

Avenues to Foreign Investment in China's Shipping Industry

Have Lease Financing Arrangements and the Free Trade Zones Opened Markets for Foreign Non-Bank Investment?

By Rick Beaumont



Beyond shipyards, many parties have a commercial interest in newbuilding projects, or the ship construction industry. The purchaser will charter the vessel out in exchange for hire payments. The charterer will subcharter the vessel or will use it to move cargo in exchange for freight payments. The lending company that provided the shipyard with funds sufficient to construct the vessel will earn interest on the loan. The mortgagee that financed the vessel's purchase will earn transaction fees associated with the deal by lending money to the purchaser in order to pay the shipyard. Many parties attempt to benefit commercially and transfer risk within the notoriously volatile shipping markets. This article focuses on the financiers and vessel management companies that grease the wheels of shipping's newbuilding market through vessel purchases and leases.

While both vessel purchases and vessel leases are traditional arrangements for ship acquisition, this paper will look at advantages and disadvantages of each arrangement in the burgeoning shipping markets of China, where new legal and regulatory developments are unveiled constantly. This article will look at the possibility of foreign investment into positions of both the financier and the purchasing vessel management company and will determine whether the Shanghai (Pilot) Free Trade Zone is a welcoming environment for such investment.

What Is Vessel Lease Financing And How Does It Compare With Bank Equity Financing?

Vessel equity financing—a loan from a bank secured by a mortgage—perhaps is the most straightforward scheme to vessel ac-

quisition. A prospective shipowner arranges with a shipyard to build a new vessel and with a bank to finance that acquisition. The purchase will be secured by a mortgage over the asset held by the bank, and the shipyard may require payments be made in installments under the building contract based upon elapse of time or upon achievement of construction objectives. Upon completion of the vessel, payment is fully transferred to the shipyard, and possession and ownership are transferred to the purchasing vessel management company with the bank a secured creditor holding a mortgage over the property.

Transactions of this sort are costly. While achievable by the largest shipping companies, many small and medium-size shipping companies lack access to the credit and the capital needed to arrange financing from a single bank positioned to accept a mortgage from a company with little else to offer as collateral besides the vessel under construction. Worldwide, stricter capital requirements imposed by Basel III have caused banks to reduce exposure to the shipping sector and to replenish their capital buffers, resulting in less cash available to lend to vessel purchasers.¹ This has driven innovative financing and leasing methods for vessel acquisition.

Identifying adequate security to finance a newbuilding project is problematic. Vessel owning companies tend to be arranged as single-ship companies to limit their liability to any judgment creditors to the single asset. Thus, financing for newbuilding projects is secured by the company's sole asset: the partly completed vessel. A vessel under construction is not a vessel until it is delivered, and the shipyard's rights to payment arise only upon completion: "The buyer has no liability to pay 90% of the price if the ship is 90%



built. It only has a liability to pay if the ship is 100% completed.”² A ship purchaser defaulting during the construction period thus leaves its creditor with an unfulfilled order for a vessel and an incomplete construction project for which it is difficult to find an alternate purchaser.

Securing a loan to purchase an existing vessel is much easier. The vessel purchaser will obtain financing through a bank and give the bank a mortgage over the asset to secure its loan. If the vessel owner defaults, the creditor must enforce the mortgage to gain possession and ownership over the asset, an often lengthy and expensive litigious process, and the risk is passed on to the purchaser in the form of higher borrowing costs.

Lease financing does better to balance risks at a lower cost to the vessel management company. Under a leasing arrangement, the creditor retains ownership but releases its right to possession. Retaining ownership puts the creditor in a much more favorable position to regain possession in situations of default. Lease financing often achieves favorable results for all parties because it balances the risks more evenly than other types of ship financing.³

Vessel leasing falls within the general legal and economic arena of asset financing but retains certain features unique to shipping.⁴ A prospective purchaser—for instance, a vessel management company—may have difficulty accessing bank equity to finance an outright purchase because of volatility in demand for new capacity, because of the purchaser’s creditworthiness and available collateral, because of limitations imposed upon the purchaser’s own balance sheet by regulatory agencies, by its own corporate governance, or by existing creditors. These and other difficulties have

all contributed to a rise in popularity of alternative arrangements. Vessel operating companies that may be unable to pursue a bank equity financing arrangement may find lease financing is still a viable arrangement by which they may obtain additional cargo space for its fleet.

In addition to lowered transaction costs, leasing arrangements can make a deal commercially viable because of certain tax and accounting advantages the leasing company can utilize to offset limitations imposed by itself, by regulators, or by creditors. Instead of lending the vessel management company funds to purchase a vessel, the leasing company owns the vessel and realizes the asset as equity on its balance sheet. Also as owner, the vessel owning company is entitled to claim a significant tax benefit due to depreciation of the asset over its commercial life.⁵ Vessel management companies often operate at or near a loss, and a company without yearly profits greater than the tax credit cannot benefit in the same way by owning the vessel that a more profitable company can. So the right to offset vessel depreciation is worth more to the leasing company than it is to the less-solvent operator management company.

A ship management company in the business of pairing sub-charterers and operators with vessels may arrange for a long-term bareboat charter spanning the expected commercial life of the asset. Under a leasing arrangement, instead of purchasing the vessel, the vessel management company leases the vessel wherein the charterer’s hire will cover the cost of the vessel and the leasing company’s margin. The leasing company will be a special purpose vehicle (SPV) set up for the purpose of owning the asset and being

legal isolation in order to protect other assets over which the company may have rights. Thus, the vessel's owner will be an SPV and will be an arm of a bank, be controlled by a shipyard, or otherwise be mostly a privately owned or subsidiary of a larger bank positioning the SPV-leasing company to receive a high credit rating.⁶ The SPV can assign the right to be paid hire on its charter agreement directly to its creditors in order to receive credit enhancement.

New building projects require a great deal of capital. A vessel management company in the business of operating vessels may see capital diluted if it is forced to raise the vessel price itself. A leasing company in the business of financing rather than managing or operating vessels, and with greater access to available credit

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markets—i.e., a bank—or a company with greater control over the transaction costs—i.e., a shipyard—is positioned better than an operator to lower transaction costs and fund the new build project more cheaply, permitting the lessee to devote its working capital to vessel management projects.⁷

Leasing arrangements can achieve lower transaction costs than equity financing because they promote greater specialization of both the lessor and lessee. The vessel management company remains focused upon pairing charters with shipping capacity, and the single-asset company remains solely focused upon capitalization in order to acquire ownership of the vessel. To accomplish this funding, the SPV may be capitalized by investment from its parent, by bond markets, or by equity markets,⁸ but in any event it must raise the full asset purchase price itself to remain legal isolation. Doing so also places the SPV in a position to securitize the asset or sell the vessel and the leasing rights without disturbing the underlying vessel operating and charter agreements. Through sale or securitization of certain rights, beneficial ownership of charter agreements can transfer without disturbing the underlying charter party.

Vessel lease financing arrangements have certain advantages over traditional bank equity financed arrangements. Among them, the leasing company retains ownership of the asset. Because it retains ownership of the asset, the leasing company is in a better position following default than a mortgagee, who must have perfected its security interest only then to foreclose and physically repossess the asset in order to exercise its security rights. Leasing may mean lower costs incurred by a trustee in bankruptcy, because leased assets are easier to repossess than mortgaged assets.⁹ In addition to lessen risk for the leasing company, the lessee can achieve and

find greater stability through a lease financing arrangement than is available through bank equity financing where, as owner of the asset, it would be exposed to volatility.

The leasing company, as owner of the asset and obligee of the lease, can securitize and sell these rights to take advantage of market fluctuations and to manage its own portfolio. Securitization allows a company to transfer assets off the company's balance sheet and into a legal isolation vehicle, issuing to investors the right to receivables generated by the vessel under chartering agreements.

With vessel lease arrangements still relatively novel in China, one of the world's most important shipping markets, popularity has grown as the legal mechanics are tested and become better understood. This article will present a legal playbook for executing both a lease and an equity financing arrangement in China. Where possible, this article will identify opportunities by which foreign investors may enter the Chinese shipping market through these deals.

Bank Equity Financing Arrangements in China

With less capital available to close newbuilding deals, traditional equity financing deals are reserved for only the top credit risks—typically the largest state-owned entities. Equity financing deals in the People's Republic of China (PRC) typically include a shipbuilding refund guarantee to secure the purchaser against the shipyard's failure to deliver in accordance with the contract. For small and medium-size shipyards, providing a refund guarantee makes the transaction impractically expensive, so these entities must bear great risks or utilize innovative security methods.

An alternative to the shipbuilding refund guarantee is the construction mortgage.¹⁰ The Maritime Law of China recognized the right of a creditor to hold a mortgage interest over a vessel under construction.¹¹ Pursuant to Article 14, for the mortgage to give the creditor a secured interest, the shipbuilding contract must be registered with the Maritime Safety Administration of China; otherwise, the creditor holds an unsecured interest over the construction project. The purchaser and the shipyard must meet citizenship requirements similar to those U.S. requirements for coastwise trade under the Jones Act.¹²

The Guaranty Law of the People's Republic of China, by way of Article 34(1)(6), outlines the procedures a creditor must follow to charge its security interest through a mortgage.¹³ The unregistered mortgage is effectively worthless, so the creditor must follow the registration procedures to secure its position; a party registering its mortgage is secured from the date of execution, but a party failing to register its mortgage remains unsecured and may not defend claims raised by third parties.¹⁴

While a creditor's substantive right to charge a construction mortgage over a vessel under construction exists pursuant to the Maritime Law of China, the Property Law of the People's Republic of China 2007 also reaffirms the right to secure a shipbuilding project with a construction mortgage. In a priority contest, the mortgage made pursuant to the Property Law 2007 trumps a mortgage entered into under the Maritime Law of China, because the Property Law derives its authority directly from the Constitution out of a basic interest for upholding economic order, while the Maritime Law arose from an interest in regulating, promoting, and developing maritime transport relations and securing the rights of parties concerned.¹⁵

Under a bank equity financing arrangement, the purchaser both



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owns and possesses the vessel subject to their creditor's security interest. Discussed thus far has been a procedure for securing a creditor's rights to a vessel through a registered construction mortgage over the vessel to give the lender executable rights over the property in case of the purchaser's default. Almost exclusively available to state-owned entities, the smaller shipping companies have been benefiting from innovative risk-allocating arrangements such as lease financing. A vessel leasing arrangement provides for a legally more streamlined approach to bank equity-financed acquisition of vessels that puts a lesser strain upon vessel managers to negotiate legally complex financing arrangements with banks, thereby allowing them to devote greater resources to pairing charters with appropriate vessels.

Lease Financing in China — Now a Viable Option, Soon To Be a Popular One

China is an important center of ship finance. In 2009, the shipping portfolio of Industrial and Commercial Bank of China (ICBC) grew to \$7.8 billion.¹⁶ In that year alone, ICBC closed 45 new shipping transactions totaling \$2.3 billion.¹⁷ Minsheng Financial Leasing, rapidly becoming one of the most important lease financing companies in China's domestic market, entered an agreement with Shanghai Guodian Shipping, a subsidiary of Fujian Guohang Ocean Shipping, to deliver 18 Panamax bulk carriers under a financial leasing arrangement.¹⁸ Rongsheng Heavy Industries Group Holdings, a Chinese heavy industries group and shipbuilder, announced that the first of the Minsheng-commissioned Panamax bulkers was delivered after three years on Oct. 28, 2011.¹⁹ Before taking delivery, the Tianjin free trade zone (FTZ)-based Minsheng placed a bullish order for 10 additional Panamax vessels in 2010 and subsequently sought Chinese candidates for lease financing.²⁰ ICBC is still one of the largest Chinese vessel leasing companies, offering an array of solutions applicable to the shipping sector including: (1) financial lease for new equipment, (2) operating lease for new equipment, (3) sale-and-leaseback financing, (4) international synthetic lease, and (5) trust lease and securitization.²¹

Leasing companies may be funded by capital markets. Shanghai-based Sinochem owns a subsidiary, Far East Horizon, that provides financial leasing services supporting major Chinese industries. The Securities Regulatory Commission in 2011 permitted the Chinese-owned subsidiary to access global equity by listing publicly in Hong Kong.²²

Chinese banks are becoming shipowners by creating leasing arms that fund newbuild projects and maintain ownership over the asset. The leasing arm can permit ship managers to charter the vessel out, putting the bank-owned asset to work and receiving the benefit through contracts-for-hire rather than through complicated procedures for mortgage. Maintaining ownership of the asset minimizes judicial intervention to repossess the vessel. Leasing companies may be an arm of a bank and thus positioned to obtain high credit ratings or credit enhancement. Leasing companies may be an arm of a shipyard or shipbuilding company and thus take advantage of favorable pricing over the asset and collapse its profit margin with the shipbuilder's margin.

In China, leasing companies must be licensed to engage in ship-leasing arrangements. In 2007, the China Banking Regulatory Commission (CBRC) began granting financial institutions licenses to lease ships.²³ In 2011, at least 17 bank-affiliated companies were

registered under the CBRC scheme to offer finance leasing solutions across aviation, heavy machinery, medical, and shipping industries.²⁴ By 2009, the leasing volume reached \$2.9 billion.²⁵ By 2011, 17 bank-affiliated financial leasing companies had been issued licenses and were supervised by the CBRC, but these 17 were not limited to ship leasing and instead included licenses to lease aviation, heavy machinery, medical equipment, and the like.²⁶ With leasing's popularity has come innovative leasing arrangements that include a cross-border vessel finance lease through an SPV established in the Tianjin FTZ to act as the vessel's owner contracting for construction with a Korean shipyard and a Marshall Islands bareboat charterer.²⁷

It is worth noting that two types of leases typically are arranged for assets such as ships, aircraft, heavy equipment, and the like: finance leases and operational leases. Finance leases are arranged for the commercial life of the asset. They end in a transfer of ownership from the lessor to the lessee, or they conclude with a lessee's option to purchase the asset for a nominal cost or in some other way the finance lease lasts for the span of the asset's functional life. Operational leases are short-term, and the same asset may be leased out once again after a lease is concluded. Operational leases may solve immediate capacity shortfalls by bridging other issues caused by uncertainty. Insofar as it is concerned with leases, this paper is primarily concerned with finance leases.

Lease Financing Arrangements Have Advantages for Both the Lessor and the Leasing Company

Beyond simplifying legal processes to obtain a secure position, shipowners may find entering ship-leasing arrangements to be prudent business decisions. Despite China's global importance to both import and export markets as well as its growing shipping sector, small and medium-size Chinese shipowners are considered unbankable by domestic banks, so these companies benefit from alternative forms of vessel acquisition arrangements, such as lease financing.²⁸

The leasing company, having both right of ownership over the asset and right to collect lease payments, can take advantage of market fluctuation by selling its ownership rights and leaving intact any underlying charters. The leasing company can be positioned to securitize its vessels and the right to collect payment on the lease arrangements.

For the leasing company to achieve such benefits, it must be a bankruptcy-remote vehicle, it must acquire ownership of the ship through a real true and irrevocable sale, and receivables owed through its rights to collect lease payments may be assigned but may not be reached by a parent company.

Two Competing Schemes for PRC Financial Leasing Companies

There are two competing schemes in the PRC under which companies may register to conduct finance leasing transactions. The CBRC issued the Measures for the Administration of Lease Financing Companies (effective March 1, 2007), which was revised by Order [2014] No. 3 of the CBRC (effective on March 13, 2014), and herein will be called the CRBC scheme. China's Ministry of Commerce (MOFCOM) issued the Measures for the Administration of Foreign-Capital Lease Industry, which became effective on March 5, 2005, and herein will be called the MOFCOM scheme.

Small to medium-size nonbank leasing companies may also engage in ship-leasing operations more easily under the MOFCOM scheme without need for a license from the CBRC. The CBRC scheme targets large financial institutions, requiring its principal investors to hold at least 50 percent of the company's registered capital on hand, while the MOFCOM scheme is more investor-friendly and is better suited for manufacturers and privately funded financial leasing companies, requiring still at least US \$5 million in assets and three years experience in lease financing.²⁹ Neither the CBRB scheme nor the MOFCOM scheme places any cap on foreign investor shareholdings in a finance leasing company.

The two schemes have drastically different capital requirements, and thus a ship management company looking to undertake a lease financing enterprise is better suited for the MOFCOM scheme's lower capital requirements.³⁰ While there is nothing in the CBRC scheme to make investors concerned that vessels are not assets suitable for lease financing under the scheme, the MOFCOM scheme specifically names "vessels" as property that may be leased under the scheme.³¹

One of the primary reasons to participate in ship lease financing arrangements rather than purchasing a ship through a bank equity financing arrangement is for ease of balance sheet management. The lease appears as debt rather than equity for the party in possession of the ship. The lessor ship management company may document the lease as a credit asset or an account receivable. The lease arrangement puts both parties at a tax advantage over a vessel sale position. Sale-leaseback arrangements may be undertaken by entities such as shipyards to take advantage of this tax credit. The sale-leaseback arrangement may also attract shipyards in need of immediate capital to fund their next build project. Sale-leaseback arrangements are specifically permitted under both the CBRC scheme³² and the MOFCOM scheme.³³

Foreign investors can take part in either scheme, however the MOFCOM scheme applies only to foreign-capital enterprises that establish a limited liability company or a joint-stock limited company within China and must take the form of a Chinese-foreign equity joint venture, a Chinese-foreign contractual joint venture, or a solely foreign-capital enterprise.³⁴ The CBRC scheme may be utilized by certain foreign entities as well. While banks are specifically prohibited from being lease financing companies under the CBRC scheme,³⁵ commercial banks may be the major investor in a lease financing company and may be registered in China or abroad.³⁶ The CBRC scheme also permits the major investor to be a leasing company registered in the PRC or abroad³⁷ or a large domestic manufacturer of products suitable for leasing.³⁸ Thus, the CBRC scheme is attractive to domestic or foreign banks, to domestic or foreign companies already in the business of lease financing, and to domestic manufacturers of products suitable for lease financing arrangements, such as state-owned shipyards, looking to invest in a lease financing arm.

Entities with foreign equity interests exceeding 50 percent are prohibited from registering vessels on the PRC registry.³⁹ Either the CBRC scheme or the MOFCOM scheme can be used to circumvent this restriction by having the registered vessel owner be a leasing company with more than 50 percent of its registered capital in the PRC.⁴⁰ While both schemes are still in effect, it appears the PRC has chosen to develop the CBRC scheme over the MOFCOM scheme by providing recent revisions to the measures and by issu-

ing guiding documentation clarifying or extending the legal purview of the scheme.

Securitization in China

While securitization has been used widely in Western shipping markets, securitization in China is relatively new, untested, and unpopular, despite developing two distinct securitization schemes. Securitization in China relies upon the special purpose trust, which is a legal fiction created by the trust contract pursuant to statutory authority: the special purpose trust is not an independent legal entity; by law the trust property is not property belonging to the trustee; and by contract the originator entrusts credit assets to

Entities with foreign equity interests exceeding 50 percent are prohibited from registering vessels on the PRC registry.

the special purpose trust. While new regulations in 2014 hope to add clarity and interest in the PRC, such securitization schemes may establish dubious rights for investors in cross-border securitization deals because of how Western courts may likely view legal isolationness of the entity issuing securities, "from a constitutional point of view it is a case of sending a boy to do a man's job."⁴¹

The CBRC scheme launched in 2005 pursuant to a pair of CBRC and People's Bank of China (PBOC) regulations permitting banks and nonbank financial institutions to entrust loan receivables to a trust company to administer as trustee of those assets.⁴² CBRC licensing and approval is required every step of the way: the banks and nonbank financial institutions must be licensed by the CBRC;⁴³ the loan receivables must constitute "credit assets" under CBRC guidelines;⁴⁴ the trust must be licensed by the CBRC;⁴⁵ and any securities the trustee may issue require specific approval both by the CBRC⁴⁶ and by the PBOC.⁴⁷

As of February, the CBRC scheme has been used to establish 85 domestic securitization transactions in China since the program launched in 2005—68 of those transactions were concluded since 2012.⁴⁸

Under the CBRC scheme, the sponsor, who originates the receivable credit assets, enters into a trust contract with the trustee, thus establishing a special purpose trust.⁴⁹ Pursuant to the Trust Law, the sponsor entrusts credit assets by contract, and the trustee issues securities.⁵⁰

In addition to the CBRC scheme, the PRC saw fit to establish another securitization mechanism under the China Securities Regulatory Commission (the CSRC scheme). The CSRC scheme is well-suited for the shipping industry because the underlying assets must be specific and be able to generate independent and predictable cash flow.⁵¹ Thus, a lease financing company wishing to securitize the regular proceeds generated by hire payments in accordance with underlying lease financing agreements and a shipyard wishing to securitize proceeds generated by buyers' installment payments will find these are suitable underlying assets for securitization by the CSRC scheme.⁵²

Under the CSRC scheme, investors entrust funds to a securities company⁵³ pursuant to a fund contract.⁵⁴ The fund manager uses the entrusted funds to purchase assets, and the manager issues asset backed securities to a maximum of 200 investors.⁵⁵ The asset-backed securities evidence the purchaser's beneficial interest in the underlying assets, and the securities can be traded and purchased by qualified foreign and domestic investors alike on stock exchanges such as the Shanghai and Shenzhen exchanges and over-the-counter market places approved by the CSRC.⁵⁶

The 2014 CSRC regulations are based on the PRC Securities Investment Funds Law,⁵⁷ which incorporates the Trust Law of the

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PRC.⁵⁸ Under the CSRC scheme, Article 5 asserts that assets entrusted into the scheme are legal isolation; however, there is reason to question how courts, especially those in foreign jurisdictions, will interpret the status of assets entrusted into the CSRC scheme, which is premised upon a set of administrative regulations incorporating statutory law. While the regulations assert that assets are remote from their originator's estate for insolvency purposes, the statutory law is less clear.⁵⁹

Assets become bankruptcy-remote upon a real true sale when the previous owner has discharged both ownership and possession of the assets. Translations of the PRC Trust Law contemplate entrustment as a discharge of possession but do not clearly and undisputedly discharge ownership. While courts in the PRC have interpreted the Trust Law to provide legal isolation to assets entrusted under Article 2, it is less certain whether Western courts will find assets to be remote from the estate in bankruptcy when those assets have been discharged for purposes of possession but not for ownership, and when the only clear guidance on the issue comes in an administrative regulation, not a statutory law.⁶⁰

While securitization is a helpful and popular device used in the Western shipping markets, the two schemes available for investment in China do not provide the certainty and wide accessibility necessary for securitization to be useful to PRC shipping markets. Amendments to the PRC Trust Law clarifying that both ownership and possession transfer with entrustment, as well as providing that trusts establish separate and identifiable legal entities rather than a set of contractual rights, would go a long way to increasing the viability of securitization in PRC shipping markets for shipyards and

for vessel lease financing companies. Furthermore, subjecting every step to approval by the requisite commission adds uncertainty to the process that would better be removed.

Opportunity for Foreign Investment in the Free Trade Zones

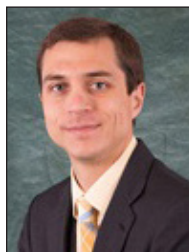
Foreign investment into leasing companies is possible in the PRC. While Tianjin has long been an attractive forum for single-ship companies, SPVs, and novel leasing ventures, the CBRC scheme has given rise to strong competition from the Shenzhen Wianhai Economic Zone and the Shanghai Pilot Free Trade Zone, where financial leasing is a stated priority.⁶¹ Under the CBRC scheme, unlike the general policy throughout the PRC, where all business actions are prohibited except for those the government has occasioned to specifically permit, the Shanghai FTZ operates on the more practical "negative list" approach, wherein business and foreign investment actions are permitted unless specifically restricted by the government.⁶² Foreign investment into the leasing industry is regulated to promote healthy development and to minimize business risk.⁶³ The PRC's Ministry of Commerce procedures regulating and administering foreign investment into the PRC leasing industry specifically permit foreign investment into the PRC's ship-leasing industry because the regulations govern leased property for transportation such as vessels and motor vessels.⁶⁴ MOFCOM is responsible for examining and administering foreign investment into the leasing industry,⁶⁵ which should be made through limited liability companies or limited through share purchase.⁶⁶

Under the MOFCOM scheme, foreign investors of a foreign-invested leasing company must have assets grossing at least US \$5 million. But under the PRC's general scheme for the Shanghai FTZ, there is no minimum registered capital requirement for standalone single ship SPV's that have been established by financial leasing companies located in the FTZ.⁶⁷ Foreign-invested companies may participate in several different forms of lease financing, such as direct leasing, subleasing, and trust leasing.⁶⁸ It is suspected that financial leasing companies registered under the CBRC scheme may establish SPVs in the Shanghai FTZ; however, the industry awaits more detailed announcements from the CBRC regarding nonbank financial institutions operating in the FTZ.⁶⁹

Ship-leasing companies operating in the PRC can lease vessels to foreign owned companies. In fact, PRC has encouraged exportation of leased ships as a means to encourage development of local harbors, the vessel construction industry, and the financial leasing industry.⁷⁰ In 2010 the State Administration of Taxation of the PRC offered a one-year export tax refund to those leasing companies registered in Tianjin and licensed to conduct financial leasing.⁷¹ Tianjin-based leasing companies engaged in financial leasing arrangements—those in which the terms are for the useful life of the vessel and by which the lessee is transferred ownership at the expiration of the term—may apply also for export valued-added tax (VAT) refunds.⁷² In the Shanghai FTZ, a pilot export tax refund is available as a project subsidiary to finance leasing companies incorporated in the FTZ.⁷³ An import-level VAT exemption is available specifically for aircraft finance leasing companies for overseas purchases, but the VAT exemption has yet to be extended to other sectors.⁷⁴

Financial leasing was an activity removed from the restricted category of MOFCOM's 2011 guidance catalog for foreign investors, and thus the activity is now permitted for foreign investors.⁷⁵

Minsheng's leasing arm, China's "most ambitious lessor," is based in the Tianjin FTZ.⁷⁶ Financial leasing companies have been permitted in the Shanghai Pilot FTZ as well. Foreign-invested banks may qualify to set up enterprises in the Shanghai FTZ.⁷⁷ Qualifying nonbank and private capital entities may set up finance leasing companies in the Shanghai FTZ.⁷⁸ Cross-border financing entities may be established in the Shanghai FTZ for purposes of offshore vessel financing.⁷⁹ While these individual entities and activities are permitted in the Shanghai FTZ, it is yet to be seen whether a foreign-invested entity may establish a finance leasing company for purposes of ship-leasing and whether that foreign-invested entity would be subject to the same CBRC regulations and licensing requirements. ☉



Rick Beaumont graduated from Tulane Law School in 2015 with a certificate in admiralty and maritime law. During law school, he was an editor of the Tulane Maritime Law Journal and worked at the Federal Maritime Commission in Washington, D.C. © 2015 Rick Beaumont. All rights reserved.

Endnotes

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⁴*Id.*

⁵See Ying Li, *The Pros and Cons of Leasing in Ship Financing*, 5 WMU JOURNAL OF MAR. AFFAIRS, No. 1, (2006) at 63.

⁶*Id.*

⁷See *Id.* at 67.

⁸First Ship Lease Trust is a Singapore-registered company that owns a portfolio of 23 ships, 16 of which are engaged in long-term lease finance arrangements, and the seven remaining ships are on shorter-term operational leases. This company is funded in part publically via the Singapore Exchange Security's main board.

⁹Ying Li, *The Pros and Cons of Leasing in Ship Financing*, 5 WMU JOURNAL OF MAR. AFFAIRS, No. 1, (2006) at 64.

¹⁰This approach is not straightforward. The approach to securing its rights requires a creditor to comply with provisions from the Maritime Law of the PRC, the Regulations of the People's Republic of China Governing the Registration of Ships, the Guaranty Law of the People's Republic of China, the Registration of Mortgages by Notaries Public Procedures 2002, and the Security Law of the People's Republic of China.

¹¹Article 14 [Maritime Law of the PRC 1992] (promulgated by Order No. 64 of the President of the PRC, Nov. 7, 1992, effective July 1, 1993), 28TH MEETING OF THE STANDING COMM. OF THE SEVENTH NAT'L PEOPLE'S CONG. (China).

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¹⁴*Id.* at Article 43.

¹⁵Compare Article 1 [Property Law of the PRC 2007] (promulgated by Order No. 62 of the President of the PRC on Mar. 16, 2007, effective Oct. 1, 2007), 5TH SESSION OF THE TENTH NAT'L PEOPLE'S CONG. (China), with Article 1 [Maritime Law of the PRC 1992].

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¹⁷*Id.*

¹⁸A *Cooperation Agreement Inked Among CCS, Fujian Guohang Group and Minsheng Financial Leasing Co. Ltd.*, CHINA CLASSIFICATION SOCIETY HEADLINES, Sept. 5, 2008.

¹⁹China: RHI Christens First Panamax Bulk Carrier Ordered by Minsheng Financial Leasing, WORLD MARITIME NEWS (Oct. 30, 2011), www.worldmaritimeneeds.com.

²⁰Neil Connor, *Minsheng Seeks Leasing Clients for Latest Orders*, TRADEWINDS, May 27, 2010.

²¹ICBC Leasing Solutions, ICBCLEASING (2008), www.icbcleasing.com.

²²Chinese Finance Leasing Firm Debuts in Hong Kong, CHINA L. & PRAC., Apr. 2011.

²³[Measures for the Administration of Lease Financing Companies] (promulgated by the CBRC on Jan. 23, 2007, effective Mar. 1, 2007) [EXPIRED] (China).

²⁴Rodricks Wong, *Ship Leasing Takes Flight in China*, MARINE MONEY INT'L (Oct. 2011) Vol. 27 No. 6, at 4, available at MARINE MONEY OFFSHORE, www.marinemoneyoffshore.com/node/6868.

²⁵*Id.*

²⁶*Id.*

²⁷*Id.* at 6.

²⁸Rodricks Wong, *The Changing Topography of Ship Finance in China*, MARINE MONEY OFFSHORE (2013), www.marinemoneyoffshore.com/node/3889.

²⁹*Finance Leasing with Chinese Characteristics*, EUROMONEY TRADING LIMITED, Jul./Aug. 2007, at sec. 2.

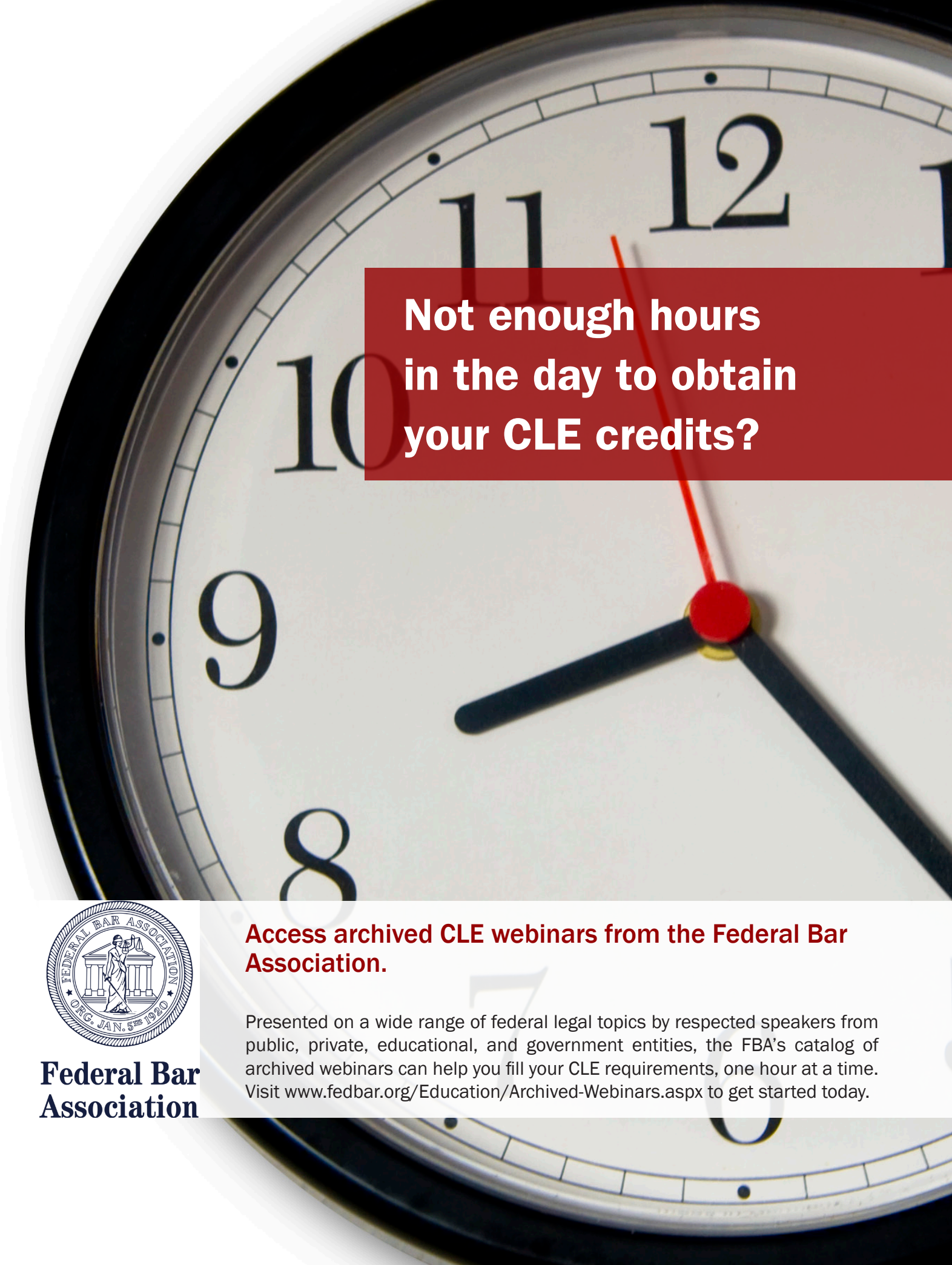
³⁰Compare the MOFCOM Scheme's capital requirement of at least US \$5 million in assets or capital (Article 7), with the CBRC Scheme's capital requirement of at least RMB80 billion (approximately \$12.9 billion) (Article 9(3)), RMB5 billion (approximately \$806 million) (Article 10(2)), or RMB10 billion (approximately \$1.6 billion) (Article 11(2)).

³¹Article 6(2) [Measures for the Administration of Foreign-capital Lease Industry] (promulgated by the first executive meeting of the Ministry of Commerce on Jan. 21, 2005, effective Mar. 5, 2005) (China).

³²See Article 5 [Measures for the Administration of Lease Financing Companies] (promulgated by the CBRC on Mar. 13, 2014, effective Mar. 13, 2014) (China).

³³Articles 5 [Measures for the Administration of Foreign-Capital Lease Industry] (promulgated by the first executive meeting of the Ministry of Commerce on Jan. 21, 2005, effective Mar. 5, 2005) (China).

³⁴Articles 2-3 [Measures for the Administration of Foreign-Capital Lease Industry] (promulgated by the first executive meeting of the Ministry of Commerce on Jan. 21, 2005, effective



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Mar. 5, 2005) (China).

³⁵Article 2 [Measures for the Administration of Lease Financing Companies] (promulgated by the CBRC on Mar. 13, 2014, effective Mar. 13, 2014) (China).

³⁶*Id.* at Article 9.

³⁷*Id.* at Article 9(2).

³⁸*Id.* at Article 9(3).

³⁹Article 2(2) [Regulations Governing the Registration of Ships] (promulgated by Decree No. 155 of the State Council of the PRC on June 2, 1994, effective Jan. 1, 1995) (China).

⁴⁰*Finance Leasing With Chinese Characteristics*, EUROMONEY TRADING LIMITED, Jul./Aug. 2007, at *2.

⁴¹Jeffrey H. Chen & Liu Haiping, *Securitization in China — Overview and Issues*, DENTONS, 1, 9 (Feb. 9, 2015), www.dentons.com/~media/PDFs/Insights/2015/February/Securitization_in_China.pdf.

⁴²[Measures for the Supervision and Admin. of Pilot Projects of Credit Asset Securitization of Fin. Inst.] (promulgated by Decree [2005] No. 3 of the CBRC on Nov. 7, 2005, effective Dec. 1, 2005) (China); [Admin. Rules for Pilot Securitization of Credit Assets] (promulgated by the Admin. Rules for Pilot Securitization of Credit Assets [2005] No. 7, jointly of the People's Bank of China and the CBRC) (China).

⁴³Article 2 [Measures for the Supervision and Admin. of Pilot Projects of Credit Asset Securitization of Fin. Inst.] (promulgated by Decree [2005] No. 3 of the CBRC on Nov. 7, 2005, effective Dec. 1, 2005) (China).

⁴⁴Article 3 [Measures for the Supervision and Admin. of Pilot Projects of Credit Asset Securitization of Fin. Inst.] (promulgated by Decree [2005] No. 3 of the CBRC on Nov. 7, 2005, effective Dec. 1, 2005) (China).

⁴⁵Article 7 [Measures for the Supervision and Admin. of Pilot Projects of Credit Asset Securitization of Fin. Inst.] (promulgated by Decree [2005] No. 3 of the CBRC on Nov. 7, 2005, effective Dec. 1, 2005) (China).

⁴⁶Article 5 [Measures for the Supervision and Admin. of Pilot Projects of Credit Asset Securitization of Fin. Inst.] (promulgated by Decree [2005] No. 3 of the CBRC on Nov. 7, 2005, effective Dec. 1, 2005) (China).

⁴⁷Article 10 [Admin. Rules for Pilot Securitization of Credit Assets] (promulgated by the Admin. Rules for Pilot Securitization of Credit Assets [2005] No. 7, jointly of the People's Bank of China and the CBRC) (China).

⁴⁸Jeffrey H. Chen & Liu Haiping, *Securitization in China — Overview and Issues*, DENTONS, 1, 2 (Feb. 9, 2015), www.dentons.com/~media/PDFs/Insights/2015/February/Securitization_in_China.pdf.

⁴⁹Articles 20 & 21 [Admin. Rules for Pilot Securitization of Credit Assets] (promulgated by the Admin. Rules for Pilot Securitization of Credit Assets [2005] No. 7, jointly of the People's Bank of China and the CBRC) (China).

⁵⁰Articles 6 to 13 [Trust Law of the PRC] (promulgated by the Standing Comm. of the Nat'l People's Cong. [2001] Order No. 50 of the Pres. of the PRC on Apr. 28, 2001, effective Oct. 1, 2001) (China); Jeffrey H. Chen & Liu Haiping, *Securitization in China — Overview and Issues*, DENTONS, 1, 2 (Feb. 9, 2015), www.dentons.com/~media/PDFs/Insights/2015/February/Securitization_in_China.pdf. At least two classes of securities are created: A

senior class of securities is issued to investors and a subordinate class of securities is held by the sponsor.

⁵¹Article 3 [Admin Provisions on the Asset Securitization Bus. of Securities Companies & the Subsidiaries of Fund Mgmt. Companies] (promulgated by the CBRC Announcement [2014] No. 49 of CSRC on Nov. 19, 2014, effective Nov. 19, 2014) (China).

⁵²Article 3 specifically includes “account receivables [and] creditors' right under lease.”

⁵³Article 2 [Law of the PRC on Securities Inv. Funds] (promulgated by the Standing Comm. of the Nat'l People's Cong. [2012] Order No. 71 of the Pres. of the PRC on Dec. 28, 2012, effective June 1, 2013) (China); Jeffrey H. Chen & Liu Haiping, *Securitization in China — Overview and Issues*, DENTONS, 1, 3-4 (Feb. 9, 2015), www.dentons.com/~media/PDFs/Insights/2015/February/Securitization_in_China.pdf.

⁵⁴Article 3 [Law of the PRC on Securities Inv. Funds] (promulgated by the Standing Comm. of the Nat'l People's Cong. [2012] Order No. 71 of the Pres. of the PRC on Dec. 28, 2012, effective June 1, 2013) (China).

⁵⁵Article 38 [Admin Provisions on the Asset Securitization Bus. of Securities Companies & the Subsidiaries of Fund Mgmt. Companies] (promulgated by the CBRC Announcement [2014] No. 49 of CSRC on Nov. 19, 2014, effective Nov. 19, 2014) (China).

⁵⁶Article 38 [Admin Provisions on the Asset Securitization Bus. of Securities Companies & the Subsidiaries of Fund Mgmt. Companies] (promulgated by the CBRC Announcement [2014] No. 49 of CSRC on Nov. 19, 2014, effective Nov. 19, 2014) (China).

⁵⁷Article 1 [Admin Provisions on the Asset Securitization Bus. of Securities Companies & the Subsidiaries of Fund Mgmt. Companies] (promulgated by the CBRC Announcement [2014] No. 49 of CSRC on Nov. 19, 2014, effective Nov. 19, 2014) (China), incorporating [Law of the PRC on Securities Inv. Funds] (promulgated by the Standing Comm. of the Nat'l People's Cong. [2012] Order No.71 of the Pres. of the PRC on Dec. 28, 2012, effective June 1, 2013) (China).

⁵⁸Article 2 [Law of the PRC on Securities Inv. Funds] (promulgated by the Standing Comm. of the Nat'l People's Cong. [2012] Order No. 71 of the Pres. of the PRC on Dec. 28, 2012, effective June 1, 2013) (China), incorporating the [Trust Law of the PRC] (promulgated by the Standing Comm. of the Nat'l People's Cong. [2001] Order No. 50 of the Pres. of the PRC on Apr. 28, 2001, effective Oct. 1, 2001) (China).

⁵⁹See Jeffrey H. Chen & Liu Haiping, *Securitization in China — Overview and Issues*, DENTONS, 1, 4-5 (Feb. 9, 2015), www.dentons.com/~media/PDFs/Insights/2015/February/Securitization_in_China.pdf comparing Article 5 [Admin Provisions on the Asset Securitization Bus. of Securities Companies & the Subsidiaries of Fund Mgmt. Companies] (promulgated by the CBRC Announcement [2014] No. 49 of CSRC on Nov. 19, 2014, effective Nov. 19, 2014) (China), with Article 2 [Trust Law of the PRC] (promulgated by the Standing Comm. of the Nat'l People's Cong. [2001] Order No. 50 of the Pres. of the PRC on Apr. 28, 2001, effective Oct. 1, 2001) (China).

⁶⁰See Jeffrey H. Chen & Liu Haiping, *Securitization in China — Overview and Issues*, DENTONS, 1, 4-5 (Feb. 9, 2015), www.dentons.com/~media/PDFs/Insights/2015/February/Securitization_in_China.pdf.

⁶¹Xin Zhang & Miller Wang, *Opinion: Aircraft and Ship Lease*

Financing Opens Up, CHINA L. & PRAC., Apr. 2014.

⁶²See *Update on Incentives for Companies To Enter the Shanghai FTZ — The Jury Is Still Out*, RHK LEGAL CORPORATE ADVISORS (Oct. 13, 2014).

⁶³Article 1 [Measures for the Administration of Foreign-Capital Lease Industry] (promulgated by the first executive meeting of the Ministry of Commerce on Jan. 21, 2005, effective Mar. 5, 2005) (China).

⁶⁴*Id.* at Article 6(2).

⁶⁵*Id.* at Article 4.

⁶⁶*Id.* at Article 3.

⁶⁷King & Wood Mallesons, *Changes to the Financial Services Market in Shanghai FTZ*, SHANGHAI FTZ SERIES (Nov. 2013) No. 3, at 3; Ernst & Young, *A Milestone for China's New Wave of Economic Reform — Shanghai Pilot Free Trade Zone*, CHINA TAX & INVESTMENT NEWS (Sept. 30, 2013) No. 2013005, at 4.

⁶⁸Article 5 [Measures for the Administration of Foreign-Capital Lease Industry] (promulgated by the first executive meeting of the Ministry of Commerce on Jan. 21, 2005, effective Mar. 5, 2005) (China).

⁶⁹King & Wood Mallesons, *Changes to the Financial Services Market in Shanghai FTZ*, SHANGHAI FTZ SERIES (Nov. 2013) No. 3, at 3.

⁷⁰*Breaking the Ice of Post-VAT Reform*, CHINA L. & PRAC., June 2010.

⁷¹See *Breaking the Ice of Post-VAT Reform*, CHINA L. & PRAC., June 2010 (citing PRC's State Administration of Taxation Circular on Carrying Out Export Tax Refund in Tianjin (Trial) for Vessels Exportation Under Financial Leasing Arrangement. CAI SHUI [2010] No. 24, Circular 24.)

⁷²*Id.*

⁷³Ernst & Young, *A Milestone for China's New Wave of Economic Reform — Shanghai Pilot Free Trade Zone*, CHINA TAX & INVESTMENT NEWS (Sept. 30, 2013) No. 2013005, at 6.

⁷⁴*Id.*

⁷⁵See Catalogue for the Guidance of Foreign Investment Industries (amended in 2011), Ministry of Commerce, PRC.

⁷⁶Neil Connor, *Minsheng Seeks Leasing Clients for Latest Orders*, TRADEWINDS, May 27, 2010.

⁷⁷Circular on China Banking Regulatory Commission on Issues Concerning Banking Supervision in China (Shanghai) Free Trade Zone, Article 3, YIN JIAN FA [2013] No. 40.

⁷⁸*Id.* at Articles 2, 4.

⁷⁹*Id.* at Article 5.



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