private lending market in China

Description

As you may know, China is throwing itself into a nationwide ecstasy in private lending market (loans between borrowers and non-bank sources) with many grassroots people pouring their bank savings into the market.

As reported by media, the interest rate offered by the end borrower may be tens of times higher than the official lending rate. This ecstasy has culminated in several high-profile social turmoil where end borrowers evaporated from people sights, leaving many private lenders on the brink of bankruptcy.

That is a gloomy picture. However, given the tight monetary policies and tightening measures taken by central government, enterprises esp mid- and small-companies are almost shut out of bank doors. To survive the difficulty, the only option left for them is look for fund from private lending market. Thus, there is real market there.

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Under Chinese laws, private lending is allowed and the interest rate can be as high as four times the official lending interest rate designated by central banks. The current official annual interest rate for a one-year loan is 6.06% and accordingly in private market, the interest rate can be up to 24.24%, attractive enough to lure not-very-greedy people sitting on big pile of cash. If the interest rate is higher than four times official rate, the excess part will be not supported by court in case of dispute.

It shall be noted that loanning between enterprises/companies are illegal and will be generally nullified by courts though it is almost commonplace phenomena in reality. So it is very risky for companies to lend to other companies. To circumvent this rule, companies wishing to make loans may lend the money to an individual who will then lend the same money to the borrowing company. However it is worth note that in 2008, China Banking Regulatory Commission and Chinaâ€™s central bank, PBOC jointly issued rules guiding and governing the incorporation and operation of small-amount loanning companies which have sprung up ever since. It is believed that such small-amount loanning companies have joined the private lending market, adding salt to the local financial problem.

In private lending, if there is sufficient mortgage or guaranty/surety, risks can be well mitigated and managed. Under Chinese laws, there are several kinds of securities available for lenders, such as real estate mortgage, share pledge, receivables pledge, surety and etc. Among those various securities, real estate mortgage will be safer given that property market in China is still appearing strong.

As far as foreign loaners are concerned, it shall be noted that foreigners making loans within China denominated in foreign currency other than Chinese official currency RMB will find their loanning activities illegal if such loans are brought before court because China prohibits circulation of foreign currency within Chinese territory except as otherwise provided by state. Back in 1996, China State Administration of Foreign Exchange declared the loanning in foreign currencies between enterprises illegal. In the Administrative Measures on Personal Foreign Exchange coming into effect in 2007, foreign individuals making foreign loans or providing securities to domestic entities are required to comply with rules relating to administration of foreign debts. Strictly speaking, foreign individuals

making loans denominated in foreign currencies to other individuals within China are also unlawful.

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