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China releases highly anticipated provisional Panda bond guidelines.

Overview

The People's Bank of China ("**PBOC**") and the Ministry of Finance ("**MOF**") have recently released the highly anticipated preliminary Panda bond[1] guidelines (the "**Guidelines**"), which took effect immediately.[2] According to the PBOC, the aggregate value of Panda bonds issued in China's Interbank Bond Market ("**CIBM**") from 2005 to August 2018 is RMB178.16 billion (approximately US$25.94 billion). The Guidelines have been released in a move to encourage more foreign issuers (i.e. sovereigns, international development institutions, financial institutions and non-financial enterprises established outside China)[3] to participate in CIBM. This move is part of the efforts to internationalise China's bond market and to align such market with the international bond market.

The Guidelines have been highly anticipated by market participants as the Panda bond framework has, to date, been largely based on generic principles and practice without specific rules. In this alert, we provide a brief overview of the Guidelines, the key changes to existing principles and practice and the practical implications on Panda bond issuances going forward.

PBOC approval

As with existing practice, the Guidelines still require foreign financial institutions to obtain the prior approval of the PBOC before they can issue Panda bonds. However, the same does not appear to apply to foreign issuers who are not financial institutions. The Guidelines state that foreign sovereigns, international development institutions and foreign non-financial enterprises issuing bonds on CIBM shall apply for registration with the National Association of Financial Market Institutional Investors ("**NAFMII**"). Although the Guidelines provide that NAFMII shall be responsible for formulating the rules governing the registration and issuance of Panda bonds by foreign sovereigns, international development institutions and foreign non-financial enterprises, no further details are provided. We expect NAFMII to provide further clarity in due course.

[1] References to Panda bonds are to Renminbi-denominated bonds issued by non-PRC entities in CIBM and governed by PRC law.

[2] Joint announcement by the PBOC and MOF [2018] No. 16 (中国人民银行 财政部公告〔2018〕第 16 号) on the Provisional Measures for the Administration on Bond Issuances by Foreign Entities in CIBM (全国银行间债券市场境外机构债券发行管理暂行办法).

[3] Including those entities established in Hong Kong, Macau and Taiwan.

It would be interesting to see whether this would lead to a shortened execution timeline for Panda bonds issued by foreign sovereigns and certain international development institutions and foreign non-financial enterprises. If so, this would be a welcome change particularly for sovereigns and certain big-name international development institutions and non-financial enterprises who are used to tapping the (international) bond market quickly when an opportunity arises.

Use of proceeds

The Guidelines do not appear to have formalised any requirements on how and where proceeds from Panda bond issuances should be used. The Guidelines do however mention that foreign issuers shall comply with relevant PBOC and other regulatory requirements on administrative procedures like the opening of bank accounts, fund transfer, cross-border remittance etc. This suggests that there is a possibility that proceeds (or parts thereof) may be remitted outside China. However, more detailed guidance in this area is needed from PBOC and other relevant regulators, on a case by case basis.

Eligibility criteria

The Guidelines set out five eligibility criteria for foreign financial institutions wishing to issue Panda bonds, similar to those generally required on existing deals. The criteria for a financial institution issuer are that it must (i) have a paid-up capital of RMB10 billion or equivalent, (ii) have sound corporate governance and risk management system, (iii) have stable financial condition with a sound credit rating and been profitable for the last three consecutive years, (iv) have experience in issuing bonds and have sound debt servicing capabilities and (v) be effectively regulated by the financial regulatory authority in the country or region where it is located and its main regulatory risk indicators comply with the requirements of the relevant financial regulatory authority.

Foreign sovereigns and international development institutions are required to have experience in issuing bonds and have sound debt servicing capabilities.

The Guidelines do not mention the eligibility criteria for foreign non-financial enterprises, and we expect NAFMII to provide further details in due course.

Private vs. public Panda bonds

The Guidelines have codified the two methods by which Panda bonds have traditionally been issued. The first method is where foreign issuers make a direct offer to qualified institutional investors (‘合格机构投资者定向发行债券’) – i.e. a form of private placement. The second method is where foreign issuers make a public offer to investors.

Private Panda bonds

The Guidelines state that where a foreign issuer makes a direct offer to qualified institutional investors, it is free to agree with such investors the form and substance of the offering documents (such as the offering circular, subscription agreement and financial statements). No public disclosure of such documents is required. In addition, a foreign issuer is free to agree with investors the accounting standards used in its financial statements.

Public Panda bonds

Disclosure requirements

The Guidelines provide that foreign issuers shall ensure that the information disclosed in an offering circular is true, accurate, complete, timely and shall not contain any false information, be misleading or omit material information. NAFMII has been tasked with formulating the detailed guidelines on disclosure requirements.

Any publicly available offering circular must be in simplified Chinese or be accompanied with a simplified Chinese translation.

Credit ratings

In the existing Panda bond market, a foreign issuer is typically required to have its bonds rated by at least two rating agencies (one of them a PRC onshore rating agency) at ‘AA’ or above. The Guidelines however state that a foreign issuer that publicly discloses the credit rating report on its bonds is required to have such credit rating report issued by a credit agency accredited by CIBM (there is no mention of the need for a ‘AA’ rating). Currently, only Chinese rating agencies are accredited by CIBM. However, both Fitch Ratings and Standard & Poor’s have said that they will seek licences to launch their China credit-rating units after NAFMII announced earlier this year that it would accept registration applications from foreign agencies.

Accounting standards

As with existing practice, foreign issuers that adopt accounting standards that have been deemed equivalent by MOF in the preparation of their financial statements (i.e. HKFRS and IFRS) would be able to have such accounting standards recognised as eligible standards for Panda bonds.

For an international development institution that adopts non-PRC recognised accounting standards in its financial statements, the Guidelines require a statement of material differences between the accounting standards used and Chinese GAAP. There does not appear to be a need for an international development institution to appoint a Chinese onshore accounting firm as the Guidelines allow prescribed foreign accounting firms to be appointed (e.g. must be duly incorporated, have good international reputation and have at least five years’ experience etc.).

For a foreign financial institution or foreign non-financial enterprise that adopts non-PRC recognised accounting standards in its financial statements, the same requirements as for an international development institution set out above apply. However, there is also an additional requirement for a statement of adjustments which must show the financial impact the differences in accounting standards have on all the material items of the financial statements. Although prescribed foreign accounting firms can also be appointed by these issuers, the statement of adjustments must be verified by a Chinese onshore accounting firm.

Conclusion

The Guidelines are a step in the right direction. The codification of the criteria for a direct offer to qualified institutional investors (i.e. private Panda bonds) provide clarity for foreign issuers looking to access this significant market. Furthermore, for certain foreign issuers (e.g. international development institutions), the Guidelines have made the issuance process simpler and more in line with international bond market practice. For other foreign issuers (e.g. those not looking to access the private Panda bond market), it may be business as usual, although we will need to wait for further clarity from NAFMII on certain issues before coming to this conclusion (e.g. eligibility critieria for foreign non-financial enterprises, registration and issuance procedure for foreign sovereigns, international development institutions and foreign non-financial enterprises etc.).

The Guidelines are intended to internationalise China's domestic bond market by aligning such market with the international bond market to attract international issuers and investors to the Panda bond market. The Guidelines' codification of eligibility criteria and issuance requirements provide significant certainty for international issuers looking to tap the Panda bond market, in particular by way of a private placement.

If you have any questions on this alert or would like to discuss further, please contact one of your usual Linklaters contacts.

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