

## China: NDRC Abolishes Pre-approval Requirement for Offshore Bond Offerings and Loans

*NDRC's easing of restrictions will likely facilitate Chinese companies' entrance into international debt capital and loan markets.*

### Introduction

On 14 September 2015, China's National Development and Reform Commission (NDRC) issued the *Circular on Promoting the Reform of the Filing and Registration System for Issuance of Foreign Debt by Enterprises* (the NDRC Circular) (国家发展改革委关于推进企业发行外债备案登记制管理改革的通知). The NDRC Circular has introduced a registration system for foreign debt to replace the existing case-by-case pre-approval system, representing a major regulatory breakthrough — easing restrictions on Chinese companies raising offshore financings. The NDRC Circular came into force immediately upon promulgation.

### Key Provisions

The key provisions affecting Chinese companies' offshore bond offerings and loans include:

- **Definition of Foreign Debt.** Under the NDRC Circular, “foreign debt” is defined to include offshore bonds and mid-and-long term international commercial loans, denominated in RMB or a foreign currency, with maturity of longer than one year, issued or borrowed by onshore PRC enterprises or their controlled offshore subsidiaries or branches.<sup>1</sup>
- **Eligible Issuers and Borrowers.** Under the NDRC Circular, issuers of offshore bonds and borrowers of offshore loans should meet the following basic requirements: good credit track record, no record of default under previously issued bonds or other debt instruments, sound corporate governance and foreign debt risk control systems, sound credit quality and strong debt repayment ability.<sup>2</sup>
- **Pre-deal Registration in Lieu of Approval.** The NDRC Circular has abolished the case-by-case pre-approval requirement under the old system for issuance of offshore bonds and incurrence of offshore loans by onshore Chinese companies, and introduced a system of registering foreign debt prior to its issuance or incurrence.<sup>3</sup> The pre-deal registration requirement also applies to offshore bond offerings and borrowings by offshore subsidiaries and branches controlled by the onshore Chinese companies.<sup>4</sup>
- **Timeframe for the Pre-deal Registration.** Under the NDRC Circular, the registration of foreign debt with the NDRC must occur on a pre-deal basis.<sup>5</sup> This means that the registration procedure must have been completed, *i.e.*, with a registration certificate obtained from the NDRC, prior to issuance of

offshore bonds or incurrence of offshore loans. Under the NDRC Circular, the NDRC has up to five business days to decide whether to accept the pre-deal registration application, and up to seven business days prior to issuing a registration certificate.<sup>6</sup>

- **Pre-deal Registration Application Documents.** Under the NDRC Circular, the pre-deal registration application must include an application report and debt issuance proposal setting out such information as currency, size, interest rate, maturity, use of proceeds and plan regarding whether or not to repatriate the proceeds.<sup>7</sup>
- **Post-closing Filing.** The NDRC Circular requires that a Chinese company file with the NDRC within 10 business days post issuance or incurrence of foreign debt.<sup>8</sup> If there is a significant discrepancy between the information contained in the pre-deal registration application and the actual issuance or incurrence, the post-closing filing must provide an explanation for such discrepancy.<sup>9</sup>
- **Use of Proceeds.** The NDRC Circular provides that issuers and borrowers have the discretion to use the proceeds onshore or offshore based on their actual business needs, giving priority to key projects and sectors, such as the development of the “One Belt, One Road” program, the Beijing-Tianjin-Hebei conurbation, the Yangze River economic corridor, and international capacity and equipment manufacturing cooperation programs.<sup>10</sup>

## Impact on Chinese Companies’ Offshore Financings

The issuance of the NDRC Circular is a significant regulatory development. By removing the pre-approval requirement for onshore Chinese companies’ offshore bond offerings and loan financings, the NDRC Circular has partly intended to facilitate offshore financing activities of the onshore Chinese companies. We expect Chinese companies to take advantage of the NDRC Circular to tap the international debt capital and loan markets.

As market practice continues to evolve, we expect to see additional implications of the NDRC Circular. At this stage, we believe that the NDRC Circular may impact Chinese companies’ offshore financings in the following areas:

- **Direct Issuance/Incurrence of Foreign Debt.** Prior to the NDRC Circular, PRC companies’ issuance of offshore bonds and incurrence of offshore borrowings would need NDRC pre-approval on a case-by-case basis. Therefore, most offshore bonds, for instance, have been offered by offshore special purpose vehicles of onshore Chinese parents, or “red chip” companies (offshore companies which are majority owned by Chinese companies), partly to avoid NDRC pre-approval. Given the abolishment of the pre-approval requirement under the NDRC Circular, some Chinese companies may elect to issue offshore bonds directly without using an offshore issuer. The benefit of such direct issuance/incurrence structure may include a positive impact on ratings and avoiding additional cost and time necessary to incorporate the offshore issuer. The downside of the direct issuance/incurrence structure would include an obligation to withhold tax on interest payments to bond investors or offshore lenders.
- **Pre-registration Requirement for Indirect Issuance/Incurrence of Foreign Debt.** Prior to the NDRC Circular, issuance of offshore bonds and incurrence of offshore borrowings by PRC companies through their offshore subsidiaries did not require pre-registering with NDRC. The NDRC Circular explicitly specifies that offshore financings by both PRC onshore parent companies and their offshore subsidiaries or branches must be registered with NDRC on a pre-deal basis. Therefore, the

deal team will need to take this into account in formulating a deal timetable, and ensure that the information included in the registration application closely reflects details of the actual offering.<sup>11</sup>

- **Timing for Pre-deal Registration.** Although the pre-deal registration procedure can be completed prior to closing, to ensure deal certainty and avoid last minute fire drills, the deal team should consider requiring the issuer to register the offshore financing before launching the deal. However, given the details of information required in the registration, the registration application may have to wait until major terms of the financing are determined. Registering the offshore financing early in the process is advisable also because whether the NDRC review will be procedural or substantive still remains to be seen. While the NDRC Circular appears to indicate that the review will be procedural, it does include issuer and borrower eligibility requirements as described above.
- **Post-closing Covenant.** Given that the NDRC Circular imposes a post-closing filing requirement, underwriters will likely require that a post-closing filing covenant by issuers be included in transaction documents.

## Uncertainties

- **Procedural or Substantive Review.** Despite the fact that the NDRC Circular provides for procedural review of the pre-deal registration application, the NDRC Circular specifies eligibility requirements for issuers and borrowers as described above. Therefore, whether the NDRC will conduct pre-registration check on credentials of issuers and borrowers remains to be seen. In addition, the NDRC Circular provides that the use of proceeds prioritize key projects and sectors, such as the development of the “One Belt, One Road” program, the Beijing-Tianjin-Hebei conurbation, the Yangze River economic corridor, and international capacity and equipment manufacturing cooperation programs. Therefore, whether this use of proceeds provision would present any substantive review hurdle remains to be seen.
- **Repatriation of Proceeds and Keepwell Structure.** As discussed above, the NDRC Circular provides that issuers and borrowers have the discretion to use the proceeds onshore or offshore based on their actual business needs, which appears to indicate that the issuers and borrowers may repatriate the proceeds from offshore financings back to China. Under certain circumstances, however, this needs to be reconciled with cross-border security rules issued by China’s State Administration of Foreign Exchange in May 2014.<sup>12</sup> The SAFE Cross-border Security Rules specifically prohibit issuers and borrowers from using the proceeds from the offshore bond issuance and borrowings, if such offshore financing is secured by a security interest provided by the issuer’s onshore parent company.

We do not believe that the NDRC Circular removes the restriction on repatriating proceeds, which SAFE imposes if onshore security is provided in connection with offshore financings. Therefore, Chinese companies that expect to use the proceeds in China may continue to rely on other “soft” credit enhancement techniques, such as the keepwell deed and equity interest purchase undertaking, to support their offshore bond offerings. Under a keepwell deed, typically the onshore parent company undertakes to ensure that its offshore subsidiary issuer remains solvent and has sufficient liquidity to service the interest and principal of the bonds. Under an equity interest purchase undertaking, the onshore parent company typically undertakes to purchase the equity interest in the onshore subsidiaries of the offshore issuer; and the purchase price will be used by the offshore issuer to service the interest and principal payment under the bonds. In addition, People’s Bank of China (PBOC), China’s central bank, also regulates Chinese companies’ issuance of offshore RMB bonds.

PBOC has yet to react to changes related to offshore RMB bond offerings resulting from the NDRC Circular.

- **Annual National Quota.** The NDRC Circular indicates that there will be an annual national quota for foreign debts, and that no registration application will be accepted once the maximum of the quota has been reached.<sup>13</sup> The NDRC has not yet announced a quota for 2015 or subsequent years. What stance the NDRC will take when determining the annual national quota for foreign debts remains to be seen.

## Conclusion

We believe the NDRC Circular will facilitate Chinese companies' offshore financings. The removal of the pre-approval requirement will likely encourage some Chinese companies to raise offshore financings using onshore entities instead of offshore financing vehicles. Chinese issuers will need to evaluate the pros and cons related to the direct and indirect offering structures under specific circumstances. Given that NDRC has yet to issue detailed guidelines to implement the NDRC Circular and that other regulatory authorities, such as the SAFE and PBOC, have yet to reconcile their rules with the NDRC Circular, certain uncertainties remain.

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## Endnotes

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- <sup>1</sup> Article 1(1) of the NDRC Circular.
- <sup>2</sup> Article 3 (7) of the NDRC Circular.
- <sup>3</sup> Article 1(2) of the NDRC Circular.
- <sup>4</sup> Articles 1(1) and 1(2) of the NDRC Circular.
- <sup>5</sup> Article 1(3) of the NDRC Circular.
- <sup>6</sup> Article 3(10) of the NDRC Circular.
- <sup>7</sup> Article 3(8) of the NDRC Circular.
- <sup>8</sup> Article 1(3) of the NDRC Circular.
- <sup>9</sup> Article 3(11) of the NDRC Circular.
- <sup>10</sup> Article 2(6) of the NDRC Circular.
- <sup>11</sup> The NDRC Circular requires that a filing be made with the NDRC within ten business days post issuance or incurrence of foreign debt, that if there is a significant discrepancy between the information contained in the pre-deal registration application and the actual issuance or incurrence, the post-closing filing must provide an explanation for such discrepancy, and that if false information was included in the pre-deal registration application willfully or with bad faith, a bad record would be included in the national credit information system. See Articles 1(3) and 3(11) of the NDRC Circular.
- <sup>12</sup> On May 19, 2014, China's State Administration of Foreign Exchange (the SAFE) issued the Provisions on the Administration of Foreign Exchange for Cross-Border Security (跨境担保外汇管理规定) and the Administration of Foreign Exchange for Cross-Border Security Implementation Guidelines (跨境担保外汇管理操作指引) (collectively, the SAFE Cross-border Security Rules). The SAFE Cross-border Security Rules came into force on June 1, 2014.
- <sup>13</sup> Article 3(10) of the NDRC Circular.