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CHINA'S NEW REGULATIONS ON  
FOREIGN DEBT – KEY NOTES FOR  
LOAN MARKET PARTICIPANTS

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The National Development and Reform Commission of the PRC<sup>1</sup> (“NDRC”) published the Administrative Measures for the Review and Registration of Medium and Long-Term Foreign Debt of Enterprises (企业中长期外债审核登记管理办法) (发改令[2023]56号) on 5 January 2023 (the “Measures”). The Measures came into effect on 10 February 2023, and represent a significant change to the previous regime that governed the registration of foreign debt under Circular on Promoting the Reform of the Filing and Registration System on the Issuance by Enterprises of Foreign Debt (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(发改外资[2015]2044号)) published by NDRC on 15 September 2015 (“Circular 2044”). The Measures supersede Circular 2044, which is no longer in effect.

The Measures clarify and update a number of areas that were covered by Circular 2044 and expand the scope of coverage. The operation of the Circular 2044 regime was subject to guidance notes that were issued from time to time. The Measures consolidate and formalise much of that material. This briefing will consider a number of the most important criteria and changes and analyse how they may affect loan market practices in relation to transactions coming within the scope of the Measures<sup>2</sup>.

## A. IN-SCOPE TRANSACTIONS

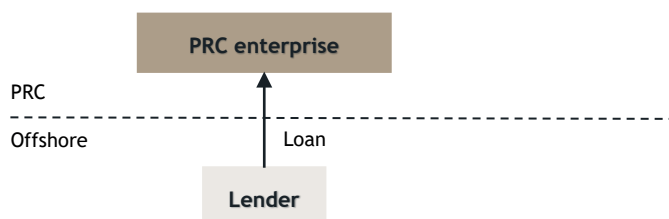
Broadly speaking, the requirements of the Measures apply to the foreign debt of PRC enterprises (or their subsidiaries) with a maturity of over one year. Debt with a maturity of up to and including one year is not covered. It is critical for borrowers, lenders and their advisors to be familiar with the scope of the Measures. We look at various aspects of the scope as follows:

### (1) Who are in-scope debtors?

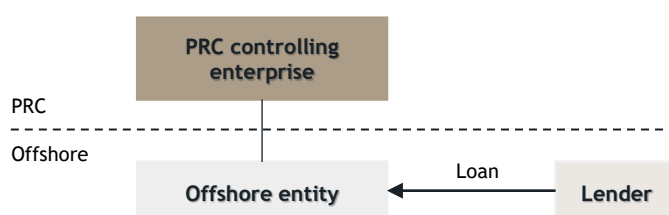
The Measures cover:

- Direct Foreign Debt
  - o Incurred by PRC incorporated enterprises (see *diagram 1*); or
  - o Incurred by offshore enterprises or branches that are controlled by a PRC incorporated enterprise (see *diagram 2*); or
- Indirect Foreign Debt
  - o Incurred in the name of an offshore enterprise whose primary business is carried on in the PRC and the debt of which is based on equity, assets, revenues or other rights of one or more PRC enterprises (see *diagram 3*).

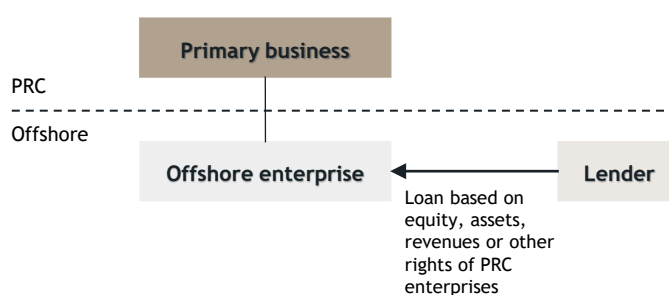
**Diagram 1 - Loan to PRC enterprises**



**Diagram 2 - Loan to offshore entities controlled by PRC enterprises**



**Diagram 3 - Indirect foreign debt**



1. Any reference to the “PRC” refers to the People’s Republic of China, excluding the Hong Kong Special Administrative Region of the People’s Republic of China, the Macau Special Administrative Region of the People’s Republic of China, Taiwan. Any reference to “offshore” means outside of the “PRC”.

2. Although this briefing mainly considers the impact of the Measures on loan transactions, much of what is said also applies to issuances of debt securities. One important difference is that the Measures provide that in the context of the issuance of debt securities, underwriters will be required to provide a due diligence report in the application. Our understanding is that this does not apply to loan facilities.



In relation to the second category of “direct foreign debt” referred to above, “control” of an enterprise means:

- i. ownership, directly or indirectly, of over half of the voting rights in that enterprise; or
- ii. although not owning over half of the voting rights in that enterprise, having the ability to direct important matters of that enterprise, including but not limited to its business operations, financial matters, human resources and technology, etc.

This includes control by way of a VIE (variable interest entity) structure. The Measures are therefore expected to cover so-called “red-chip” companies, variable interest entities and other enterprises which are not incorporated in the PRC, but are indirectly controlled by a PRC company or individual.

In relation to “indirect foreign debt”, the Measures do not define “primary business” or “based on equity, assets, revenues or other rights of one or more PRC enterprises”. However, according to the practice guidelines to the Measures (the “Practice Guidelines”)<sup>3</sup>, the NDRC’s review and registration is required if:

- i. the offshore debt of an offshore entity whose subsidiaries or affiliates in the PRC in aggregate contribute more than 50% of the borrower’s consolidated revenue or net profit or more than 50% of the borrower’s consolidated total assets or net assets; and
- ii. the main operation of the borrower’s business is conducted in the PRC or a majority of the borrower’s senior management are PRC citizens or residents of the PRC.

As a result, in addition to red-chip structures (which were already covered under the Circular 2044 regime), the Measures could potentially extend to a borrowing entity even if it was not PRC incorporated, and all of its direct and indirect shareholders were not incorporated or domiciled in the PRC, if the business has sufficient connection with the PRC such that the criteria referred to in the above paragraph are satisfied. It is important to note that the NDRC adheres to the principle of “substance over form” in such assessment.



At an early stage in the structuring process, parties should prepare a corporate structure diagram showing the borrower group (including ultimate beneficial shareholders). Even if the shareholders do not appear to be based in or domiciled in the PRC, if there are PRC subsidiaries or business operations of the borrower then it is necessary to consider whether these bring the loan within scope of the Measures under “indirect foreign debt”.

## (2) Who are in-scope creditors?

The Measures cover debts owing to offshore creditors. Debts owing to PRC incorporated lenders will not be regarded as foreign debts under the Measures unless the lender is an offshore banking unit or offshore branch of a PRC bank, or where the lender is a PRC bank acting through its free trade unit where the source of funds is from outside the PRC.



Where a PRC bank is involved as a creditor, parties should consider how best to structure their transaction taking into account the offshore lending rules jointly issued by the People’s Bank of China and the State Administration of Foreign Exchange (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 27”). For example, in the context of a syndicated loan facility, participation in loans (exceeding one year) owing by a PRC enterprise to a PRC bank does not fall within the Measures (and thus would not require review and registration with the NDRC) but it would fall within the scope of PBOC Circular 27 and subject to requirements therein, including quota and loan purpose restrictions.

## (3) What is in-scope debt?

The Measures apply to most forms of debt, including commercial loans, senior bonds, perpetual bonds, capital bonds, medium-term notes, convertible bonds, exchangeable bonds and financial leases having a maturity of over one year. As a result, debt with a maturity of up to or including one year will be exempt from having to comply with the Measures. This list of in-scope debt is not expressed to be exhaustive and it is possible that other instruments are captured.

3. Practice Guidelines for the Review and Registration of Medium and Long-Term Foreign Debts of Enterprises (企业借用中长期外债审核登记办事指南) published by the NDRC, which became effective on 10 February 2023.

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## B. USE OF PROCEEDS

The use of proceeds of the loan must not:

- contravene any laws or regulations of the PRC;
- threaten or harm the PRC's national interest or security of the nation's economics, information or data;
- violate the PRC's macroeconomic controls and objectives;
- contravene national development plan and industry policy;
- result in an increase in hidden local government debt; or
- be for use for opportunistic investment or speculation, and except for a banking financial institution, the proceeds cannot be used for any kind of lending, unless the on-lending has been approved.

The Measures prohibit any use of proceeds that does not comply with the terms of the NDRC registration.



It is important to consider the use of proceeds at an early stage of a deal, and accurately describe the intended use of proceeds in the application materials submitted to NDRC. For example, if the proceeds of the loan are intended to be on-lent by the borrower it is essential that such use be specified in the application.

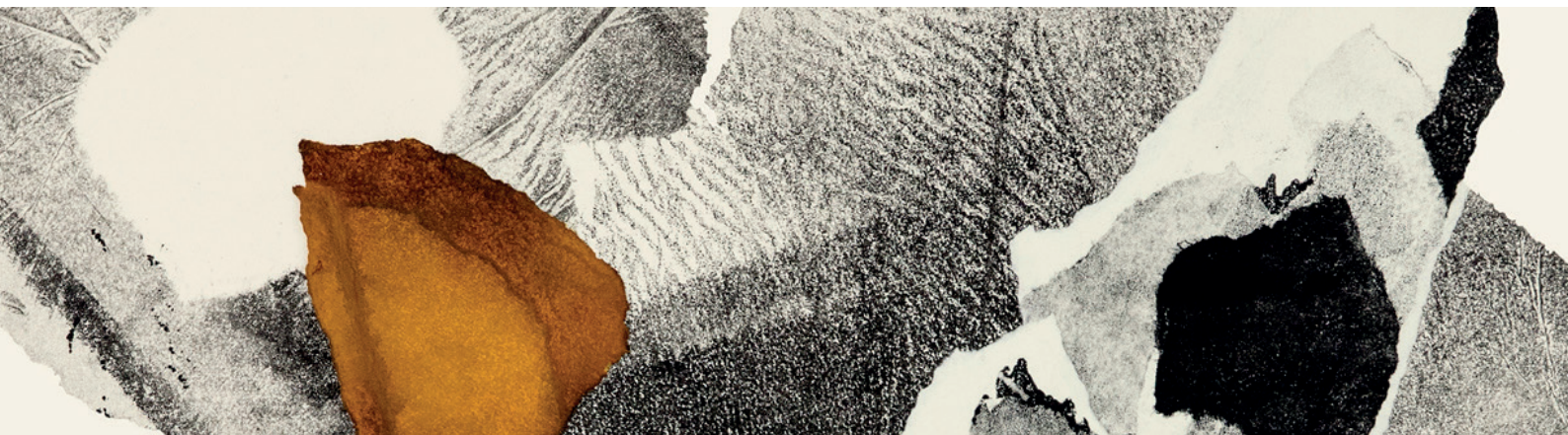
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## C. INITIAL APPLICATION

An application must be made to the NDRC for review and registration of any loan falling within the scope of the Measures. If the application is successful, the applicant will receive a Certificate of Review and Filing of Foreign Debt (a "Registration Certificate"). The Registration Certificate should be obtained before the first drawdown under the facility agreement.



Under the Circular 2044 regime, it was possible to make the application based on a termsheet (instead of a signed facility agreement). The Practice Guidelines specify that the executed facility agreement and guarantee/security documents (among other application materials) will form part of the application package. This could have a material impact of the deal timeline, and loan transaction parties are advised to take this into account at an early stage of the transaction and plan ahead, especially in event-driven financings where the loan closing is tied closely with the closing of related transactions such as an acquisition.



The “review and registration” timeline for the NDRC is expressed to be three months from the application being accepted. If the NDRC decides that the application materials are inadequate (which it is meant to do within five working days after the application is made) then the timeline does not begin until the inadequacies are addressed satisfactorily. By way of comparison, under Circular 2044, the timeline was only seven working days, though this was extended to 45 working days by later NDRC guidelines published in response to the Covid-19 pandemic.



Market participants must bear in mind these timelines when planning their transaction timetables. In circumstances where urgent funding is required, parties may consider undertaking a one-year bridge financing (which does not require NDRC foreign debt registration), to be refinanced by longer term debt at a later stage upon completion of the NDRC foreign debt registration.

The application materials will include an application report including:

- i. information on the enterprise and its existing debts;
- ii. details of and analysis of the new foreign debt to be incurred;
- iii. proposals regarding the repayment of the foreign debt; and

- iv. an undertaking letter regarding the authenticity of the foreign debt.

A legal opinion and letter of undertaking from PRC qualified lawyers are also required to be submitted. The contents of the opinion and letter of undertaking are not specified in the Measures and may vary depending on the deal structure. It is advisable that legal advice be sought at an early stage.

## D. ON-GOING COMPLIANCE

Applicants will be required to submit the following documents or notify the NDRC as set out in the table below.

Timing	Main documentation requirements
Prior to initial utilisation	<ol style="list-style-type: none"> <li>1. Application report</li> <li>2. Letter of undertaking from the applicant</li> <li>3. PRC legal opinion</li> <li>4. Letter of undertaking from PRC lawyers</li> <li>5. Executed facility agreement and guarantee/security documents</li> </ol>
Within 10 business days of each utilisation	Utilisation report detailing the particulars of the borrowing
Within the last 5 business days at the end of each January and July	Report regarding: <ul style="list-style-type: none"> <li>• the use of proceeds;</li> <li>• the status of payment obligations (for example, if there has been any default); and</li> <li>• certain other material information relating to the borrower’s operations.</li> </ul>
Within 20 business days of amendments in relation to the terms of the loan (for example, in relation to the currency or type of debt instrument, use of proceeds, or certain other substantial changes)	Notification must be made to the NDRC, but details are not specified at this time
Occurrence of material development affecting ability to honour debt obligations	Notification must be made to the NDRC, but details are not specified at this time



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## E. OTHER RELEVANT MATTERS

### *(1) Status of borrower and associated persons*

The Measures provide that none of the borrower, its controlling shareholders or de facto controlling persons must have, in the three years prior to the application, committed criminal offences relating to:

- corruption;
- bribery;
- illegal possession of assets;
- misappropriation of assets; or
- sabotage of the socialist market economic order.

They must also currently not be under formal investigation on suspicion of other offences or of material violations of laws and regulations.

It is worth noting that the Measures no longer prohibit the use of proceeds to make good losses of the borrower.

### *(2) Filing/registration vs. approval*

Under Circular 2044, an in-scope loan required a registration filing. Under the Measures, it is understood that the NDRC will conduct a “review and registration”. Applicants may have experienced that even under the Circular 2044 regime the process went beyond a simple registration process, but the change in terminology could indicate that the NDRC will conduct a substantive review of the application and the circumstances of the borrower, and it is more of an approval process rather than a mere registration process.

There is little guidance in terms of how the review is to be conducted. It is likely that it will include checking whether the application and the applicants are compliant with the requirements of the Measures (for example, in relation to the use of proceeds). However, there is no officially published guidance as to whether there is a substantive review rather than just checking whether the basic requirements of the Measures are complied with.

### *(3) Liabilities for non-compliance*

As with the Circular 2044 regime, a failure to register the debt in accordance with the Measures should not render the relevant debt unenforceable. However, the NDRC may take other steps such as interviewing the responsible persons or issuing a public warning. There may also be a public warning if, in the making of the application, false or misleading information is provided.

The Measures also clarify that intermediaries such as accounting firms, law firms and underwriters bear responsibility for their actions in relation to an in-scope transaction. They have an obligation not to provide services for any in-scope debt which it knows or should have known to be in breach of the Measures, or issue a due diligence report, opinion or relevant disclosure that contains any active concealment, inaccuracy, misrepresentation or material omission. Failure to comply can result in a public warning. It is not known whether this applies to foreign intermediaries in relation to services provided offshore.

### *(4) Impact on existing transactions*

#### *Transitional arrangements*

A number of transactions now under way may be affected by the Measures coming into force including:

- transactions that were not in-scope under Circular 2044, but are in-scope under the Measures;
- transactions where documentation has been signed, but no drawdown has occurred;
- transactions where a filing has been submitted with the NDRC, but the registration is not complete; or
- transactions where the documentation requires amendment in order to comply with the Measures (for example, in relation to the use of proceeds).

There will also be transactions featuring more than one of these elements. The Measures do not indicate how each of these circumstances is to be dealt with, so we suggest that the parties shall seek advice or consult with the NDRC to enquire how the Measures affect their transaction.

On the other hand, the Practice Guidelines clarify that registrations completed under Circular 2044 continue to be effective, and the relevant enterprises shall comply with the risk management and reporting requirements under the Measures going forward.



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*(5) Contractual terms*

The Circular 2044 regime has been in effect for a number of years, and typical loan documentation relating to in-scope transactions included terms to reflect the NDRC requirements, including on the use of proceeds, representations and covenants that the borrower must comply with Circular 2044. There was a condition precedent to drawdown that the NDRC registration was completed. To a large extent, these were based on standard generic obligations (for example, the obligation to obtain any required authorisations) and modified to specifically mention the requirements under Circular 2044.

Under the new regime, lenders are likely to insist on including the Registration Certificate as a condition precedent, and more detailed obligations to ensure borrowers comply with the Measures.

Beyond that, it is harder to predict how things might evolve. A misrepresentation or breach of covenant in relation to a NDRC related requirement could result in an event of default, but given that non-compliance is not expected to result in the loan becoming unenforceable, lenders may consider that standard (generic) NDRC related provisions are sufficient. In any event, we expect that with the benefit of future experience in making the filings, and any further guidance from the NDRC, market practice in such contractual obligations will develop over time.

## **CONCLUSION**

The Measures represent a significant evolution from the Circular 2044 regime. Although they clarify the scope of certain requirements, there remain some areas of uncertainty. An important example is in the scope of covered entities, which now appears to potentially cover companies even if they and their shareholders are not incorporated in the PRC (see In-scope borrowers above). Multinational companies with operations or subsidiaries in the PRC must consider whether the Measures apply even when the borrowing is made by an offshore company and there are no PRC shareholders in the ownership structure. This may also be relevant to an inbound acquisition financing of a business based in the PRC.

The application of the Measures to these kinds of transactions could in time turn out to be the most significant development brought about by the Measures. And although the impact on contract documentation might be limited, it seems that borrowers, lenders and their lawyers need to understand whether their tried and tested financing structures come within the Measures, and if they do, how best to comply with the rules.

*King & Wood Mallesons has deep and broad experience when it comes to advising in relation to cross-border financings involving PRC regulatory issues. We regularly act for borrowers, lenders (based in the PRC or elsewhere) and other participants in loans and other types of debt financings.*

*Should you wish to discuss what the legal and regulatory developments outlined in this article mean for you or your business, please contact a member of our team.*

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