or not an application is accepted for processing will be given on the online portal. For documentation/evidentiary purposes, enterprises may print out the online notice or request the approval and registration authority to issue the notice (*Article 13 of the Administrative Measures*).
- (d) The Administrative Measures further state that the approval and registration authority will, within 3 months of the date of acceptance of the application for processing, issue the Certificate of Approval and Registration or (as the case may be) notice of refusal of approval and registration (*Article 14 of the Administrative Measures*).
- (e) The Administrative Measures also state that, after acceptance of the application for processing, if there is a need for enterprises to make additional disclosures or explanations, or for intermediaries to make further enquiries, the approval and registration authority may issue a notice requiring written supplemental documents or correction. The period of time between the issuance of such notice to the date of receipt of all required documents under the notice will not count towards the 3-month period referred to above. If the enterprise fails to provide a written response within the time stipulated in the notice, the authority may terminate the review and state the reasons for doing so (*Article 15 of the Administrative Measures*).
- (f) The period of validity of the Certificate of Approval and Registration is one year (*Article 16 of the Administrative Measures*).
- (g) After the application has been approved, the relevant enterprise should submit an application for modification to the approval and registration authority before the occurrence of any of the following events:
 - (i) any change to the proposed currency or type of debt instrument;
 - (ii) any material change to the use of proceeds; and
 - (iii) any other circumstance which will result in a material modification of matters relating to the Certificate of Approval and Registration.

The approval and registration authority will, within 20 working days of accepting the application for modification, provide a written approval if satisfactory reasons are provided. If satisfactory reasons are not provided, the authority will issue a notice of disapproval for modification, stating reasons. The time for making supplemental disclosures, explanation or for an intermediary to make further enquiries shall not be included in the 20-working day period (*Article 18 of the Administrative Measures*).

Further explanation may be required for the concepts of "material change" and "material

modification" as there is no detailed discussion of such concepts in the Administrative Measures.

- (h) If, during the approval process, an enterprise wishes to withdraw the application due to change in financial planning, project adjustments, etc., it should promptly submit an application to the approval and registration authority for such withdrawal. (*Article 19 of the Administrative Measures*).
- (i) For red-chip enterprises, the NDRC Q&A Guidance states that a red-chip enterprise applying for filing and registration of foreign debt is advised to use its major operating subsidiary as the applicant (*Q33 of the NDRC Q&A Guidance*). However, the Administrative Measures require the entity making the application to be the headquarters of the onshore entity that is controlled by the red-chip enterprise (i.e. head company, head office, etc.) (*Article 11 of the Administrative Measures*). Therefore, in the case of a red-chip enterprise, further explanation may be required to clarify the entity that should submit the application.

At the reporting stage, the following should be noted:

- (a) In addition to the requirement for reporting of information on each foreign debt borrowing within 10 working days after such borrowing, enterprises are also required to report the status of their foreign debt within 10 working days after the expiry date of the Certificate of Approval and Registration (*Article 24 of the Administrative Measures*). No distinction is made between reporting obligations for a term facility and a revolving facility. It remains to be seen whether reporting is required for redrawn loans under a revolving facility.
- (b) Moreover, an enterprise also needs to report use of the proceeds of its foreign debt, the status of and plans for repayment of both the principal and interest, and the key operating indicators, within 5 working days from the last day of January and July each year. If any material circumstance may affect the enterprise's ability to honour its debt, such circumstance shall also be reported on a timely basis, and the enterprise shall take measures to prevent any spillover of onshore default risk and cross default risk (*Article 26 of the Administrative Measures*).

6. Clarification of legal liability of enterprises (and their main responsible persons) and intermediaries

The NDRC currently implements the "Three Times Warning" system against non-compliant enterprises with foreign debt. The Administrative Measures clarify the penalties and legal liability of non-compliant enterprises (which may include discussions with the main responsible persons of the relevant enterprises and publicly warning the relevant enterprises), relevant intermediaries and responsible persons; broaden the scope of responsibility of such persons (including, in the case of intermediaries, where the relevant intermediary knows or should have known that an enterprise borrows foreign debt in contravention of the Administrative Measures, and provides relevant intermediary services to the relevant enterprise); and increase the legal consequences for non-compliant entities (*Chapter 5 of the Administrative Measures*). Intermediaries (including banks) may need to pay attention to strengthening the due diligence of borrowers, such as ascertaining whether the borrower is a red-chip enterprise, through examining its shareholding structure.

7. Strengthening risk prevention measures

In view of the risks of default on foreign debt in recent years, the Administrative Measures raise the bar on risk prevention and control of foreign debt of enterprises. They require information on risk prevention and control measures to be included in the application for a Certificate for Approval and Registration (*Article 12(4) of the Administrative Measures*), and also introduce a reporting obligation on any material circumstance which may affect the enterprise's ability to honour its debt (*Article 26 of the Administrative Measures*), so as to strengthen prevention and supervision of risk of default on foreign debt.

8. Strengthening protection of state secrets and commercial secrets

The Administrative Measures specify that use of the proceeds of foreign debt shall not threaten or be detrimental to the national interest, economic, information and data security of the PRC (*Article 8 of the Administrative Measures*). Moreover, they require enterprises or intermediaries to report to the relevant domestic competent authorities in advance if they are inspected or investigated by overseas regulatory authorities as a result of its foreign debt borrowings, or if national security or public interest is involved (*Article 27 of the Administrative Measures*). They also set out confidentiality obligations of both enterprises and approval and registration authorities (*Article 35 of the Administrative Measures*).

Conclusion

Since its promulgation in 2015, Circular 2044 has been supplemented by various means including the NDRC Q&A Guidance.

The new Administrative Measures are generally consistent with previous management practice of foreign debt set out in Circular 2044 (and the NDRC Q&A Guidance) – with the addition of further clarification on the scope of application; updated application and reporting requirements; and enhancements on the prevention of risk of default of foreign debts and protection of state secrets and commercial secrets.

It remains to be seen how the Administrative Measures will be applied in practice.

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