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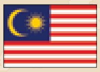

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# China's New Guidelines on M&A Loans

To facilitate Chinese companies in their domestic and international expansions through merger and acquisition ("M&A") activities in light of the global financial crisis, the China Banking Regulatory Commission ("CBRC") promulgated the Guidelines on *Risk Management for Loans Extended by Commercial Banks for Mergers and Acquisitions* (the "Guidelines") on December 6, 2008.

The Guidelines lifted the prohibition on the provision of acquisition loans by commercial banks in a M&A transaction set out in the *PRC General Lending Rules* issued in 1996. Qualified PRC incorporated commercial banks are now permitted to conduct M&A loan business and provide acquisition financing to PRC incorporated purchasers, whether such purchasers are purely domestic or foreign-invested.

An "M&A transaction" means a transaction in which a Chinese incorporated company acquires or obtains actual control of a "going concern", whether through purchases of existing equity interests, subscription of newly issued capital, acquisitions of assets or assumption of debt. Thus banks are continued to be prohibited from extending financing to greenfield investments or non-control type acquisition.

Before extending an M&A loan, the lending bank must meet, among others, a number of risk management requirements such as the following: (1) the outstanding amount of M&A loans should not (a) exceed 50% of the lending bank's core net capital, or (b) 5% of the bank's core net capital for any single borrower; (2) the loan should not account for more than 50% of the total funding for any M&A transaction; (3) the term of any M&A loan should not exceed five years; (4) adequate security has been obtained from the borrower and (5) internal review procedures have been instituted to monitor the performance of the M&A loans. In addition, the lending banks must analyze the industrial or strategic correlations between the acquirer and the target to the proposed transaction before extending such loan. Thus it is questionable whether M&A financing is available to non-strategic investors, such as private equity or venture capital funds.

It is expected that the Guidelines, which came out at a critical time, will encourage business consolidations in China by strengthening financial support for M&A transactions. While the Guidelines seemingly open the door for leverage buy-outs in China, there are still many practical questions left unanswered. Doubts and concerns remain on the immediate effects of t he Guidelines on China's M&A market, as most Chinese banks lack the sophisticated risk evaluation, pricing and management system to take up the M&A lending business.

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