M&A Lending Exits Banking Gray Zone

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State-owned companies are expected to benefit from the decision to let banks write loans for mergers and acquisitions.

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Responding to Beijing's initiative to encourage the financial sector and support economic growth, the China Banking Regulatory Commission (CBRC) for the first time has given legal status to merger and acquisition lending.

Guidelines for the commercial banks that will be allowed to offer M&A loans were issued by the CBRC on December 9.

The new policy lets strong commercial banks -- defined as those with at least 10 percent capital adequacy ratios -- write the loans.

The policy change was not expected to lead to wave of leveraged buyouts. But it should give banks and their clients a legal route for M&A loans, which until now were issued cautiously inside a gray legal zone.

The move also parallels a series of government measures and initiatives aimed at encouraging state-owned enterprises to pursue overseas, cross-region and cross-industry consolidations, CBRC said.

In addition, as the number of overseas M&A transactions by Chinese enterprises grows, CBRC said, M&A lending services would support international expansions.

"M&A loans will promote corporate consolidation," said Arthur Cai, computer maker Lenovo Group's head of corporate development for the Asia Pacific region.

Moreover, Cai thinks state-owned companies will be in a better position than private firms, particularly small- to medium-sized enterprises, to benefit from the new policy as they try to finance expansions.

Risk management is a focal point for regulators. CBRC said its principle is "to allow qualified commercial banks to offer M&A lending, provided that they adroitly balance market needs and risk control." The policy also stipulates that buyers and target companies "have relatively high industry or strategic connections."

"Commercial banks involved in M&A lending that concern cross-border transactions also must evaluate country risks, foreign-exchange risks and transit-of-capital risks," CBRC said.

Borrowers should provide guarantees such as assets and equity, or third-party guarantees. Loans are limited to 50 percent of a bank's net core capital, and a loan to a single borrower cannot exceed 5 percent of net core capital. Payback terms cannot exceed five years.

"Banks are responsible for eliminating risks when lending for M&A," said Cong Feng, a senior M&A manager with Citic Securities. "Credit examiners should look at whether projects make sense or not, and whether there is solid security to back up the loan."

Permitting M&A loans will benefit state-owned banks such as Industrial and Commercial Bank of China, said a senior executive at ICBC's investment banking division. "It will clear up difficulties that investment banks have previously encountered," the executive said. "ICBC once fought strenuously to have this new policy carried out."

Until now, the ICBC executive said, some bankers were tempted to mask M&A lending as standard credit to bypass regulators.

The policy also applies to the more than 30 foreign banks incorporated in China, a CBRC official who participated in drafting the guidelines told Caijing.

But foreign banks are cool toward the policy. "I have not yet heard any internal discussion on M&A lending," said Lisa Liang, a public relations manager at JP Morgan Chase Bank (China) Ltd.

"Foreign banks so far have had relatively little involvement in the merger and acquisition market in China," said Ashley Jing, a senior executive at South Korea's Woori Bank.

Foreign banks hold about 2 percent of the total assets in China's banks. With limited yuan deposits, they rely on the interbank market to maintain liquidity.

"Moreover, foreign banks' knowledge about Chinese companies is relatively limited compared to local Chinese banks," Jing said. "M&A projects are extremely risky."

Banks qualified under CBRC's guidelines include China's four, major state-owned banks as well as China Merchants, Citic Bank, and Industrial Bank. Each has reported a 10 percent capital adequacy level, according to third quarter financial statement.

Most commercial banks, including Shenzhen Development Bank and Pudong Development Bank, currently would not be qualified because they failed to reach the 10 percent threshold in the third quarter.

"CBRC has set the principle for M&A lending," said Citic's Cong. "We will wait and see how commercial banks respond."