

COUNTRIES COVERED

China » China's New Regulation on Overseas Loans by Domestic Banks p 779

International Briefings

China

CHINA'S NEW REGULATION ON OVERSEAS LOANS BY DOMESTIC BANKS

Authors Xu Zhang and Sisi Shen are partners and Lili Li is an associate of DeHeng Law Offices, Beijing, China. Email: zhangxu@dehenglaw.com ; shenss@dehenglaw.com and lilyli@dehenglaw.com

The People's Bank of China (PBOC) and the State Administration of Foreign Exchange (SAFE) jointly promulgated a new regulation relating to overseas loans. The Circular of the People's Bank of China and the State Administration of Foreign Exchange on Matters Relating to the Overseas Loan Business of Banking Financial Institutions (Yinfa [2022] No. 27) (关于银行业金融机构境外贷款业务有关事宜的通知 (银发[2022]27号)) (PBOC Circular No. 27) took effect on 1 March 2022.

SCOPE OF APPLICATION

Under PBOC Circular No. 27, overseas loan business encompasses domestic banks with international settlement business capabilities directly advancing loans in Renminbi and foreign currencies to overseas borrowers within their approved business scope, or indirectly advancing loans in Renminbi and foreign currencies with a term of more than one year to overseas borrowers by lending funds to overseas banks.

Under PBOC Circular No. 27, overseas borrowers refer to non-financial enterprises legally incorporated outside of mainland China (mainland China does not include Hong Kong SAR, Macau SAR and Taiwan region). Also, the loans advanced by domestic banks to overseas sovereign institutions are subject to PBOC Circular No. 27 and included in the calculation of overseas loan balance.

RESTRICTIONS ON THE USE OF OVERSEAS LOANS

PBOC Circular No. 27 provides clear regulation on the use of overseas loans based on a "positive requirement + negative list" method. Positive requirement means that an overseas loan must be used for relevant expenditures within the business scope of the overseas borrower concerned. For example, overseas loans, if used for overseas investment, must comply with the regulations of the relevant domestic regulatory authorities on overseas investment. At the same time, PBOC Circular

No. 27 provides the following three prohibitions for overseas loans under the negative list:

- shall not be used for securities investment or repayment of overseas debts under overseas loans under domestic guarantee;
- shall not be used for sham transactions or other forms of speculation and arbitrage transactions;
- shall not be transferred back to and for use within mainland China by means of lending funds, equity investment or otherwise to mainland China.

In relation to the above requirements, in the course of diligence on overseas borrowers applying for overseas loans, domestic banks should comprehensively review the business scope of those overseas borrowers from the perspectives of compliance of relevant domestic and overseas laws, commercial nature and commercial logic, ensuring loan use for relevant expenditures within the business scope of the overseas borrowers concerned. At the same time, attention should be paid to identify a sham transaction and whether the use of loan funds by the overseas borrower crosses any red line of the negative list. In particular, domestic banks should strengthen the review and supervision of loan funds to determine whether the loans are transferred back to and for use within mainland China by means of debt or equity. When the overseas loan is a refinancing, domestic banks should in particular verify whether the prior debt is a debt under the "domestic guarantee for offshore loans".

OVERSEAS LOAN BALANCE CALCULATION

PBOC Circular No. 27 created the overseas loan balance management mechanism, specifying an upper limit for the overseas loan balance of domestic banks.

Basic rules of balance management are as follows:

- $\text{Overseas loan balance} \leq \text{Upper limit of the overseas loan balance.}$
- $\text{Upper limit of the overseas loan balance} = \text{Net tier 1 capital of the domestic bank}^1 (\text{eg the working capital in the case of a domestic branch of a foreign bank}) \times \text{Overseas loan leverage ratio}^2 \times \text{Macro-prudential regulation parameter.}^3$
- $\text{Overseas loan balance} = \text{Overseas loan balance in Renminbi and foreign currencies} + \text{Overseas loan balance in foreign currencies} \times \text{exchange rate risk conversion factor.}^4$

The following issues should be particularly noted in the management of the overseas loan balance:

- (1) based on the current leverage ratio and macro-prudential regulation parameter, the overseas loan balance for the China

International Briefings

Development Bank should not exceed 1.5 times its net tier 1 capital, the overseas loan balance for the Export-Import Bank of China should not exceed three times its net tier 1 capital, and the overseas loan balance for other banks should not exceed 0.5 times their net tier 1 capital;

- (2) based on the current exchange rate risk conversion factor, the equivalent loan balance in foreign exchange is multiplied by 1.5 for the calculation of the overseas loan balance. The regulatory authority is able to adjust the current exchange rate risk conversion factor in line with shifting policy goals for the development of overseas Renminbi loans;
- (3) domestic banks should maintain their overseas loan balance at any time point within the upper limit; if exceeded, the bank should suspend issuing new overseas loans to reduce the overseas loan balance to within the upper limit;
- (4) except for the balance actively incurred through providing overseas loans, the external claims arising from the performance of the domestic guarantee by the domestic bank should be included in the calculation of the overseas loan balance;
- (5) trade financing handled by a domestic bank based on real cross-border trade settlement, loans granted by domestic banks to overseas borrowers through separate accounting units of free trade non-resident accounts (except for loans to overseas borrowers with Renminbi funds allocated by the head offices of domestic banks), and overseas loans granted by domestic banks through offshore accounts are not included in the calculation of overseas loan balance.

REQUIREMENTS FOR ACCOUNT OPENING AND INFORMATION SUBMISSION

Account opening

An overseas borrower can process the loan transaction either through an account opened with the domestic lending bank or an account with an overseas bank. Prior to PBOC Circular No. 27, there was no regulation concerning opening an account to receive loan proceeds either with a domestic lending bank or an overseas bank.

Information submission

Domestic banks must submit information in relation to overseas loans in Renminbi and foreign currencies, cross-border receipts and payments, and accounts to PBOC and SAFE. Within five working days of the beginning of the next month, domestic banks are also required to report statistical information to PBOC and SAFE such as changes in their overseas loan balance at the end of each month.

Annually before 30 June, domestic banks or their branches and sub-branches are required to report to PBOC, SAFE their latest audited capital data, development of overseas loan business in the previous year and plans for the current year.

KEY POINTS ON PRE-LOAN REVIEW

PBOC Circular No. 27 requires domestic banks to strengthen the review for loan transactions when handling overseas loans in Renminbi and foreign currencies. Specifically, the content of the review includes:

- the authenticity and compliance of the debtor's subject qualifications;
- the use of funds;
- the expected sources of repayment funds;
- the relevant transaction background in respect of the overseas loan business;
- compliance with relevant domestic and overseas laws and regulations;
- compliance reviews on issues such as anti-money laundering, anti-terrorist financing, and anti-tax evasion obligations, etc. ■

- 1 According to Art 3 of PBOC Circular No. 27, net tier 1 capital or working capital is subject to the latest audited financial report.
- 2 The current overseas loan leverage ratio is 1.5 for China Development Bank, 3 for the Export-Import Bank of China, and 0.5 for other banks.
- 3 The current macro-prudential regulation parameter is 1.
- 4 The current exchange rate risk conversion factor is 0.5.