

Corporate Alert

May 29, 2014

SAFE Issues Circular 29 to Ease the Approval Requirements for Cross-Border Guarantees

On May 19, 2014, the State Administration of Foreign Exchange (“SAFE”) released provisions aiming to simplify the existing process and ease approval requirements for foreign guarantees in China and further broaden the scope and circumstances for the provision of foreign guarantees in cross-border transactions. According to the Notice on Issuing the Provisions of Foreign Exchange Administration of Cross-Border Guarantees (“Circular 29”), the Provisions of Foreign Exchange Administration of Cross-Border Guarantees (the “Provisions”) and Practice Guidance of Foreign Exchange Administration of Cross-Border Guarantees (the “Guidance”) will take effect as of June 1, 2014, and 12 regulations and rules regarding the current foreign guarantee regime in China will be abolished at the same time. However, Measures for the Administration of Foreign Guarantees by Institutions within China, which were promulgated in 1996, will remain effective.

Below are the key changes under the Provisions and the Guidance:

A. Main Changes and Updates of Foreign Guarantee Regime in China

I. **New Concept of “Cross-Border Guarantee” (“跨境担保” in Chinese).**

This is the first time for SAFE to introduce a concept of “Cross-Border Guarantee” (“CBG”) which is broader than a foreign guarantee under rules adopted previously in China. When the following two requirements are satisfied, the guarantee under a guarantee agreement will be regarded as CBG:

- the guarantor (which includes both entities and individuals) commits to the creditor in writing that the guarantor is legally bound to perform the obligations of payment pursuant to the guarantee agreement; and
- cross-border payment and receipt of funds or cross-border transfer of the ownership of certain assets may take place due to the performance of the above-mentioned commitment by the guarantor.

Specifically, Cross-Border Guarantee covers the following three types of guarantee:

1. Onshore guarantee for offshore debt (“内保外贷” in Chinese) where the guarantor is incorporated within China while both the debtor and the creditor are incorporated outside China.
2. Offshore guarantee for onshore debts (“外保内贷” in Chinese) where the guarantor is incorporated outside China while both the debtor and the creditor are incorporated within China.
3. Other CBG include but are not limited to the following:

- a. onshore guarantor with the debtor and the creditor being onshore or offshore respectively;
- b. offshore guarantor with the debtor and the creditor being onshore or offshore respectively;
- c. onshore guarantor, debtor and creditor with the collateral registered offshore; and
- d. offshore guarantor, debtor and creditor with the collateral registered onshore.

II. Prior SAFE Approval is Eliminated and only Postregistration is Needed in Certain Circumstance

Subject to Section 3 below, the execution and performance of the guarantee agreement for CBG will not be subject to SAFE's prior approval. Instead, postregistration with SAFE will be the main administrative measure for the CBG. Circular 29 makes it clear that SAFE's approval, registration, filing or other administration requirement shall not be a condition precedent for the CBG contract to take effect.

Below are the detailed filing requirements for the different types of CBG:

1. In the case of onshore guarantee for offshore debt, the onshore guarantor shall register with SAFE within 15 working days upon the occurrence of any of the following:
 - execution of the guarantee contract;
 - execution of certain amendments to the guarantee contract or to the key clauses in the underlying debt contract (such as the extension of the contract, the debt/secured amount, debt/guarantee period or change to the creditor, etc.); and
 - guarantor's performance of its guarantee obligation.
2. In the case of offshore guarantee for onshore debt, the creditor must be an offshore financial institution and the debtor must be an onshore nonfinancial institution.

Upon the performance of the guarantee obligation by the offshore guarantor in favor of the onshore creditor, the onshore debtor will consequently incur foreign debt owed to the offshore guarantor. Thereafter, the onshore debtor shall register with SAFE for the short-term foreign debt¹ and file the relevant information with SAFE within 15 business days upon the performance of the guarantee obligation. The unpaid principal of foreign debt arising from the

¹ Pending SAFE's further clarifications, such short-term debt registration under the Provisions may imply that the onshore debtor is obligated to pay off the foreign debt owed to the offshore guarantor within a year.

performance of the guarantee agreement owed by the onshore debtor is not allowed to exceed the onshore debtor's audited net assets in the previous year; if exceeded, the exceeded amount shall use up part of the foreign debt quota of the onshore debtor; if the foreign debt quota is not enough, the exceeded portion will be deemed and handled as foreign debt without SAFE's approval.

3. In the case of other CBG:

There is no registration requirement for the guarantee agreement with respect to such other CBR nor for the performance of it if the CBG is in compliance with other applicable rules and regulations.

III. Limited Situations Requiring SAFE Approval

1. In the case of onshore guarantee for offshore debt:

When the onshore guarantor is a nonbank institution, after it has performed its obligation under the guarantee agreement and before the offshore debtor has fully paid off the debt owed to the onshore guarantor, the onshore guarantor is not allowed to enter into a new guarantee agreement for onshore guarantee for offshore debt without SAFE's approval. This restriction does not apply to an onshore bank guarantor.

2. In the case of offshore guarantee for onshore debt:

After the guaranty obligation under the guarantee agreement has been performed by the offshore guarantor and before the onshore debtor has fully paid off the debt owed to the offshore guarantor, without SAFE's approval, (a) the onshore debtor is not allowed to enter into a new agreement which is backed up by an offshore guarantee for such debtor's onshore debt; or, (b) if the new offshore guarantee for such debtor's onshore debt has been entered into yet the funds have not been fully withdrawn by such an onshore debtor, such an onshore debtor shall temporarily suspend the withdrawal of any funds under that loan agreement.

IV. Other Noteworthy Points Under the Provisions and the Guidance

1. Special Guarantor in the Case of Onshore Guarantee for Offshore Debt

a. Individual guarantor

The Provisions suggest that onshore individuals may be able to independently provide the onshore guarantee. (*Currently, onshore individuals may only provide joint guarantee together with an onshore corporate guarantor.*)

- b. Multiple guarantors
In the case of multiple onshore guarantors for the same onshore guarantee for offshore debt, the parties may freely agree on any of the guarantors to deal with the registration with local SAFE in the place where such guarantor is located.
2. Restrictions on the Use of the Offshore Loan Backed Up by Onshore Guarantee in the Case Of Onshore Guarantee for Offshore Debt
- a. The debtor is not allowed to directly or indirectly transfer such offshore funds back to China by way of the arrangement of loan, equity investment or security investment within China.
 - b. The offshore loans are not allowed to be used by offshore entities or offshore individuals to directly or indirectly make equity investment or debt investment in a PRC onshore entity. Such forbidden investment includes but is not limited to the following:
 - i. the debtor directly or indirectly uses the offshore loan for equity or debt investment in onshore entities;
 - ii. the offshore loan is used by the debtor to directly or indirectly acquire the equity in an offshore company if more than 50 percent of such offshore company's assets are located within China;
 - iii. the offshore loan is used to repay the debts of the debtor or the debts of other offshore entities if the previous funds had been directly or indirectly transferred back to China by way of equity investment or debt investment; or
 - iv. the debtor uses the offshore loans to prepay the goods or service trading fees to onshore entities and the payment is made more than one year ahead of the provision of the goods or service and the total prepaid amount exceeds USD one million or 30 percent of the total purchase price.

Specific approval by SAFE is required if the debtor plans to use the offshore loan for any of the above-mentioned restricted purposes.

Contact Information

If you have any questions regarding this alert, please contact:

Li Chen

li.chen@akingump.com

+86 10.8567.2220

Beijing

Qiong (Lucy) Lu

llu@akingump.com

+852 3694.3016

Hong Kong

Gregory D. Puff

gpuff@akingump.com

+852 3694.3010

Hong Kong

William L. Rosoff

wrosoff@akingump.com

+86 10.8567.2210

Beijing

Allison Zhu

azhu@akingump.com

+852 3694.3054

Hong Kong