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Structural Arrangements for Participating into Cross-Border Lending

By Michael Mei and Kelly Xi

This article intends to introduce several arrangements in connection with how an offshore bank can, with its own foreign exchange funds, achieve participating and sharing the risk at the same time benefiting with an onshore bank from its loan project after the local bank has entered into relevant loan documents with an FIE ("Borrower").

Assignment

The onshore and offshore banks enter into an assignment agreement, pursuant to which the onshore bank assigns, entirely or partially, its rights over the borrower to the offshore bank. However, since such assignment will change the onshore foreign exchange loan to the borrower into foreign debt, such assignment will be governed by the PRC foreign debt administration system.

➢ Foreign debt registration

According to Article 40 of the Foreign Debt Administration Tentative Measures jointly promulgated by the State Development Planning Commission, the Ministry of Finance and the State Administration of Foreign Exchange ("SAFE") on 8 January 2003, when an onshore institution either borrows foreign debts or provides foreign security, in case it fails to comply with the required approval formalities or make registration in accordance with relevant rules, any foreign loan contract or security contract executed by it shall not have any legally binding effect. Therefore, although it is the Borrower rather than the onshore bank and the offshore bank who are the two parties to the assignment agreement responsible for going through such required legal formalities, such assignment may be deemed invalid due to its evasion of the PRC foreign debt administration system where the Borrower fails to go through said formalities.

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In practice, a loan agreement executed by the borrower and the lender is usually required for the purpose of foreign debt registration. A SAFE office may reject to register the foreign debt if there is only the assignment agreement. Under such scenario, the borrower will be unable to complete the relevant registration and that will finally make it impossible for the onshore and offshore banks to complete the actual assignment between them

- Notice

According to the PRC Company Law, the assignment needs to be notified to the borrower, or it will not take effect upon the borrower. Without such notice, when the onshore bank enters into bankruptcy proceedings, the offshore bank will have no right to directly make claims against the borrower and the borrower will be under no obligations to directly make payment to the offshore bank, either.

- Security

The rights under the relevant security agreements will be assigned simultaneously in case of an assignment between the onshore and offshore banks. However, in practice, it is necessary for the borrower to cooperate with the offshore bank on executing relevant agreements and going through relevant formalities (including but not limited to registration of change in mortgage and foreign security registration). Otherwise the offshore bank will be at risk of being unable to realize its secured claim.

Participation

The onshore and offshore banks enter into a participation agreement, pursuant to which the offshore bank provides the onshore bank with certain proportion of the loan amount committed to the borrower by the onshore bank and benefits from the proceeds out of such loan in proportion to its commitment to the loan amount accordingly.

- Foreign debt registration

The participation agreement is solely an arrangement between the two banks and will not take effect upon the borrower. In any case under this arrangement, the borrower only establishes the legal relationship with the onshore bank and has sole obligations to make payment to the onshore bank. Therefore, it is unnecessary for the borrower to conduct foreign debt registration with a SAFE office. The onshore bank will be solely responsible for arranging its own foreign debt as a local commercial bank.

- Bankruptcy remote

Since the participation agreement does not result in the change of the creditor, the relevant claim will not be separated from the bankruptcy risk of the onshore bank, i.e. when the onshore bank enters into bankruptcy proceedings, the claim arising from the participation into the loan by the offshore bank will not be separated from the liquidation assets of the onshore bank and the offshore bank can only claim its rights as general creditor pursuant to the participation agreement. In the meantime, in respect of the borrower, since the creditor is the onshore bank, the offshore bank will have no right to directly make claims against the borrower, either.

- Security

  Given that the creditor remains unchanged under such arrangement, the relevant security rights will not be affected, and it is unnecessary for the borrower to sign any documents with the offshore bank or go through relevant registration formalities.

Risk Participation

The onshore and offshore banks enter into a risk participation agreement, pursuant to which the onshore bank will pay certain consideration to the offshore bank while the offshore bank will pay the principal and incurred interest to the onshore bank where the borrower fails to perform its repayment obligations according to the original loan agreement. Under this arrangement, it is only the risk rather than the claim to be transferred. Therefore, it is unnecessary for the borrower to conduct foreign debt registration and there is no cashflow transfer between the two banks except for the consideration paid by the onshore bank. Since such transfer does not make any impact upon the original debt or security, for the borrower, the loan will not be changed or affected, either. However, it is noteworthy that it may be difficult for the onshore bank to achieve its commercial purpose of obtaining foreign exchange funds through this arrangement.

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