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New constraints on Chinese insurers providing outbound guarantees for offshore debt

The China Insurance Regulatory Commission ("CIRC") and State Administration for Foreign Exchange ("SAFE") have issued a joint circular which limits the extent to which insurers can provide onshore guarantees for offshore debt, amongst other governance requirements. This contributes to a series of measures to bolster the stability of insurance companies and also reflects the latest outbound investment rules aimed at limiting the exposure of domestic institutions to high risk offshore assets and more closely regulating transactions structured through offshore vehicles.

The circular, which was promulgated with immediate effect on 13th February 2018, restricts Chinese insurers in their use of *Nei Bao Wai Dai* ("**NBWD**") financing structures – i.e. in providing, either directly or through back to back transactions with domestic issuing banks, guarantees or standby letters of credit to offshore lenders, to support loans to their offshore subsidiaries.

NBWD structures are widely used by Chinese companies to raise debt offshore as they only involve registration with SAFE and avoid the heavier regulatory burdens of direct cross border lending. However, CIRC is concerned that the relatively unconstrained use of these structures by insurance companies is exposing them to excessive liquidity, leverage and refinancing risks - and the new measures seek to guard against this by imposing more regulation and oversight.

The new restrictions affecting insurers' NBWD transactions include, among other things:

- **Ownership of borrower**: insurers may only provide NBWD guarantees (whether directly or via issuing banks) for the debt of companies in which they have at least a 95% shareholding;
- **Approval for transactions > $50m**: insurers must obtain approval from the Insurance Asset Management Association for any NBWD debt financing exceeding $50m (or equivalent);

- **Cap on aggregate NBWD debt**: the funds obtained by the group through NBWD structures may not exceed 20% of the group's net assets as at the end of the previous quarter;
- **Solvency and governance requirements**: to engage in any NBWD transaction, the insurer must meet certain solvency and governance requirements – including a comprehensive solvency adequacy ratio of at least 150%;
- **Restrictions on subject of collateral to issuing banks**: insurance groups may only use the capital, capital reserves and undistributed profits of their holding company, and not insurance liability reserves, as collateral to local banks for the issuance of counter-guarantees or standby letters of credit under NBWD structures;
- **Offshore borrowers to be properly capitalised**: offshore borrowers must be sufficiently capitalised to service and repay the loan, considering factors such as currency, amount, costs and tenor; and the group must work with a collaborating partner of strong calibre to achieve this;
- **Restrictions on use of proceeds**: proceeds of NBWD financings may only be used to finance the relevant specified investment project and may not be lent to any third party;
- **Offshore borrower to be first point of recourse**: the insurer must always seek to procure repayment by the offshore borrower first before paying out itself under the onshore guarantee;
- **Offshore investment custodian to handle cross border cashflows**: insurers must allow any cross-border cashflows related to the NBWD transaction to be handled through a designated account by their offshore investment custodian, who will submit oversight reports to CIRC;
- **Reporting requirements**: insurers must report details to CIRC upon any signing of NBWD arrangements, any delay in closing, any material adverse event that may lead to enforcement of the onshore guarantee and any performance of the onshore guarantee; and
- **Prohibition of NBWD financings in disguised form**: sham transactions that are essentially NBWD financings in disguised form are prohibited.

The regulators reiterate several times the importance of compliance with existing rules and particularly that the underlying investments must not violate the outbound investment regulations of the National Development and Reform Commission (NDRC). Amendments to these regulations, which entail more comprehensive scrutiny of investments alongside more streamlined processes, are due to take effect on 1st March 2018 (see our previous alert which outlines the anticipated changes).

Since these measures have been introduced, CIRC has further demonstrated its commitment to controlling risk by taking temporary control of one of China's most acquisitive insurers, Anbang Insurance Group, and initiating a prosecution of its founder.

Going forward, lenders should be mindful of these constraints when structuring transactions with members of insurance groups. The circular specifically states that CIRC and SAFE are seeking to be more collaborative in their information sharing and monitoring processes, so any failure by the insurance group to follow the rules is likely to have an impact on the SAFE registration process.

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