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China

Lending & Secured Finance

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This country-specific Q&A provides an overview of lending & secured finance laws and regulations applicable in China.

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China: Lending & Secured Finance

1. Do foreign lenders (including non-bank foreign lenders) require a licence/regulatory approval to lend into your jurisdiction or take the benefit of security over assets located in your jurisdiction?

No, a licence/regulatory approval is not required for foreign lenders or non-bank lenders to lend into the People's Republic of China (for the purpose hereof only, excluding Hong Kong Special Administrative Region, Macau Special Administrative Region and Taiwan, the "PRC" or "China"), nor for foreign lenders or non-bank lenders to take security over assets located in the PRC.

However, it is worth to mention the following regulatory requirements where foreign lenders or non-bank lenders lend into the PRC or take security over assets located in the PRC:

- **Foreign debt quota** – pursuant to the regulations of the People's Bank of China of the PRC ("PBOC"), a foreign debt quota is required for a Chinese borrower to borrow loans from foreign lenders. The risk-weighted outstanding amount of all foreign loans borrowed by the Chinese borrower shall not exceed its foreign debt quota. The foreign debt quota is calculated as follows:

*the borrower's capital or net assets * cross-border financing leverage ratio * macro-prudential regulation parameter*

Depending on the types of borrower, the calculation of foreign debt quota is different – for an enterprise borrower the quota is calculated based on its net assets and the cross-border financing leverage ratio is 2; for a bank borrower the quota is calculated based on its Tier 1 capital and the leverage ratio is 0.8; for a non-bank financial institution (e.g. insurance companies) the quota is calculated based on its capital and the leverage ratio is 1. Currently the macro-prudential regulation parameter is 1.25 for both financial institution borrowers and enterprise borrowers.

- **NDRC medium and long-term foreign debt registration** – for medium and long-term foreign loans (i.e. foreign loans with a tenor of more than 1 year), the borrower is required to apply in advance with National Development and Reform Commission of the PRC ("NDRC") for review and registration. It is noteworthy that, the NDRC medium and long-term foreign debt

registration is required not only where the borrower is a Chinese enterprise, it is also required where the borrower is an offshore subsidiary or an offshore branch controlled by a Chinese enterprise or where the foreign loan is borrowed overseas by a Chinese enterprise indirectly. According to the Administrative Measures for the Review and Registration of Medium and Long-term Foreign Debts of Enterprises ("NDRC Foreign Debts Measures") issued by NDRC in January 2023, indirect borrowing of foreign loans overseas by a Chinese enterprise, means that an Chinese enterprise of which the main business activities are conducted within China, based on the equity, assets, earnings, or other similar rights and interests of this Chinese enterprise, borrows commercial loans overseas in the name of an enterprise registered overseas.

- **SAFE foreign debt registration** – after signing of the loan agreement, the borrower is required to register the loan agreement with State Administration of Foreign Exchange of the PRC ("SAFE").
- **Cross-border security registration** – under PRC laws there are two types of cross-border security that need to be registered with SAFE, which are NBWD and WBND. NBWD refers to a financing transaction where both the borrower and the lender(s) are located outside of China while the guarantor/security provider is located in China, and WBND refers to a financing transaction where both the borrower and the lender(s) are located in China while the guarantor/security provider is located outside of China. Other types of cross-border security are generally not required to be registered with SAFE. For example, if foreign lenders lend into China and take security over assets located in China, the security is not required to be registered with SAFE.

In addition to the above, security created over certain types of assets located in the PRC need to be registered at the relevant asset-based registry for perfection purpose. Please see section 8 for details.

2. Are there any laws or regulations limiting the amount of interest that can be charged by lenders?

As a result of the market-oriented interest rate reform, currently there are no laws or regulations generally

limiting the amount of interest charged by lenders.

It is noteworthy that, according to the Supreme People's Court's latest judicial interpretation, the interest rate for private lending shall not exceed four times the Loan Prime Rate¹ for one-year loan when the loan agreement is concluded. Generally speaking, private lending refers to lending transaction between natural persons, companies or other organizations, but excludes loans provided by regulated financial institutions (such as by a bank). The Supreme People's Court's latest judicial interpretation clearly provides that it shall not apply to loans provided by regulated financial institutions. However, in practice the PRC courts may apply the above interest rate limit to loans provided by other lenders (including by foreign lenders).

Footnote(s):

¹ Loan Prime Rate is the benchmark rate published on a monthly basis by the National Interbank Funding Center authorized by the People's Bank of China.

3. Are there any laws or regulations relating to the disbursement of foreign currency loan proceeds into, or the repayment of principal, interest or fees in foreign currency from, your jurisdiction?

Yes, we summarize the legal requirements relating to the disbursement and repayment of foreign loan as follows:

- **SAFE foreign debt registration** – after signing of the loan agreement, the borrower is required to register the loan agreement with SAFE.
- **Foreign debt account(s)** – after completing the SAFE foreign debt registration, the borrower may open foreign debt account(s) with relevant bank for the purpose of the disbursement of loan proceeds and the repayment of loan principal and payment of interest.
- **Foreign loan currency** – the disbursement currency and the repayment currency shall be consistent with the loan currency provided in the loan agreement.
- **Foreign debt cancellation registration** – After the foreign loan is repaid in full, the borrower shall conduct cancellation registration in respect of the foreign debt with relevant bank².

Footnote(s):

² According to a SAFE regulation dated October 23, 2019, the foreign debt cancellation registration will be conducted with relevant bank in future. Before this SAFE regulation, the cancellation registration was done with

SAFE.

4. Can security be taken over the following types of asset: i. real property (land), plant and machinery; ii. equipment; iii. inventory; iv. receivables; and v. shares in companies incorporated in your jurisdiction. If so, what is the procedure – and can such security be created under a foreign law governed document?

Under PRC laws, security can be created over the following types of asset:

- land use right and buildings
- machinery, equipment, inventory and other moveables
- receivables
- shares in Chinese companies
- intellectual property
- ships
- aircrafts
- vehicles

Regarding the procedure, security created over certain types of assets located in the PRC need to be registered at the relevant asset-based registry for perfection purpose. Please see section 8 for details.

In addition to the security registration procedure, under PRC laws there are two types of cross-border security that need to be registered with SAFE, which are NBWD and WBND. NBWD refers to a financing transaction where both the borrower and the lender(s) are located outside of China while the guarantor/security provider is located in China, and WBND refers to a financing transaction where both the borrower and the lender(s) are located in China while the guarantor/security provider is located outside of China. Other types of cross-border security are generally not required to be registered with SAFE. For example, if foreign lenders lend into China and take security over assets located in China, the security is not required to be registered with SAFE. In practice, cross-border security registration may need to have been completed prior to the application of security registration with relevant asset-based registry, it's advisable to check with relevant authorities on a case by case basis.

As a matter of the lex situs doctrine, such security is typically governed by PRC laws since the security asset is located in China.

5. Can a company that is incorporated in your

jurisdiction grant security over its future assets or for future obligations?

A Chinese company can create mortgage over its machinery, equipment, raw materials, semi-manufactured products as well as finished products, both currently owned and to be owned in the future. A Chinese company can also grant security for a series of obligations (up to a maximum secured amount) that will arise over a certain period of time in future.

6. Can a single security agreement be used to take security over all of a company's assets or are separate agreements required in relation to each type of asset?

Under PRC laws it is not possible to take security over all assets of a company through a single security agreement. Separate agreements are required in relation to each type of asset.

7. Are there any notarisation or legalisation requirements in your jurisdiction? If so, what is the process for execution?

Generally, there are no notarisation or legalisation requirements in China.

8. Are there any security registration requirements in your jurisdiction?

Yes. We set out below the security registration requirements for the following types of asset:

- **Land use right and buildings:** registration at the local real property registry³
- **Machinery, equipment, inventory and other moveables:** online registration at Credit Reference Centre of the People's Bank of China⁴
- **Receivables:** online registration at Credit Reference Centre of the People's Bank of China
- **Shares in Chinese companies:** registration at (i) the local SAMR, or (ii) the securities depository and clearing institution⁵
- **Intellectual property:** registration at the relevant IP registry
- **Ships:** registration at the local maritime registry
- **Aircrafts:** registration at Civil Aviation Administration of China
- **Vehicles:** registration at the local vehicle registry

Footnote(s):

³ Before the introduction of uniform real property registration system, historically security over land use right and security over buildings was separately registered at local land bureau and local housing bureau.

⁴ This security shall be registered at Credit Reference Centre of the People's Bank of China starting from January 1, 2021, before which it was historically registered at the local State Administration for Market Regulation ("SAMR").

⁵ Depending on the types of company whose shares are pledged, the registration authority is different – security over shares in limited liability company is registered with local SAMR, while security over shares in company limited by shares is usually registered with the securities depository and clearing institution (with exceptions).

9. Are there any material costs that lenders should be aware of when structuring deals (for example, stamp duty on security, notarial fees, registration costs or any other charges or duties), either at the outset or upon enforcement? If so, what are the costs and what are the approaches lenders typically take in respect of such costs (e.g. upstamping)?

Registration costs in China are minimal, and the borrower usually pays the registration costs (if any) directly. For example, registration fee for security over land use right and buildings – RMB80 or RMB550 (depending on the types of land use right and buildings) for each registration; registration fee for security over receivables – RMB30 per annum for each registration; and no registration fee is payable for security over shares.

For stamp duty, the borrower is required to pay stamp duty in relation to the loan agreement at the rate of 0.005% of the loan amount and the lenders are also required to pay stamp duty at the rate of 0.005% of the loan amount. No stamp duty is payable in relation to the taking of security over assets located in China. But any transfer of shares and real property at the time of enforcement (including a sale of a mortgaged property) will attach ad valorem stamp duty.

Other than the above, there are no other material costs in China that lenders should be aware of when structuring deals.

Typically, the loan documents will contain cost and expense clauses by which the borrower will pay and indemnify the lenders all costs and expenses incurred in

connection with the loan transaction.

10. Can a company guarantee or secure the obligations of another group company; are there limitations in this regard, including for example corporate benefit concerns?

PRC laws generally allow a company to guarantee or secure the obligations of another group company, except for financial assistance which will be discussed in section 11 below.

Please note that corporate authority (e.g. board resolutions or shareholder resolutions) will be required in order for a company to provide a guarantee or security. In particular, if a company guarantees or secures the obligations of its shareholder or its actual controller, shareholder resolutions of the company will be mandatorily required.

For listed companies, the regulations of China Securities Regulatory Commission ("CSRC") prevent the provision of financial assistance (including the provision of guarantee or security) for acquiring shares of the listed company. CSRC regulations also require the listed company pass shareholder resolutions for the following guarantee or security: (i) guarantee or security provided to third party after the total secured amount of the listed company and its controlling subsidiaries has exceeded 50% of the latest audited net assets; (ii) guarantee or security provided to third party whose asset-liability ratio has exceeded 70%; (iii) one single guarantee or security the amount of which has exceeded 10% of the latest audited net assets; and (iv) guarantee or security provided to its shareholders, its actual controllers or their related parties.

11. Are there any restrictions against providing guarantees and/or security to support borrowings incurred for the purposes of acquiring directly or indirectly: (i) shares of the company; (ii) shares of any company which directly or indirectly owns shares in the company; or (iii) shares in a related company?

The Company Law of the PRC was revised and adopted on December 29, 2023, which shall come into effect on July 1, 2024. This revision makes substantial changes to more than 50% of the Company Law's current clauses, and introduces, among others, the financial assistance into the Company Law for the first time. According to clause 163 of the revised Company Law, a joint stock company shall not provide loans, guarantee/security or

other financial assistance for another person to acquire shares of the joint stock company or its parent company, except for the purpose of implementing an employee stock ownership plan by the joint stock company. A joint stock company may provide financial assistance for another person to acquire shares of the joint stock company or its parent company, only if it is for the benefit of the joint stock company and is passed through a shareholders' resolution or a board resolution of the joint stock company, provided that the accumulative amount of financial assistance shall not exceed 10% of the issued share capital of the joint stock company.

Moreover, for listed companies, CSRC regulations prevent the provision of financial assistance (including the provision of guarantee or security) for acquiring shares of the listed company. CSRC regulations also require the listed company pass shareholder resolutions for the following guarantee or security: (i) guarantee or security provided to third party after the total secured amount of the listed company and its controlling subsidiaries has exceeded 50% of the latest audited net assets; (ii) guarantee or security provided to third party whose asset-liability ratio has exceeded 70%; (iii) one single guarantee or security the amount of which has exceeded 10% of the latest audited net assets; and (iv) guarantee or security provided to its shareholders, its actual controllers or their related parties.

12. Can lenders in a syndicate (or, with respect to private credit deals, lenders in a club) appoint a trustee or agent to (i) hold security on the lenders's behalf, (ii) enforce the lenders' rights under the loan documentation and (iii) apply any enforcement proceeds to the claims of all lenders in the syndicate?

Yes. Security agent concept is generally recognised in the PRC and a security agent can hold security, enforce the lenders' rights under the loan documents and apply any enforcement proceeds in accordance with the instructions of the lenders in the syndicate.

13. If your jurisdiction does not recognise the role of an agent or trustee, are there any other ways to achieve the same effect and avoid individual lenders having to enforce their security separately?

Not applicable.

14. Do the courts in your jurisdiction generally give effect to the choice of other laws (in particular, English law) to govern the terms of any agreement entered into by a company incorporated in your jurisdiction?

For a foreign-related contract, PRC laws generally allow the parties to choose the governing law (PRC laws or a foreign law) of such contract except to the extent that, the choice of foreign law violates mandatory PRC legal provisions or any provision of the foreign law violates a public policy of the PRC in the determination of a particular issue, in which case PRC laws would be the applicable laws. Under PRC laws, the following contracts are considered to be a foreign-related contract: (i) either party or both parties to the contract are foreign persons or foreign entities; (ii) the habitual residence of either party or both parties to the contract locate outside the territory of the PRC; (iii) the subject matter of the contract is outside the territory of the PRC; (iv) the legal fact that leads to establishment, change or termination of the contract relationship happens outside the territory of the PRC; and (v) other contracts that may be determined as a foreign-related contract.

For loan agreements entered into between a Chinese company and foreign lenders, PRC laws generally allow the parties to choose a foreign law (in particular, English law) as the governing law, and PRC courts will give effect to the choice of foreign law.

For security documents, however, as a matter of the *lex situs* doctrine, the security is typically governed by PRC laws since the security asset is located in China.

15. Do the courts in your jurisdiction generally enforce the judgments of courts in other jurisdictions (in particular, English and US courts) and is your country a member of The Convention on the Recognition and Enforcement of Foreign Arbitral Awards (i.e. the New York Arbitration Convention)?

Under PRC laws, PRC courts shall, according to the international treaties concluded or acceded to by the PRC or based on the principle of reciprocity, review an application or pleading for the recognition and enforcement of a judgment rendered by a foreign court. If, upon review, the foreign judgment neither contradicts the fundamental principles of PRC laws nor violates state sovereignty, security and public interest, PRC courts shall rule to recognize and enforce the foreign judgment. China

officially signed The Hague Convention on Choice of Court Agreements in September 2017 and currently China is still going through the ratification procedure. As of today, there is no other international treaty in respect of recognition and enforcement of judgment between the PRC and England/US.

Yes, China is a member of The Convention on the Recognition and Enforcement of Foreign Arbitral Awards (i.e. the New York Arbitration Convention).

16. What (briefly) is the insolvency process in your jurisdiction?

The Enterprise Bankruptcy Law of the PRC provides for three types of insolvency proceedings, which are reorganization, conciliation and bankruptcy liquidation. An insolvency proceeding is commenced by filing an application with the competent PRC court.

A debtor can file an application for reorganization, conciliation or bankruptcy liquidation with the competent PRC court if the debtor is insolvent (a debtor will be considered insolvent if it is unable to pay off its due debt and/or its assets are not sufficient to pay off all its debts). A creditor can also apply for reorganization or bankruptcy liquidation of a debtor with the competent PRC court if the debtor is unable to pay off its due debt. If the court accept the application, it shall appoint an administrator. Once appointed, the administrator will take over all the debtor's assets as well as the management of the debtor. The administrator shall report to the court and be supervised by the creditors' meeting and by the creditors' committee.

During the reorganization proceedings, the debtor or the administrator shall prepare and submit a draft reorganization plan to the court and the creditors' meeting within six months (unless otherwise extended) after the court accept the reorganization application. The creditors will discuss the draft reorganization plan in the creditors' meeting, and will be divided into groups based on the categories of debts for voting on the draft reorganization plan. If all groups of creditors pass the draft reorganization plan, it will be submitted to the court for approval. The reorganization proceedings shall be terminated upon approval of the reorganization plan by the court. If the reorganization plan is not passed by the creditors' meeting or in other circumstances prescribed by the Enterprise Bankruptcy Law, the court will terminate the reorganization proceedings and declare the bankruptcy of the debtor.

A debtor can apply for conciliation with the court directly,

it can also apply for conciliation after the court accept a bankruptcy application made by a creditor but before the declaration of bankruptcy of the debtor. In applying for conciliation, the debtor shall submit a draft conciliation agreement. The creditors' meeting will discuss and vote on the draft conciliation agreement. If it is passed by the creditors' meeting, the court shall rule to acknowledge the draft conciliation agreement and terminate the conciliation proceedings. If the draft conciliation agreement is not passed by the creditors' meeting or in other circumstances prescribed by the Enterprise Bankruptcy Law, the court will terminate the conciliation proceedings and declare the bankruptcy of the debtor.

Once the court declares the bankruptcy of the debtor, it shall notify the debtor, the administrator and the creditors, and make a public announcement. The administrator shall prepare a conversion plan and a distribution plan for the bankruptcy estate, and submit the same to the creditors' meeting for discussion. Once passed by the creditors' meeting and approved by the court, the administrator shall be responsible for selling off the bankruptcy estate (usually through auction) and carrying out the distribution plan. Following the final distribution of the bankruptcy estate, the administrator will submit to the court a distribution report, based on which the court will decide whether to conclude the bankruptcy proceedings.

17. What impact does the insolvency process have on the ability of a lender to enforce its rights as a secured party over the security?

As a matter of principle, upon the debtor's insolvency a secured lender shall still enjoy priority over the security assets and can enforce the security in accordance with the provisions of PRC laws.

The Enterprise Bankruptcy Law of the PRC provides that after the court accepts the insolvency application, the preservation measures concerning the debtor's property shall be released and the execution procedures shall suspend. Similar to unsecured creditors, a secured lender shall file its claim (among others, specifying the claim amount as well as whether the claim is secured or not) with the administrator and participate in the insolvency proceedings. In particular, during the reorganization proceedings a secured lender shall suspend the enforcement of security. However, if there is possibility that the collateral may be damaged or the collateral value may decrease dramatically so that it will prejudice the rights of the secured lender, the lender may apply with the court for resumption of the enforcement of security.

18. Please comment on transactions voidable upon insolvency.

Under PRC laws, basically there are two types of transactions voidable upon insolvency, which are fraudulent transactions and preferential transactions. To be specific, the following transactions are voidable upon insolvency: (i) transferring of the debtor's assets for free within one year before the court accepts the bankruptcy application; (ii) transactions entered into with other parties at an undervalue within one year before the court accepts the bankruptcy application; (iii) security provided for existing debts within one year before the court accepts the bankruptcy application; (iv) payment of undue debts in advance within one year before the court accepts the bankruptcy application; (v) waive of claim by the debtor within one year before the court accepts the bankruptcy application; or (vi) payment made to specific creditors (while the debtor has been insolvent already) within six months before the court accepts the bankruptcy application.

19. Is set off recognised on insolvency?

Yes, mutual debts can be set off in insolvency proceedings, but with limitations. The debts to be set off must arise before the court accepts the bankruptcy application. If the creditor know that the debtor is insolvent when it acquires the debt to be set off, then set off is not permitted because this will procure for the creditor an advantage to the prejudice of the debtor's assets. And debt of unpaid capital contributions to the debtor is generally not permitted to be set off.

20. Are there any statutory or third party interests (such as retention of title) that may take priority over a secured lender's security in the event of an insolvency?

Under PRC laws, a maritime lien shall take priority over a secured lender's security created over a ship (i.e. ship mortgage), regardless whether in the event of an insolvency or not. Similarly, aircraft lien shall also take priority over a secured lender's security created over aircraft (i.e. aircraft mortgage).

21. Are there any impending reforms in your jurisdiction which will make lending into your jurisdiction easier or harder for foreign lenders?

The NDRC Foreign Debts Measures has come into force on February 10, 2023, upon which the Notice of

Promoting the Administrative Reform of the Recordation and Registration System for Enterprises' Issuance of Foreign Debts, which was issued by NDRC back in 2015 shall be repealed. As mentioned above, the NDRC medium and long-term foreign debt registration is required not only where the borrower is a Chinese enterprise, it is also required where the borrower is an offshore subsidiary or an offshore branch controlled by a Chinese enterprise or where the foreign loan is borrowed overseas by a Chinese enterprise indirectly. According to the NDRC Foreign Debts Measures, indirect borrowing of foreign loans overseas by a Chinese enterprise, means that an Chinese enterprise of which the main business activities are conducted within China, based on the equity, assets, earnings, or other similar rights and interests of this Chinese enterprise, borrows commercial loans overseas in the name of an enterprise registered overseas. The NDRC Foreign Debts Measures also provide, among others, more requirements on the qualification of the borrower as well as limitations on the loan purpose. All these changes are expected to affect the lending into China by foreign lenders.

22. What proportion of the lending provided to companies consists of traditional bank debt versus alternative credit providers (including credit funds) and/or capital markets, and do you see any trends emerging in your jurisdiction?

Traditional bank debt remains the most important source of lending provided to companies in China. Debt capital markets also play a significant role in the China market. Shadow banking (e.g. trust loans etc.) increased considerably in recent years and reached its peak by the end of 2016. With the strict regulation imposed by Chinese regulators from 2017, shadow banking has

decreased these two years in the China market. According to PBOC, as of the end of 2022 the proportion of bank loans in the China market is around 60%, the proportion of shadow banking is around 20% and debt capital markets around 10%.

23. Please comment on external factors causing changes to the drafting of secured lending documentation and the structuring of such deals such as new law, regulation or other political factors

There are several external factors causing changes to the drafting of secured lending documentation and the structuring of such deals.

For example, the Civil Code of PRC has come into force from January 1, 2021, upon which date the Property Law, the Contract Law, the Security Law, the Tort Law, the Marriage Law, the Succession Law, the Adoption Law, the General Principles of the Civil Law as well as the General Rules of the Civil Law ceased to have effect. It is expected that the application and interpretation of the Civil Code will lead to consequential changes to the loan agreement as well as the security documents in the market.

LIBOR transition will also cause changes to the drafting of lending documentation, in particular the rate switch mechanics and the replacement of screen rate provisions. The scale of the task facing the financial sector (especially in light of COVID 19 related delays) requires the implementation of the adjustments to systems, infrastructure and documentation required to facilitate transition from LIBOR, as far in advance of the end of 2021 as possible. PBOC (as the central bank of PRC) and industry working groups work closely and coordinate with relevant authorities in other jurisdictions to ensure an orderly transition process in China.

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