

DRAFTING ON OFFSHORE LOANS OF ENTERPRISES WITHOUT GOVERNMENT GUARANTEE



CONTACT



Duong Van Tin
Attorney - Partner



Doan Minh Anh
Attorney

On May 12, 2022, the State Bank of Vietnam (SBV) published a Draft replacing Circular No. 12/2014/TT-NHNN stipulating requirements for enterprises' offshore loans without Government guarantee ("Draft") with major supplements to the requirements for offshore loans as well as for borrowers with the aim of tightening control over offshore loans ("OSL").

The remarkable contents having great influence on borrowing enterprises recorded in the Draft include:

1. Borrowing expenses and cap on borrowing expenses

a. Supplement provision on borrowing expenses

Article 3.4 of Draft provides the supplement provisions (underlined part) on foreign borrowing expenses that: *"total expenses payable by the Borrower to the Lender, loan guarantors, loan insurers, agents and other related parties, expressed as a percentage annually of total loan amount, including foreign borrowing interest rate, internal return rate, fees and other expenses related to the OSL, excluding interest on late payment penalty, commitment fee when drawdown is not made as agreed, early repayment fee, fees relating to foreign exchange and interest rate derivatives transactions and foreign contractor taxes"*

b. Detailed provisions on cap on offshore borrowing expenses

According to Article 9 of Draft, Borrower, Lender and related parties shall agree but in no cases exceeding the cap expenses.

Regarding OSL denominated in foreign currency:

- Reference rate¹ + 8% per annum in case of using reference rate; **or**
- SOFR Term Rate² + 8% per annum in case of not using reference rate.

Regarding OSL denominated in VND:

Interest rate of Vietnam Government bonds³ + 8% per annum

Comments. The detailed above shall deem to be a measure for the State to control the borrower on abuse of declaring expenses related to the loans as a reasonable expense to deduct tax for enterprises.

With this provision, enterprises are likely to be affected when the actual and reasonable expenses related to the loans will not be included in the borrowing expenses, or the actual payable expenses is higher than the allowable cap.

⁽¹⁾ **Reference rate** is the interest rate calculated by one or several international organizations, publicly listed, and selected by the Lender and the Borrower as the basis for determining the interest rate of a particular OSL.

⁽²⁾ **6-month SOFR Term Rate** published by CME on the official website of CME, is determined at the nearest time before the signing date of loan agreement and its amendments, supplements.

⁽³⁾ Implemented interest rate of 10-year government bonds in VND at the latest date before the date of signing loan agreement and its amendments, supplements.

2. Supplement provisions on table of estimated foreign borrowing expenses

The Draft stipulates that the Borrower is responsible for making the **Table of estimated foreign borrowing expenses at the time of signing** the offshore loan agreement and its amendments, supplements. The Table of estimated foreign borrowing expenses is used to:

For short-term OSL. The Borrower shall present a Table of estimated foreign borrowing expenses for drawdown or repayment so that the competent credit institution where providing account services shall verify for drawdown or money transfer to pay foreign borrowing expenses of the Borrower and provide SBV upon request.

For the medium and long-term OSL. The Borrower declares the estimated foreign borrowing expenses in the Application for registration/Registration for change of OSL when registration/amendment of the OSL in accordance with the current regulations on foreign exchange management in terms of borrowing and repayment of enterprises.

3. Foreign exchange (FX) derivatives transaction

The Draft stipulates that FX derivatives transaction when borrowing offshore is mandatory condition in some of the following cases when making OSL, specifically (underlined conditions):

Regarding short-term OSL. Applicable when short-term OSL have a total loan amount of more than USD 500,000 or other foreign currencies with equivalent value. The execution of the FX derivatives transaction must be before or at the time of drawdown date, and the transaction value must be at least 30% of the drawdown value and the transaction term must be consistent with the repayment plan of the short-term OSL.

Regarding medium and long-term OSL. Applying to loans where there are transfers to repay the principal with a value of more than USD 500,000 or other foreign currencies with equivalent value. The Borrower must perform the FX derivatives transaction at least 03 months before the principal repayment date, and the value of the transaction must be at least 30% of the principal repayment amount and the term of the transaction must be consistent with the principal repayment plan of the medium and long-term OSL.

This requirements **do not apply** (i) to the Borrower being a credit institution or foreign bank branches that are licensed to conduct business and provide FX services in accordance with current laws and (ii) in case the Borrower expects to have enough foreign currency revenue for loan repayment.

In case the Borrower does not conduct a FX derivatives transaction as it is expected to have enough foreign currency revenue for loan repayment, but in due date, the Borrower does not have or does not have enough foreign currency in order for repayment upon evidencing that due to objective reasons, foreign currency sources from production and business activities of the Borrower are delayed, the Borrower is entitled to buy foreign currency at competent credit institutions for repayment and **must** commit to sell foreign currency to that credit institution when receiving foreign currency from production and business activities.

Comments. The above provision aims to make enterprises form a hedging habit against foreign exchange rate risks and stabilize the foreign currency market and exchange rate management. However, this can also reduce the profit that the borrowing enterprises can gain from this exchange rate differences.

4. Limit on use purposes of short-term OSL

The Draft supplements limit on the use purposes of short-term OSL, in which, the purposes that are not entitled to use short-term OSL include:

- (i) Debts arising from loan agreements with residents; and
- (ii) Debts arising from transactions of buying and selling trading securities; purchasing capital contribution or shares of another entity; buying investment real estate; and receiving project transfer.

5. Medium and long - term OSL limit

The Draft stipulates additional limits related to OSL. Regarding OSL for the implementation of Investment Projects, the Draft remains the loan limit which will correspond to the maximum amount not exceeding the differences between the total investment capital and the equity capital recorded in the decision for Investment Policy Approval (IPA), the Investment Registration Certificate (IRC).

Regarding Increase of capital scale for legitimate production and business of the Borrower. The Borrower must ensure that the balance of medium and long-term domestic and offshore loans (including expected medium-term and long-term foreign loans) of the Borrower does not exceed 03 times the equity according to the latest audited Financial Statement at the time of signing the loan agreement or the charter capital in case the equity is lower than the charter capital of the Borrower.

Regarding Restructuring of OSL. Maximum loan limit does not exceed the balance of principal and interest of the existing OSL.

6. Transitional provisions

Enterprises should pay attention to the transitional provisions for existing loans to ensure compliance with loan conditions as prescribed by law. Whereby:

Short-term loan agreements with a total loan amount of more than USD 500,000 or other foreign currencies with equivalent value that have been signed before the effective date of this Circular and are in compliance with the laws at the time of signing but have not fully drawdown, FX derivatives transaction must be conducted to prevent exchange rate risks.

Medium and long-term loan agreements signed before the effective date of this Circular and in compliance with the laws at the time of signing but have not fully repaid the principal, and subject to the case of FX derivatives transaction, FX derivatives transaction must be conducted to prevent exchange rate risks.

Currently, the Draft is still in the process of discussion and collecting feedbacks. Although there is no term for promulgation, the changes provided by the Draft have a significant impact on corporate finances in Vietnam and should be noted.