BELT AND ROAD PRACTICAL GUIDE

HOW TO FINANCE THE BELT AND ROAD

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INTRODUCTION

Since the commencement of the "Belt and Road" initiative (BRI), numerous domestic and foreign banks have provided loan financing support for BRI projects. Iconic projects such as the Jakarta-Bandung High-Speed Railway in Indonesia, the China-Laos Railway, the Port of Chancay in Peru, and the wind power project in Bukhara, Uzbekistan, have received bank financing support and are either completed or nearing completion.

The success of these projects is in large part due to thorough assessments of the host countries and the projects themselves, and properly planned financing structures. In this guide, we have prepared 10 practical tips for financing BRI projects, and explore how to understand and mitigate related financing risks. We will consider due diligence, documentation, credit support, financing structures, credit insurance, derivative instruments, and green finance.

CONTENTS

04 Tip one: Conduct Due Diligence Before the Project Begins, to Understand the Conditions of the Host Country and the Legal and Regulatory Landscape

06 Tip two: How Do Contractors Participate in Project Financing?

08 Tip three: Preparations for a Rainy Day - Choosing the Appropriate Governing Law and Dispute Resolution Mechanism in the Loan Documents

10 Tip four: Signing Loan Documents - Simple Yet Complex

12 Tip five: Taking Security is No Small Matter

16 Tip six: Another Credit Support Option - Keepwell Deeds

18 Tip seven: Chinese Banks “Going Global” and Enhancing Financing Channels for the BRI

19 Tip eight: Using Insurance and other Credit Tools to Mitigate Risks Associated with Investing in Emerging Markets

20 Tip nine: Using Financial Derivatives to Control Interest Rate and Exchange Rate Risks

22 Tip ten: Focus on Green Financing Opportunities

TIP1: CONDUCT DUE DILIGENCE BEFORE THE PROJECT BEGINS, TO UNDERSTAND THE CONDITIONS OF THE HOST COUNTRY AND THE LEGAL AND REGULATORY LANDSCAPE

In BRI projects, understanding the specific conditions of the host country is extremely important. Thorough due diligence not only helps enterprises and banks avoid potential risks but can also ensure the smooth implementation of projects. Therefore, prior to the initiation of a project, investors should conduct due diligence on the legal and regulatory framework relating to foreign investment, franchising, project establishment, permits, bidding processes, and environmental assessments in the host country.

Preliminary Research

It is essential to understand the economic, political, and cultural context of the host country, and a starting point for this is using publicly available information including government reports, and industry studies.

In one actual case, a state-owned enterprise invested in a power plant in a particular country, but did not adequately understand the risk of foreign exchange reserve shortages in that country. Without sufficient US dollar reserves, the project's earnings were not allowed to be distributed to foreign shareholders, making it difficult for the enterprise to transfer its earnings abroad and to service its debt. Cases like this are not uncommon in BRI investments. Therefore, prior to the start of any project, it is crucial to understand the legal and regulatory environment and policies of the host country in order to mitigate risks and avoid financial losses.

Legal Framework Analysis

Firstly, it is important to understand the host country's legal system, including the basic framework of laws, such as the constitution, sources of law, and administrative law. Secondly, it is advisable to examine industry-specific regulations, analysing the legal framework for the relevant sectors and understanding the regulatory bodies and their responsibilities. Furthermore, it is necessary to be aware of any applicable international treaties and agreements by examining the international legal obligations that affect the host country. As of 2023, there are nearly 90 Bilateral Investment Treaties in force between China and BRI nations as well as several Multilateral Investment Treaties. These international treaties provide many useful protections to overseas investors and their projects in the host country.

On-site Inspection

If possible, investors should conduct an inspection of the project site and engage with local government officials, business partners, and community members to gather first-hand information.

Engage a Lead Legal Advisor

When Chinese enterprises invest abroad, it is best to engage lead legal advisors with the background and experience in advising Chinese investors on these kinds of projects. These advisors should not only possess an international perspective and extensive experience with cross-border projects, but they should also have a deep understanding of the operational methods and decision-making processes of Chinese businesses. They can better understand the particular challenges that Chinese enterprises face when investing overseas. Furthermore, they can serve as a bridge between Chinese enterprises and local law firms, facilitating communication and ensuring that the legal services provided align with the enterprise's strategic objectives.

There are some countries with incomplete legal frameworks or where the local lawyers may have limited experience in similar projects. In these situations, legal advisors with experience in advising Chinese companies and banks on cross-border financings can provide essential support, helping projects to progress smoothly while mitigating potential legal risks. Project financing legal advisors should possess a fundamental understanding of the relevant industries, the due diligence structures and documentation classifications. For example, in the initial phases of the financing of a power station, they can prepare a comprehensive due diligence checklist and design targeted due diligence plans, whether it is for a hydro-electric, wind, nuclear, or thermal power station.

The lead legal advisors could help to review the due diligence reports prepared by local lawyers and, in some cases, conduct independent research into local laws to check the report's contents. This enables them to identify any errors or inadequacies, and prompt local lawyers to improve the report's findings to identify and mitigate risks to the client.

Bank financiers on BRI projects also need to conduct certain due diligence for the purposes of the financing. This will often cover the legal system of the host country, the feasibility of dividend distributions or loan repayments by the project company, and whether withholding tax is imposed. They should also ask the borrower to provide a comprehensive due diligence report before loan disbursement.

TIP2: HOW DO CONTRACTORS PARTICIPATE IN PROJECT FINANCING?

Financial institutions are not the only financiers involved in project financing - project contractors can also play a key role.

Contractors may assist through deferred payment financing. For example, contractors may not require the owner to make interim payments strictly in accordance with the terms of an EPC contract, instead agreeing with the owner to postpone payments for the contract work and allowing the owner to pay later. Contractors can further seek accounts receivable financing from lenders based on the deferred payments.

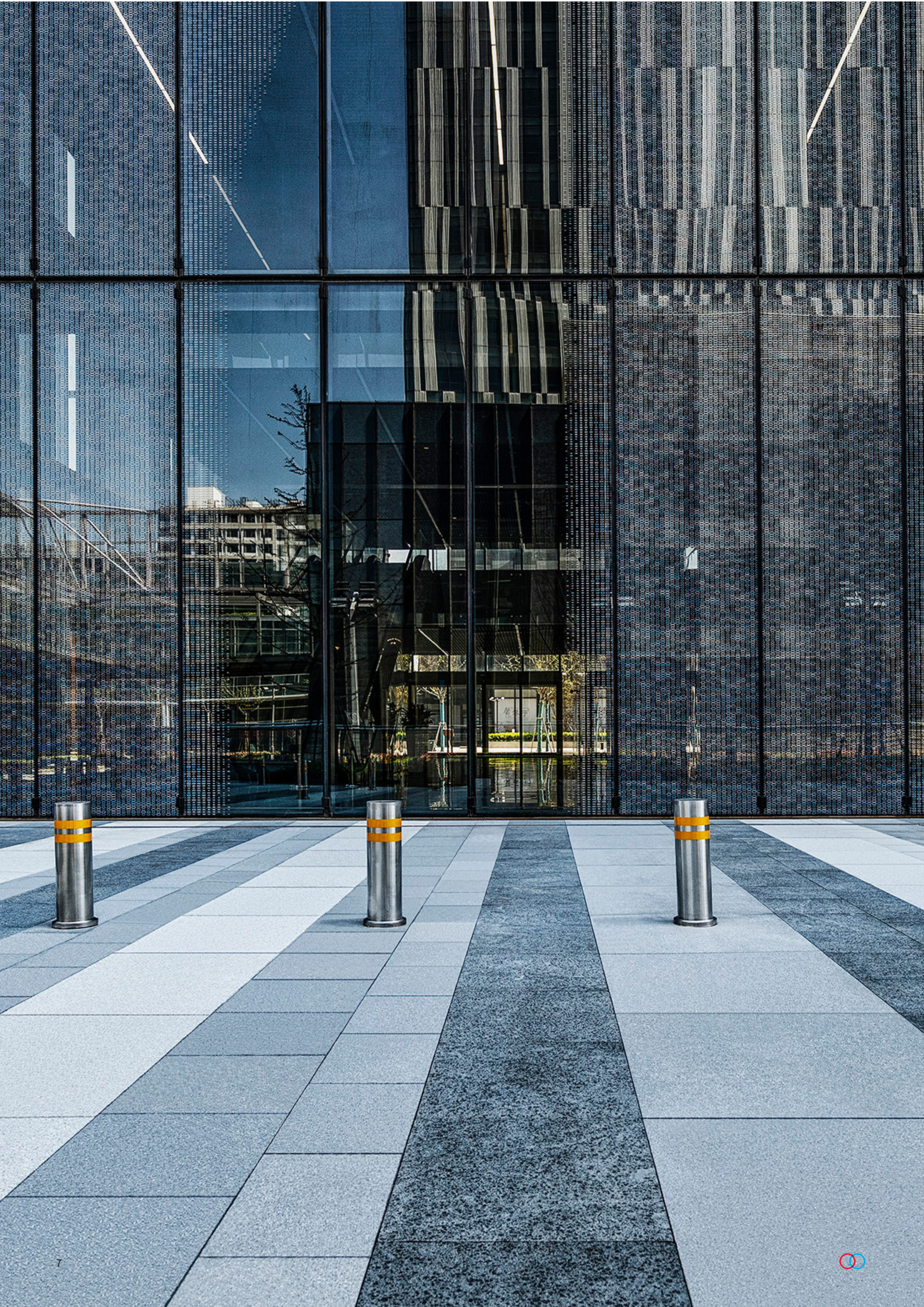
Deferred payment financing is becoming increasingly popular in project financing. This can help to:

- enhance the contractor's competitiveness in international engineering projects. In complex international situations, especially when there is host country risk or when project owners have limited financing capabilities, the ability to provide financial support for projects is a crucial factor in winning bids.

- promote project progress. Compared to the time-consuming bank export buyer credits, deferred payment financing allows construction to begin immediately after the signing of the EPC contract and the deferred payment financing agreement.

- generate additional revenue. The deferred payment interest rate is usually higher than bank financing rates, and contractors can benefit from this additional revenue.

The following points should be considered when structuring contractor project financing: What term arrangements should be used for the project financing? How does the project financing cycle align with the project repayment cycle and cash flow? How do parties choose the type of collateral and security agreements? How will financial institutions benefit from the collateral? What are the security enforcement requirements in relation to future cash flow recovery from the project? Can the receivables be transferred or factored in the future? What are the relevant foreign exchange cross-border fund flow mechanisms? How do they manage relationships among contractors, shareholders, and other creditors? These issues should be considered and addressed in advance with the benefit of proper legal advice.



TIP3: PREPARATIONS FOR A RAINY DAY – CHOOSING THE APPROPRIATE GOVERNING LAW AND DISPUTE RESOLUTION MECHANISM IN THE LOAN DOCUMENTS

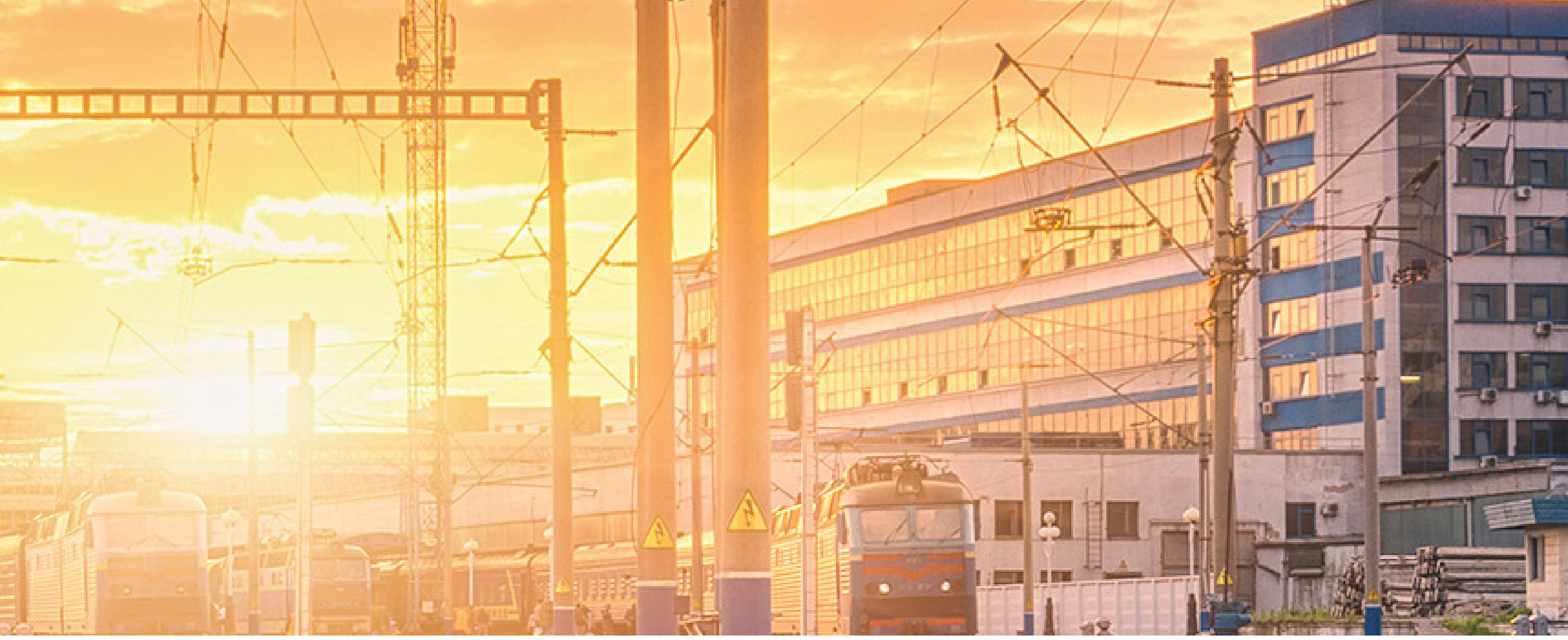
Financings for projects under the BRI often span long periods and are fraught with various risks and uncertainties, such as projects not being completed on time, the income generated during the project cycle not covering debt service requirements, or significant changes in the political environment or economic policies of the host country. The choice of governing law and dispute resolution mechanism in the loan documents is crucial, as all parties will want to resolve disputes in an appropriate manner. A poor choice of governing law and/or dispute resolution mechanisms can lead to additional time and costs for the parties involved, as well as difficulties in enforcing rights. The method of dispute resolution should be determined at the time the loan documents are signed. For example, if it is not agreed to resolve disputes through arbitration in the loan documents, arbitration will not be an option when a dispute arises later unless both parties agree otherwise.

Governing Law

The governing law of the loan documents is the substantive law applicable to their interpretation and plays a critical role in defining the rights and obligations of the parties involved.

Currently, most loan documents used in the international loan markets use either New York or English law because of their international recognition and substantial body of case law. If the project financing is in the Asia-Pacific region, English law and Hong Kong[1] law (which was originally based on English law) are commonly chosen as the governing law for loan documents. In BRI projects involving Chinese banks and enterprises, Hong Kong law has several advantages as the governing law for loan documents.

[1] For the purpose of this guide, "Hong Kong" means Hong Kong Special Administrative Region of the People's Republic of China.



Advantages of Hong Kong Law as Governing Law:

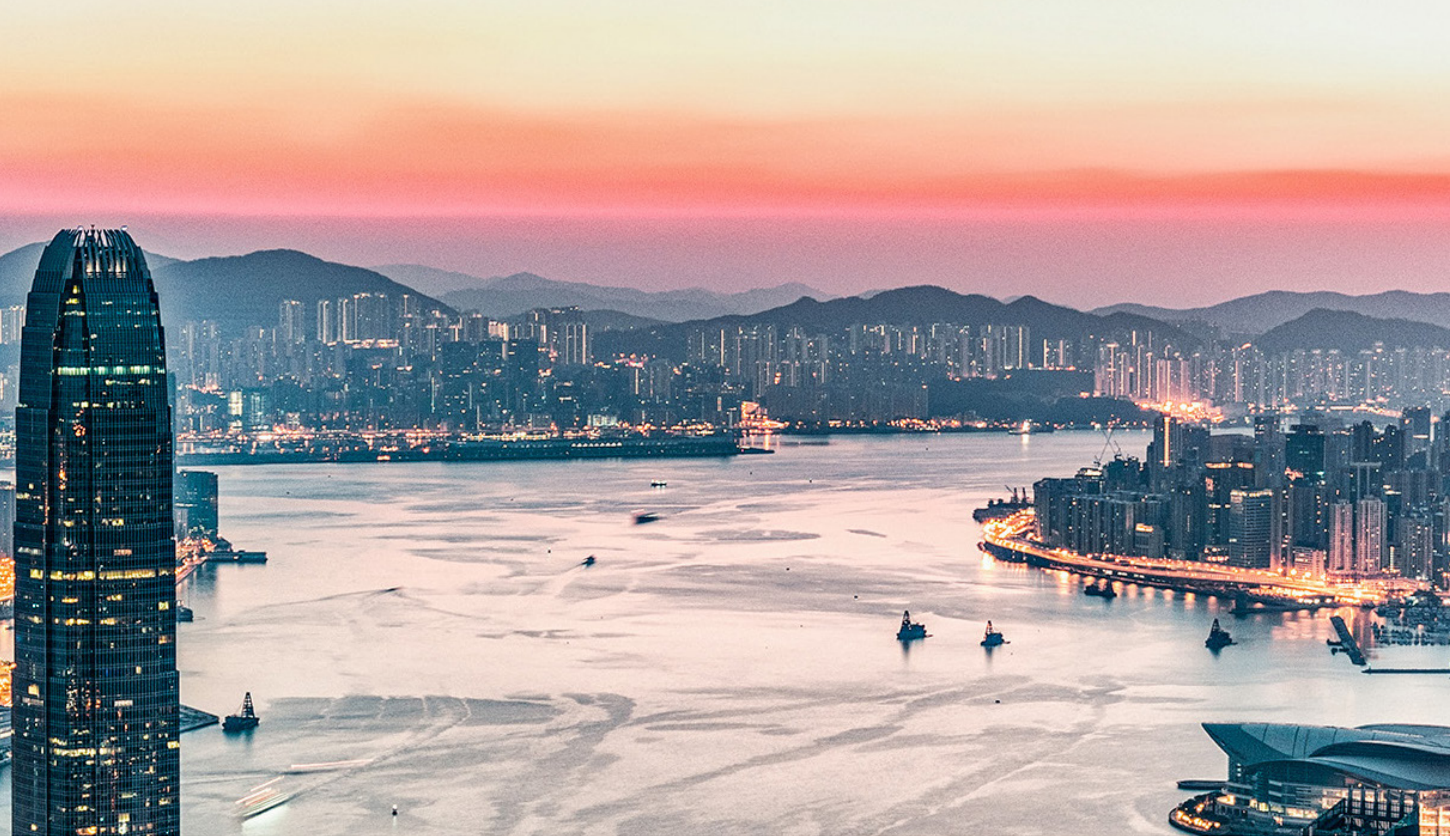
- Hong Kong, like a number of other jurisdictions in the region, such as Singapore, Malaysia, India, and Australia, operates under a common law system.
- Unlike other common law jurisdictions, Hong Kong is the only jurisdiction that uses both Chinese and English in its laws, with both languages being official. The statutory laws of Hong Kong all have bilingual versions, which hold equal legal status. Courts at all levels in Hong Kong can conduct litigation in either English or Chinese, and there are many legal practitioners with strong bilingual capabilities.
- There are standard loan market documents governed by Hong Kong law published by the Asia Pacific Loan Market Association (APLMA). They are available in English, and there is also a Chinese version of the facility agreement available for reference.
- If Hong Kong is chosen as the dispute resolution location, selecting Hong Kong law as the governing law can help to expedite court or arbitration proceedings. This is because although the governing law specified in the documents does not necessarily align with the location of the dispute resolution, courts or arbitral tribunals may require the parties to provide expert opinions on foreign law principles if they are unfamiliar with the relevant foreign governing law, which could delay or increase the costs of the dispute resolution.

Furthermore, when selecting the governing law of the documentation, especially security documents, it is necessary to consider whether there are mandatory laws for the location of the assets or other factors that necessitate choosing the law of the asset's location. In a project financing, the governing laws of the loan agreement and various security documents need not be the same.

Dispute Resolution Mechanism

The dispute resolution clause in the documentation stipulates the procedures and forum for resolving disputes, which normally includes courts or arbitration. In the loan market, it is common for loan documents to choose courts for the resolution of disputes. Arbitration also has its advantages, including the confidentiality of the arbitration process and award, the ability for both parties to select arbitrators based on industry expertise, and the enforceability of arbitration awards in other states under the Convention on the Recognition and Enforcement of Foreign Arbitral Awards (also known as the "New York Convention").

One significant advantage of choosing Hong Kong courts for dispute resolution (as opposed to courts in other foreign countries) is that the judgments of the Hong Kong courts can be enforced in mainland China under the Arrangement on Reciprocal Recognition and Enforcement of Judgments in Civil and Commercial Matters by the Courts of the Mainland and of the Hong Kong Special Administrative Region.



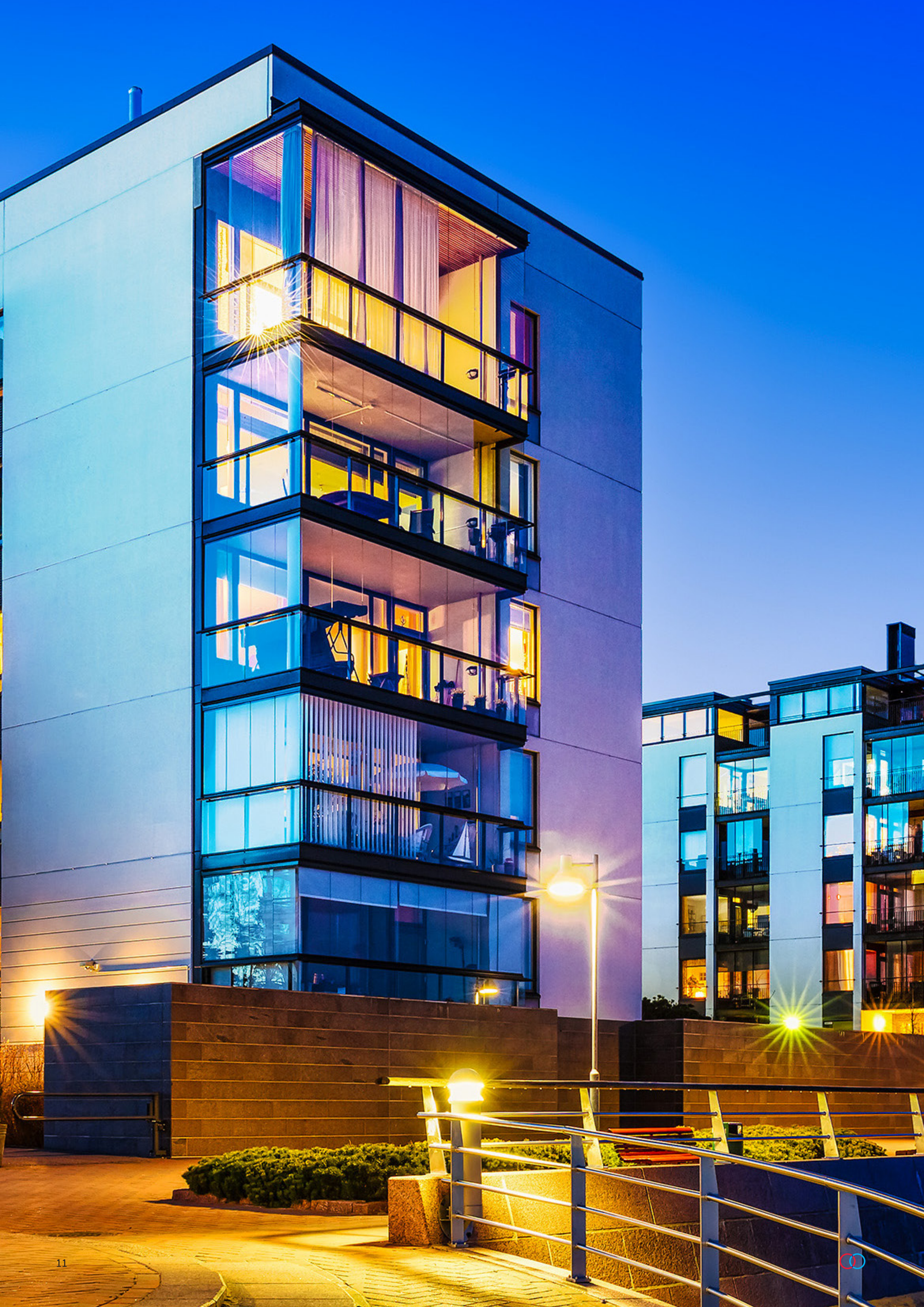
TIP4: SIGNING LOAN DOCUMENTS- SIMPLE YET COMPLEX

Signing may sound simple — after all, it involves just putting pen to paper. However, in practice it is not so straightforward. In BRI projects where parties may be located in multiple locations, arranging for all of the signatories to meet in one place to sign the loan documents is often not feasible.

If the governing law of the loan documents is Hong Kong law, the contracting parties may opt to do a "virtual signing" whereby authorised signatories of each party sign the documents and exchange the signed documents via email. Whether the documents are a normal contract or a deed, a prudent approach is for one party's lawyer to send written signing instructions by email to all parties, who then print the documents, sign them, and return the completed signature pages along with the complete execution version of the document in a single email to the lawyer who issued the signing instructions. The lawyer can then compile all the signed pages into a complete signed document. This process aligns with one of the options provided in the operational guidelines issued by the Law Society of England and Wales.

The contracting parties must also follow the legal requirements of the jurisdictions of the signatories, the signing location, and the jurisdiction where the contract is executed. For instance, for a company established in Hong Kong, it may use its common seal to execute loan documents, although this is not mandatory. If it chooses to use the common seal, the execution must comply with the company's articles of association regarding the use of the common seal. If the documents to be executed are deeds, and the Hong Kong company does not use the common seal, it must adhere to the Hong Kong Companies Ordinance (Cap. 622), which requires that the document be signed by either a sole director or one director along with the company secretary. The document should indicate that it is executed as a deed by the relevant company, and be delivered as a deed.

Unlike "virtual signing", electronic signing (signing documents in a digital form) is not widely accepted in the Asia-Pacific region. For example, under Hong Kong law, although the Electronic Transactions Ordinance (Cap. 553) regulates electronic signing, there remains uncertainty about whether deeds can be executed through electronic signing.



TIP5: TAKING SECURITY IS NO SMALL MATTER

Project financing is often "limited recourse". This means that in the event of a loan default, the lender can only seek recourse against the project's income and assets, and cannot pursue the project sponsor or the borrower's parent company. There are exceptions to "limited recourse", such as in greenfield development projects where the sponsor or parent company may need to provide credit support before the project is completed.

Because so many project financings are "limited recourse," lenders for BRI projects need to better understand how to take security properly on project income and assets. This is crucial for ensuring that in the event of a loan default or the borrower becoming insolvent, the lender can obtain priority over the borrower's project income and assets.

To facilitate understanding of the common types of collateral and how to take security in different jurisdictions, we set out below a brief introduction to taking security in certain "Belt and Road" countries[2] :

[2] The contents of the table relating to Singapore, Indonesia, Vietnam and Malaysia are summarised based on our observations and deal experience and are subject to the local law and local counsel's advice. Please refer to our publication "A Guide to Taking Security in Asia" for more details. (https://www.kwm.com/au/en/insights/latest-thinking/publication/a-guide-to-taking-security-in-asia.html).

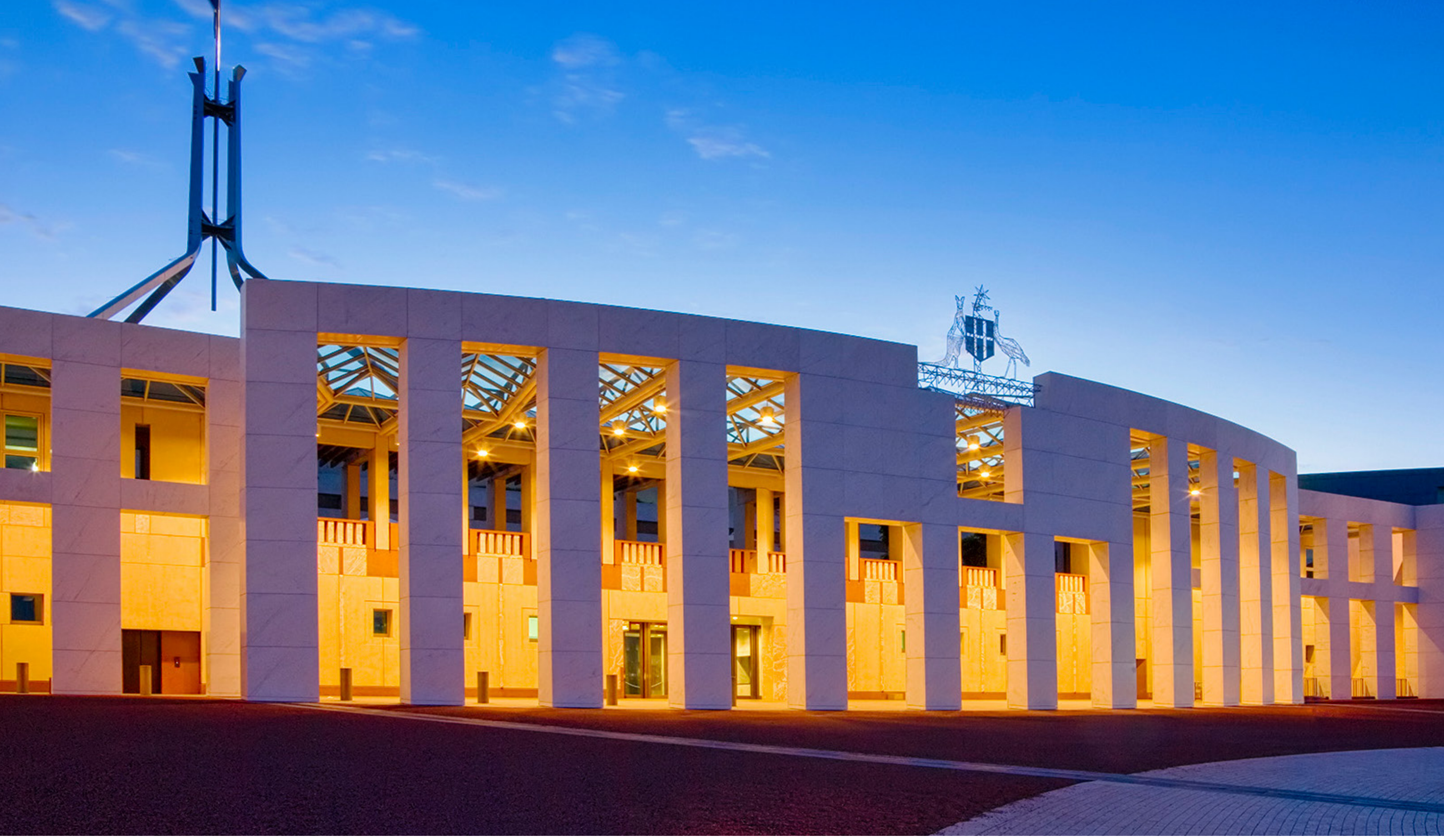
Hong Kong	• **Types of Security Available** Under Hong Kong law, security can be taken through mortgages, charges, or pledges for most assets, including real estate, ships, aircraft, equity, contractual rights, machinery, bank accounts, and intellectual property. • **Is Registration Required for Security Interests?** For companies established in Hong Kong or for foreign companies registered as "non-Hong Kong companies," details of certain types of security specified under the Hong Kong Companies Ordinance (Cap. 622) must be submitted to the Hong Kong Companies Registry for registration within one month of their creation. This includes most kinds of security commonly taken in project financings. Additionally, security over certain assets classes requires registration with the relevant registries; for example, a mortgage over real estate must be registered with the Hong Kong Land Registry. • **Is Notarisation Required for Security Documents?** No notarisation is required. • **Is Stamp Duty Payable?** Generally, the creation of security does not require the payment of stamp duty. However, enforcing a security interest may require stamp duty to be paid; for example, transfers of equity or real estate may incur stamp duty. • **Can Foreign Lenders Obtain and Enforce Security?** Generally, this is possible. However, operating a loan business in Hong Kong requires the lender to obtain a "money lender" license unless there is an applicable exemption.
Mainland China	• **Types of Security Available** Under Chinese law, security can generally be created through mortgages or pledges, including over real estate, ships, aircraft, equity, accounts receivable, machinery and equipment, intellectual property, etc. Compared to Hong Kong law, it is harder to take security over contractual rights and bank accounts, and the scope for floating charges is narrower. The creation of security over contractual rights is generally limited to accounts receivable and when taking security over bank accounts, the deposits must be “specified.” Floating charges are limited to charges over production equipment, raw materials, semi-finished and finished products. • **Is Registration Required for Security Interests?** Most security interests need to be registered. Mainland China does not have a unified security registration authority, so parties will need to pay attention to the registration requirements relevant to the particular asset class. For example, equity pledges of non-listed companies need to be registered with the State Administration for Market Regulation, while equity pledges of listed companies need to be registered with the China Securities Depository and Clearing Corporation Limited. If cross-border security is taken, the relevant registration requirements of the State Administration of Foreign Exchange should also be complied with. • **Is Notarisation Required for Security Documents?** Generally, security documents under Chinese law do not need to be notarised. However, if the security provider is established overseas, foreign exchange regulators or local registration agencies may require notarisation of the overseas security provider’s articles of association and authorisation documents. • **Is Stamp Duty Payable?** The creation of security generally does not require stamp duty to be paid. When enforcing security over certain asset classes (such as equity or real estate), stamp duty may be payable. • **Can Foreign Lenders Obtain and Enforce Security?** There are generally no legal restrictions, but parties should consider the aforementioned requirements from the State Administration of Foreign Exchange regarding cross-border security registration and some local registration agencies may have special requirements for overseas security providers.

Singapore	• **Types of Security Available** Under Singapore law, security can generally be created over most asset classes through mortgages, charges, or pledges, including real estate, ships, aircraft, equity, contractual rights, machinery and equipment, bank accounts, intellectual property, etc. • **Is Registration Required for Security Interests?** Companies incorporated or registered in Singapore must file a registration in respect of any security specified under the Singapore Companies Act within 30 days after the creation (if the security documents are signed in Singapore) or within 37 days (if the security documents are signed outside Singapore) with the Accounting and Corporate Regulatory Authority (ACRA) in Singapore. Generally, most types of security interests commonly taken in loan projects will be submitted for registration. Additionally, security over specific asset classes may also need to be submitted for registration with the relevant registration authority. For example, real estate security should be registered with the Singapore Land Authority. • **Is Notarisation Required for Security Documents?** Not required. • **Is Stamp Duty Payable?** Security over real estate and equity will require payment of an ad valorem duty not exceeding 500 Singapore dollars. • **Can Foreign Lenders Obtain and Enforce Security?** Generally, there are no restrictions. It is important to note that lending operations in Singapore require a “money lender” license unless there is an applicable exemption.
Indonesia	• **Types of Security Available** Under Indonesian law, security interests can be created through mortgages (*hak tanggungan*), fiduciary guarantees (*jaminan fidusia*), pledges (*gadai*), movable mortgages (*hypothec*), or warehouse receipts (*resi gudang*), covering real estate, ships, equity, accounts receivable, machinery and equipment, bank accounts, intellectual property, etc. • **Is Registration Required for Security Interests?** Security documents have different registration requirements depending on the type of security. For instance, fiduciary guarantees must be registered with the Fiduciary Registration Office (*Kantor Pendaftaran Fidusia*), and mortgages must be registered with the relevant land office (*kantor pertanahan*). • **Is Notarisation Required for Security Documents?** Generally, security documents do not need notarisation; however, fiduciary guarantee agreements must be notarised in Indonesian. It is recommended to sign security documents such as pledges and warehouse receipts before a notary in Indonesia. If a power of attorney signed abroad is to be used in Indonesia, it must be notarised and legally certified by the relevant Indonesian embassy. • **Is Stamp Duty Payable?** Security documents require a payment of IDR 10,000 (less than USD 1) in stamp duty. • **Can Foreign Lenders Obtain and Enforce Security?** There are generally no restrictions.

Vietnam	• **Types of Security Available** Under Vietnamese law, security can generally be created over most assets through mortgages or pledges, including real estate, ships, aircraft, securities, accounts receivable, or machinery and equipment. • **Is Registration Required for Security Interests?** Different registration requirements apply depending on the relevant asset class. For example, security over land use rights, and mortgages on aircraft and ships must be registered with the relevant registration authority, while security over assets pledged and stored with Vietnam Securities Depository (VSD) must be registered at VSD. Some other security interests are not mandatory but can be registered at the request of the parties involved. • **Is Notarisation Required for Security Documents?** Mortgages on land use rights or other real estate must be notarised at the notary office in the province or city where the assets are located. Other types of security documents do not need notarisation. • **Is Stamp Duty Payable?** Not required. • **Can Foreign Lenders Obtain and Enforce Security?** With the exception of land use rights and immovable assets, foreign lenders can enforce security over most assets. It should be noted that foreign lenders' lending activities are regulated in Vietnam.
Malaysia	• **Types of Security Available** Under Malaysian law, security can be taken over most assets through mortgages, debentures, pledges, liens, or assignments, inlcuding real estate, ships, aircraft, shares, bank accounts, rights under contracts, or machinery and equipment. • **Is Registration Required for Security?** Security granted by companies incorporated under the Companies Act 2016 must be registered with the Companies Commission of Malaysia (CCM) within 30 days of creation. Security granted by companies registered under the Labuan Companies Act 1990 must be registered within one month of the creation with the Labuan Financial Services Authority (LFSA). Security interests over Malaysian real estate, aircraft, and motor vehicles must be registered with the relevant registries in Malaysia. • **Is Notarization Required for Guarantee Documents?** Not required. However, note that any power of attorney in the security document may require to be registered in the High Court of Malaysia. • **Is Stamp Duty Payable?** Stamp duty must be paid on the main security documents at the rate of 0.5% of the principal amount of the relevant loan. If the loan currency is foreign, the maximum stamp duty amount is RM 2,000, approximately USD 480. Stamp duty of RM 10 (approximately USD 2.4) is payable in respect of each secondary security document. • **Can Foreign Lenders Obtain and Execute Guarantees?** Generally, foreign lenders can take and enforce security in Malaysia. However, it is important to note that foreign lenders may be subject to some regulatory hurdles, such as restrictions on real estate ownership and foreign equity ownership. Additionally, Malaysian companies borrowing from foreign lenders or Malaysian companies granting security to foreign mortgagees must comply with the foreign exchange management rules and requirements of the Bank Negara Malaysia.

Given the different requirements across jurisdictions, lenders should consider the differences and advantages of the different laws and take advice from legal advisors regarding the project financing structure.

Common security enforcement methods include auction and public or private sales. There are many considerations, including the type of collateral, the legal requirements of the local jurisdiction, bankruptcy procedures, and the time and cost of enforcement.



TIP6: ANOTHER CREDIT SUPPORT OPTION - KEEPWELL DEEDS[3]

A keepwell deed is typically signed by a parent company to provide credit support for its subsidiaries. Under a keepwell deed, the keepwell provider is usually required to maintain the net assets of the offshore debtor above a certain level, to provide liquidity for the debtor's repayments, and to retain control and ownership over the debtor.

Unlike asset security and guarantees provided by Chinese parent companies for their offshore subsidiaries, a keepwell deed does not require registration with the State Administration of Foreign Exchange. However, there are several key differences between keepwell deeds and guarantees from the perspective of creditors:

[3] Please refer to these articles for more details and analysis: (i) *Are Keepwell Deeds Keeping Well?* (https://www.kwm.com/hk/en/insights/latest-thinking/are-keepwell-deeds-keeping-well.html) and (ii) *From Gloom to Bloom: Peking Founder Ruling On Keepwell Deeds Overturned on Appeal* (https://www.kwm.com/hk/en/insights/latest-thinking/keepwell-in-connection-with-the-court-of-appeal-judgment-on-the-peking-founder-case.html)

	Guarantee	Keepwell Deed
Obligations of the Parent Company	Ensure that the debtor repays the relevant debts on time; otherwise, the guarantor will fulfill the obligations to the creditor	Facilitate the debtor's ability to repay debts by providing loans, investing in the debtor, purchasing equity, etc.
Trigger Points for Obligations	The debtor fails to repay the relevant debts	Certain liquidity and solvency events of the debtor
Creditor's Right of Recourse	Direct debt recovery rights against the guarantor	Claims for losses incurred due to the failure of the keepwell provider to fulfill its obligations under the keepwell deed
Foreign Exchange Registration in China	Registration of guarantees from mainland Chinese entities for offshore debt is required with the State Administration of Foreign Exchange in China	Not required
Additional Conditions	None	Obligations of the keepwell provider may be subject to obtaining government approvals for remitting funds out of China

Lenders are advised to consider recent Hong Kong court cases regarding the enforceability of keepwell deeds.

In the Peking University Founder case[4] and the Tsinghua Unigroup case[5], the Hong Kong Court of First Instance held that the keepwell deeds governed by English law were binding and enforceable contracts. However, the remedies available to the beneficiaries of the keepwell deeds were limited by a clause requiring the keepwell provider to use its "best efforts" to obtain approval from the relevant government authorities to transfer funds out of China. The court further reasoned that if the keepwell provider's obligations were triggered only after its entering a restructuring process, it would be practically impossible to obtain the Chinese government's approval for remittances abroad. Therefore, even if the keepwell provider made no effort to obtain such approval, it would not be in breach of its "best efforts" obligation. The first instance decision was overturned by the Hong Kong Court of Appeal in the Peking University Founder case[6] . The appellate court found that the original trial court failed to consider that Peking University Founder (the keepwell provider) could fulfil its liquidity support commitments under the keepwell deed in multiple ways, and not all of these ways would require government approval. The appellate court determined that the keepwell deed explicitly stated that Peking University Founder may, but not must, obtain government approval to perform its obligations. Thus, Peking University Founder could not rely on the clause requiring "best efforts" to obtain government approval to avoid fulfilling its obligations.
These cases are all in all very favourable news for lenders benefiting from keepwell deeds. However, the Peking University Founder case is subject to appeal to the Hong Kong Court of Final Appeal, so the outcome of the case is subject to change.

Additionally, the enforcement of Hong Kong court rulings regarding keepwell deeds in mainland China is also a matter of ongoing concern for foreign lenders.

[4] [2023] HKCFI 1350. Judgment is available at: https://legalref.judiciary.hk/lrs/common/search/search_result_detail_frame.jsp?DIS=152651&QS=%2B&TP=JU
[5] [2023] HKCFI 1572. Judgment is available at: https://legalref.judiciary.hk/lrs/common/search/search_result_detail_frame.jsp?DIS=153235&QS=%24%28Tsinghua%29&TP=JU
[6] [2024] HKCA 445. Judgment is available at:
https://legalref.judiciary.hk/lrs/common/search/search_result_detail_frame.jsp?DIS=159968&QS=%28on%2Bappeal%2Bfrom%2BHCA%7C%E5%8E%9F%E9%AB%98%E9%99%A2%E6%B0%91%E4%BA%8B%E8%A8%B4%E8%A8%9F%7C%E5%8E%9F%E9%AB%98%E7%AD%89%E6%B3%95%E9%99%A2%28%E5%8E%9F%E8%A8%9F%E6%B3%95%E5%BA%AD%29%E6%B0%91%E4%BA%8B%E8%A8%B4%E8%A8%9F%29&TP=JU

TIP7: CHINESE BANKS "GOING GLOBAL" AND ENHANCING FINANCING CHANNELS FOR THE BRI

In the early stages of the BRI, China's policy banks provided significant support for related loan financing needs. Chinese commercial banks can also provide financing support through their overseas subsidiaries and branches. In contrast, the domestic operations of Chinese commercial banks could only extend loans to overseas entities via free trade branches or offshore banking units. At the beginning of 2022, the People's Bank of China and the State Administration of Foreign Exchange jointly issued the "Notice on Offshore Lending Business of Banking Financial Institutions" (Yin Fa [2022] No. 27) (PBOC Notice 27), which considerably broadened the range of domestic banks that are eligible to engage in overseas loan business. Chinese licensed banks capable of conducting international settlement business may engage in offshore lending in renminbi or foreign currencies within their approved operational scope and up to the prescribed quota on overseas loan balances.

The participation of eligible domestic Chinese commercial banks in overseas loan business can diversify available financing channels in the overseas loan market, especially in Hong Kong. If a project loan involves both overseas and domestic banks (including syndicated loans), it is important to note the following when structuring the financing:

- Any guarantees provided by domestic guarantors to the participating domestic banks for all or part of the overseas loans do not constitute domestic guarantees for foreign loans.
- Cross-border loans extended by domestic banks to overseas borrowers do not qualify as "foreign debt" as defined in the "Administrative Measures for the Review and Registration of Enterprises' Medium and Long-Term Foreign Debt" (National Development and Reform Commission Order [2023] No. 56) (Document No. 56) (also known as "NDRC Order 56"), and thus do not require review and registration under Document No. 56.

Therefore, in syndicated loans led by overseas banks, increased participation from domestic banks can enlarge the financing pool. However, it is essential to carefully consider the relevant regulatory requirements when structuring the financing, including the proper handling of any domestic guarantee registration and the applicability of NDRC Order 56.

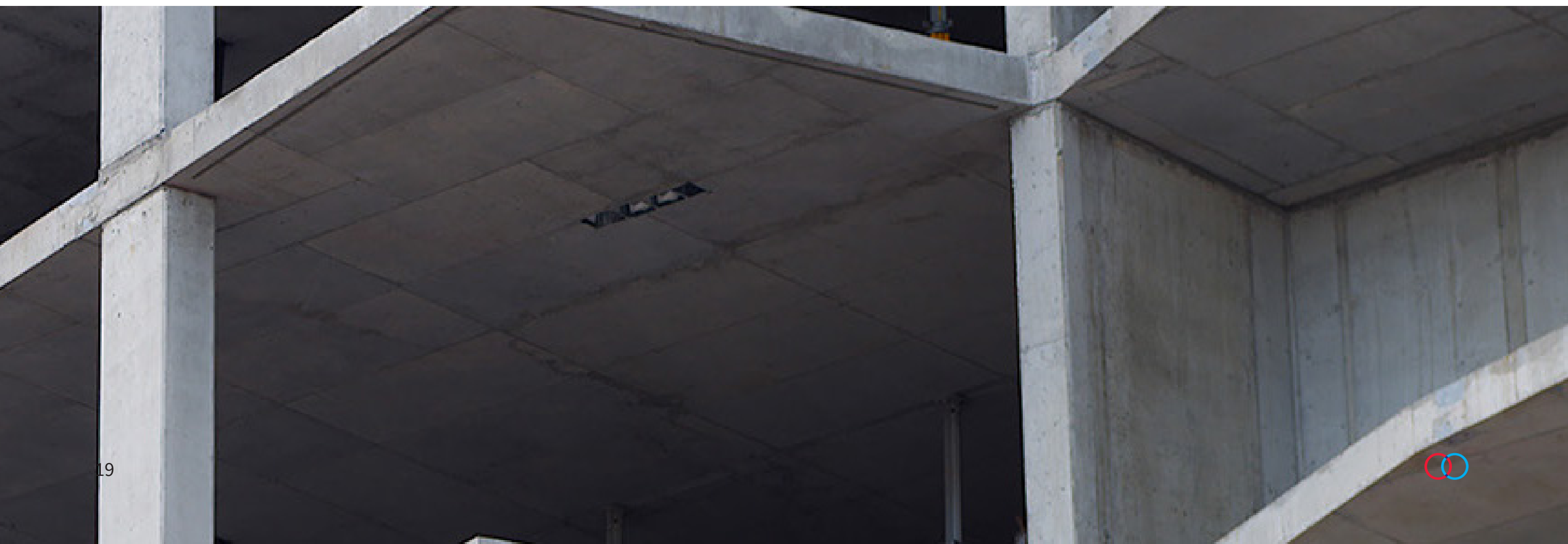
PBOC Notice 27 stipulates that overseas loans should primarily be used for expenditures of overseas enterprises that relate to their scope of business, and it explicitly prohibits the use of these loan proceeds for certain specified purposes, including securities investments or repatriating funds to mainland China through lending or equity investments. Given that BRI projects are typically for overseas investments, these restrictions should not pose significant obstacles.

TIP8: USING INSURANCE AND OTHER CREDIT TOOLS TO MITIGATE RISKS ASSOCIATED WITH INVESTING IN EMERGING MARKETS

Under the BRI, investments in emerging markets are filled with opportunities but are also accompanied by political and commercial risks. To mitigate these risks, investors and project sponsors can use various financial instruments, including credit insurance and export credit.

- **Credit Insurance:** Credit insurance is a risk management tool that provides protection for investors in case of debtor default. In BRI projects, credit insurance is particularly useful as these projects often involve cross-border transactions, and the instability of the political and economic environment can increase the risk of default. Credit insurance generally includes political risk and commercial risk coverage.
    - **Political Risk:** This insurance covers losses resulting from political events such as war, expropriation, and currency restrictions. It is particularly useful for investors investing in countries with unstable political environments.
    - **Commercial Risk:** Commercial insurance covers business risks such as buyer bankruptcy and insolvency. This is important for protecting investors from changes in the business environment.
- **Export Credit:** Export credit is another important financial tool that supports domestic companies in selling goods and services to overseas markets. In BRI projects, export credit can take various forms, including but not limited to buyer credit (loans provided to foreign importers or their banks to support purchases from the exporting country) and seller credit (credit provided directly by financial institutions in the exporting country to domestic exporters to facilitate the sale of goods or services to foreign buyers).

In BRI projects, companies can use risk management tools such as credit insurance and export credit to manage political and commercial risks throughout their investment and financing processes. Moreover, companies should carefully review legal documentation to guard against hidden risks. For instance, credit insurance policies typically include a clause which provides that in the event of a trade or investment dispute, the insured must first engage in arbitration or litigation with the relevant counterparty. The insurer is not obligated to cover a loss until a binding arbitration award or court judgment is obtained and enforced. This kind of clause has become a focal point in many disputes over export credit insurance claims. Consequently, companies should seek to properly understand the relevant credit insurance and export credit documents to better manage potential risks when seeking recourse. Experienced cross-border financing legal advisors can assist companies to review the relevant policies and documents before signing, identifying legal issues and other risks, and proposing strategies for negotiation.



TIP9: USING FINANCIAL DERIVATIVES TO CONTROL INTEREST RATE AND EXCHANGE RATE RISKS

When participating in project financings, businesses can mitigate interest rate and exchange rate risks using financial derivatives. These tools include, but are not limited to, forward contracts, options and currency swaps.

- **Foreign Exchange Forward Contracts:** Enterprises can use foreign exchange forward contracts to hedge against fluctuations in future exchange rates.

- **Foreign Exchange Options:** Using foreign exchange options, companies can limit their exposure to exchange rate risks. If the market exchange rate moves unfavourably for the company, it can choose not to exercise the option to avoid losses; conversely, it can profit if the market moves favourably.

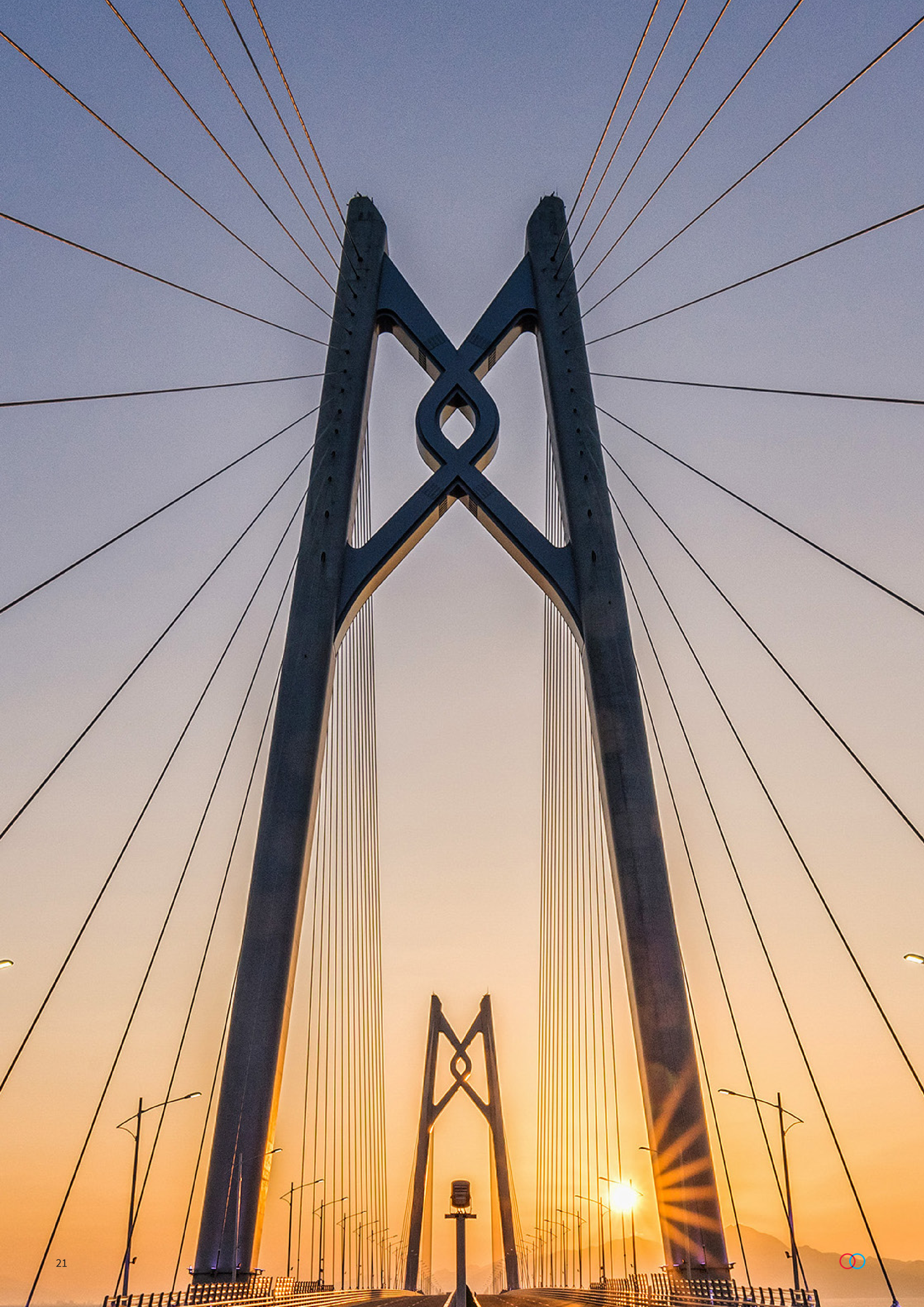
- **Foreign Exchange Swaps:** Foreign exchange swaps allow two parties to exchange a specified amount of one currency for another at an agreed exchange rate on the first settlement date, with a reverse exchange of the two currencies at another agreed rate on a second settlement date. This can be used to hedge exchange rate risk and manage liquidity.

- **Currency Swaps:** Currency swaps allow companies to convert one currency into another and then re-exchange it back to the original currency at a predetermined exchange rate on an agreed future date. This can be used not only to manage exchange rate risk but also to adjust capital structure.

- **Cross-Currency Interest Rate Swaps:** This type of swap involves the exchange of interest rates between two different currencies, which can help companies hedge against risks arising from interest rate fluctuations. For example, according to the 2010 Annual Report of Asia Cement (China) Holdings Corporation, the company entered a swap contract with a nominal amount of USD 50,000,000, maturing on March 18, 2012, with payment exchanges based on a CNY/USD exchange rate of 6.8262, and interest rate swaps based on the London Interbank Offered Rate plus 0% to 1.0% per annum[7]. Additionally, according to the 2023 Annual Report of Techtronic Industries Company Limited, the company similarly used cross-currency interest rate swaps to reduce the interest rate risk and other foreign currency risks of its floating debt in USD and HKD[8].

When implementing these hedging strategies, companies need to pay attention to various legal issues, such which documentation to use (e.g., ISDA Master Agreement, NAFMII Master Agreement, SAC Master Agreement, and other financial institutions' master agreements), the regulatory requirements applicable to the counterparty, legal restrictions on cross-border transactions, and tax implications. In particular, the design of the aforementioned exchange rate and interest rate hedging derivatives is relatively complex, requiring companies and financial institutions to have considerable expertise. Specialist lawyers can assist during the negotiation phase to ensure that the agreements meet the commercial intentions of the parties.

[7] Please refer to: http://www.achc.com.cn/Upload/Investor/201304171448283946.pdf
[8] Please refer to: https://www.ttigroup.com/sites/default/files/2024-03/car2023.pdf



TIP10: FOCUS ON GREEN FINANCING OPPORTUNITIES

Under the framework of the BRI, green financing opportunities are becoming an important means of promoting sustainable development. In particular, financial instruments such as green bonds, green loans, and sustainability-linked loans and bonds not only provide investors with channels to participate in global sustainable development projects but also meet the growing demand from businesses in terms of environmental, social, and governance (ESG) criteria.

Green Bonds and Green Loans

Compared to conventional debt instruments, the defining characteristic of green bonds and green loans lies in their financing purpose, which is for "eligible green projects". The prevailing internationally recognised standards for evaluation include the Green Loan Principles jointly issued by the Loan Market Association (LMA), the Asia-Pacific Loan Market Association (APLMA), and the Loan Syndications and Trading Association (LSTA), as well as the Green Bond Principles set forth by the International Capital Market Association (ICMA). Within the framework of the BRI, green financing can be well-suited for various types of projects.

Firstly, renewable energy power plants — such as solar parks, wind farms, and hydroelectric projects are often financed through green financing. These projects not only contribute to reducing carbon emissions but also promote a sustainable energy structure. Secondly, projects aimed at improving energy efficiency, including the construction and renovation of efficient power and heating facilities, can also benefit from green financing. Furthermore, green transportation projects, such as electric transport systems and sustainable public transport infrastructure, alongside waste management and other initiatives involving waste recycling and wastewater treatment, often meet the standards for green financing. This can lead to preferential terms in the financing, including reduced interest

rates, extended financing tenors and higher loan amounts. Lenders may also have simplified approval processes.

Sustainability-linked Loans and Sustainability-linked Bonds

Alongside green loans and green bonds there has been substantial growth in sustainability-linked loans and sustainability-linked bonds. Sustainability-linked loans are not required to be used for ESG purposes; instead, the interest rate or other key financing features are linked to whether the borrower achieves pre-agreed "key performance indicators". One example was when Ant Group converted a $6.5 billion loan into a sustainability-linked loan in 2022. This was the largest sustainability-linked loan in Asia.

Professional legal advisors can advise on laws, regulations, and policies related to green financing. They can help to ensure compliance with the applicable regulations during the financing process, thereby reducing legal risks. Additionally, they assist businesses in understanding and meeting green investment standards, which is crucial for obtaining green financing, and can help to draft and review the relevant contracts. They can also coordinate with third-party organisations to certify the green financing framework, and facilitate the arrangement of green financing for suitable projects once the relevant certificates are obtained.

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