

Pitfalls and Principles of Financing Transactions in China

Vivienne Bath

Professor of Chinese and International Business Law

University of Sydney



Introduction

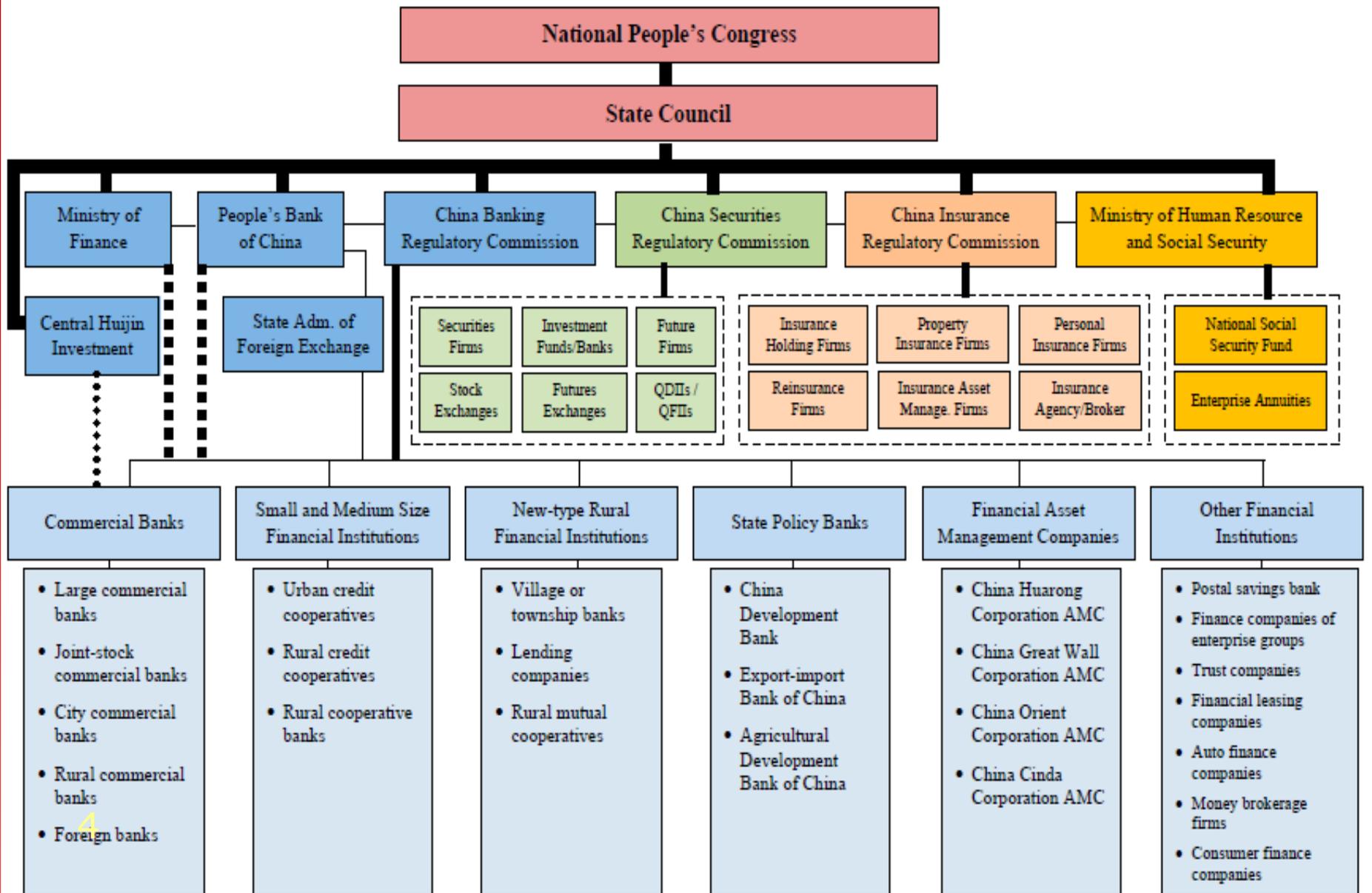


- Complexity of regulatory system
- Rigidity of rules and attempts to operate within (or outside) them
- Sometimes arbitrary nature of implementation and enforcement
- Constantly changing rules and investment/operating environment
- Examples: financing and operating through variable interest entities; bankruptcy and implications for the financiers/creditors; role of criminal law

Complexity of regulatory system

- China's commitments on services re WTO accession – opening up of financial sector – became policy requiring foreign investment in China (JV banks and WFOEs rather than branches) - but not necessarily on equal terms
- System directed towards presence: no operations in China without registration; government preference for investment; issues for cross-border service providers
- Investment/presence and operations subject to regulatory approvals
- Multiplicity of regulators and regulations
- Pitfalls: failure to understand rules and potential costs

Table 8. China: Financial System Architecture



Regulations on establishment

- WTO commitments
- *Foreign Investment Industry Catalog*
- *Administrative Regulations of the People's Republic of China on Foreign-Invested Banks, etc (2006)*
- *Measures for the Administration of Equity Investment by Overseas Financial Institutions in Chinese-Funded Financial Institutions (2003)*

Regulation – all financial institutions

- *Commercial Banking Law; Law on Administration and Supervision of Banking Industry, etc.*
- *Guidelines on the Supervision and Administration of External Audits of Banking Financial Institutions (2010)*
- *Professional Ethics Guidelines for Practitioners of Banking Financial Institutions (2010)*
- *Tentative Administrative Measures for Financing Security Companies (2010)*
- *Guidelines on the Risk Management of Bank Account Interest Rates of Commercial Banks (2009)*
- *Guidelines on Liquidity Risk Management of Commercial Banks (2009)*
- *Guidelines for the Reputation Risk Management of Commercial Banks (2009); Guidelines for the Information Technology Risk Management of Commercial Banks, etc*

Regulation – specific regulations

- *Notice of the Shanghai Bureau of the China Banking Regulatory Commission on the Risk Reminder of Further Strengthening Employee Management of Foreign-funded Banks (2012)*
- *Notice of the Shanghai Dispatched Office of the China Banking Regulatory Commission on Further Strengthening the Liquidity Management of the Branches of Foreign Banks in Shanghai (2011)*
- *Measures for the Implementation of Administrative Licensing of Foreign-Invested Financial Institutions by the China Banking Regulatory Commission*

Rigidity of system

- Examples : Leasing and financing companies – limitations; Controls over lending and loans; Registration and approval of “foreign” debt; Currency controls; Fund managers; state-owned banks lending to large SOEs
- Consequences: growth of “gray” or “informal” financial sector; structures designed to avoid limitations.
- Getting around the rules? If everyone does it, is it legal? Variable interest entities and off-shore structures; Wu Ying.

Pitfalls – implementation and enforcement

- Differential enforcement? Emphasis on regulatory compliance v implementation of principles
- Example – bankruptcy. Who goes into formal bankruptcy? Who wins and who loses?
- Connections, the role of government, employees and related problems – information (state secrets, business secrets or no-one's secrets?)
- Criminal law and politics – when do connections become bribes? Who is prosecuted and why?

Changing environment

- Constant change – policy and regulation (encourage the private sector; increase foreign access to bond markets; increase convertibility of RMB)
- Risks: The informal financial sector and the case of Wu Ying
- Changes in policy not necessarily liberalizing - world-class banking and financial system v vested interests (CCP; SOEs; government)