

German Schuldschein is back in fashion: Moving along the Silk Road to China

Dr. Michael Lamla, Head of Corporate Banking at **Agricultural Bank of China** follows the key internationalisation theme of this year's conference and discusses the new interest of using Schuldschein in Chinese markets.



Schuldschein – generally translated as a German certificate of indebtedness – is enjoying something of a revival as an alternative source of funding for German financial and corporate borrowers. While the devastating credit squeeze that had been gumming up the interbank and commercial paper loan markets in 2008/09, the Schuldschein became a reliable funding alternative. As such, the corporate Schuldschein loan segment reached a new record high on several scores in 2015. The issuance volume increased by more than 60% to EUR 19bn. The number of transactions climbed by 14% to a new peak amounting to 106. Furthermore the largest-ever Schuldschein was issued in 2015 by ZF Friedrichshafen. The main trigger for this positive development has been increasing M&A activity.

Additionally, the Schuldschein has also made its way into neighbouring countries such as Switzerland and France. The internationalisation of the Schuldschein environment can be marked in clear figures with 29% of all transactions and one quarter of the total issuance volume being emitted by non-German issuers.

One example can be seen in China. Due to the country's economic growth and internationalisation plenty of German companies are expanding their business focus to the Orient. Reasons vary and have changed over time with a shifting of production plants to reduce costs, and the exploitation of new markets being just two possible reasons. Furthermore, not only do big DAX companies like VW, BMW or Siemens go abroad, but more and more corporates of the German Mittelstand are moving along the Silk Road. With this being the case, the question of a sustainable financing must be considered.

Large MNEs who have access to the capital market can easily refinance via Panda-Bonds (onshore) or – since the liberalization of the Chinese market – Dim-Sum-Bonds (offshore). Unfortunately, this is not as attractive for smaller financing operations or feasible for companies such as SMEs. Also the Chinese banking and capital market system distinguishes itself considerably from the German or European counterpart in the following ways:

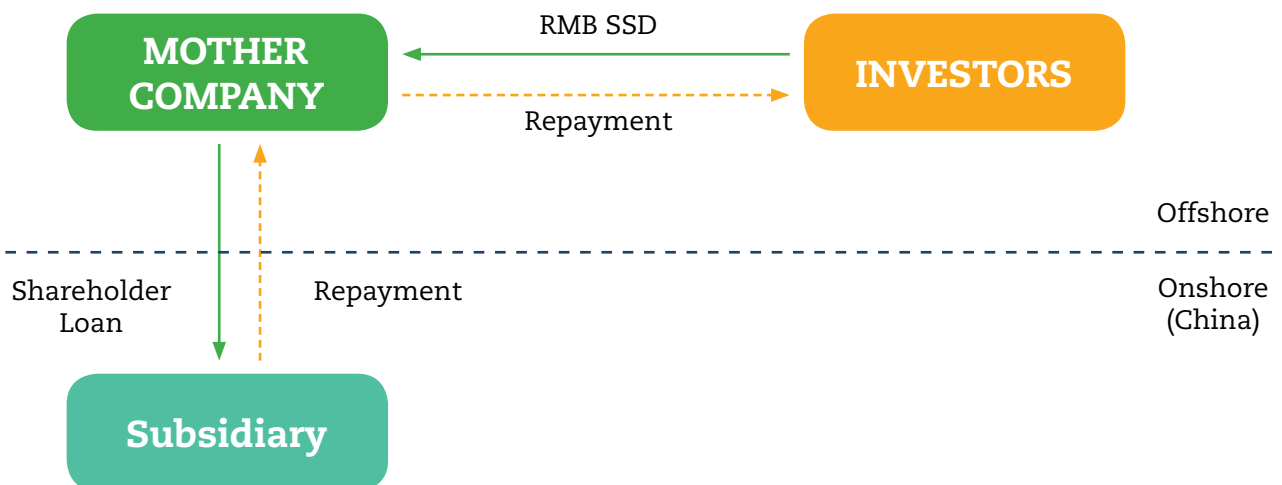
- (i) Maturity
- (ii) Collateralisation
- (iii) Interest risk
- (iv) Currency risk
- (v) Credit volume
- (vi) Credit worthiness / rating.

One of the first barriers of local financing in China is the maturity of financing. The attempt to match the maturity of debt with corresponding assets, which is particularly popular in Germany, does not match banking practice in China. Here the Renminbi (RMB/ CNY/ CNH) denominated Schuldschein can harmonise the cash-flows under maturity and currency aspects by providing a natural hedge.

Further challenging aspects can be found in China's extensive documentation, the collateral requests of local banks, and difficulty for Europeans to understand local law. As well as this, the total borrowing volume is limited by the credit worthiness of the Chinese subsidiary.

In most cases the offshore financing on a EUR-basis in connection with a Cross-Currency-Swap (CCS) seems to be an attractive possibility at first glance. Often it emphasises as not being practical due to a lack of market liquidity in a long-term CCS on RMB. Not to mention the diverging spreads of RMB on- and off-shore exchange rates (CNY versus CNH).

Structure



Schuldschein is a flexible alternative for all contingencies in terms of total volume, maturity and currency. The decreased judicial complexity because of the relatively simple documentation based on German law reinforces this flexibility.

These facts make the Schuldschein-vehicle an attractive complement to an onshore-loan agreement. As such, this may increase the appeal of Schuldschein as it comes into vogue in China in the same way it has in Germany and abroad.



Prof. Dr. Michael Lamla will be speaking at this year's **International Schuldschein Forum**, taking place on the 13th and 14th of June in Frankfurt, Germany.

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