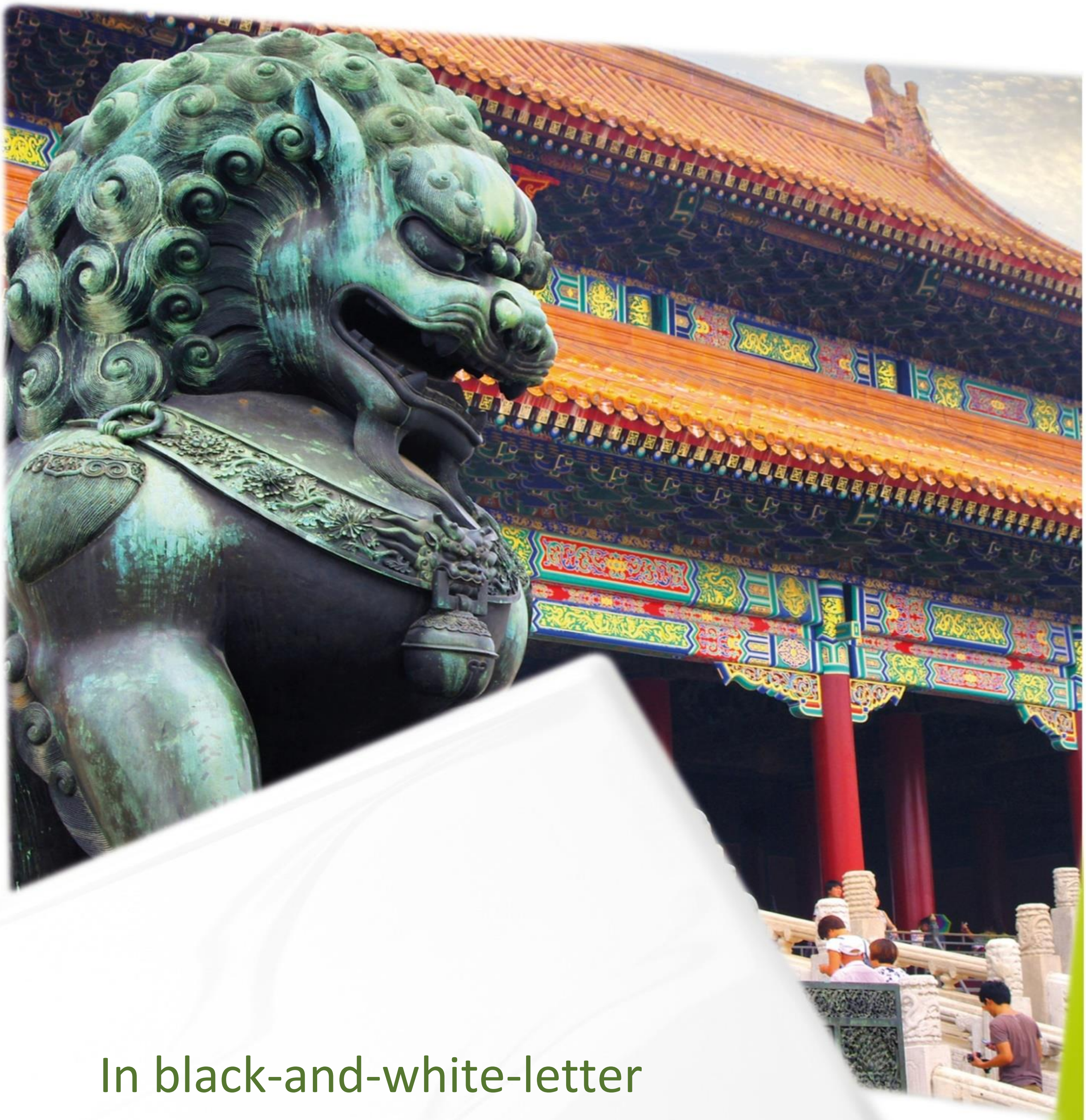

In black-and-white-letter law: China issues new Panda bond rules

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Hogan Lovells

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In a move designed to boost the issuance of Panda bonds and encourage foreign participation in the Chinese bond market, the People's Bank of China (the Chinese central bank, "**PBOC**") and the Ministry of Finance jointly issued the *Administration of Issuance of Overseas Institutional Bonds in the National Inter-bank Bond Market Interim Measures*（全国银行间债券市场境外机构债券发行管理暂行办法）which were promulgated on, and took effect on, 8 September 2018 (the "**2018 Panda Bond Measures**").

The 2018 Panda Bond Measures provide clear guidelines to overseas issuers on how to issue Renminbi ("**RMB**") bonds in China, an important step toward the opening up of the Chinese bonds market. The previous rules in this area, the *Issuance of RMB Bonds by International Development Institutions Interim Measures (2010 Revision*)（国际开发机构人民币债券发行管理暂行办法）("**2010 Panda Bond Measures**") were invalidated by the joint announcement of the PBOC, the Ministry of Finance, National Development and Reform Commission ("**NDRC**") and the China Securities Regulation Commission ("**CSRC**") (Announcement [2018] No. 15)（中国人民银行、财政部、发展改革委、中国证券监督管理委员会公告〔2018〕第15号）which was issued on, and became effective as of, 8 September 2018.

"Panda bonds" refer to bonds issued by foreign institutions incorporated outside the People's Republic of China ("**China**" or the "**PRC**") in the Chinese bond market. Panda bonds are attractive to foreign borrowers because they enable foreign borrowers to tap into an alternative source of financing for themselves and their Chinese subsidiaries, via the third largest bonds market in the world. Furthermore, Panda bonds are issued onshore and therefore are more liquid compared to RMB bonds issued offshore (known as 'dim sum' bonds), due to the much larger pool of liquidity onshore. Panda bonds are typically denominated in RMB, but may be issued in other currencies such as Special Drawing Rights of the International Monetary Fund ("**SDR**"). As of the end of September 2018, based on public sources in China, there have been 127 Panda bonds issued on the interbank market, with a value of RMB 292 billion (US$ 42.51 billion).

Panda bonds can be especially attractive for multinational manufacturing companies seeking to diversify funding sources for their subsidiaries in China beyond straight borrowing, corporate bond issuance and asset-backed securities. For example, the overseas holding company of a China manufacturer can issue Panda bonds in China which are denominated in RMB, and then on-lend the proceeds to its Chinese subsidiaries as shareholder loans on an arm's length basis. The overseas issuer can use the principal and interest payments received under the shareholder loans from its Chinese subsidiaries to fund the principal and interest payments owed to the bondholders. This structure allows overseas issuers to finance the operations of their Chinese subsidiaries without bearing any foreign currency exchange risk (as the shareholder loans are made in, and repaid in, RMB). However, it is important to avoid any mismatch in the cash flows between the holding company and its Chinese subsidiaries on the one hand and the payments due to investors in such Panda bonds on the other.

Although the 2010 Panda Bond Measures only referred to International Development Institutions ("**IDIs**")[1], other types of issuers (including sovereign entities/foreign governments, financial institutions and non-financial enterprises) have also issued Panda bonds since the launch of the Panda bonds market. The 2018 Panda Bond Measures expressly expand the scope of qualified issuers

[1] Under the 2010 Panda Bond Measures, the expression "international development institutions" referred to multilateral, bilateral and regional financial institutions for international development that are engaged in the business of making development loans and investments.

from IDIs to also include foreign governments, financial institutions and non-financial enterprises that are duly registered outside China.

Lowered requirements for foreign government and IDI issuers

The 2018 Panda Bond Measures also relax the requirements applicable to foreign governments and IDIs acting as issuers of Panda bonds, compared to the 2010 Panda Bond Measures. In particular, the 2018 Panda Bond Measures only require foreign governments and IDIs to have bond issuance experience and a sound level of solvency; compare this to the more stringent requirements they had to meet under the 2010 Panda Bond Measures set out below:

- A local credit rating of AA or higher must be provided by at least two rating agencies, one of which must be registered in China; and
- Issuers are required to possess an investment track record of more than US$1 billion worth of loans or equity investments in China.

Fewer approvals

Under the 2010 Panda Bond Measures, IDIs also had to obtain approval from the PBOC, NDRC, CSRC and the State Administration of Foreign Exchange ("**SAFE**") as well as consent from the State Council. Now, in a significant deregulation of the sector, under the 2018 Panda Bond Measures, all types of issuers (except for financial institutions – see the next paragraph) are only required to apply for registration with the National Association of Financial Market Institutional Investors ("**NAFMII**"), a self-regulating body.

Stricter criteria for overseas financial institution issuers

Overseas financial institutions, however, are subject to stricter requirements when issuing Panda bonds. In particular, they must obtain approval from the PBOC and submit the following application documents:

- Issuance application;
- Resolutions issued by the issuer's supreme organ (board of directors or shareholders' meeting) approving the issuance of the bonds;
- Prospectus;
- Financial and accounting reports for the last three years and the latest financial report (if any);
- The relevant document(s) issued by a local financial authority in the place where the issuer is located approving the applicant's participation in financial business relating to bonds issuance;
- Credit rating report and post-issuance rating arrangements (if any);
- Security agreement and explanation on the creditworthiness of the security provider (if any); and
- Legal opinion issued by legal counsel located in China and the country or region where the issuer is located.

Furthermore, overseas financial institutions wishing to issue Panda bonds have to meet certain conditions prior to carrying out bond issuance, including but not limited to the following:

(i) the actual paid-up capital of the issuer must be not less than RMB 10 billion (US$ 1.46 billion) or its equivalent in any other currency;
(ii) the issuer must have good corporate governance and adequate risk management systems in place;
(iii) the issuer must be in a sound financial condition, have sound credit standing and have made profits over the last three years;
(iv) the issuer must have relevant bonds issuance experience and good debt solvency; and

(v) the issuer must be subject to effective supervision by the local financial regulatory authority in the place where it is located.

Prior to the issuance and pricing of the Panda bonds, financial institutions have to file the offering circular, credit rating report (if any), underwriting agreement and syndicate agreement, legal opinions and other relevant final documents with the PBOC.

Requirements for foreign governments, IDIs and non-financial enterprise issuers

The 2018 Panda Bond Measures do not set out issuance conditions for foreign governments, IDIs and non-financial enterprises. Given that the PBOC has delegated rule-making powers to NAFMII, the existing rules[2] issued by NAFMII will likely apply to the issuance of Panda bonds by foreign governments, IDIs and non-financial enterprises until such time as NAFMII issues additional rules and guidelines.

Accounting principles

The 2010 Panda Bond Measures required IDI issuers to adopt the Chinese generally accepted accounting principles (GAAP) or equivalent foreign accounting standards as determined by the PRC Ministry of Finance. This requirement no longer applies under the 2018 Panda Bond Measures, as long as issuers that do not use Chinese GAAP or equivalent accounting standards explain the major differences between their accounting standards and Chinese GAAP and, if the issuers are financial institutions or non-financial enterprises, the impact that the different accounting standards may have on key financial items of their financial reports.

Applicable laws

The 2010 Panda Bond Measures required the issuance of Panda bonds and any related disputes to be governed by Chinese law. This requirement has been abolished by the 2018 Panda Bond Measures. This means that under the new Panda bond regime, overseas issuers will have the ability to choose the governing law of their Panda bonds.

Information disclosure and other requirements

The 2018 Panda Bond Measures also set out standards on disclosure of information to investors (e.g. publicly disclosed offering documentation must be in simplified Chinese or a simplified Chinese translation must be provided), registration, custody and settlement, as well as rules governing foreign exchange registration with SAFE, the opening of RMB accounts, fund transfers and investor protection requirements.

It is worthwhile mentioning that the Shenzhen and Shanghai stock exchanges are in the process of drafting their own sets of listing rules for Panda bonds.

Conclusion

The 2018 Panda Bond Measures represent a significant opportunity for those overseas corporates and financial institutions wishing to tap into the huge pool of RMB liquidity in China. The gate is somewhat higher for overseas financial institutions, but has been set at a fairly low level for non-financial institutions. Assuming NAFMII is reasonable and open-minded about registration and does not promulgate any new restrictive rules, overseas investors wishing to tap into this pool of liquidity should find it a market that is now much more easily accessible, although geopolitical trade tensions at time of writing may inevitably have an impact on appetite for raising RMB debt.

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2 Such as the *Debt Financing Instruments by Non-Financial Enterprises in the Inter-bank Bond Market Administrative Measures*（银行间债券市场非金融企业债务融资工具管理办法）and *Guidelines on Rules for the Issuance of Debt Financing Instruments of Non-Financial Enterprises in the Inter-bank Market*（银行间市场非金融企业债务融资工具发行规范指引）.

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