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Legal Commentary

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NDRC Draft Rule to Support Quality Borrowers' Foreign Debt

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Background

On 14 March 2024, the National Development and Reform Commission("**NDRC**") of the People's Republic of China ("**PRC**") issued the *Circular on Supporting Quality Enterprises to Borrow Medium-and Long-term Foreign Debts to Promote Quality Development of the Real Economy (Draft for Comments)* (the "**Draft Circular**")(*《国家发展改革委关于支持优质企业借用中长期外债促进实体经济高质量发展的通知（征求意见稿）》*) to solicit public opinion from 14 March 2024 to 13 April 2024. According to NDRC, the Circular is aimed to expand China's high-level opening-up and facilitate the cross-border financing by quality enterprises that satisfy the eligibility requirements under the Draft Circular (as further discussed below) ("**Quality Enterprises**") in order to support the development of real economy.

As a general requirement, the borrowing of foreign debt by PRC domestic enterprises (or the offshore enterprises or branches under their control) with a term of exceeding one year shall be subject to the approval and registration by NDRC, prior to the issuing or borrowing of foreign debt, and other requirements under the *Administrative Measures for the Review and Registration of Medium and Long-Term Foreign Debt of Enterprises* ("**Circular No.56**") (*《企业中长期外债审核登记管理办法》*). To facilitate the implementation and application of Circular No.56, NDRC issued the guidelines in early 2023, including 69 practical Q&A frequently being asked by market players during practice (the "**Guidelines**").

Further to Circular No.56 and the Guidelines, the Draft Circular further simplifies the application procedures and requirements for Quality Enterprises to borrow foreign debt and optimizes the relevant foreign debt management regime.

Highlights of the Draft Circular

I. Quality enterprises defined

Eligibility requirements	Comments / Thoughts
It shall comply with the relevant requirements in Circular No.56;	Quality Enterprises shall still comply with all the applicable regulatory requirements under Circular No.56 in the same manner as non-Quality Enterprises, including without limitation, the restrictions over the use of foreign debts in Article 8, and the

Eligibility requirements	Comments / Thoughts
	eligibility requirements for enterprises that borrow foreign debts in Article 9. According to Article 9 of Circular No.56, any enterprise that borrows foreign debt with a term of exceeding 1 year shall satisfy the following eligibility requirements: ■ it is duly incorporated and validly existing, with legally compliant business operations and a robust and well-functioning corporate structure; ■ there is a reasonable need for the borrowing of foreign debt, the use of proceeds shall comply with Article 8 of Circular No.56, and it has good credit standing and should be able to meet the payment obligations and have a robust foreign debt risk management system; and ■ within the past 3 years, neither it, its controlling shareholder(s) nor actual controller(s) have committed crimes relating to corruption, bribery, misappropriation of assets or other crimes that disrupt the order of socialist market economy, or have been investigated on suspicion of crimes or significant violation of laws.
Its production and business operations shall comply with China's macro-economic control policies and industrial policies;	For non-Quality Enterprises, the restriction is on the use of foreign debt proceeds–i.e., they cannot use foreign debt proceeds in such a manner that violates China's macro-economic control policies and industrial policies. For Quality Enterprises, in addition to the restriction on the use of foreign debt proceeds above, their production and business operations must comply with China's macro-economic control policies and industrial policies as well. In practice, borrowers may check against the latest China Industrial Structure Adjustment Guidance Catalog (《产业结构调整指导目录》) issued by the NDRC, the latest five-year plan of China (China's 14th Five-Year Plan for now) and the five-year plans for the specific industries relevant to the borrowers to confirm if this requirement is satisfied.
Its major business and financial indicators are in leading positions in the industry or in the region;	No specific indicators have been provided. Based on our project experience, NDRC may accept industrial or regional leading status or competitive advantages for consideration.
It has an international credit rating of investment-grade level (BBB-and above) or a domestic credit rating of AAA; and	In general, international credit rating agencies (such as Standard & Poor's, Moody's and Fitch) apply stringent standards when rating China's domestic enterprises, and normally only large state-owned enterprises, or well-known private companies may obtain the international credit rating

Eligibility requirements	Comments / Thoughts
	of BBB-or above. For private companies with strong growth prospects and stable financials, pursuing a favorable credit rating from domestic rating agencies is more practicable.
During the past 3 years, (i) there exists no default for the debt borrowed domestically or overseas, and there was no continuing deferred payment of principal and interest; (ii) there has been no material violation of laws and regulations, and it was not included on the blacklist for dishonesty; and (iii) with respect to the financial statements, there has been no negative opinion, or a rejection to issue an opinion received from a certified public accountant (CPA). If a CPA issues a reserved opinion, the significance of the matters with reservation by the opinion has been mitigated.	/

II. Simplified application procedures for Quality Enterprises

1. Aggregate quota allowed covering subsidiaries

NDRC's Explanatory Notes to the Draft Circular further clarify that Quality Enterprises will be allowed to submit an aggregate foreign debt application plan covering their subsidiaries so that the quota can be shared and allocated within the group or applied in installments. Accordingly, enterprises will be given more flexibility in the use and allocation of foreign debt and repetitive application on similar matters can be avoided.

Notably, NDRC has previously clarified in the Guidelines that any group company or parent company may apply for the foreign debt quota for its subsidiaries, provided that it will need to specify in its application each specific borrowing entity (i.e., the subsidiaries that will borrow foreign debts), their foreign debt quota and proposed purpose. It seems to us that, under the Draft Circular, Quality Enterprises are afforded with more flexibility, i.e., they do not need to specify allocation of foreign debt quota on each relevant subsidiary and purpose in their applications, but may apply for an aggregate foreign debt quota at the group company or parent company's level and allocate such quota within the group at their own discretions.

2. Conditional acceptance introduced for the absence of a signed facility agreement (FA) / due diligence report (DDR) and authenticity commitment letter (ACL) from the underwriter

For international commercial loans, NDRC may accept indicative documents instead of a fully signed FA if the borrower is not able to provide it, provided that the signed FA shall be supplemented during the reporting to NDRC after the first utilization of loan proceeds. As a practical matter, we understand such indicative documents may include facility commitment letters or term sheets stipulating the essential lending details. The conditional acceptance is designed to shorten the period of uncertainty for borrowers to obtain overseas financing–it would be time-consuming and add uncertainty if the parties will have to finalize and sign the FA first before they can submit the application with NDRC for foreign debt registration, which is likely to take another three months or even longer.

For foreign bonds issuance, the DDR and ACL from the underwriters can be exempted during the application if the lead underwriter has not been decided, provided that the DDR and ACL will be supplemented during the first reporting to NDRC after the bonds issuance.

3. Flexible approach for legal opinions

According to the Guidelines, a legal opinion issued by external professional agencies is one of the application documents for foreign debt registration. According to the Draft Circular, however, Qualified Enterprises with a domestic credit rating of AAA or an international credit rating of A-and above may provide legal opinions issued by their inhouse legal or compliance. This alternative approach may save legal cost in particular in repeating / similar transactions and to minimize confidentiality concerns.

III. Enhanced ongoing monitoring by NDRC

According to the Draft Circular, NDRC will establish the coordination regime with its local counterparts and the other governmental departments to supervise and examine the borrowing of foreign debt by Quality Enterprises. Spot check will be introduced with a focus on the following:

- the utilization ratio of the granted foreign debt quota;
- whether the proceeds are used in compliance with its prescribed purpose; and
- whether the information reporting to NDRC is duly and timely completed.

The monitoring regime and specific measures are yet to be released.

Outlook

The Draft Circular underscores Chinese government's momentum in encouraging Quality Enterprises to better coordinate their domestic and international funding resources to ultimately boost the real economy. We expect that it will largely enhance the efficiency and reduce the costs for China's Quality Enterprises in seeking overseas financing. The final version of the Draft Circular may be slightly different than its current draft and its implementation awaits to be tested. We will closely monitor the developments and share our insights.

Important Announcement

This Legal Commentary has been prepared for clients and professional associates of Han Kun Law Offices. Whilst every effort has been made to ensure accuracy, no responsibility can be accepted for errors and omissions, however caused. The information contained in this publication should not be relied on as legal advice and should not be regarded as a substitute for detailed advice in individual cases.

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