Asia Pacific Guide to Lending and Taking Security - China/Mainland China

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# When considering whether to lend

## 1. Is it necessary or advisable for any lender, arranger, facility agent or security agent to be licensed, qualified or otherwise entitled to carry on business in this jurisdiction: (a) by reason only of its execution, delivery or performance of the finance documents; or (b) to enable it to enforce its rights under the finance documents?

No.

## 2. Will any lender, arranger, facility agent or security agent be deemed to be resident, domiciled, carrying on business or subject to tax by reason only of the execution, delivery, performance or enforcement of the finance documents?

No, although interest and fees payable to the offshore lender, arranger, facility agent or security agent are subject to PRC withholding tax and VAT.

## 3. Are there any regulatory reporting requirements that lenders must observe in connection with those transactions?

No.

## 4. Is it necessary to establish a place of business in your jurisdiction in order to enforce any provision of the finance documents?

Generally, it is not necessary to establish a place of business in the PRC to enforce any loan or security documents.

## 5. Is a foreign bank/financial institution permitted to approach local entities for business?

Yes, as long as communications with local entities are limited to the underlying loan transaction.

# When lending to borrowers

## 1. Are there any restrictions in relation to the type of borrower who may borrow foreign currency or in relation to the term of foreign currency and/or the amount of foreign currency borrowed by local entities?

2017 Regime

On 12 January 2017, the People's Bank of China (PBOC), the central bank of the PRC, further revised the macroprudential administrative regime ("**2017 Regime**") in relation to inbound financing on a nationwide basis, which came into effect on the same date.

An entity incorporated in the PRC (whether a PRC domestic enterprise or a foreign-invested enterprise (FIE), i.e., a company that is not wholly owned by PRC nationals or entities) may obtain inbound financing from offshore lenders without any prior approval from the PBOC or the State Administration of Foreign Exchange (SAFE), the PRC exchange control authority.

Under the 2017 Regime, a borrower may obtain inbound financing provided that the "outstanding" may not exceed the "ceiling".

"Outstanding" means, in respect of the borrower, the sum of the amount drawn but not yet repaid under each of its inbound financings (loans, trade finance, certain contingent liabilities, etc.) with risks pertaining to the tenor, type and exchange rate of each inbound financing taken into account.

"Ceiling" means the maximum amount of "outstanding" permitted under the 2017 Regime, which is calculated based on the borrower's net asset value (if the borrower is not a financial institution), or tier one capital (if the borrower is a banking financial institution) or paid-up capital plus capital reserve (if the borrower is a nonbanking financial institution) multiplied by the leverage ratio and the macroprudential adjustment multiplier, each as determined by the PBOC.

The PBOC may adjust the relevant multipliers and calculation methods from time to time, either generally or with respect to a particular enterprise or industry.

Under the 2017 Regime, where the borrower is not a financial institution, the borrower should perform the following:

File its inbound financing with the SAFE capital account information system no later than three working days before the drawdown.

Update its inbound financing and other relevant data (such as details of the offshore lender, tenor of the loan, amount of the loan, interest rate and its net assets value) with the SAFE on an annual basis.

For any change to its audited net assets value or certain terms of the financing agreement (such as an offshore creditor, the tenor of the loan, amount and interest rate), the borrower should promptly update the SAFE.

Foreign Debt Regime

If the borrower is a FIE, it may elect to continue to follow the rules applicable to the existing foreign debt regime by relying on the borrowing gap available (in the case of a FIE borrower) in calculating the amount of foreign debt that it may incur ("**Foreign Debt Regime**") or the 2017 Regime.

Under the Foreign Debt Regime, the borrower must effect a "foreign debt registration" with the local branch/sub-branch of the SAFE. As long as the borrower has registered its foreign debts with the SAFE and the aggregate amount of its foreign debts does not exceed its so-called borrowing gap, it may freely borrow from non-Chinese lenders.

NDRC registration

The borrower must obtain a Certificate of Approval and Registration (in Chinese, 审核登记证明) from the National Development and Reform Commission (NDRC) before incurring any foreign debt with a tenor of over one year.

Local regulations

Different local regulations apply to some specific regions, such as the free trade zones. This guide does not cover the different regulatory registration, filing or reporting requirements under those local regulations.

## 2. Are there any restrictions on the rate of interest or default interest that may be charged?

There is no regulatory restriction on the interest rate or default interest rate that may be charged on foreign debt. However, the interest rate is part of the information required for SAFE registration. The SAFE can refuse to register a loan if the interest rate is not deemed acceptable. Usually, the interest rate will be acceptable to the SAFE if it is in line with the market interest rate (e.g., by reference to SOFR, Term SOFR or any other replacement benchmark rate commonly adopted in the market in the case of a USD foreign loan).

## 3. Are there any restrictions on particular lenders or classes of lender entering into credit transactions with borrowers?

No, there is no regulatory restriction of this type. A foreign lender may be a foreign financial institution, a company (whether or not it is a related company of the borrower) or a foreign citizen.

## 4. Are there any exchange controls that will apply to payments to be made in foreign currencies or to foreign lenders?

Please refer to the answer to question 1 of this section.

2017 Regime

The borrower should use the loan proceeds for its manufacturing and business operations.

Foreign Debt Regime

After the completion of foreign debt registration with the SAFE, the borrower must open a designated foreign debt account with a bank in the PRC, which will be used to receive the loan proceeds. The loan proceeds must be remitted into the foreign debt account. They may only be used for the borrower's operation within its scope of business, i.e., the specific scope of business that is recorded in its business license.

NDRC requirements

For foreign debt with a tenor over one year, the loan proceeds may only be used for purposes recorded on the Certificate of Approval and Registration (in Chinese, 审核登记证明) issued by the NDRC. In particular, the use of such foreign debt shall not:

Violate any PRC laws and regulations;

Threaten or be detrimental to the national interests, economy, information and data security of the PRC;

Contravene the goal of the PRC's macroeconomic regulation and control;

Contravene the PRC's development, planning and industrial policies;

Increase local government's hidden debts; or

Be used for speculative purposes or (except for banking/financial institutions) be lent to others (other than any circumstance which has been stated in the application materials and approved by the NDRC).

## 5. Is there any requirement to deduct or withhold tax from any amounts to be paid or repaid to a lender (whether domestic or foreign)? If so, at what rate must tax be deducted and from what kinds of payment?

A foreign company without any presence in the PRC but receives profits, interest, rent, royalties or other income from sources in the PRC is subject to withholding tax on that income. The withholding tax rate is 10%, unless the foreign company is from a jurisdiction with which China has entered into a tax treaty that allows a preferential rate.

## 6. Are there any “thin capitalization” or other rules that may limit the extent to which interest payments may be deducted for tax purposes?

According to the PRCs thin capitalization rules, interest for debts in excess of the prescribed debt-to-equity ratio (i.e., 5:1 for financial enterprises and 2:1 for other enterprises) is not deductible unless the borrower is able to prove that borrowings from a related lender are on arm's length terms or that the actual tax burden of the domestic borrower is no higher than its domestic related lender.

In this answer, reference to "thin capitalization" is not a reference to a company's borrowing capacity (in the PRC, the expression is sometimes used in that context).

## 7. Are there any registration, notarization, translation or reporting requirements in relation to the loan documents?

Other than the cross-border financing filing and foreign debt registration with the SAFE or the NDRC, there are no other registration, reporting or notarization requirements in relation to the loan agreement. Further, the loan agreement and other relevant transaction documents will need to be translated if such documents are to be submitted to a PRC court in legal proceedings. Please refer to the answers to question 8 of the "If things go wrong" section.

However, there are governmental approval and registration requirements in relation to certain security documents. Please refer to the answers to questions 11 and 12 of the "If taking security" section.

## 8. Are there any stamp, documentary, registration, notarization or other taxes, duties or fees chargeable in relation to the loan documents? If yes, what are the amounts and when are they payable?

Stamp duty is levied on categories of dutiable documents that have legal effect in the PRC and that are "protected under PRC law." The categories of dutiable documents are exhaustive so that any document that does not fall within these categories is not subject to stamp duty in the PRC.

For dutiable documents, stamp duty is due on the execution of the documents if the documents are executed in the PRC. However, if a document is executed outside the PRC but is used in the PRC, stamp duty will be payable.

A loan agreement is subject to stamp duty. Each party to the loan agreement must pay stamp duty at the rate of 0.005% of the principal amount (e.g., 5,000 out of 100 million). However, there is debate on whether it is the foreign party's obligation to pay the stamp duty in the case of a foreign debt agreement. The issue is whether the stamp duty applies to a foreign lender. Failure to pay the required stamp duty will trigger sanctions by the tax authority (such as a penalty), but it will not affect the validity, legality or enforceability of the agreement itself and it will not prevent the admission of the loan agreement as evidence in court.

Effective from 1 May 2016, VAT at the rate of 6% is charged on income derived by a foreign entity for providing a service in the PRC.

There are no other documentary, registration or other similar taxes, duties or fees chargeable in respect of a loan agreement.

Foreign debt registration with the SAFE and the NDRC is free of charge.

For security documents, please refer to the answers to questions 11 and 12 of the "If taking security" section.

## 9. Does the law recognize the subordination of the debt that a debtor owes to one creditor to that which the debtor owes to another creditor? If yes, how is this usually effected?

PRC law recognizes the concept of subordination. Subordination is usually effected by way of a contractual arrangement among the senior creditor, the subordinated creditor and the debtor.

## 10. Are there any classes of unsecured and unsubordinated creditor whose claims against a debtor would rank equally with or above those of the debtor’s other unsecured and unsubordinated creditors (e.g., the claims of employees and tax authorities or the claims of creditors under particular kinds of instrument)? If yes, what classes of creditors are preferred?

The PRC Enterprise Bankruptcy Law sets out a hierarchy of debts to determine payment priority. The following claims rank above those of general (or "common") unsecured and unsubordinated creditors, and they must be paid in the following descending order of priority:

Bankruptcy expenses

Common interest debts incurred for the benefit of the creditors

Employee claims including unpaid salaries, medical and disability subsidies, basic old age and medical insurance premiums, and compensation in accordance with PRC law

Social insurance premiums and outstanding tax

If the property available for distribution in the bankruptcy is insufficient to discharge all of the debts within a particular rank of debts, the discharge of the debts within that rank will be effected on a pro rata basis.

## 11. Are there any consumer protection or similar laws that apply if credit is made available to individuals or other classes of debtor? If yes, what laws are applicable?

Currently, PRC nationals are not allowed to borrow money from outside the PRC. The PRC consumer protection regime is therefore not relevant.

## 12. Are there any prohibitions or limitations on the extent to which a company can give financial assistance for the purchase of: (a) its own shares or those of any affiliated company; or (b) assets owned by it or any affiliated company?

There is no concept of "financial assistance" in the PRC and therefore, there is no particular prohibition on a PRC company providing security or giving a guarantee to a third party. Nevertheless, the PRC Company Law contains a general restriction on PRC companies providing security on behalf of its shareholders or de facto controllers. Where a PRC company provides security to secure the liabilities of any of its shareholders or a person who actually controls the PRC company, the security must be approved by its shareholders. Approval must be in the form of a shareholders' resolution passed by the shareholders with more than half of the voting rights of all the shareholders present at the relevant shareholders' meeting. Shareholders whose debts are being secured by the company and any shareholders controlled by the de facto controller are not entitled to vote.

# If taking security

## 1. Are there any classes of unsecured and unsubordinated creditor whose claims against a debtor would rank equally with or above those of the debtor’s secured creditors?

No. Secured creditors generally have priority to the extent of the value of their security, but any portion of the debt not covered by the value of the security is treated as an unsecured claim.

## 2. May security given by a company rank in a specified order so as to secure liabilities owed to different creditors of the company in that order and, if that is not possible, is it viable for parties to enter into a contractual arrangement for the purposes of moderating this order?

For certain types of security, such as a mortgage, it is permissible for a security provider to create securities in favor of different creditors over the same assets. The PRC Civil Code contains general provisions in terms of priority among different creditors in relation to securities created over the same assets. For example:

If there is more than one mortgage over the same asset (with a mortgage taking effect on registration with the relevant governmental authority), the priority is determined based on the sequence of registration.

If there is a mortgage and a pledge over the same asset, a registered mortgage has priority over a pledge but a pledge has priority over an unregistered mortgage.

However, in practice, except for mortgages over real property, having more than one mortgage over the same asset does not often occur in banking transactions.

## 3. Does this jurisdiction recognise the concept of floating security or similar equivalent (i.e., security over a changing pool of assets that the company giving the security is free to buy, sell and generally deal with)?

The PRC Civil Code recognizes the concept of a floating mortgage. This is usually created over assets such as equipment, raw materials, semi-finished products and finished products.

## 4. If so, are there any practical reasons why floating security is difficult to take, maintain or enforce?

A floating mortgage will take effect when the mortgage contract takes effect, but it will not be upheld against bona fide third parties unless it is registered with the PBOC. Due to the floating nature of the underlying assets, a floating mortgage is not common in banking transactions.

## 5. May security be granted to a trustee to be held on trust for the lenders from time to time, in such a way that a change of lenders does not require new security to be taken?

Yes, although for domestic syndicated loan transactions, as only licensed trust companies may carry on trust business but cannot be a party to a syndicated loan transaction, a security agent (rather than a security trustee), which is one of the lending banks, is used.

## 6. If not, are there any techniques that can be used to achieve substantially the same effect (e.g., parallel debt structures)?

Not applicable.

## 7. If an agent holds security for the lenders rather than a trustee, is it necessary to take new security on a change of lenders? If no, why not? If yes, are there ways to structure the transaction to avoid such a requirement?

No. If the security is held by a security agent, it is not necessary to take new security (or amend the security agreement or update the security registration with government authorities) if there is a change of lenders.

## 8. Under the laws of this jurisdiction, is there any class of asset over which it is difficult or impossible to grant effective and perfected security, or in relation to which any security granted will be of limited effect?

Under the PRC Civil Code, a mortgage or a pledge cannot be created over the following assets:

Land title (with a few exceptions, land title belongs to the state; therefore, the land title cannot be mortgaged or pledged and, instead, the land use right can be mortgaged).

A land use right in relation to collectively owned land (which refers to some land in rural areas).

Educational facilities, hospital facilities and other public service facilities.

Assets whose title or use right is unclear or in dispute.

Assets that are subject to attachment.

Assets that are not allowed to be mortgaged or pledged by law (as may be prohibited by national and local laws and regulations).

## 9. Under the laws of this jurisdiction, are there any restrictions on offshore lenders taking security over any class of asset?

There are no such restrictions.

## 10. Must a company receive a corporate benefit in return for giving a guarantee or security? In particular, are there restrictions on the grant of upstream and cross-stream guarantees and security? If yes, briefly what is the effect of these laws?

There is no concept of "corporate benefit" under PRC law; therefore, there is no prohibition on a PRC company providing security or a guarantee to a third party.

## 11. What type of security interests does your jurisdiction recognise, e.g., pledge, charge, mortgage, hypothecation? In relation to each type of security interest, please state the formalities required to create and perfect that security.

Types of typical security

The PRC Civil Code recognizes the following types of typical security:1

Guarantee

It is not necessary to complete any regulatory formalities to create and perfect a guarantee.

Mortgage

A mortgage can be created over real property and movable assets.

For a mortgage over real property (including real property with construction in progress), the mortgage will take effect on its registration with the local authority (usually the local real estate registration authority).

For a mortgage over movable assets (such as equipment, vehicles and aircraft), the mortgage will take effect when the mortgage contract takes effect, but it will not be upheld against bona fide third parties unless it is registered with the relevant authority. See the answer to question 4 of this section in relation to a floating mortgage.

Pledge

A pledge can be created over movable assets and certain rights (such as stocks, equity interest and accounts receivable). For a pledge over movable assets, the pledge will take effect when the pledged asset is delivered to the pledgee. For a pledge over rights, the pledge will take effect when the following occur:

The certificate evidencing that right (such as a certificate of time deposit) is delivered to the pledgee; and

The pledge is registered with the relevant authority.

Deposit

A cash deposit takes effect when the deposit is delivered to the beneficiary.

Lien

It is not necessary to complete any regulatory formalities to create and perfect a lien.

General

Administrative practices and requirements in different provinces, cities, districts and counties may vary. It is therefore advisable to check with the relevant local authorities before taking security.

For further details on the registration requirements, see the answer to question 12 of this section.

1 Apart from the types of typical PRC law security listed, the PRC Civil Code also recognizes the "non-standard security" interest contemplated by "non-typical security contracts." Such contracts are contracts that do not take the form of a guarantee, mortgage or pledge but would nevertheless serve a security function according to their respective terms. Currently, security by transfer of ownership, retention of title, financial leasing and factoring arrangements would generally fall within the scope of such "non-standard security." The overall legal judicial practice regarding such "non-standard security contracts" has not yet been well established. It is expected to evolve given that the PRC Civil Code is still fairly new legislation and it is not yet common for creditors to take "non-standard security" in the market. Hence, we have only focused on the types of typical security in our responses that are most popular among offshore lender banks.

## 12. Are there any registration, translation or notarization requirements in relation to security, guarantees, subordination or intercreditor documents?

Jurisdiction of companies involved

There are some particular requirements, depending on whether the security relates to a PRC company or a foreign entity.

For a pledge over an equity interest in a PRC company, the pledge must be recorded in the company's share register and registered with the local counterpart of the State Administration for Market Regulation.

If the beneficiary of the security is a foreign entity, the exchange control regulations on cross-border security may be relevant. In particular, if:

Both the primary obligor and the creditor (i.e., the beneficiary of the security) are foreign parties; and

The security provider (references to "security provider" include reference to guarantors as well) is a PRC party,

the security provider (references to "security provider" include reference to guarantors as well) must effect cross-border security registration with the State Administration of Foreign Exchange. The registration is not a condition that affects the validity of the security but without registration, it will be difficult for the security provider to remit the enforcement proceeds out of the PRC when the security is enforced.

Additional requirements in some localities

In some localities, there are additional administrative requirements. For example, for a mortgage over real property, if the mortgagor or mortgagee is a foreign entity, the mortgage contract and the foreign entity's corporate documents may need to be notarized and legalized1 or apostilled2 before they are permitted to be submitted to the local authorities.

Subordination and intercreditor documents

There are no registration or notarization requirements in relation to subordination or intercreditor documents.

1 Applicable to documents issued in a non-contracting state of Hague Convention Abolishing the Requirement of Legalization.

2 Applicable to documents issued in a contracting state of Hague Convention Abolishing the Requirement of Legalization.

## 13. Are there any stamp, documentary, registration, notarization or other taxes, duties or fees chargeable in respect of security, guarantees, subordination or intercreditor documents? If yes, what are the amounts and when are they payable?

No stamp duty is payable in relation to securities (including guarantees), subordination or intercreditor documents.

In most cases, the registration of securities is free of charge, except that local authorities may charge a fee for the registration of a mortgage over real property. Local practice should therefore be checked at an early stage.

# If things go wrong

## 1. Please provide a brief description of the insolvency regime. In particular what rights and duties do unsecured and secured lenders have on the insolvency of a debtor? Are there any other matters of concern?

Bankruptcy Law

The PRC Enterprise Bankruptcy Law ("**Bankruptcy Law**") came into effect on 1 June 2007.

The Bankruptcy Law introduced the following key concepts:

Voluntary and involuntary bankruptcy

An independent administrator

The involvement of creditors in the administration of the bankruptcy

Restructuring and settlement

Extraterritoriality, allowing property outside the PRC and certain foreign proceedings to fall within the regime

Voidable transactions

Ratable distribution

Grounds for bankruptcy

An enterprise qualifies for bankruptcy, restructuring or settlement under the Bankruptcy Law if one of the following occurs:

The enterprise is not able to meet its obligations to repay its debts, and its assets are less than its liabilities.

The enterprise is knowingly incapable of paying its debts.

Application to court

Bankruptcy proceedings are commenced in the people's court in the location in which the enterprise is domiciled. Either the debtor or its creditors can initiate it. If the debtor is a financial institution, the relevant regulatory authorities under the State Council file the court application.

Appointment of an administrator

On acceptance of the bankruptcy application, the court appoints a bankruptcy administrator. The bankruptcy administrator may be a member of a recognized legal, accounting or specialist bankruptcy firm, or they may otherwise possess the relevant professional expertise and qualifications.

The administrator reports to the people's court and the creditors' meeting, and the creditors' committee supervise them. The creditors' meeting can replace the administrator or seek their removal if they fail to perform their duties in a lawful and impartial manner or if the creditors' meeting decides that there are circumstances that prevent them from performing their duties competently.

Creditors' meetings

The Bankruptcy Law involves creditors in the bankruptcy process through creditors' meetings and the creditors' committee.

A creditor that has submitted a claim in bankruptcy is entitled to attend and vote at the creditors' meeting. The exception is that secured creditors cannot vote on the adoption of a settlement plan or a distribution plan of the debtor's assets unless they have waived their right to priority. Generally, a resolution of the creditors' meeting is passed by a simple majority of the creditors with voting rights that are present at the meeting and that represent 50% or more of the value of the debtor's unsecured debt.

The creditors' meeting may establish a creditors' committee that comprises creditor representatives elected by the creditors' meeting, and it must include an employee representative of the debtor or a representative of its trade union. The creditors' committee is responsible for supervising the management, disposal and distribution of the debtor's property, proposing the convening of creditors' meetings and any other duties that are delegated to the creditors' committee by the creditors' meeting.

Priority and ranking of debts

The Bankruptcy Law sets out a hierarchy of debts to determine payment priority. Payment must be made in the following descending order of priority:

Bankruptcy expenses

Common interest debts incurred for the benefit of creditors

Employee claims including unpaid salaries, medical and disability subsidies, basic old age and medical insurance premiums, and compensation in accordance with PRC law (such as compensation payable due to the early termination of an employment contract)

Social insurance premiums and outstanding tax

General or "common" unsecured claims

If the property available for distribution in the bankruptcy is insufficient to satisfy the discharge of all of the debts within a particular rank of debts, the distribution within that rank will be effected on a pro rata basis.

Secured creditors generally have priority to the extent of the value of their secured property, and any shortfall is treated as an unsecured claim.

Restructuring and settlement

The Bankruptcy Law also provides a formal process by which to restructure or rehabilitate viable businesses. Although the court may have accepted a bankruptcy application, the Bankruptcy Law allows a debtor or its creditors, prior to an enterprise being declared bankrupt, to apply to the court for the restructuring or reorganization of its business. The legislation also allows a debtor to apply for a compromise or settlement of its debts with its creditors.

## 2. Is it possible to obtain a moratorium before insolvency?

A moratorium is imposed on the debtor's assets upon the acceptance of the bankruptcy application by the court. Upon the acceptance of the bankruptcy application, all preservation measures (such as court attachments) against the debtor's property are lifted and all enforcement actions are suspended. Civil actions or arbitration procedures that have commenced against the debtor but that are not completed are stayed. Any repayment of debts to a creditor during this period is deemed invalid.

## 3. When a company is the subject of a formal insolvency procedure, can the company’s pre-insolvency transactions be set aside?

The administrator can petition the people's court to revoke the following types of transactions entered into within one year preceding the court's acceptance of the bankruptcy application:

Transfers of property for no consideration

Transactions carried out at markedly unreasonable prices

Provision of security for unsecured debts

Premature settlement of undue debts

Renouncement of creditors' claims

The administrator can also recover debts that have been repaid to individual creditors within six months prior to the acceptance of the bankruptcy petition, except where the debtor has benefited from the repayment.

Transactions that conceal or transfer assets for the purpose of avoiding liabilities, fabricating debts or acknowledging a fictitious debt would be deemed invalid under the Bankruptcy Law.

## 4. When can a lender enforce its security? Can security be enforced out of court following an event of default (or other contractual trigger event), or is a court order required? Are there any restrictions that apply before a lender may enforce its security?

Assets subject to security do not fall within the scope of bankruptcy assets. Secured creditors may exercise their security rights from the date the court approves the settlement that is part of the bankruptcy proceedings.

## 5. Do any limitation periods apply in relation to bringing an action to enforce security?

Yes, the statutory time limit in relation to the action is three years, subject to suspension and discontinuation provided by law. Calculation of the three-year period may be paused or restarted under certain circumstances. The beneficiary of the security should take legal action against the security provider within the time limit in relation to the action of the primary debt. Usually, the beneficiary of the security takes legal action against the primary obligor and security provider concurrently.

## 6. Is there any particular way in which secured assets must be liquidated on enforcement (e.g., by auction or court sale)?

No.

## 7. Are there any particular legal or practical difficulties or delays in enforcing security?

Without the cooperation of the debtor or security provider, the beneficiary will need to go through court proceedings to enforce the security.

If the debtor and the security provider fail to honor the court judgment or arbitral award after the beneficiary of the security obtains a favorable judgment or arbitral award, the creditor can apply to the court for the enforcement of the judgment or arbitral award. Typically, the court disposes of the assets by way of a public auction organized by the court. The court may request the beneficiary of the security to provide information (such as bank account details and the location of the assets) in relation to the relevant assets. This may add certain difficulties or prolong the process in relation to the enforcement, as it will take additional time for the beneficiary to collect the relevant information (which may not always be available).

## 8. In relation to enforcement, are there any specific requirements to be borne in mind if the lender is a foreign entity?

There are several specific requirements, as set out below.

Engaging PRC counsel

Procedurally, for a foreign lender to take legal action before a PRC court, it must engage a qualified PRC law firm. The power of attorney of the lender from outside the PRC for engaging the PRC law firm must be notarized and legalized1 or apostilled2 in the lender's home jurisdiction.

Language version

Court proceedings in the PRC are conducted in Chinese. Therefore, where a transaction document is prepared in English or another foreign language, a Chinese translation must be prepared and submitted to the court. Usually the people's court will require the translation to be prepared or reviewed by a third-party translation firm designated by or acceptable to the court.

Governing law

Generally, parties to a contract with a "foreign element" are allowed to choose either PRC law or foreign law as the governing law of the contract, unless otherwise provided under PRC law.

Loan documents and security documents entered into by a foreign lender are considered contracts with a "foreign element." The foreign lender may (but it is not obliged to) choose PRC law or foreign law to govern its loan and security documents to be entered into with PRC clients, except under certain PRC laws. A mortgage over property located in the PRC and any pledge over rights (such as an equity pledge, a pledge over receivables, a pledge over securities and negotiable instruments) created in the PRC must be governed by PRC law.

If the parties to a transaction document choose to have it governed by foreign law, the PRC court may still apply PRC law during the court proceedings in relation to the transaction document if it determines the following:

The parties have not provided or proved the relevant contents of the foreign law to the court.

The parties chose the foreign law to evade mandatory PRC law requirements.

The choice of the foreign law violates the social and public interests of the PRC.

Recognition and enforcement of a foreign court judgment

Under the PRC Civil Procedures Law, a foreign party seeking the recognition and enforcement of a foreign court judgment in the PRC court may perform one of the following:

Make a direct application for the recognition and enforcement of that judgment to a relevant PRC court.

Ask a foreign court to submit a request to the PRC court for the recognition and enforcement under the judicial assistance procedure.

The PRC court will only recognize and enforce a foreign judgment when both the PRC and the country where the judgment in respect of which enforcement is sought have concluded or acceded to a bilateral or international judicial assistance treaty regarding the mutual recognition and enforcement of commercial judgments, or where reciprocity can be demonstrated.

If there is no international judicial assistance treaty regarding the recognition and enforcement of commercial judgments between the PRC and the relevant country, in practice, the PRC court would only consider an application if the foreign applicant is able to prove the existence of reciprocity, i.e., that the courts of the foreign jurisdiction would enforce and have previously enforced a judgment of a PRC court. Although proof of reciprocity by the foreign plaintiff is not specifically stated in the PRC Civil Procedures Law, as a matter of practice, it appears to be a requirement of the PRC courts.

Therefore, in the PRC, it would be difficult to enforce a judgment given by a foreign court unless the PRC has concluded or acceded to a judicial assistance treaty regarding the enforcement of a commercial judgment with that foreign jurisdiction.

Recognition and enforcement of a foreign arbitral award

The PRC acceded to the New York Convention on the Recognition and Enforcement of Foreign Arbitral Awards ("**New York Convention**") on 22 April 1987. The party seeking the recognition and enforcement of a foreign arbitral award in a PRC court may make a direct application to a competent PRC court within two years after the award is made. Under the notice published by the Supreme People's Court on implementing the New York Convention, the PRC court may reject the application for the recognition and enforcement of foreign awards on the following grounds, as set forth in Article V of the New York Convention:

A party to the arbitration agreement ("**Arbitration Agreement**"), under the laws applicable to it, had no capacity to enter into the Arbitration Agreement, or the Arbitration Agreement was indeed invalid under the law to which the parties are subject or, in the case where there is no express governing law of the Arbitration Agreement, the Arbitration Agreement was indeed invalid under the law of the place where the arbitration award was made.

The party against whom the application is filed was not given proper notice of the appointment of the arbitrator or was otherwise unable to present its case.

The award deals with any dispute not contemplated by or not falling within the terms of the Arbitration Agreement or the award contains decisions on matters beyond the scope of the submission to arbitration. However, if the award contains decisions on matters submitted to arbitration that can be separated from those not submitted, the part of the award that contains decisions on matters submitted to arbitration will be enforced.

The composition of the arbitral tribunal or the arbitral procedures was not in accordance with the agreement of the Arbitration Agreement or, failing that agreement, with the law of the place where the arbitration took place.

The award has not become binding on the parties, or it has been annulled or its enforcement has been suspended by the court or in accordance with the law of the place where arbitration took place.

The PRC court decides that the dispute is incapable of being settled by arbitration under the laws of the PRC.

The PRC court holds that the enforcement of the arbitration award in the PRC would be contrary to the public interests of the PRC.

For foreign arbitral awards made in a territory that is not a member of the New York Convention, the recognition and enforcement of those awards will be reviewed in light of bilateral agreements between that jurisdiction and the PRC (if any) or in light of the principle of reciprocity.

1 Applicable to documents issued in a non-contracting state of Hague Convention Abolishing the Requirement of Legalization.

2 Applicable to documents issued in a contracting state of Hague Convention Abolishing the Requirement of Legalization.

## 9. Is there any reason why you think that arbitration rather than litigation might be advantageous in resolving disputes under the finance documents, and if so, why? Please outline the relative merits of arbitration and litigation, including the ease of enforcement of foreign judgments and foreign awards from different jurisdictions. Is it possible to rely on a hybrid enforcement provision that allows the lenders to opt for either arbitration or litigation as they see fit?

In practice, in the PRC market, for most banking transaction documents (even those of foreign banks' subsidiary banks or branches in the PRC), the parties choose to have their disputes resolved by the court rather than use arbitration.

One important advantage of having a dispute resolved by the court is that if a party is not satisfied with the results of the court's judgment at the first hearing, it may appeal to a higher court for a second (and final) hearing. In arbitration, there is no second hearing. As mentioned, the enforcement of an arbitral award needs to go through the court.

In light of the above, we do not consider there to be a strong advantage in using arbitration rather than court litigation to resolve disputes under the finance documents.

Finally, the effect of a hybrid enforcement provision that provides for an option for the lenders to choose between arbitration and litigation depends on the governing law of such enforcement provision. From a PRC law perspective, a jurisdiction clause that allows for a choice between court proceedings and arbitration is invalid. Therefore, PRC courts will not recognize the effect of a hybrid enforcement provision if the parties have chosen PRC law as the governing law or the PRC courts have otherwise decided to apply PRC law to determine the effect of such provision.1

However, there is one exception to such rule in judicial practice: If a party has submitted the dispute to the selected arbitration institution based on a hybrid enforcement provision and the opposing party does not object to it before the commencement of the first hearing of the arbitration tribunal, then the arbitration tribunal will proceed with arbitration even if the jurisdiction clause is a hybrid one. Meanwhile, a hybrid enforcement provision will generally be acceptable to the PRC courts if the parties have expressly chosen a foreign law that recognizes the effect of such provision as the governing law of such provision.

1 This would usually happen if: (i) the parties have not expressly selected a governing law for the hybrid enforcement provision but have chosen a PRC arbitration institution or the PRC as the place of arbitration; or (ii) the parties have not expressly selected a governing law for the hybrid enforcement provision and have not expressly agreed on the arbitration institution or place of arbitration, but the dispute has a PRC nexus (for example, one of the parties is a PRC resident or the contract is signed within the territory of the PRC).

## 10. Are asymmetrical jurisdiction clauses enforceable? (By this we mean clauses that allow the lenders, but not the borrowers, to make certain choices in relation to choice of jurisdiction and how to litigate. These types of clauses allow the lenders, but not the borrowers, to commence proceedings in any court they choose, but restrict the borrowers to commencing proceedings in one jurisdiction only. This may also allow the lenders, but not the borrowers, to choose whether to litigate the finance documents before a court or to submit to arbitration in relation to them, but restrict the borrowers to either litigation or arbitration, as specified in the agreement).

It is not prohibited by law to document that the lenders, but not the borrowers, may commence proceedings in any court they choose but restrict the borrowers to commence proceedings in one jurisdiction only.

However, under PRC law, the parties must select in the loan agreement either court litigation or arbitration to resolve the disputes.

# Working digitally

## 1. Is it possible for documents to be executed electronically (whether by the manual insertion of a digital signature or the use of an e-signing platform) under the laws of this jurisdiction? If so, is this limited to only particular types of finance documents?

In general, electronically signed finance documents are legally valid and enforceable in the PRC, provided that the electronic signatures satisfy all of the following conditions and are therefore deemed reliable electronic signatures under PRC law:

The electronic data that is used to generate the electronic signature is exclusively owned by the signing party at the time of execution.

The electronic data that is used to generate the electronic signature is exclusively controlled by the signing party at the time of execution.

Any alteration to the electronic signature after signing can be detected.

Any alteration to the contents and form of any electronic data can be detected after signing.

However, finance documents may not be executed using electronic signatures in certain scenarios as they are subject to specific form requirements. For example, for finance documents that must be registered with the relevant authorities (e.g., in the case of the registration of an equity pledge or mortgage of real property), the relevant authorities usually only accept wet ink signatures and/or company chops for registration purposes.

## 2. Where the witnessing of a signing is contemplated, is it possible for the witness to verify the signature over a live video call?

Witnessing is not mandatory for signing of finance documents under PRC law. Nevertheless, where witnessing is required pursuant to the stipulation of the underlying finance document, the witness will usually attend the signing process in person.

## 3. Is it possible to register/perfect security electronically without wet ink signatures?

It depends on the type of security contemplated by the undertaking finance documents. For mortgage over real property, an equity pledge and other types of security that require the physical submission of the registration application with the relevant authorities, the relevant authorities usually only accept wet ink signatures. For certain types of security that either do not require registration or can be registered or perfected through online registration with the relevant authorities (e.g., mortgage of movable assets, pledge over receivables, etc.), the security can be registered and/or perfected electronically without requiring wet ink signatures.

## 4. Are there any other legal restrictions that may prevent the parties from executing a finance transaction electronically?

There are no additional restrictions other than those stated in our responses to questions 1 and 3 of this section.

# Contributors

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This chapter was prepared by Baker & McKenzie FenXun.

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