

SHIPPING

CHINA: NEW SAFE REGULATIONS EASE RESTRICTIONS ON CROSS-BORDER SECURITY

On 19 May 2014, China's State Administration of Foreign Exchange ("SAFE") published the tongue-twisting Provisions on the Administration of Foreign Exchange for Cross-Border Guarantees, the Operational Guidelines for Foreign Exchange Administration for Cross-Border Guarantees, and the Catalogue of the Repealed Regulations (together, the "New Regulations").

Weighing in at 30 densely (translated) pages, the New Regulations are unlikely to trouble Ernest Hemingway for the crown of economical and understated prose. And, although they are not recommended reading for the faint of heart or weak of stomach, the New Regulations nevertheless represent a huge step forward by SAFE in its efforts to liberalise cross-border security.

The New Regulations came into force on 1 June 2014. By repealing 12 existing regulations and notices, SAFE has alleviated significant hurdles on cross-border security and has signalled a shift from an approval system to a registration system. The benefits extend to the shipping community.

Framework

Both the previous and the New Regulations, classify cross-border security structures into three categories according to the place of registration of the guarantor/security provider, debtor and creditor:

- i. Nei Bao Wai Dai or "Outbound Security" (内保外贷): guarantee/security provided by an onshore (i.e. Chinese) guarantor/security provider for a debt owed by an offshore debtor to an offshore creditor;
- ii. Wai Bao Nei Dai or "Offshore Security" (外保内贷): guarantee/security provided by an offshore guarantor/security provider for a debt owed by an onshore debtor to an onshore creditor; and
- iii. any other type of cross-border security in which the guarantor/security provider is either onshore or offshore and one of the creditor and debtor is onshore but the other is offshore.

Main Changes

1. Nei Bao Wai Dai (内保外贷)

A. Registration replaces approval

Onshore entities are no longer required to go through a lengthy and stringent approval process if they want to give cross-border guarantees and security.

Onshore banks are no longer subject to a pre-approved annual quota and may freely provide foreign guarantees and security provided they have been approved to engage in such business. A guarantee or security is now required to be reported to SAFE via a capital account information system after the guarantee or security is provided. Onshore non-bank entities are now only required to register the guarantee or security with SAFE within 15 days of execution (approval was previously required).

B. No shareholding

Onshore non-bank entities are no longer required to be a shareholder of the offshore debtor (although the restriction still applies to offshore bond issuance).

C. Individuals as guarantors/security providers

Individuals are now expressly permitted to be guarantors/security providers. The same provisions relating to non-bank entities apply.

D. Enforcement and de-registration

No approval is required to make an offshore payment under an enforced guarantee or security although reporting to or registration with SAFE is required depending on whether the entity is a bank or not.

If the foreign guarantee/security is enforced, the onshore guarantor/security provider cannot enter into any new Nei Bao Wai Dai without SAFE approval before the offshore debtor has discharged the debt to it.

A foreign guarantee or security is required to be de-registered once the offshore debtor has repaid the debt in full or the payment obligations of the onshore guarantor/security provider has expired.

2. Wai Bao Nei Dai (外保内贷)

A. Registration replaces approval

In the case of a Wai Bao Nei Dai transaction, no approval from SAFE is required if:

- i. the onshore debtor is a non-financial institution;
- ii. the onshore creditor is a financial institution; and
- iii. the guarantee/security is provided to secure a loan or committed facility and is in compliance with applicable laws and regulations both on and offshore.

The guarantee or security is reported to SAFE via the capital account information system.

B. Enforcement and registration of foreign debt

Upon enforcement of an offshore guarantee or security, the onshore debtor owes the offshore guarantor/security provider a debt by way of subrogation.

The onshore debtor is required to:

- i. ensure that the total outstanding principal amount of such foreign debt does not exceed the debtor's audited net assets for the preceding financial year;
- ii. register and file the debt with SAFE within 15 business days; and
- iii. fully discharge the debt before entering into any new Wai Bao Nei Dai transaction or make any further drawdown under any existing Wai Bao Nei Dai transaction (otherwise SAFE approval is required).

3. Other types of cross-border guarantee or security

If the cross-border security or guarantee does not fall under Nei Bao Wai Dai or Wai Bao Nei Dai no registration or approval is required (unless otherwise explicitly stated by SAFE).

Practical implications

As mentioned at the outset, the shipping community stands to benefit from the relaxation of SAFE's rules on cross-border security or guarantees.

While examining every possible permutation is beyond the scope of this article, the New Regulations have a very real impact on the provision of:

- i. downstream guarantees provided by PRC parent companies (e.g. state-owned enterprises) in favour of offshore shipowners supporting offshore debt incurred by their onshore or offshore chartering subsidiaries;

- ii. club LoUs provided by offshore (IG) Clubs in favour of Chinese counterparties and in support of Chinese members as well as, potentially, from China P&I on behalf of onshore members / to offshore counterparties;
- iii. refund guarantees in support of shipbuilding contracts;
- iv. standby letters of credit issued by an onshore bank in favour of offshore banks providing offshore credit to offshore borrowers or on behalf of onshore charterers / traders; and
- v. mortgages, among others.

Conclusion

While it is too early to say whether the New Regulations signal a broader shift in Chinese policy, those who stand to benefit from guarantees provided by onshore guarantors should take heart from a recent decision of the Qingdao Maritime Court.

The Court appears to have been dealing with the old regulations as the onshore guarantor sought to block an application to enforce a London arbitration against it on the basis that the guarantee was invalid for failure to register with SAFE and that it would be against Chinese public policy to enforce the award (under the New Regulations, failure to register with SAFE no longer invalidates the security). Nevertheless, the position adopted by the Court is encouraging.

The Court enforced the award, stating that although the guarantee had neither been approved, nor registered with SAFE, this was just a violation of Chinese laws regarding foreign exchange control and not a violation of Chinese public policy: enforcing the award will not cause a violation of basic principles of Chinese laws, will not infringe the sovereignty of China, and will not endanger the state security or social order of China.

The New Regulations offer only a partial liberalisation of the cross-border security regime. Yet, while a number of restrictions remain, they should be welcomed for what they are – a significant reform which makes cross-border security a clearer, more flexible, and more accessible proposition.

Contact

If you have any questions please contact Dimitris Seirinakis or your usual Ince contact.



Dimitris Seirinakis

Consultant, Shanghai
dimitris.seirinakis@incelaw.com

Ince & Co is a network of affiliated commercial law firms with offices in Beijing, Dubai, Hamburg, Hong Kong, Le Havre, London, Monaco, Paris, Piraeus, Shanghai and Singapore.

E: firstname.lastname@incelaw.com
incelaw.com

24 Hour International Emergency Response Tel: + 44 (0)20 7283 6999

LEGAL ADVICE TO BUSINESSES GLOBALLY FOR OVER 140 YEARS

The information and commentary herein do not and are not intended to amount to legal advice to any person on a specific matter. They are furnished for information purposes only and free of charge. Every reasonable effort is made to make them accurate and up-to-date but no responsibility for their accuracy or correctness, nor for any consequences of reliance on them, is assumed by the firm. Readers are firmly advised to obtain specific legal advice about any matter affecting them and are welcome to speak to their usual contact.

© 2014 Ince & Co International LLP, a limited liability partnership registered in England and Wales with number OC361890. Registered office and principal place of business: International House, 1 St Katharine's Way, London, E1W 1AY.