International Factoring in China Part I: overview of legal regimes for factoring industry

Description

Factoring has been a big thing in China trade arena recent years. Ever since a push by China Ministry of Commerce promulgating in 2012 a set of new rules regarding setup of commercial factoring firms, commercial factors have been mushrooming in China with particularly robust growth in Tianjin, Shanghai, Guangzhou and Shenzhen.

However, bank factoring has been around for decades since Bank of China joined Factors Chain International in 1993. In a sense, China's international factoring started much earlier than domestic factoring. Despite the two-decade long history, China does not have any special rules governing factoring business until just recent years.

This post is aimed at introducing the current legal regimes for China factoring business according to Chinese legislation structure.

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I. National/State Laws

China has not enacted any special factoring laws regulating factoring entities and business operation so far. As part of China Contract Law which was enacted in 1999, rules governing assignment of contractual rights are provided therein, which furnishes the sketchy legal framework governing factoring in China.

> Article 79 Assignment of Rights; Exceptions
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> The obligee may assign its rights under a contract in whole or in part to a third person, except where such assignment is prohibited:
>
> (i) in light of the nature of the contract;
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> (ii) by agreement between the parties;
>
> (iii) by law.
>
> Article 80 Duty to Notify When Assigning Rights; Revocation of Assignment Subject to Assignee's Consent
>
> Where the obligee assigns its rights, it shall notify the obligor. Such assignment is not binding upon the obligor if notice was not given.

A notice of assignment of rights given by the obligee may not be revoked, except with the consent of the assignee.

Article 81 Assumption of Incidental Rights in Case of Assignment

Where the obligee assigns a right, the assignee shall assume any incidental rights associated with the obligee's right, except where such incidental right is exclusively personal to the obligee.

Article 82 Assigned Rights Subject to Accrued Defenses of Obligor

Upon receipt of the notice of assignment of the obligee's right, the obligor may, in respect of the assignee, avail itself of any defense it has against the assignor.

Article 83 Availability of Set-off to Obligor

Upon receipt of the notice of assignment of the obligee's right, if the obligor has any right to performance by the assignor which is due before or at the same time as the assigned obligee's right, the obligor may avail itself of any set-off against the assignee.

These provisions in China Contract Law deal with receivables that cannot be assigned, how to make an effective assignment of contractual rights, revocation of assignment, assignment of incidental rights, and debtor's defenses and set-off rights.

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Prior to enactment of China Contract Law, assignment of contractual rights is discouraged as General Principles of China Civil Laws required consent of the debtor for assignment of contractual rights by creditors.

It shall be born in mind that in the context of China Contract Law, the concept of "contractual rights" encompasses a lot more than accountant receivables which always refer to financial/monetary obligations owing by debtors. A contractual right assignable under a contract can be a right of requesting the debtor to perform non-pecuniary obligations.

We will later on comment on each provision regarding its impact on factoring practice in China.

II. Administrative Regulations

There is so far no any known regulation in relation to factoring industry promulgated by China State Council, though China State Council has indicated support for account receivable financing and building credit system in China.

III. Ministerial and Local Ordinances

By ordinances here, I refer to rules prescribed by central ministries and local governments.

By China Ministry of Commerce:

1. Early in 2012, China Ministry of Commerce issued the Notice on Work Related to Commercial Factoring Pilot Program, outlining the basic rules for incorporating and operating commercial

factoring companies in both Tianjin and Shanghai areas. Since then, factoring companies have sprung up quickly.

2. Later on, China Ministry of Commerce approved the proposals put forward by Tianjin and Shanghai in regard of their respective version executing the pilot program. In the written reply to the proposals, the Ministry required that the registered capital of commercial factoring company shall not be less than RMB 50 million, and foreign investors shall or their affiliated entities shall have relevant experience and track records in factoring; commercial factoring companies must have “commercial factoring” in their names; the risk assets shall not be greater than 10 times its net asset value; it also required that commercial factors shall registered the assigned receivables on the online system administered by China Central Bank so as to make known to the public the ownership of the receivables.
3. Further in August of 2013, China Ministry of Commerce, having sensed the wild growth of commercial factoring companies, issued another notice “Notice on Improving Regulatory Work on Commercial Factoring Industry”, requesting commercial factoring companies to register themselves with the ministry and requesting factoring companies to report significant events such as related transactions in an amount of more than 5% of its net assets, indebtedness in an amount of more than 10% of its net assets, contingent liability of more than 20% of net assets, change of shareholder who has more than 5% of shareholding, change of chairman of the board of the directors and general manager and reduction of capital, merger, division, dissolution and bankruptcy.

By China Banking Regulatory Commission:

In April of 2014, China Banking Regulatory Commission stepped up the Provisional Measures on Factoring Business of Commercial Banks laying out rules for factoring activities by commercial banks.

This piece of rules details on what factoring is (giving definition of factoring), classification of factoring and how banks should conduct factoring business. The factoring definition therein has been widely quoted in papers discussing factoring laws.

By local governments:

Besides Tianjin and Shanghai, local municipal governments in Shenzhen, Guangzhou, Suzhou and Chongqing have also promulgated local rules based on the principles set out by China Ministry of Commerce, promoting local factoring industry.

IV. Judicial Rules and Practice

So far, there has been no guidelines from China Supreme Court to its local subordinates on how to deal with disputes arising from factoring activities.

However with the rampant increase of factoring companies and voluminous businesses transacted, disputes have rocketed in number as well. There has been call for judicial interpretation on legal relations involved in factoring business.

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In October of 2014, Tianjin High People Court issued its first piece of guidelines on how to apply laws to factoring disputes in terms of both substantive issues and procedural issues.

In July of 2015, Tianjin High People's Court published its second piece of guidelines addressing legal issues that are not covered by its first piece of guidelines.

Combined together, the two pieces of judicial instructions from a local high court (instead of China Supreme Court) have shed lights on how Chinese courts will handle factoring disputes, touching all those important issues such as validity of assignment of receivable, notice of assignment, conflict of claims on one receivables, set-off right, prohibition of assignment in sale contract etc.. It is obvious that these local rules may have some influence on courts in other parts of China in dealing with factoring cases.

It shall be clearly born in mind that Tianjin High Court's instructions cannot be taken as directives to other courts outside of Tianjin city. For example, while Tianjin court seems to support the registration of assignment of receivables conferring the legal effect of constructive notice, but Shanghai court has ruled that the registration of assignment lacking the basis of statutory laws was of no mandatory legal effect.

I will later on write about and comment on the two guidelines issued by Tianjin High People Court.

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Author
admin

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