Commercial factoring business in China Free Trade Zone to take off

Description

[You may wish to download a PDF version of this post, click New Rules for Commercial Factoring in Shanghai Free Trade Zone_140604.]

New and detailed rules regarding special treatments for certain industries in China (Shanghai) Pilot Free Trade Zone (the "**Shanghai FTZ**") have erupted recently covering quite a number of sectors that may otherwise not be accessible by foreign investors, among which is commercial factoring. According to the website of Shanghai FTZ, a new regulation entitled "Provisional Regulatory Measures on Commercial Factoring Business in Shanghai FTZ" (the "**FTZ Rules**") was posted in February of 2014, paving the way for commercial factoring companies to be set up more easily and grow faster within Shanghai FTZ. Compared with the local rules regarding commercial factoring issued by Shanghai Pudong government with the endorsement of China Ministry of Commerce, the FTZ Rules don't really have any significant breakthrough but rather incorporate new instructions and new developments in respect of or in relation to commercial factoring.

Here is the brief summary of this Shanghai FTZ Rules.

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I. Concept of Commercial Factoring in the Provisional Regulation

There has been no uniform definition of factoring in China. Different government regulations may come up with somehow different definition.

(1) In the Pudong Government local rules regarding commercial factoring, "commercial factoring" refers to suppliers assigning their account receivables under goods sale contract or service contract with buyers to commercial factors who in turn provide trade financing, receivable ledgering services.

(2) In another piece of regulation recently issued by China Banking Regulatory Commission (the "**CBRC**"), "factoring" is comprehensive financial services encompassing receivables collection, ledgering, bad debts security and financing on the precondition that creditors have assigned their account receivables (to banks).

(3) In FTZ Rules, "commercial factoring" refers to suppliers assigning their existing and future account receivables to factors (non-banking institutions) for financing or for services of account ledgering, collections or protection pursuant to the factoring contract concluded between the suppliers and factors.

The scope of factoring business does not diverge that much from one definition to another. The bright spot in the FTZ Rules is that for the first time, official rules recognize the factoring of future account receivables. Under current legal regime pertinent to factoring, mainly the provisions in China Contract Law regarding assignment of contractual rights, it is believed that the rights under contracts referred to in China Contract Law shall mean only those rights that have come into existence other than those receivable to arise in the future. Indeed, CBRC had issued an notice in 2012 in which CBRC expressly prohibits factoring of future receivables. This breakthrough will have far-reaching impact on the

development of Chinese factoring industry.

II. Setup of Commercial Factors

The FTZ Rules have simplified the procedures of setting foreign-invested commercial factoring companies. Investors shall firstly apply to FTZ administration commission for certificate of filing after obtaining which investors shall just go to company registration authority for registration of factoring company. Compared with procedures for foreign investments outside of the free trade zone, this indeed will save a lot of runaround work and time in getting your business entity established in China.

In the meantime, FTZ Rules also permit lease finance companies to add commercial factoring business as part of their business scope provided that such added factoring business shall be related to their core businesses, namely related to leased objects or related to their clients.

Foreign invested new lease finance companies may also apply to FTZ administration commission for approval after obtaining which the investors shall go to company registry authority for registration of the lease finance companies.

A commercial factoring company shall meet the following conditions:

(1) its investor shall have experience in operating commercial factoring business or related businesses;

(2) investors shall have such scale of assets and financial strength as necessary for conducting factoring business and have sound corporate governance and risk management systems, and have not been penalized for violation of rules in recent period of time;

(3) upon applying for setup of commercial factoring company, there should be two or more senior managers who have experience in financial fields without records of bad credibility;

(4) the commercial factoring company shall have a registered capital of not less than RMB 50 millions which shall only be contributed in money;

(5) there shall be sound internal control systems including risk assessment, business flows and procedures, supervision etc.;

(6) lease companies undertaking commercial factoring shall meet the setup conditions prescribed for lease companies.

The name of a commercial factoring company must contain the words “commercial factoring”.

III. Business Operation

(1) Business scope

The business that commercial factoring companies do includes: (a) import and export factoring; (b) domestic and offshore factoring; (c) consultation related to factoring; (d) other approved businesses.

On the other hand, the FTZ Rules make it clear that commercial factoring companies cannot undertake the following businesses: (a) taking deposits; (b) money lending; (c) undertaking debts collection not

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related to factoring; (d) making investment on behalf of others; (e) other business activities prescribed as not allowed by the state.

(2) Receivables that can be factored

FTZ Rules require that the account receivables assigned to commercial factors must be those within its normal life of payment, or in other words not due yet. In principle, the following account receivables are not assignable:

(a) void account receivables arising from unlicensed business operation in violation of state laws and regulations;

(b) account receivable arising from trade in dispute;

(c) account receivable arising from contract under which it is agreed that goods can be returned if sale is not completed;

(d) account receivables arising from guarantee money and other money of similar nature;

(e) account receivables that may be set off;

(f) account receivables that have been assigned or collateralized;

(g) account receivables against which a third party makes a claim based on subrogation;

(h) account receivables that are not assignable as provided by law or as agreed by the parties;

(i) account receivables that are the subject matter of compulsory measures or proceedings;

(j) account receivables that may have other defects.

Such requirements on legal technicalities will open rooms for legal professional work to ensure compliance.

(3) Risk Management

(a) Commercial factors shall undertake the online registration of themselves with the Public System of Account Receivable Pledge maintained by China People's Bank, the central bank of China. For each account receivable assigned, the factor shall register the account receivable with the pledge system, and accordingly effect changes and cancellation of such account receivables.

(b) Commercial factors shall make sure that their risk assets shall in principle not be more than 10 times their net assets. Risk assets refer to the amount of assets resulted from deducting cash, bank deposits and government bonds from the total assets.

(4) Business Report

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Commercial factors shall file its information with the Commercial Factoring Information System maintained by China Ministry of Commerce, such as corporate profile, qualification of senior officers, financial conditions, business development and internal control systems.

Commercial factors shall report its business information via the said filing system within 15 business days of the end of every preceding month and season.

It shall be noted that the FTZ Rules impose a two-year period for its life. In other words, after two years, the FTZ Rules may come to an end or may have to be altered. For investors that are keen to tap Chinese factoring industry, it is a good opportunity to grab to set up your China business presence.

Commercial factoring is on the rise but given Chinese business environment in particular credit environment, it won't be just rosy beds ahead. Commercial factors shall rely heavily on professional assistance to ensure that their factoring deals are well protected under Chinese laws.

Date Created
May 2014
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