



# ICLG

The International Comparative Legal Guide to:

## Securitisation 2017

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A practical cross-border insight into securitisation work

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# China

Roy Zhang



Zhou Jie



King &amp; Wood Mallesons

## 1 Receivables Contracts

- 1.1 Formalities. In order to create an enforceable debt obligation of the obligor to the seller: (a) is it necessary that the sales of goods or services are evidenced by a formal receivables contract; (b) are invoices alone sufficient; and (c) can a binding contract arise as a result of the behaviour of the parties?**

Pursuant to the *General Principles of the Civil Law of the Peoples' Republic of China* ("PRC"), a debt obligation could be created by a contract. Generally speaking, PRC laws do not mandatorily request the sale of goods or services to be evidenced by a formal receivables contract; instead, the *PRC Contract Law* allows a contract to be concluded in writing (including formal written contract, letter or electronic communications), oral or other forms. Such general principle is subject to certain exceptions created by other laws, for instance, the *PRC Property Rights Law* requests a formal written contract for the transfer of land use rights.

In the PRC, invoices shall be produced in standard format and used for tax purposes only. An invoice alone is insufficient to evidence the conclusion of an enforceable debt obligation of the obligor to the seller, unless it is coupled with other evidence to prove the existence of contractual relationship, such as communications between the parties and the conduct of the parties.

A binding contract can arise as a result of the behaviour of the parties, provided that such behaviour covers the performance of major obligations by the seller and the acceptance by the obligor in respect of the seller's such performance.

- 1.2 Consumer Protections. Do your jurisdiction's laws: (a) limit rates of interest on consumer credit, loans or other kinds of receivables; (b) provide a statutory right to interest on late payments; (c) permit consumers to cancel receivables for a specified period of time; or (d) provide other noteworthy rights to consumers with respect to receivables owing by them?**

**(a) Limit of Rates of Interest**

PRC laws do not limit rates of interest on loans denominated in currencies other than RMB, the lawful currency of the PRC. Commercial banks are able to freely negotiate the interest rates of foreign exchange loans with their borrowers.

The interest rates of RMB loans extended by commercial banks are regulated by the Peoples' Bank of China ("PBOC"), which will,

from time to time, issue benchmark interest rates of RMB loans for different tenors. Since October 2004, commercial banks are not subject to ceilings of interest rates on RMB loans, while since 20 July 2013, they are not subject to interest rate floor on RMB loans either.

Pursuant to the *General Principles of Loan* issued by the PBOC in 1996, entities other than commercial banks and other financial institutions approved by the banking regulator are not allowed to extend loans in the PRC. However, PRC laws do not prohibit private lending which means financing among natural persons, legal persons or other organisations (excluding financial institutions). The interest rates of such private lending are not subject to PBOC's regulatory requirements imposed on commercial banks, but pursuant to the *Interpretation concerning the Application of Law in the Trial of Private Lending Cases* issued by the PRC's Supreme Court on 6 August 2015 and effected on 1 September 2015, the lender's claim against the borrower for the interest will be upheld if the rate does not exceed 24% *per annum* or if it has been paid by the borrower and its rate does not exceed 36% *per annum*.

**(b) Interest on Late Payment**

Pursuant to the *PBOC's Rules on Interest Rate of RMB Loan*, the late repayment of an RMB loan borrowed from commercial banks shall be subject to the default interest rate, which could vary from 130% to 150% of the interest rate as stipulated in the relevant RMB loan agreement.

Other than the default interest rate applicable to RMB loans granted by commercial banks, the default interest rate of private lending should not exceed 24% *per annum*, otherwise it will not be upheld by the People's Court pursuant to the *Interpretation concerning the Application of Law in the Trial of Private Lending Cases* issued by the PRC's Supreme Court on 6 August 2015 and effected on 1 September 2015.

Except for the above, as general principles created by the *PRC Contract Law*: (i) the parties are allowed to agree on interest on late payment in contract, provided that such interest on late payment is not excessively higher than the actual loss suffered by the non-defaulting party, otherwise the defaulting party may apply to the People's Court or Arbitration Tribunal for adjustment; and (ii) where there is no agreement regarding interest of late payment, the non-defaulting party is allowed to claim for compensation caused by such late payment through the People's Court or Arbitration Tribunal.

**(c) Consumer's Rights to Cancel Receivables for a Specified Period of Time**

Under the *PRC Consumer Protection Law* which was amended on 25 December 2013 and came into effect on 15 March 2014, unless mandatorily provided under laws and regulations or otherwise agreed upon by the parties, the consumer has the right to return the

commodities within seven days from the date following receipt of the commodities, and may also return the commodities after such seven-day period should the conditions to cancel contract are met. The State Administration of Industry and Commerce released the *Administrative Measures for Online Trading* on 26 January 2014, which came into effect on 15 March 2014. Pursuant to such rule, subject to exceptions as provided therein, where an online commodity operator sells commodities, the consumer is entitled to return the commodities within seven days from the date following receipt of the commodities without giving a reason.

In addition, there are some other regulations and provincial level rules applicable to specific marketing methods that impose “cooling-off” periods for the benefit of consumers that would enable consumers to withdraw from their commitment to transactions that they have previously entered into, for example:

- (i) Pursuant to the *Regulations on Direct Selling* issued by the State Council in 2005, where the consumer purchases goods under a “direct selling”, namely purchase the goods from the sales person directly hired by the manufacturer, the consumer is entitled to return the goods and get the purchase price refunded within 30 days after the purchase, provided that the goods have not been unpacked.
- (ii) Pursuant to Shanghai’s local rules regarding consumer protection, if the consumer purchases goods under a door-to-door marketing, the consumer is entitled to return the goods and get the purchase price refunded within seven days after the purchase without any reasons.
- (d) **Other Noteworthy Rights of Consumers Regarding Receivables**

It is noteworthy that the seller’s rights to claim for consumer’s payment of receivables would be subject to the statutory limit generally applicable to all civil rights; for instance, under an international sale of goods, if the seller fails to claim for the consumer’s payment of the purchase price within four years after the due date, such receivables would not be upheld by the People’s Court any more.

### **1.3 Government Receivables. Where the receivables contract has been entered into with the government or a government agency, are there different requirements and laws that apply to the sale or collection of those receivables?**

Generally, PRC laws do not provide different requirements for the sale or collection of government receivables generated under a commercial transaction, except that the formalities of government procurement agreement shall be compliant with the *PRC Government Procurement Law*. However, it is notable that, under PRC laws, all the payments to be made by the government or a government agency shall be included in the annual budget of the central or local government, which shall be approved by the People’s Congress of the corresponding level.

## **2 Choice of Law – Receivables Contracts**

### **2.1 No Law Specified. If the seller and the obligor do not specify a choice of law in their receivables contract, what are the main principles in your jurisdiction that will determine the governing law of the contract?**

In the absence of choice of law in a receivables contract, the main principles for determining the governing law will differentiate between domestic transactions and foreign-related transactions.

If the transaction is a purely domestic transaction, PRC law could be the only governing law to the contract.

If the transaction is a foreign-related transaction, pursuant to the *PRC Laws on Governing Law of Foreign-related Civil Relationships* effective from 1 April 2011, the governing law can be determined based on the principles of “country of the party with characteristic performance” and “country most closely connected”.

Pursuant to the *Interpretation on Several Issues Concerning Application of the PRC Laws on Governing Law of Foreign-related Relationships (I)* issued by the PRC’s Supreme Court on 28 December 2012, where a transaction falls under any of the following circumstances, the court may determine it to be a foreign-related transaction: (i) where any of the parties is foreign citizen, foreign legal person or other organisation or stateless person; (ii) where the residence of any party is located outside the territory of the PRC; (iii) where the subject is outside the territory of the PRC; (iv) where the legal fact that leads to establishment, change or termination of civil relationship happens outside the territory of the PRC; or (v) other applicable circumstances.

### **2.2 Base Case. If the seller and the obligor are both resident in your jurisdiction, and the transactions giving rise to the receivables and the payment of the receivables take place in your jurisdiction, and the seller and the obligor choose the law of your jurisdiction to govern the receivables contract, is there any reason why a court in your jurisdiction would not give effect to their choice of law?**

No. There is no reason why a PRC court would not give effect to the parties’ choice of law under such circumstances.

### **2.3 Freedom to Choose Foreign Law of Non-Resident Seller or Obligor. If the seller is resident in your jurisdiction but the obligor is not, or if the obligor is resident in your jurisdiction but the seller is not, and the seller and the obligor choose the foreign law of the obligor/seller to govern their receivables contract, will a court in your jurisdiction give effect to the choice of foreign law? Are there any limitations to the recognition of foreign law (such as public policy or mandatory principles of law) that would typically apply in commercial relationships such as that between the seller and the obligor under the receivables contract?**

Pursuant to the *PRC Laws on Governing Law of Foreign-related Civil Relationships* and the Supreme Court’s interpretation thereto issued in 2012, the above situation would enable the receivables contract to be deemed as a contract with a “foreign element”, and the PRC court would generally give effect to the choice of foreign law.

The above general principle will not apply under the following circumstances:

- (a) PRC laws have mandatory principles of law for this type of contract. For instance, a contract in respect of real estate shall be governed by laws where the real estate is located, and a Sino-foreign joint venture contract shall be mandatorily governed by the PRC law, etc.; and
- (b) choosing foreign law as the governing law will jeopardise the public interest of the PRC, in which case PRC law shall be the governing law.

## 2.4 CISG. Is the United Nations Convention on the International Sale of Goods in effect in your jurisdiction?

PRC acceded to the CISG in December 1986. When acceding to the CISG, PRC made two reservations for Item (b) of Paragraph 1, Article 1 and Article 11. However, PRC's reservation to Article 11 was retrieved in 2013.

## 3 Choice of Law – Receivables Purchase Agreement

### 3.1 Base Case. Does your jurisdiction's law generally require the sale of receivables to be governed by the same law as the law governing the receivables themselves? If so, does that general rule apply irrespective of which law governs the receivables (i.e., your jurisdiction's laws or foreign laws)?

No, PRC law does not require the sale of receivables to be governed by the same law as the law governing the receivables themselves.

### 3.2 Example 1: If (a) the seller and the obligor are located in your jurisdiction, (b) the receivable is governed by the law of your jurisdiction, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of your jurisdiction to govern the receivables purchase agreement, and (e) the sale complies with the requirements of your jurisdiction, will a court in your jurisdiction recognise that sale as being effective against the seller, the obligor and other third parties (such as creditors or insolvency administrators of the seller and the obligor)?

Due to the foreign exchange control in the PRC, a PRC seller is not able to sell the receivables generated from a PRC obligor to an offshore purchaser.

Purely from the choice of law perspective, a PRC court would recognise the choice of PRC law to the receivables purchase agreement ("RPA").

### 3.3 Example 2: Assuming that the facts are the same as Example 1, but either the obligor or the purchaser or both are located outside your jurisdiction, will a court in your jurisdiction recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller), or must the foreign law requirements of the obligor's country or the purchaser's country (or both) be taken into account?

A PRC court recognises the choice of PRC law and recognises the sale as being effective against the seller, the obligor and other third parties, provided that the relevant requirements under the PRC law for the sale have been complied with.

The foreign law requirements of the obligor's country or the purchaser's country (or both) may apply with respect to enforcement actions against the obligor or the purchaser, as applicable.

### 3.4 Example 3: If (a) the seller is located in your jurisdiction but the obligor is located in another country, (b) the receivable is governed by the law of the obligor's country, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the obligor's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the obligor's country, will a court in your jurisdiction recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller) without the need to comply with your jurisdiction's own sale requirements?

The principles regarding the recognition of the choice of foreign law governing the sale of the receivables, as discussed in questions 2.3 and 3.1 above, will apply.

Assuming the sale is effective against the seller and other third parties in the PRC, pursuant to its governing law, a PRC court will recognise the sale as being effective against the seller and such other third parties, provided that:

- (a) mandatory rules and requirements under PRC law must be complied with if, and to the extent that, they are applicable. For instance, due to foreign exchange control, the seller may be subject to the authenticity verification imposed by the foreign exchange authority for its sale of receivables to the purchaser; and
- (b) when bringing enforcement actions against the seller before a PRC court, the rules regarding enforcement of foreign court judgment or arbitration awards will apply.

### 3.5 Example 4: If (a) the obligor is located in your jurisdiction but the seller is located in another country, (b) the receivable is governed by the law of the seller's country, (c) the seller and the purchaser choose the law of the seller's country to govern the receivables purchase agreement, and (d) the sale complies with the requirements of the seller's country, will a court in your jurisdiction recognise that sale as being effective against the obligor and other third parties (such as creditors or insolvency administrators of the obligor) without the need to comply with your jurisdiction's own sale requirements?

Please see the answer to question 3.4 above.

### 3.6 Example 5: If (a) the seller is located in your jurisdiction (irrespective of the obligor's location), (b) the receivable is governed by the law of your jurisdiction, (c) the seller sells the receivable to a purchaser located in a third country, (d) the seller and the purchaser choose the law of the purchaser's country to govern the receivables purchase agreement, and (e) the sale complies with the requirements of the purchaser's country, will a court in your jurisdiction recognise that sale as being effective against the seller and other third parties (such as creditors or insolvency administrators of the seller, any obligor located in your jurisdiction and any third party creditor or insolvency administrator of any such obligor)?

If the obligor is located in the PRC, please see question 3.2 above.

If the obligor is located in a country other than the PRC, please see question 3.4 above.

## 4 Asset Sales

### 4.1 Sale Methods Generally. In your jurisdiction what are the customary methods for a seller to sell receivables to a purchaser? What is the customary terminology – is it called a sale, transfer, assignment or something else?

Sale of receivables is deemed as an assignment of contract rights under the *PRC Contract Law*. The *PRC Contract Law* stipulates that a creditor may assign its rights under a contract to a third party, subject to any assignment restrictions contained in the original contract or otherwise stated in PRC law.

The customary terminology in the PRC for the sale of receivables is “assignment”.

### 4.2 Perfection Generally. What formalities are required generally for perfecting a sale of receivables? Are there any additional or other formalities required for the sale of receivables to be perfected against any subsequent good faith purchasers for value of the same receivables from the seller?

A sale of receivables will generally be deemed as completed between the seller and the purchaser upon the execution of a RPA. Pursuant to the *PRC Contract Law*, the assignment of contract rights by a creditor will become effective against the obligor once a notice of assignment has been serviced to the obligor.

PRC laws do not request additional or other formalities for the sale of receivables to be perfected against any subsequent good faith purchasers. Although the PBOC has established an online registration system for the pledge of account receivables, which also opens for registration of sale of receivables, such sale of receivables registration has not been vested with a public announcement function by law to claim against *bona fide* third party purchasers.

It is notable that where the sale of receivables involves the transfer of security interest attached to the assigned receivables, the answers to questions 4.3 and 4.12 below will apply. Furthermore, where the receivables are generated under a cross-border transaction, or the sale of receivables will cause conversion of RMB to foreign currency, the answer to question 8.5 below will apply.

### 4.3 Perfection for Promissory Notes, etc. What additional or different requirements for sale and perfection apply to sales of promissory notes, mortgage loans, consumer loans or marketable debt securities?

Under the *PRC Instruments Law*, promissory notes are deemed as on-demand payment instruments and can only be issued by commercial banks. Transfer of promissory notes will request the endorsement from issuer or holder, as the case may be, and delivery of the same to the purchaser.

In respect of mortgage loans, pursuant to the *PRC Property Rights Law* and *PRC Security Law*, the mortgage rights enjoyed by the seller can be transferred together with the secured indebtedness, but the mortgage rights in favour of the purchaser shall be registered with the relevant registration authority.

The sale of consumer loans will not be subject to additional or different sale or perfection requirements, in addition to question 4.2 above.

The sale of marketable debt securities issued in the public market, such as bonds and notes, shall be conducted through the applicable

clearing agency, such as China’s Securities Depository and Clearing Corporation Limited (for bonds traded on the stock exchange) and China’s Government Securities Depository Trust & Clearing Co. Ltd. (for notes traded on the National Inter-bank Market).

### 4.4 Obligor Notification or Consent. Must the seller or the purchaser notify obligors of the sale of receivables in order for the sale to be effective against the obligors and/or creditors of the seller? Must the seller or the purchaser obtain the obligors’ consent to the sale of receivables in order for the sale to be an effective sale against the obligors? Whether or not notice is required to perfect a sale, are there any benefits to giving notice – such as cutting off obligor set-off rights and other obligor defences?

Pursuant to the *PRC Contract Law*, the assignment of contract rights by a creditor will become effective against the obligor once a notice of assignment has been served to the obligor.

The obligor’s consent to the sale of receivables is normally not required for the sale to be an effective sale against the obligor unless expressly required under the original receivables contract.

The notice to the obligor will make the sale of receivables effective against the obligor, and will give rise to certain benefits to the purchaser, as follows:

- (a) the obligor will not be able to claim for set-off rights against the seller entitled to the obligor after the service of the notice;
- (b) the obligor must make payments as directed by the purchaser and the obligor can no longer discharge its obligations by making payment to the seller;
- (c) enforcement actions may be taken by the purchaser against the obligor directly without involving the seller; and
- (d) depending on the content of the receivables contract and notice, the obligor and the seller may no longer amend the underlying receivables contract.

Having said that, the notice will not cut-off the obligor’s existing rights against the seller under the receivables contract, such as claiming for the seller’s non-performance of its obligation.

### 4.5 Notice Mechanics. If notice is to be delivered to obligors, whether at the time of sale or later, are there any requirements regarding the form the notice must take or how it must be delivered? Is there any time limit beyond which notice is ineffective – for example, can a notice of sale be delivered after the sale, and can notice be delivered after insolvency proceedings have commenced against the obligor or the seller? Does the notice apply only to specific receivables or can it apply to any and all (including future) receivables? Are there any other limitations or considerations?

There are no requirements regarding the timing of service of the notice to the obligor, nor are there any requirements regarding the form a notice must take or how the notice must be delivered in order for the notice to be legally valid and effective under PRC laws. In practice, a notice of assignment will generally be made in written form and include a request for an acknowledgment of the assignment (or, where applicable, a consent to the assignment) by the obligor for evidence purposes.

There is no time limit beyond which the delivery of notice would become ineffective. A notice may be delivered to the obligor regardless of whether an insolvency proceeding has commenced against the obligor. However, it is strongly suggested that notice be sent before the insolvency proceedings against the seller have commenced.

A notice may relate to all, or only part of, the existing receivables between the obligor and the seller, and subject to the answer to question 4.10 below.

**4.6 Restrictions on Assignment – General Interpretation. Will a restriction in a receivables contract to the effect that “None of the [seller’s] rights or obligations under this Agreement may be transferred or assigned without the consent of the [obligor]” be interpreted as prohibiting a transfer of receivables by the seller to the purchaser? Is the result the same if the restriction says “This Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]” (i.e., the restriction does not refer to rights or obligations)? Is the result the same if the restriction says “The obligations of the [seller] under this Agreement may not be transferred or assigned by the [seller] without the consent of the [obligor]” (i.e., the restriction does not refer to rights)?**

Yes. All the above restrictions will prohibit the seller from assigning its rights or transferring its obligations to a third party without the obligor’s consent. In addition, it is explicitly provided under the *PRC Contract Law* that if the debtor transfers all or part of its obligations to a third party, the consent of the creditor shall be obtained.

**4.7 Restrictions on Assignment; Liability to Obligor. If any of the restrictions in question 4.6 are binding, or if the receivables contract explicitly prohibits an assignment of receivables or “seller’s rights” under the receivables contract, are such restrictions generally enforceable in your jurisdiction? Are there exceptions to this rule (e.g., for contracts between commercial entities)? If your jurisdiction recognises restrictions on sale or assignment of receivables and the seller nevertheless sells receivables to the purchaser, will either the seller or the purchaser be liable to the obligor for breach of contract or tort, or on any other basis?**

Such restrictions are generally enforceable in the PRC, and we are not aware of any exceptions to this rule.

If the seller sells the receivables to the purchaser irrespective of the prohibitions in the receivables contract, it is the seller who will be liable to the obligor for breach of contract. Under such circumstances, the sale will not be effective against the obligor unless its consent is obtained.

**4.8 Identification. Must the sale document specifically identify each of the receivables to be sold? If so, what specific information is required (e.g., obligor name, invoice number, invoice date, payment date, etc.)? Do the receivables being sold have to share objective characteristics? Alternatively, if the seller sells all of its receivables to the purchaser, is this sufficient identification of receivables? Finally, if the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors, is this sufficient identification of receivables?**

Under PRC laws, a sale document must provide sufficiently specific descriptions of the receivables to be sold so that they are capable of being identified at the time of the assignment. This does not necessarily require that each receivable has to be separately identified.

There is no legal requirement on what specific information is required, but in practice, in order to make the receivables identifiable, some basic information such as obligor’s name, invoice date, payment date, etc., needs to be stated. The receivables being sold do not necessarily need to share objective characteristics.

A statement that the seller sells all of its receivables to the purchaser is unlikely to be deemed as sufficient identification of receivables, nor will a statement that the seller sells all of its receivables other than receivables owing by one or more specifically identified obligors be deemed as sufficient.

**4.9 Recharacterisation Risk. If the parties describe their transaction in the relevant documents as an outright sale and explicitly state their intention that it be treated as an outright sale, will this description and statement of intent automatically be respected or is there a risk that the transaction could be characterised by a court as a loan with (or without) security? If recharacterisation risk exists, what characteristics of the transaction might prevent the transfer from being treated as an outright sale? Among other things, to what extent may the seller retain any of the following without jeopardising treatment as an outright sale: (a) credit risk; (b) interest rate risk; (c) control of collections of receivables; (d) a right of repurchase/redemption; (e) a right to the residual profits within the purchaser; or (f) any other term?**

As discussed in question 4.1 above, the sale of receivables is to be carried out by way of assignment of contract rights. As a general contract law principle, a PRC court would generally respect the parties’ intent to honour a transaction as an assignment of contract rights. However, in certain circumstances, the PRC court may still characterise the transaction as a loan, for example:

- (a) There is no receivables contract or the receivables contract is null and void. Pursuant to the *PRC Contract Law*, a contract may be deemed as null and void under the following situations:
  - (i) it is concluded through the use of fraud or coercion by one party to jeopardise the interests of the State;
  - (ii) malicious collusion is conducted to jeopardise the interests of the State, a collective or a third party;
  - (iii) an illegitimate purpose is concealed under the guise of legitimate activities;
  - (iv) damage to the public interest; or
  - (v) violation of the compulsory provisions of laws and administrative regulations.

Under such circumstances, where the court found that the purchaser has already known the non-existence or invalidity of the receivables contract when entering into the assignment with the seller, the purchaser is likely to be deemed as granting loans to the seller.

- (b) The RPA is ambiguous in respect of the assignment of receivables.
- (c) The assignment of the receivables by the sellers is not a normal and fair sale with reasonable consideration and constitutes a gratuitous assignment by the sellers of its proprietary rights, or an abnormal under-sale of its assets, or an abandonment of its creditor’s rights. Under such circumstances, the assignment, sale or abandonment shall be null and void if, pursuant to the *PRC Enterprise Bankruptcy Law*, such act occurs during the period commencing within one year prior to the acceptance by the People’s Court of the bankruptcy case of the seller.

- (d) Where the assignment of receivables is made on the condition that the seller will retain credit risk of the receivables, such assignment is very likely to be re-characterised as a loan.
- (e) Pursuant to the China Banking Regulatory Commission (“CBRC”)’s notice issued in 2009, when a banking institution assigns its credit assets, it shall not retain the credit risks of the credit assets to be assigned, nor is it allowed to retain right of repurchase/redemption thereof.
- (f) The PRC Law is silent on whether a right to the residual profits retained by the seller would jeopardise treatment as an outright sale.

Subject to the above, to our general understanding, where the seller retains interest rate risks and/or control of collection of receivables and/or a right to the residual profits, the assignment of receivables is unlikely to be jeopardised.

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**4.10 Continuous Sales of Receivables. Can the seller agree in an enforceable manner to continuous sales of receivables (i.e., sales of receivables as and when they arise)? Would such an agreement survive and continue to transfer receivables to the purchaser following the seller’s insolvency?**

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PRC laws do not squarely deal with this issue. In our general experience, the following requirements need to be followed in order to make such continuous assignment of receivables enforceable:

- (a) the RPA has clearly stated the parties’ intention of continuous assignment of receivables; and
- (b) the receivables shall be identifiable. Please see our answer to question 4.8 above.

While following the seller’s insolvency, pursuant to the *PRC Enterprise Bankruptcy Law*, the administrator would have the power to reject or continue to perform any pre-petition executory contracts, and whether the sale agreement would survive and continue to be effective is also subject to our answer to question 6.3 below.

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**4.11 Future Receivables. Can the seller commit in an enforceable manner to sell receivables to the purchaser that come into existence after the date of the receivables purchase agreement (e.g., “future flow” securitisation)? If so, how must the sale of future receivables be structured to be valid and enforceable? Is there a distinction between future receivables that arise prior to versus after the seller’s insolvency?**

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There is no clear legal basis under PRC laws for the enforceability of a current transfer of future receivables before the seller’s insolvency. General understanding is that if (a) the future receivables arise from a presently-existing receivables contract, (b) the seller has already performed its major obligations (such as delivery of goods with agreed quantity and quality), and (c) proper notice has been served to the obligor, the present sale of receivables is unlikely to be challenged.

Where the seller goes into bankruptcy, pursuant to the *PRC Enterprise Bankruptcy Law*, the administrator would have the power to reject or continue to perform any pre-petition executory contracts.

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**4.12 Related Security. Must any additional formalities be fulfilled in order for the related security to be transferred concurrently with the sale of receivables? If not all related security can be enforceably transferred, what methods are customarily adopted to provide the purchaser the benefits of such related security?**

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The nature of the assets constituting the related security will determine the additional formalities, if any, applicable to the transfer. Pursuant to the *PRC Property Rights Law* and *PRC Security Law*, the formalities applicable to transfer of security could be categorised as follows:

- (a) pursuant to Article 192 of the *PRC Property Rights Law*, mortgage rights are very likely transferred simultaneously along with the transfer of the secured indebtedness and such mortgage transfer shall remain valid even without re-registration. However, such mortgage transfer, without being re-registered in favour of the new mortgagee, shall not be effective against any *bona fide* third party;
- (b) for pledges of moveable assets, which are established by execution of a written pledge contract and delivery of possession of the pledged object to the pledgee, the pledge rights may be transferred together with the secured indebtedness by assignment and re-delivery of the possession of the pledged assets to the pledgee;
- (c) for the pledges of rights, which are established by execution of a written pledge contract and delivery of possession of rights documents, such as draft, promissory notes, cheques, bonds in the form of definitive note, depository notes, warehouse receipts, bill of lading, and pledge rights may be transferred together with the secured indebtedness only by execution of a new pledge contract and endorsement on and/or delivery (as the case may be) of the rights documents to the new pledgee; and
- (d) for the pledge of rights, which are established by execution of a written pledge contract and registration with relevant registration agencies, such as securities, equity interest, IP rights, receivables, etc., pledge rights may be transferred together with the secured indebtedness only by execution of a new pledge contract and re-registration of the pledge in favour of the new pledgee.

In addition, where the creation of the existing security also involves other government authorities’ approval/registration process, for instance, mortgage/pledge of bonded warehouse goods would request the approval from customs, and security in favour of offshore creditor requests approval and/or registration from the SAFE, the transfer of such security interest shall also be subject to re-approval by and/or re-registration with relevant original approving/registration authorities.

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**4.13 Set-Off; Liability to Obligor. Assuming that a receivables contract does not contain a provision whereby the obligor waives its right to set-off against amounts it owes to the seller, do the obligor’s set-off rights terminate upon its receipt of notice of a sale? At any other time? If a receivables contract does not waive set-off but the obligor’s set-off rights are terminated due to notice or some other action, will either the seller or the purchaser be liable to the obligor for damages caused by such termination?**

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No. Under the *PRC Contract Law*, the obligor may set-off the receivables against the amount the seller owes to it when the obligor



receives the notice of assignment of the receivables provided that the latter amount is due at the same time as, or prior to that of, the receivables.

The *PRC Contract Law* is silent on when the obligor's right of set-off terminates, but it appears that if the obligor does not claim such right promptly after it receives such notice, such right will terminate. Under such circumstances, neither the seller nor the purchaser is liable to the obligor for the termination of the set-off right.

#### 4.14 Profit Extraction. What methods are typically used in your jurisdiction to extract residual profits from the purchaser?

In the PRC, it is not common that a right to residual profits retained by the seller is directly set in the terms of a receivables contract. However, in a receivables securitisation transaction, the seller is very likely to be the subordinated security holder which is entitled to all residual cash after all senior securities being fully repaid. Therefore, when there are residual profits, the residual profits may be allocated to the seller as a subordinated security holder.

## 5 Security Issues

### 5.1 Back-up Security. Is it customary in your jurisdiction to take a "back-up" security interest over the seller's ownership interest in the receivables and the related security, in the event that an outright sale is deemed by a court (for whatever reason) not to have occurred and have been perfected (see question 4.9 above)?

There is no such concept as "back-up security" under PRC laws.

### 5.2 Seller Security. If it is customary to take back-up security, what are the formalities for the seller granting a security interest in receivables and related security under the laws of your jurisdiction, and for such security interest to be perfected?

This is not applicable in the PRC.

### 5.3 Purchaser Security. If the purchaser grants security over all of its assets (including purchased receivables) in favour of the providers of its funding, what formalities must the purchaser comply with in your jurisdiction to grant and perfect a security interest in purchased receivables governed by the laws of your jurisdiction and the related security?

Pursuant to Article 228 of the *PRC Property Rights Law*, the pledgor and the pledgee shall sign a written contract for the pledge of receivables. The pledge over receivables comes into effect when the pledge has been duly registered with the Credit Reference Centre ("CRC") of the PBOC.

### 5.4 Recognition. If the purchaser grants a security interest in receivables governed by the laws of your jurisdiction, and that security interest is valid and perfected under the laws of the purchaser's jurisdiction, will the security be treated as valid and perfected in your jurisdiction or must additional steps be taken in your jurisdiction?

The security interest will not be automatically perfected under PRC laws after it is perfected under the laws of the purchaser's

jurisdiction. Registration with the CRC, as mentioned in question 5.3 above, must be made in the PRC.

### 5.5 Additional Formalities. What additional or different requirements apply to security interests in or connected to insurance policies, promissory notes, mortgage loans, consumer loans or marketable debt securities?

There are no definitive rules with additional requirements applying to security interests in, or connected to, insurance policies under PRC law.

A security interest in promissory notes may be created by way of a pledge. Article 224 of the *PRC Property Rights Law* stipulates that the pledgor and the pledgee shall draw up a written contract for the pledge and such security interest shall be created upon the delivery of the pledged promissory note to the pledgee. In addition, pursuant to Article 98 of the *Judicial Interpretations of the PRC Security Law*, the promissory note shall be endorsed on the reverse side with the word "pledge" in order to be enforceable against a *bona fide* third party. Therefore, delivery and endorsement are the statutory requirements to create a perfected pledge on promissory notes.

A security interest in marketable debt securities, such as bonds, may also be created by way of a pledge. The pledgor and the pledgee shall enter into a written contract and such security interest shall be created upon the delivery of the certificate of marketable debt securities to the pledgee if it is in the form of definitive note. Moreover, pursuant to Article 99 of the *Judicial Interpretations of the PRC Security Law*, the certificate shall be endorsed on the reverse side with the word "pledge" in order to be enforceable against a *bona fide* third party. Under the circumstance that there is no tangible certificate, the pledge rights shall be created upon the registration of such pledge at the relevant authority. The relevant depository and clearing institutions refer to the China Securities Depository and Clearing Corporation Limited where marketable debt securities are traded on the stock exchange, or China Government Securities Depository Trust & Clearing Co. Ltd. and Shanghai Clearing House where the marketable debt securities are traded on the National Inter-Bank Market.

PRC laws are silent on whether security interest could be created over the mortgage loans or consumer loans or not.

### 5.6 Trusts. Does your jurisdiction recognise trusts? If not, is there a mechanism whereby collections received by the seller in respect of sold receivables can be held or be deemed to be held separate and apart from the seller's own assets (so that they are not part of the seller's insolvency estate) until turned over to the purchaser?

Trusts are recognised under PRC laws. However, the trust in the PRC is usually in a form of special purpose trust. A CBRC-licensed trust company operates as the trustee and administers the trust assets for the benefits of beneficiaries. A PRC court may not give effect to collection trust in relation to receivables which is conducted by virtue of "hold on trust" or "trust declaration". Before the monies turned over to the purchaser, the monetary proceeds held by the seller constitute the seller's asset, therefore there stands the comingling risk if the seller goes bankrupt. Nonetheless, if the purchaser has paid off the purchase price and the collections are deposited separately and apart from the seller's other assets, in practice the PRC courts may probably permit the purchaser to get the collections back even if the seller is insolvent.

**5.7 Bank Accounts. Does your jurisdiction recognise escrow accounts? Can security be taken over a bank account located in your jurisdiction? If so, what is the typical method? Would courts in your jurisdiction recognise a foreign law grant of security (for example, an English law debenture) taken over a bank account located in your jurisdiction?**

Escrow accounts are recognised and widely used in the PRC.

Except that the pledge created by a bank as the pledgee over export tax rebate accounts is recognised by the PRC Supreme People's Court in accordance with the *Provisions of Relevant Issues Concerning the Trial of Cases Involving Loans Pledged with an Export Tax Rebate Custodian Account* promulgated by the Supreme People's Court on 22 November 2004, there is no concept of security over a bank account under PRC laws.

Bank accounts are not considered a type of property explicitly recognised by PRC law as pledgeable assets. Instead, cash is, in general, characterised as a special type of movable asset and the pledge is explicitly recognised under PRC laws. The general rule under the *PRC Security Law* is that no pledge may be created over future funds in bank accounts. Funds in a bank account for a pledge shall be ascertained and identified at the time of perfection of the pledge. Pursuant to Article 85 of the *Judicial Interpretations of the PRC Security Law*, the cash may be delivered to the creditor in its possession as security for the performance of an obligation, and the creditor may have priority in applying such cash towards the satisfaction of an obligation owed to the creditor, if the cash is "fixed" in the form of special accounts (i.e. the parties have to specify the account as well as the cash balance standing to the credit of such an account).

Any cash flow in or out after the account has been fixed will require the pledgor to re-issue a pledge notice/confirmation specifying the updated cash balance. Such confirmation letter shall be issued each time a change occurs to the account balance. Otherwise, the pledge will no longer be valid under PRC laws.

We noticed a few precedents that the security governed by foreign laws over a PRC account was recognised by PRC courts. PRC is not a common law jurisdiction. Case precedent might not be recognised by other courts.

**5.8 Enforcement over Bank Accounts. If security over a bank account is possible and the secured party enforces that security, does the secured party control all cash flowing into the bank account from enforcement forward until the secured party is repaid in full, or are there limitations? If there are limitations, what are they?**

Not applicable to bank accounts other than an export tax rebate custodian account. In respect of the export tax rebate custodian account, pursuant to the *Provisions of Relevant Issues Concerning the Trial of Cases Involving Loans Pledged with an Export Tax Rebate Custodian Account*, the pledgee may, to the extent of the outstanding secured debt, apply all the funds in the pledged bank account to discharge such debt.

**5.9 Use of Cash Bank Accounts. If security over a bank account is possible, can the owner of the account have access to the funds in the account prior to enforcement without affecting the security?**

This is not applicable to bank accounts other than an export tax rebate custodian account. In respect of the export tax rebate

custodian account, the owner of the account could not access the funds in the export tax rebate account unless the pledgee agrees to release the funds in the account in whole or in part.

## 6 Insolvency Laws

**6.1 Stay of Action. If, after a sale of receivables that is otherwise perfected, the seller becomes subject to an insolvency proceeding, will your jurisdiction's insolvency laws automatically prohibit the purchaser from collecting, transferring or otherwise exercising ownership rights over the purchased receivables (a "stay of action")? If so, what generally is the length of that stay of action? Does the insolvency official have the ability to stay collection and enforcement actions until he determines that the sale is perfected? Would the answer be different if the purchaser is deemed to only be a secured party rather than the owner of the receivables?**

After a sale of receivables that is otherwise perfected, and provided that the sale of receivables is not subject to any situations as stated in question 4.8 above and the clawback discussion in question 6.3 below, the rights of a purchaser made in good faith will remain unaffected by subsequent insolvency proceedings of a seller. However, the situation would be different if:

- (a) The purchaser is deemed to only be a secured party with respect to the receivables. In such circumstances, pursuant to Article 16 of the *PRC Enterprises Bankruptcy Law*, a moratorium would apply to all creditors (secured and unsecured) upon the acceptance by the PRC court of a petition of insolvency in respect of the seller. The moratorium would last until an order of insolvency and liquidation issued by the PRC court. During the moratorium, the secured creditor would be stayed from enforcing its security. Pursuant to Article 109 of the *PRC Enterprises Bankruptcy Law*, upon liquidation of the seller's estate, a secured creditor would have priority over all unsecured creditors (other than statutory preferential creditors) over the property secured.
- (b) The seller goes into insolvency after it has executed the RPA with the purchaser but neither party has completed the performance of such agreement. Under such circumstances, pursuant to Article 18 of the *PRC Enterprises Bankruptcy Law*, the bankruptcy administrator will have the right to determine whether to terminate or to continue to perform such agreement. If the bankruptcy administrator fails to notify the purchaser within two months of the acceptance of any bankruptcy petition in respect of the seller, or fails to reply within 30 days upon receipt of a purchaser's demand to make such a decision, such agreement shall be deemed to be terminated. If the bankruptcy administrator determines to continue to perform such agreement, the purchaser shall perform such agreement, provided that the purchaser has a right to require the bankruptcy administrator to provide a guarantee for such performance. The agreement would be deemed to be terminated if the bankruptcy administrator refuses to provide a guarantee.

If the bankruptcy administrator determines to continue to perform such receivables contracts, the purchaser's rights under the RPA would not be affected.

On the contrary, if the bankruptcy administrator refuses to continue to perform such receivables contract, the receivables contract would be terminated accordingly. In that case, the purchaser is only entitled to ask the underlying obligor for those receivables in relation to the obligations that have already been performed by the seller; whilst for the purchase price and damage corresponding to the rest parts,

the purchaser may only be able to claim through distribution of bankruptcy property as an ordinary creditor of the seller.

**6.2 Insolvency Official's Powers. If there is no stay of action, under what circumstances, if any, does the insolvency official have the power to prohibit the purchaser's exercise of its ownership rights over the receivables (by means of injunction, stay order or other action)?**

This is not applicable in the PRC.

**6.3 Suspect Period (Clawback). Under what facts or circumstances could the insolvency official rescind or reverse transactions that took place during a "suspect" or "preference" period before the commencement of the seller's insolvency proceedings? What are the lengths of the "suspect" or "preference" periods in your jurisdiction for (a) transactions between unrelated parties, and (b) transactions between related parties? If the purchaser is majority owned or controlled by the seller or an affiliate of the seller, does that render sales by the seller to the purchaser "related party transactions" for purposes of determining the length of the suspect period? If a parent company of the seller guarantees the performance by the seller of its obligations under contracts with the purchaser, does that render sales by the seller to the purchaser "related party transactions" for purposes of determining the length of the suspect period?**

The transactions between the seller and its related or unrelated parties will be subject to the same principle of clawback.

Article 16 of the *PRC Enterprise Bankruptcy Law* restricts any payments from the debtor to its creditors once the court has accepted the bankruptcy petition in relation to the debtor. The bankruptcy administrator also has the right under Article 32 of the *PRC Enterprise Bankruptcy Law* to request the court to revoke any preferential payments made by the bankrupted entity within the six-month period prior to the court's acceptance of the bankruptcy petition, unless those payments benefit the bankrupt entity's estate.

Under Article 31 of the *PRC Enterprise Bankruptcy Law*, the bankruptcy administrator has the right to request the court to revoke any of the following acts relating to the debtor's assets to the extent occurring within one year prior to the court's acceptance of the bankruptcy petition: (a) transferring the property gratis; (b) trading at an obviously unreasonable price; (c) providing property guaranty to unsecured debts; (d) paying off debts not due; or (e) abandoning claims.

**6.4 Substantive Consolidation. Under what facts or circumstances, if any, could the insolvency official consolidate the assets and liabilities of the purchaser with those of the seller or its affiliates in the insolvency proceeding? If the purchaser is owned by the seller or by an affiliate of the seller, does that affect the consolidation analysis?**

There is no concept of substantive consolidation in the PRC.

**6.5 Effect of Insolvency on Receivables Sales. If insolvency proceedings are commenced against the seller in your jurisdiction, what effect do those proceedings have on (a) sales of receivables that would otherwise occur after the commencement of such proceedings, or (b) on sales of receivables that only come into existence after the commencement of such proceedings?**

Subject to the answer to question 4.10 above regarding the recognition of future receivables, our discussion in question 6.1 (b) above will apply.

**6.6 Effect of Limited Recourse Provisions. If a debtor's contract contains a limited recourse provision (see question 7.3 below), can the debtor nevertheless be declared insolvent on the grounds that it cannot pay its debts as they become due?**

Since, under the limited recourse provision, the recourse of the creditor is limited to the available assets of the debtor and if there is any shortfall the debt will be extinguished, it seems unlikely that the debtor will be declared on such grounds.

## 7 Special Rules

**7.1 Securitisation Law. Is there a special securitisation law (and/or special provisions in other laws) in your jurisdiction establishing a legal framework for securitisation transactions? If so, what are the basics?**

Since 2005, the PRC regulatory authorities and the market participants worked out two possible securitisation structures, i.e. special-purpose trust structure ("SPT Structure") and the asset-backed specific plan structure ("ABSP Structure", before 2014, namely specific asset management plan structure ("SAMP Structure")).

**SPT Structure** – the SPT Structure is broadly used by financial institutions under the jurisdiction of the CBRC (particularly, banks and auto finance company) to package their credit portfolio into asset-backed securities traded in the National Inter-bank Bond Market ("NIBBM"). In 2005, credit portfolio asset securitisation started with the successful debut of two pilot transactions launched respectively by the China Development Bank ("CDB") and the China Construction Bank ("CCB"). These two deals were made possible after years of joint efforts by multiple government bodies led by the CBRC and the PBOC. Upon closing of the first two pilot transactions, the PBOC and the CBRC jointly issued the *Administrative Measures on Pilot Projects for Securitisation of Credit Assets Procedures* on 20 April 2005. In addition, the CBRC further released the *Measures for the Supervision and Administration on Pilot Securitisation Projects of Credit Assets of Financial Institution* to set out detailed requirements and procedures for the ABS products with an SPT Structure. After a series of legal frameworks had been well set up, the CBRC issued another round of pilot approvals for securitisation projects across a range of underlying asset pools including residential mortgages, auto loans, SME loans and non-performing loans. By the end of 2008, 11 banks and financial institutions issued ABS in the two rounds of approvals, with a total value of RMB 67 billion. On 17 May 2012, the PBOC, the CBRC and the Ministry of Finance ("MOF") released the *Notice on Matters Regarding Further Expansion of Credit Asset*

*Securitisation Pilot Projects* (“Pilot Notice”), whereby the Chinese regulators announced a quota of RMB 50 billion for this new round of credit assets securitisation transactions in the PRC. Pursuant to the Pilot Notice, no re-securitisation or complex synthetic products will be encouraged by the regulatory authorities, the senior tranche of ABS have to be reviewed and rated by at least two credit rating agencies, and the originators are now required to retain a certain portion of the junior tranche (in principle, no less than 5% of the total issued securities). Furthermore, the investment by one single investor should be capped within 40% of the total issuance. Pursuant to the *Circular Concerning the Filing Process of Securitization of Credit Assets* which was promulgated by CBRC on 20 November 2014, and the public announcement which was promulgated by the PBOC on 6 April 2015, the approval from CBRC is not required for relevant financial institutions anymore and has been replaced with a filing procedure with CBRC while the approval from PBOC has been replaced by a registration procedure, which both imply a loose regulatory trend in this field.

**SAMP Structure/ABSP Structure** – Running in parallel with the ABS under SPT Structure (which is designed specifically for financial institutions), the SAMP Structure was brought to the PRC market in May 2005 under an interim rule, *Administrative Measures for Securitisation Business by Securities*, constituted by the China Securities Regulatory Commission (“CSRC”). Furthermore, on 15 March 2013, CSRC further released the *Administrative Measures on Securitisation Business of a Securities Company* (“SAMP Rules”). Pursuant to the SAMP Rules, a securities firm launches a SAMP to issue certificates in the stock exchange (i.e., Shanghai Stock Exchange and Shenzhen Stock Exchange) to raise funds from investors. Upon completion of the offering, the SAMP will invest the proceeds in return for a specific, predominantly corporate asset with a sustainable and predictable cash flow. The scheme provides a return to the investors through a dedicated bank account. Similarly to a typical securitisation transaction, under the SAMP structure, cash flows from the asset will be the main source for repayment of principal and interest to investors. For credit enhancement, the external guarantor or liquidity supporter will be on standby and top up the cash flow or provide certain liquidity facilities in case of any shortfall. On 19 November 2014, the CSRC has promulgated the *Administrative Measures on Securitisation Business of a Securities Company and Subsidiary of Fund Management Company*, together with the *Information Disclosure Guidance and Due Diligence Guidance* thereto, which has replaced the SAMP Rules and broadened the subject which could launch ABSP from securities firm to securities firms and subsidiary of fund management companies. Similar to the reform of the SPT Structure regime, the approval from CSRC has been cancelled and now the manager of ABSP shall instead perform the filing obligation with the Asset Management Association of China with the local bureau of CSRC copied. Apart from that, the scope of secondary market for the transfer of notes under ABSP has now been extended to relevant Stock Exchange, National SME Share Transfer System, Interagency Quotation and Service System of Private Placement Product and OTC market, which is in line with the secondary market of corporate bonds.

**7.2 Securitisation Entities. Does your jurisdiction have laws specifically providing for establishment of special purpose entities for securitisation? If so, what does the law provide as to: (a) requirements for establishment and management of such an entity; (b) legal attributes and benefits of the entity; and (c) any specific requirements as to the status of directors or shareholders?**

Other than the trust scheme for SPT Structure and the asset-backed

specific plan for ABSP Structure, PRC law is silent on the set-up of a special purpose vehicle in other forms for securitisation.

**SPT Structure** – the trust plan as a special purpose trust will be used as a vehicle to hold the legal title to the underlying assets, which constitute the trust assets. The SPT managed by the trustee (i.e. the CBRC-regulated trust company) is not a legal person under PRC law and the disposal and utilisation of all the trust assets will be managed in the name of the trustee. There is no corporate governance requirement in respect of the SPT. For the decision-making procedure, usually the trust document will specify the matters and circumstances subject to the approval of all or majority beneficiaries; the rest will be at the discretion of the trust company in a fiduciary capacity.

**ABSP Structure** – as with the SPT structure, the specific asset management plan is also not recognised as a legal person under PRC law. When setting up the ABSP, the investor entrusted the money into the ABSP, the securities company or subsidiary of fund management company as manager of the ABSP will utilise the raised money to invest in the underlying asset. In comparison with the SPT, ABSP is less advanced in terms of legal integrity, tax neutrality and accounting clarity, a situation which in turn might affect its ability to achieve true sale and bankruptcy remoteness.

**7.3 Limited-Recourse Clause. Will a court in your jurisdiction give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) limiting the recourse of parties to that agreement to the available assets of the relevant debtor, and providing that to the extent of any shortfall the debt of the relevant debtor is extinguished?**

A limited-recourse clause is an enforceable contractual arrangement under PRC law.

**7.4 Non-Petition Clause. Will a court in your jurisdiction give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) prohibiting the parties from: (a) taking legal action against the purchaser or another person; or (b) commencing an insolvency proceeding against the purchaser or another person?**

PRC laws do not expressly prohibit or restrict a non-petition clause, and we believe it will impose enforceable obligations on a party who makes non-petition undertaking. However, there is a theoretical argument that whether the rights of claim conferred upon by the PRC laws and regulations may not be waived by the provisions contained in the agreement, and to our knowledge, such non-petition clause has not been tested in a PRC court.

**7.5 Priority of Payments “Waterfall”. Will a court in your jurisdiction give effect to a contractual provision in an agreement (even if that agreement’s governing law is the law of another country) distributing payments to parties in a certain order specified in the contract?**

A PRC court will generally give effect to a contractual provision on payment distribution based on the principle of freedom of contract.

**7.6 Independent Director. Will a court in your jurisdiction give effect to a contractual provision in an agreement (even if that agreement's governing law is the law of another country) or a provision in a party's organisational documents prohibiting the directors from taking specified actions (including commencing an insolvency proceeding) without the affirmative vote of an independent director?**

A PRC court generally may give effect to a contractual provision, or a provision in a party's organisational documents, prohibiting the directors from taking specified actions without the affirmative vote of an independent director. However, in the PRC, the shareholder can convene a shareholding meeting to decide the filing of bankruptcy of the company without any proposal from board level. As such, the independent director's vote cannot block the resolution of shareholders in respect of bankruptcy filing.

**7.7 Location of Purchaser. Is it typical to establish the purchaser in your jurisdiction or offshore? If in your jurisdiction, what are the advantages to locating the purchaser in your jurisdiction? If offshore, where are purchasers typically located for securitisations in your jurisdiction?**

Subject to the answer to question 7.2 above regarding the establishment of the special purpose entities for securitisation, neither the SPT as to SPT Structure nor the specific asset management plan as to ABSP Structure is recognised as a legal person under PRC laws.

**SPT Structure** – The SPT itself is not a legal person but merely a trust plan under a trust company. Under PRC laws, a trustee has to be a CBRC-regulated trust company which is established under the PRC law. Currently, PRC trust companies are not able to establish offshore trust plans.

**ABSP Structure** – The ABSP itself is not a legal person but a bundle of contractual rights over the underlying assets. All the relevant agreements are entered into by the securities company or the subsidiary of fund management company on behalf of the ABSP, and all the qualified securities companies or subsidiaries of fund management companies which are allowed to be managers of ABSP are incorporated in the PRC.

In short, current PRC securitisation regimes (SPT Structure and ABSP Structure) only allow onshore purchasers.

## 8 Regulatory Issues

**8.1 Required Authorisations, etc. Assuming that the purchaser does no other business in your jurisdiction, will its purchase and ownership or its collection and enforcement of receivables result in its being required to qualify to do business or to obtain any licence or its being subject to regulation as a financial institution in your jurisdiction? Does the answer to the preceding question change if the purchaser does business with more than one seller in your jurisdiction?**

Merely owning receivables and collecting and enforcing receivables, even purchasing from more than one seller, will not result in an offshore purchaser being subject to financial licence requirements.

Notwithstanding the above, if the purchaser is to establish a business existence in the PRC for receivables purchase business, pursuant to the relevant regulations issued by the Ministry of Finance in 2012, it may be deemed as engaging in commercial factoring business, which will in turn give rise to approval from the Ministry of

Finance. For your information, currently the foreign investment in commercial factoring is still under trial, and the foreign invested commercial factoring companies are only allowed to be established in Shanghai, Tianjin, Shenzhen, Guangzhou and particular regions of Jiangxi, Chongqing, Jiangsu and Suzhou.

**8.2 Servicing. Does the seller require any licences, etc., in order to continue to enforce and collect receivables following their sale to the purchaser, including to appear before a court? Does a third party replacement servicer require any licences, etc., in order to enforce and collect sold receivables?**

The seller may, without any licence, continue to enforce and collect receivables after the completion of the sale to the purchaser.

A third party replacement servicer may or may not require any licence to enforce and collect sold receivables, depending on the nature of the underlying assets.

**8.3 Data Protection. Does your jurisdiction have laws restricting the use or dissemination of data about or provided by obligors? If so, do these laws apply only to consumer obligors or also to enterprises?**

The *PRC Contract Law* requires parties to a contract to act in good faith and perform obligations such as maintaining confidentiality in accordance with the nature and purpose of the contract and/or trade usage. Parties to the contracts must comply with this general principle of confidentiality.

*The Interim Provisions on the Protection of Trade Secrets of Central Enterprises*, promulgated by the State-owned Assets Supervision and Administration Commission on 25 March 2010, classifies customer information as one of the trade secrets owned by the central State-owned enterprises. It also requires such enterprises to enter into a confidentiality agreement with the counterparty when dealing with customer information and other trade secrets.

Where the seller is a financial institution licensed by CBRC, the seller will be subject to general confidentiality requirements applicable to financial institutions. In particular, pursuant to a notice issued by the PBOC in 2011 (YIN FA 2011 No. 17), banking institutions in the PRC are not allowed to provide any information regarding individual consumers to any offshore entities or individuals.

**8.4 Consumer Protection. If the obligors are consumers, will the purchaser (including a bank acting as purchaser) be required to comply with any consumer protection law of your jurisdiction? Briefly, what is required?**

Please see our discussion in question 1.2 above.

**8.5 Currency Restrictions. Does your jurisdiction have laws restricting the exchange of your jurisdiction's currency for other currencies or the making of payments in your jurisdiction's currency to persons outside the country?**

Yes, the PRC imposes strict controls on both convertibility and transferability of the RMB, which is mainly governed by PRC Foreign Exchange Regulations and various rules and notices issued by the SAFE.

A new tendency regarding the payment of RMB outside the PRC is that, starting from 2009, the PBOC launched an RMB

internationalisation scheme, under which PRC entities are allowed to make payments of RMB to persons outside the PRC for international trade settlement.

## 9 Taxation

**9.1 Withholding Taxes. Will any part of payments on receivables by the obligors to the seller or the purchaser be subject to withholding taxes in your jurisdiction? Does the answer depend on the nature of the receivables, whether they bear interest, their term to maturity, or where the seller or the purchaser is located? In the case of a sale of trade receivables at a discount, is there a risk that the discount will be recharacterised in whole or in part as interest? In the case of a sale of trade receivables where a portion of the purchase price is payable upon collection of the receivable, is there a risk that the deferred purchase price will be recharacterised in whole or in part as interest? If withholding taxes might apply, what are the typical methods for eliminating or reducing withholding taxes?**

PRC withholding taxes may be imposed depending on the nature of the receivables and the location of the seller and purchaser. For example, pursuant to the *Enterprise Income Tax Law* of the PRC (“EIT Law”) and its implementation rules, interest income derived from treasury bonds issued by the Ministry of Finance under the State Council of the PRC is exempt from EIT. Additionally, pursuant to the *Announcement on Exemption of Income Tax Levied on Interest from Local Government Bonds* (Cai Shui [2013] No.5), enterprises are exempt from EIT on interest income derived from local government bonds issued in 2012 and thereafter.

Interests and royalties (including also royalties for the use of the industrial and commercial equipment) sourced from the PRC and derived by a seller or purchaser being a non-tax resident will generally be subject to a withholding tax at the rate of 10%. The tax rate may be reduced or exempted by the applicable double tax treaty or other relevant documents. The obligors are obliged to withhold and settle the withholding tax with the PRC tax authority for the seller or purchaser.

Provided that the seller or the purchaser is domestically incorporated, there would be no PRC withholding taxes imposed on the payment on receivables made by a PRC obligor to the seller or purchaser.

The risk needs to be evaluated on a case-by-case basis and largely depends on the discretion of the relevant tax authorities.

The tax rate may be reduced or exempted by the applicable double tax treaty or special tax arrangements. For example, if a non-resident enterprise is a resident of Hong Kong, pursuant to the *Agreement between the Mainland of China and the Hong Kong Special Administrative Region for the Avoidance of Double Taxation and the Prevention of Fiscal Evasion with Respect to Taxes on Incomes* promulgated on 21 August, 2016 by State Administration of Taxation, such tax rate of interests and royalties mentioned above is reduced to 7% from 10%.

**9.2 Seller Tax Accounting. Does your jurisdiction require that a specific accounting policy is adopted for tax purposes by the seller or purchaser in the context of a securitisation?**

There is no express accounting policy in the PRC adopted by the seller and purchaser for tax purposes in the context of a securitisation. The seller shall comply with the *China Accounting*

*Standard for Enterprise No. 23 – Derecognition of Financial Assets* (“CAS No. 23”). CAS No. 23 was published by the MOF in 2006 and replaced the former circular *Accounting Provisions of Credit Assets Securitisation*.

Pursuant to the *Circular of Relevant Taxation Policy Issues Relevant to the Securitisation of Credit Assets* (Caishui [2006] No. 5), the originator shall realise its gains and losses derived from the sales of credit assets in a securitisation of credit assets in accordance with the EIT Law and settle the EIT accordingly.

**9.3 Stamp Duty, etc. Does your jurisdiction impose stamp duty or other transfer or documentary taxes on sales of receivables?**

The agreement for sales of receivables does not fall into the categories of taxable documents, and thus will not be subject to any Stamp Duty or other transfer or documentary taxes on sales of receivables.

**9.4 Value Added Taxes. Does your jurisdiction impose value added tax, sales tax or other similar taxes on sales of goods or services, on sales of receivables or on fees for collection agent services?**

The sales of taxable goods and the provision of labour services in relation to the processing of goods and of repair and replacement services within the PRC are subject to Value Added Tax (“VAT”). The VAT rate ranges from 0% to 17%. The standard rate is 17%.

Business Tax (“BT”) applies to the provision of services (excluding processing services and the repair and replacement services). It also applies to the transfer of intangible assets such as goodwill, patents and the sale of real estate properties in the PRC. BT rates range from 3% to 20%. BT and VAT are mutually exclusive.

The service fee received by the collection agent shall generally be subject to BT. Normally, the sales of receivables are not taxable with regard to both VAT and BT. However, the MOF and State Administration of Taxation jointly issued two circulars in 2011, officially kicking off the transformation of BT to VAT (“Transformation”) for the service industry. Pursuant to the two circulars, depending on the nature of the receivables, certain categories of service previously imposed by BT may now be subject to VAT (e.g. financial leasing sector). Thus, the sales of receivables in relation to such services technically may also be subject to VAT. Given the Transformation is still in a state of flux, the practice of turnover tax implications of the sales of receivables may vary in different locations.

**9.5 Purchaser Liability. If the seller is required to pay value added tax, stamp duty or other taxes upon the sale of receivables (or on the sale of goods or services that give rise to the receivables) and the seller does not pay, then will the taxing authority be able to make claims for the unpaid tax against the purchaser or against the sold receivables or collections?**

If the tax authority deems the sale of receivables to be taxable from the VAT perspective under the new VAT scheme after the Transformation, the seller would be the taxpayer and shall undertake the obligations of filing and settling the VAT. It is not likely that the tax authority would be able to claim unpaid taxes against the purchaser or against the sold receivables, unless the receivables are considered by the tax authority to have been sold with no consideration or with an unreasonable price, under which the tax authority is entitled to petition a court to revoke such sale of receivables.

**9.6 Doing Business. Assuming that the purchaser conducts no other business in your jurisdiction, would the purchaser's purchase of the receivables, its appointment of the seller as its servicer and collection agent, or its enforcement of the receivables against the obligors, make it liable to tax in your jurisdiction?**

Pursuant to the *EIT Law*, if the purchaser is not a PRC resident for tax purposes, it is taxed only on its PRC and foreign sourced income that is attributable to their establishments or places of business in the PRC, which shall be assessed depending on various factors (including the nature of receivables, the activities undertaken by the purchaser in the PRC, etc.). If there is a double tax treaty between the PRC and the country (or region) where the purchaser is located, the provisions of such treaty shall prevail.

Assuming the purchaser is located outside the PRC, generally the purchaser will not be liable to tax in the PRC from the EIT perspective provided that its activities are limited only to purchasing receivables, appointing the seller as its servicer and collection agent, or enforcing against the obligors and it conducts no other business in the PRC, unless such activities undertaken by the purchaser constitute a permanent establishment as prescribed by the applicable double tax treaty. Please refer to questions 9.3 and 9.4 above for the implications of turnover taxes and Stamp Duty.

**9.7 Taxable Income. If a purchaser located in your jurisdiction receives debt relief as the result of a limited recourse clause (see question 7.3 above), is that debt relief liable to tax in your jurisdiction?**

Pursuant to the *Notice on the Work of Annual Report of Year 2008 on the Implementation of Accounting Standards Enterprises* (Caihuihan [2008] No. 60) issued by the Ministry of Finance, debt exemptions accepted by an enterprise, which meet the conditions for recognition in accordance with the provisions of the accounting standards, should normally be recognised as current income and therefore are subject to EIT.

If the debt relief as the result of a limited recourse clause meets the conditions for recognition in accordance with the provisions of the accounting standards, such relief shall be subject to EIT.

### Acknowledgment

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