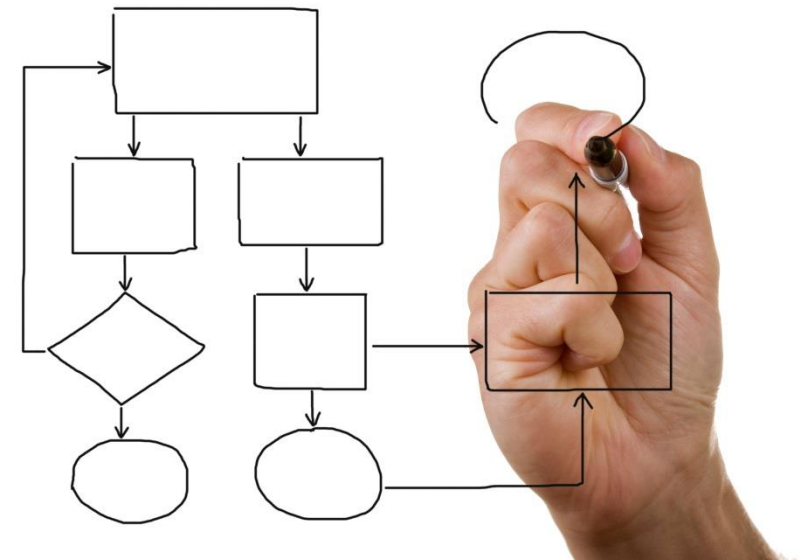


PRC cross-border loan structures

Refresher on key legal and regulatory issues concerning PRC-related lending

December 2018



What will we cover?

> **Some recent policy trends**

- Outbound investment
- Inbound investment
- Deleveraging the economy and tackling systemic risks



> **Legal and regulatory considerations for typical PRC-related lending structures**

- Offshore loan supported by onshore guarantee/security/SBLC
- Offshore loan supported by onshore keepwell undertaking
- Offshore loan supported by equity pledge over foreign owned onshore subsidiary
- Direct inbound lending

Recent policy trends



Outbound direct investment

> March 2018 – amendments to NDRC outbound investment regime:

Broader and closer scrutiny of investments

- E.g.
- More offshore investments caught
 - What constitutes an investment construed more broadly
 - National interest/ national security implications considered

More investments subject to NDRC approval

- E.g. for investments:
- in real estate, hotels, cinemas, sports clubs, entertainment, military equipment, cross border water resources and mass media
 - with no underlying business
 - in breach of host country's standards/ politically sensitive

Streamlining of processes for permitted investments

- E.g.
- “Road pass” regime abolished
 - Approvals/filings required at a later stage
 - Applications require resubmission only upon *material* change
 - Applications may be made directly to relevant level of NDRC

> General increase in outbound investment during the course of 2018, in response to clarification of rules

> Slowdown in momentum towards end of 2018, as Chinese investors exercise caution in response to US/China trade war

Inbound direct investment

- > Restrictions on Nei Bao Wai Dai financing structures for inbound investments lifted

Loan purpose	NBWD financing permitted?	
	Pre-Jan 2017	Post-Jan 2017
Acquisition of an onshore entity as target (from an onshore or offshore seller)	X	✓
Acquisition of an offshore parent of an onshore entity as target	X (unless 50% Assets Rule not triggered)	✓
Injection into an onshore entity by way of debt or equity	X	✓ Except portfolio investments in securities
Dividend recapitalisation	Unclear (possible breach of Refinancing Rule)	✓
Other purposes not requiring the loan proceeds to be remitted onshore	✓	✓

- > New shorter negative list - June 2018
 - reduction in restricted sectors: 63 → 48
- > Liberalisation of rules affecting foreign investment into certain restricted sectors
 - e.g. banking, insurance, securities, automotives, agriculture, science & technology, internet & information, cultural & educational services, financial services, tourism, healthcare etc.
- > Tax incentives for foreign investment in encouraged industries



Deleveraging the economy and tackling systemic risks

Measures taken in 2018 affecting foreign debt include:

> New limitations on insurance groups providing outbound guarantees/SBLCs for offshore debt e.g.

Ownership of
borrower \geq 95%

Approval for
transactions $>$
\$50m

Total NBWD
debt of group \leq
20% net assets

SPV borrowers
to be properly
capitalised

Limits on subject
of collateral to
local banks

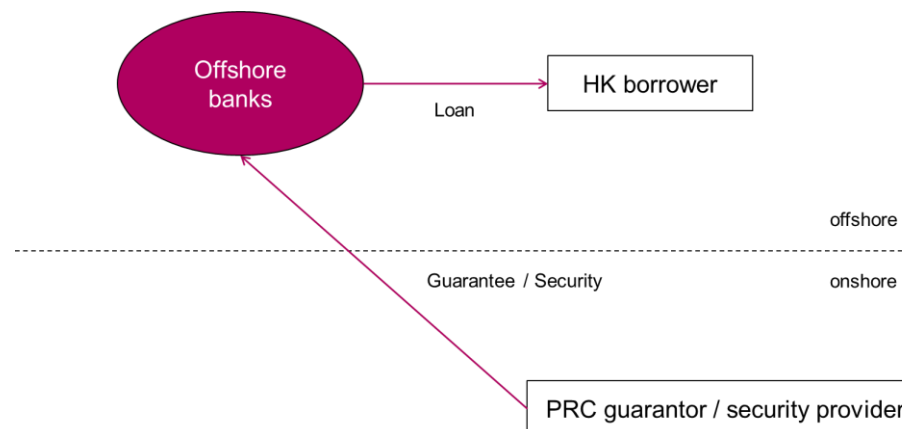
- > New restriction on local governments providing outbound guarantees/SBLCs for offshore debt
- > New restriction on counting public assets towards net assets for financial testing purposes
- > Higher governance standards for enterprises engaging in foreign debt activities
- > Discouragement of developers raising foreign debt for real estate projects (onshore or offshore)
- > Stricter approach to registering loans under NDRC 2044 (see slide 11)

Refresher on typical PRC-related lending structures



Structure 1: offshore loan supported by an onshore guarantee

- > Agreement must be **registered with SAFE**, pursuant to SAFE Circular 29
- > This is required for **outbound remittance** - not legal effectiveness of guarantee
- > Application must be **submitted within 15 working days of signing**
- > Registration may be a condition precedent or subsequent to funding
- > SAFE Circular 29 also requires guarantor has **no outstanding subrogation debt** owing to it from any offshore debtor
- > Registration in name of Agent vs individual lenders



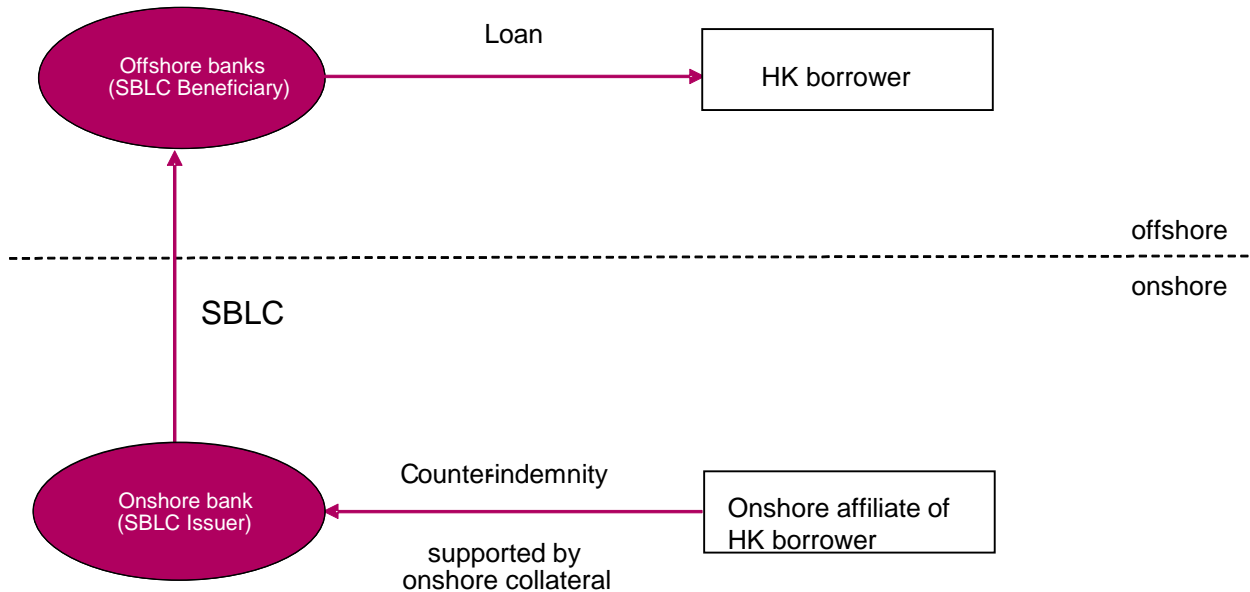
If there is onshore security...

- > In addition to SAFE registration, may need registration of the security interest at the relevant asset-based registry

Asset	Relevant registry	Effect of registration
Land use rights	Local land resources bureau	Required for effectiveness
Buildings	Local housing bureau	Required for effectiveness
Equipment, machinery, inventory, other moveables	State Administration for Industry and Commerce (SAIC)	Required for priority
Shares	SAIC	Required for effectiveness
Intellectual property	Relevant local IP registry	Required for effectiveness
Receivables	Credit Reference Centre of PBOC	Required for effectiveness

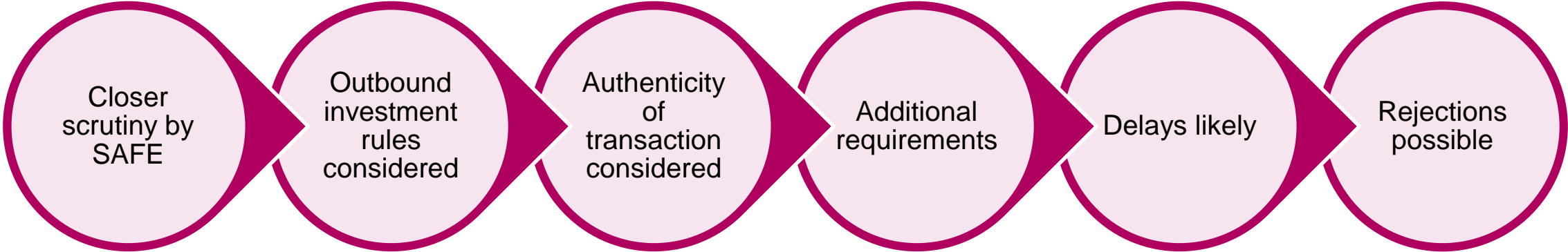
- > Registration can take a few weeks to obtain following application
- > SAFE registration of the security agreement may need to have been completed prior to such application – need to check with relevant local authorities on a case by case basis

If the guarantee is substituted for an SBLC...



- > Same legal and regulatory framework applies
- > Onshore bank may report to SAFE through a pre-established data interface program (i.e. no need to apply for registration within 15 working days)
- > No outstanding subrogation debt requirement does not apply to banks
- > Collateral provided to onshore bank subject to usual asset-based security registrations, where applicable

If the proceeds are to be invested or retained offshore...



If the offshore borrower is controlled by an onshore entity...

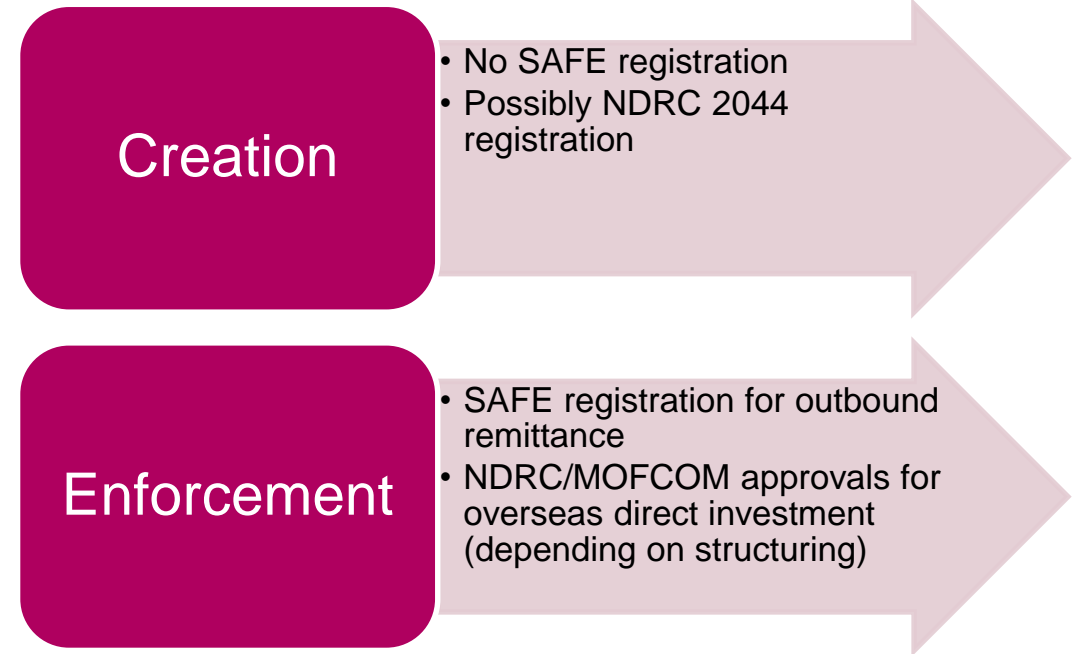
- > NDRC Circular 2044 technically requires all foreign debt \geq 1 year incurred by offshore subsidiaries “controlled by” onshore entities to be registered and filed with the NDRC
- > In practice, local NDRCs have not always required registration for commercial loans (as opposed to bonds), especially where no credit support from an onshore entity and no remittance of proceeds onshore
- > Consequences of failing to register:
 - should not affect legal validity of loan
 - could result in blacklisting and/or impact any cross border capital flows
- > Trends at end of 2018:
 - Growing trend of borrowers being asked to register with central NDRC (as opposed to local)
 - Suggestions NDRC will be taking a stricter approach towards registering all mid/long term loans and may even extend requirements to cover short term loans as well
- > Important to check with local NDRC on a case by case basis

Structure 2: offshore loan supported by onshore keepwell undertaking

What is a keepwell undertaking?

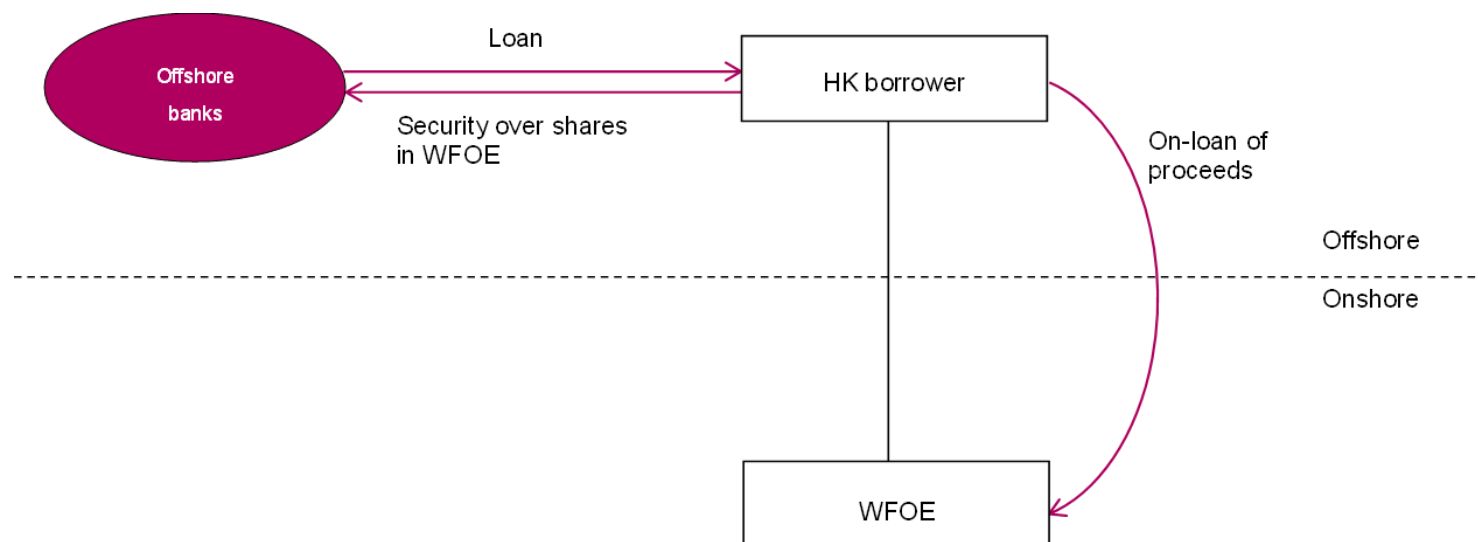
- > Typically the onshore parent undertakes to:
 - maintain ownership/control of the borrower
 - ensure borrower has a specified minimum net worth at all times
 - make equity/debt contributions to borrower to allow it to meet its payment obligations under the loan
- > A keepwell undertaking is **not a guarantee**:
 - Lenders are not direct beneficiaries
 - Failure to perform → borrower has a claim for specific performance or damages against parent
→ lenders have debt claim against borrower

What are the relevant regulatory barriers?



Structure 3: offshore loan supported by WFOE equity pledge

- > Historically, MOFCOM approval required for WFOE equity pledge – uncertain and lengthy process
- > Recent transactions suggest this requirement has ceased to apply in practice and the regulatory hurdles are now merely procedural:
 - Possibly filing with MOFCOM
 - Registration with SAIC
- > Registration with SAIC required for effectiveness of security
- > Any cross border proceeds loan must comply with inbound lending rules



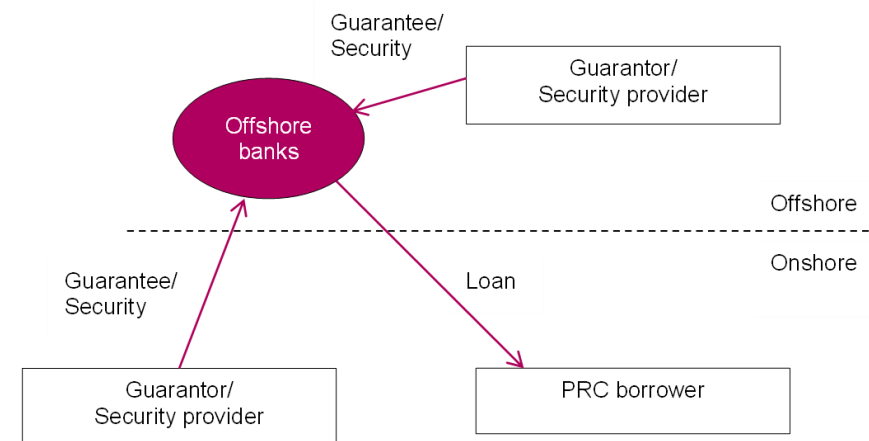
Structure 4: direct inbound lending

Direct lending is **relatively uncommon** because:

- > withholding tax applies on interest payments
- > PRC companies are subject to foreign debt quotas
- > until recently, NDRC approval for non-FIE borrowers

Regulatory considerations:

- > Relevant foreign debt quota
- > Restrictions for real estate enterprises and local government financing vehicles
- > Pre-drawdown SAFE registration
- > NDRC registration and filing under NDRC Circular 2044 required if tenor ≥ 1 year
- > All proceeds directly to onshore proceeds account (e.g. no prior offshore fee deductions)
- > Registration in name of Agent vs individual lenders



Questions



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