# CBRC Revised Guidelines on Acquisition Financing in China

April 2015

Since the Guidelines on Risk Management of Merger and Acquisition Loans granted by Commercial Banks (商业银行并购贷款风险管理指引) (the "**Guidelines**") came into force in 2008, banks in China have not responded to the increasing demand of M&A loans from PRC borrowers and the offshore market continued to be the primary financing source for PRC borrowers to fund their outbound acquisitions. Such lack of interest in M&A loans among PRC banks is partly a consequence of the strict qualification and lending rules under the Guidelines.

After more than six years of implementation and experiment, the China Banking Regulatory Commission (the "**CBRC**") recently revised the Guidelines with a view to facilitating the development of the M&A loan market in China.

Key changes made to the Guidelines include:

## 1. QUALIFICATIONS AND CONDITIONS

a. The Guidelines now apply not only to commercial banks, but also to policy banks, local branches of foreign banks and finance companies of enterprise groups.

b. The requirements (1) 100% loan loss specific reserve adequacy ratio and (2) the general reserve balance of not less than 1% of concurrent loan balance have been removed, such that a bank may provide M&A loans if, on an on-going basis:

   i. it has a sound risk management system and an efficient internal control mechanism;

   ii. its capital adequacy ratio is not less than 10%;

   iii. all its other regulatory indices meet applicable regulatory requirements; and

   iv. it has a professional team responsible for M&A loan due diligence and risk assessment.

c. The amount of an M&A loan should not exceed 60% of the total acquisition price (which has been increased from 50% under the previous Guidelines) and the term of the loan should not exceed 7 years (increased from 5 years under the previous Guidelines).

d. The security requirements for M&A loans have also been relaxed. The security requirements for M&A loans do not have to be more stringent than security for other loans, provided that security is taken that is proportionate to the risks associated with the M&A loan.

## 2. ENHANCING RISKS MANAGEMENT

The Guidelines continue to stress the importance of administration and information systems, as well as establishing effective internal controls and risk management, including:

a. having a system to statistically analyse M&A loans in accordance with regulatory requirements.

b. reporting to CBRC the concentration limit on a per-borrower, group customer, industrial, national or jurisdictional basis.

c. ascertaining the leveraged ratio of M&A loans and ensuring reasonable funding by equity contribution.

d. strengthened due diligence and after lending loan management and supervision.

e. mandatory terms in the loan agreement to protect lenders' interest, including the lender's right to take risk control measures upon any material change in the business strategy of the acquired group, and the condition of the security provider or the security assets.

In summary, the revised Guidelines have relaxed certain lender qualification requirements and permitted longer loan tenor and higher loan-to-acquisition price ratio, while continuing the emphasis on risk assessment and internal controls to guard against non-performing loans and fraudulent transactions.

While competition is inevitable, the international banks should welcome the healthy development of the onshore M&A loan market in which loans are granted based on commercial rather than policy reasons. There will be more opportunities for every market participant and borrowers and lenders should see more financing options and structures.

Please see our previous newsletter "Gate Opened for Acquisition Finance in China" for a full analysis of the Guidelines.

If you would like further information on any aspect of this note, please contact a person mentioned below or the person with whom you usually deal:

**Owen Chan**
Partner, Hong Kong
owen.chan@hoganlovells.com
+852 2840 5668

**Jenny Yim**
Senior Associate, Hong Kong
jenny.yim@hoganlovells.com
+852 2840 5660