

Appendix C

PRC Draft Law and SETC Guide **Principles**

APPENDIX C

DRAFT SME PROMOTIONAL LAW

Chapter One General Principles

Article 1

This law is formulated to promote the development of SMEs, to improve the success of SME operations throughout the country and to accelerate the role of the SME in the national economy and social development.

Article 2

Those SMEs that are included are those enterprises established inside People's Republic of China and in conformity with the criteria set by the State Council.

Article 3

The State Council sets the policy that will encourage, actively support and guide SMEs in their creation and growth.

Article 4

The State Council is to encourage those SMEs, in conformity with industry policies, that are in the areas of high technology, environment protection, have the potential of increasing employment, and those from minority nationality regions, remote regions and undeveloped parts of the country.

Article 5

Article 5 directs that:

- a. The SME Management Department under The State Council shall centralize the guidance and coordination of SMEs for the total country, publish SME policies, accelerate foreign cooperation and promote expansion of the SME social service system.
- b. The relevant departments under the State Council shall guide and serve SMEs in accordance with their respective responsibilities.

- c. The various SME Management Departments of the local governments above the county level shall guide and serve SMEs within their administration.

Article 6

The State hereby protects the legal rights and interests of SMEs and their shareholders. No encroachment is allowed on the property and legal rights and interests of SMEs.

Chapter Two Fund Support

Article 7

The State Council and the local governments at all levels should allocate SME Development Funds in the Financial Budget to encourage the development of SMEs.

Article 8

The State establishes SME Development Funds, which consists of:

- a). Funding that is allocated by the government for SME development.
- b). A certain proportion of funds shall be extracted from yearly SME taxes.
- c). Allows for the use of the earnings from such taxes for Fund operations.
- d). Allows for funds to receive donations.
- e). Other funding.

Article 9

The priority of State SME Development Funds are directed to the following:

- a). Structure of facilities
- b). Economic and technological guarantees
- c). Technology innovation, new technology and product research
- d). Establishment and promotion of credit guaranty program
- e). Specialization and coordination with big enterprises
- f). Assistance for enterprise development and compensation for overseas investment risk

- g). Loan discount
- h). Training
- i). Support of SME service system
- j). Appraisal consulting and legal assistance
- k). Other projects demanding support

The establishment and usage of SME Development Funds are otherwise stipulated separately by the State Council.

Article 10

Local governments are given authority to set up SME Special Funds in accordance with the needs of their area in order to promote the development of local SMEs.

Article 11

- a). The State Council and the Provincial governments are given authority to grant SMEs preferential taxation, however,
- b). The State Council will stipulate the specific procedure of preferential taxation.

Article 12

- a). The State hereby creates an SME Development Bank, which will use the present network of city commercial banks to support SMEs borrowing.
- b). Other State Policy Banks will actively provide financial services to SMEs in conformity with industry policies.

Article 13

- a). Commercial banks should, in accordance with this law and other relevant regulations, expand SME lending, widen the services to SMEs, improve SME lending methods and management systems and actively provide services such as funding and management information to promote SME development.
- b). Non-financial institutions are motivated to support SME development in terms of funding.

Article 14

The State is to take measures to improve access for SME direct financing and encourages qualified SMEs to go public.

Article 15

Allows SMEs to create credit guaranty organizations and be engaged in mutual guaranty financing.

Article 16

The State creates an SME credit guaranty organization and the State Council will separately stipulate the methods to be used in improving credit guaranty organizations.

Article 17

- a). The State SME Credit Guaranty Organization is composed of Cities, Provinces and the State and shall provide guarantees for SME financing.
- b). The City SME credit guaranty program shall guaranty lending organizations that provide loans within their jurisdiction.
- c). The Provincial SME credit guaranty organizations serve mainly municipal SME credit guaranty organizations within their jurisdiction and are limited in operation to providing guarantees. (Shall not operate any other type of business.)
- d). The State SME Credit Guaranty Organization provides policies and funding for SME credit guaranty.

Article 18

Credit guaranty organizations will give priority to SMEs who have trained management, sound financial and accounting systems and have the ability to pay taxes in due time and in full amount.

Article 19

SMEs, who suffer losses caused by governmental budget reductions, can apply to the Management Organization of SME Development Fund for assistance.

Chapter Three Technology Innovation

Article 20

- a). The State encourages SMEs to strengthen technology information and introduce advanced technology, industrial craft and equipment according to market demand and national industry policies.
- b). SMEs in the manufacturing industries that are contractors for big enterprises are eligible for the benefits of the loan discount policy for technology reformation.

Article 21

The State shall create an SME technology innovation fund to support SME technology information, new product research and development and to promote SME high-tech products.

Article 22

The relevant government departments may cooperate with research institutions, set up special organizations or provide facilities for SME product research and technology development. They are also encouraged to guide SMEs into high technology to improve their operations and products.

Article 23

SMEs should strengthen cooperation with research institutions and universities in terms of technology, development and communication for industrialization of technological achievements.

Chapter Four Expansion of Marketing

Article 24

The State encourages big enterprises to establish stable and cooperative relationships with SMEs in the areas of raw material supply, manufacturing, sales, technology development and transformation.

Article 25

The State encourages SMEs to optimize their resources through with acquisitions and mergers.

Article 26

- a). The government should set aside a certain portion of all government procurement for SMEs.

- b). The purchasing contracts between the government and big enterprise, should include a set-aside provision where a certain portion of each contract shall be subcontracted to an SME.

Article 27

The State encourages SME exports and foreign economic and technological cooperation and exchange. The relevant departments and organizations of the State should guide and help SMEs in exporting their products and services.

Article 28

The State encourages SMEs to invest overseas and obtain compensation according risks taken.

Article 29

The State encourages SME service organizations to hold SME product exhibitions and information; provide assistance to SMEs in furthering their knowledge of market conditions and assistance in the process of market expansion at home and abroad.

Article 30

The State encourages SMEs to secure foreign capital and advanced experience in technology and management by means of the industry policy of utilizing national foreign funding and to constitute joint ventures or cooperative ventures.

Chapter Five Servicing System

Article 31

The State encourages all walks of life to strengthen the establishment of SME service organizations and foster SME programs for improved support to SMEs.

Article 32

The local SME Management Department may set up SME service centers and can entrust the task to research institutions in order to provide a focal point in the delivery of services to SMEs.

Article 33

SMEs can set up organizations such as SME associations, if necessary, for self-management, self-constraint and self-service.

Article 34

All kinds of intermediates should provide needed support to SMEs in areas such as management, information technology, marketing, investment, financing, manufacturing security, training, international cooperation, guidance on starting enterprises, exhibitions and law consulting, etc.

Article 35

Local governments should create favorable conditions for SMEs by providing necessary facilities, equipment, business information and consulting services to support individuals wanting to start an enterprise.

Article 36

The State encourages all relevant institutions including universities to guide SMEs on starting an enterprise, in the training of the staff and management.

Chapter Six Supplementary Articles

Article 37

Provinces, autonomous regions and municipalities directly under the Central Government may stipulate rules for implementation of SME Promotion Law according to the local conditions and practical need.

Article 38

This law is to be put into effect on xxx (year) xxx (month) xxx (date).

The Law as drafted gives the different levels within government much latitude in structuring programs that support the SME community. This latitude insures the support or “buy-in” of the Provincial and City governments. However, it provides an opening of having a multitude of programs having varying degrees of risk being implemented within the country without the central government having the ability to keep such risks within an acceptable range.

The degree and quality of programs that will be implemented will depend, in a large part, on the expertise in developing such programs in any given area of the country, the support for such programs at any location and the financial ability of various regions. Currently the national emphasis on SME development has been met with a patchwork of programs with no common thread to tie the programs together on a national basis. Where some areas are reported to have very good programs with reasonable risks being taken, others have troubled programs and even other regions of the country having nothing in the way of operating programs.

For the vision set out in the law being passed by Congress to be achieved, there must be programs available in all sectors of the country. Those programs must be financially sound and well managed.

Normally, in most countries, a law passed by the central government will have certain limits for such structures where, within those limits, lower level governments could design certain aspects of the programs, but normally will not leave open the option whether a region or local government will implement the program. (See the model legislation in Exhibit E.)

The National government should consider such limits on any additional legislation especially if the re-guaranty program is created at the National level. By constructing the re-guaranty program in a certain way, the limits that were not included in the original legislation could be instituted for those that take advantage of the national program. The Law does provide a wide menu of services that would be implemented in support of SMEs; similar to those that are in operation in the United States, England and Japan. On balance, the Law is a good law and one that will deliver much needed services to the SME community, if the various programs throughout the country can be pulled together in a cohesive manner.

SETC GUIDE PRINCIPLES

POLICIES FOR THE ESTABLISHMENT, FINANCING, OPERATION, REGULATION, AND SUPERVISION OF PUBLIC CREDIT GUARANTY FUNDS

The following recommendations issued by SETC are structured much like Rules and Regulations of other countries. They try to further explain the Law and how that law will be implemented. They are in accordance with the economic working conference of the Central Government and the requirement for developing an SME credit guaranty program issued by the National Economic and Trade Working Conference, as well as the relevant provisions of the Contract Law and the Guaranty Law.

I. The guide principles of the pilot SME credit guaranty system

(a) The nature of SME credit guaranty

The term “SME Credit Guaranty” in this opinion means the activity that a guaranty institution undertakes when assuming the primary responsibility when the loan covered by the guaranty does not perform as promised in the Contract between the SME and the lender.

An SME credit guaranty institution must adhere to the guaranty activity stipulated in the Guaranty Law. All SME credit guaranty institutions are non-financial institutions and are not allowed to engage in financial credit operations. (Their only form of operation is that of guarantying loans made by approved financial institutions.)

All SME credit guaranty institutions are not-for-profit in the initial stage and their guaranty fund and operation costs are mainly from governmental budgetary funds and asset transfers with the balance coming from guaranty fee income charged to the lenders and/or SMEs.

II. The guiding principles of establishing the pilot SME credit guaranty system are:

- (a) The principle of supporting development while being risk-adverse.
- (b) The principle of governmental support and market-oriented operation.
- (c) The principle of developing a guaranty program and improving credit availability.

III. SME credit guaranty system

The SME credit guaranty system is composed of three levels of institutions: City, Provincial and State. Its operation includes the guaranty of a loan to an SME

issued by an entity at the City level while a re-guaranty is one that is issued for the benefit of the City level by an entity at the Provincial level.

(a) City SME credit guaranty institution

An SME credit guaranty institution should be organized at the city level to serve the SMEs in their geographic area. In order to control the risk effectively, generally county (district) credit guaranty institutions are not established independently but rather are included in a City guaranty program. Those counties (districts) with large economic impact and financial resources to support a guaranty program may establish such institutions.

(b) Provincial SME Credit Guaranty Institution.

The SME credit guaranty institution at the Provincial level is organized to service the needs of the City credit guaranty institutions located in the Province. The Province acts as a re-guarantor of the loan activity of the City's guaranty and is authorized to oversee the operations at both the Provincial and City levels.

IV. National SME credit guaranty institution

In order to limit the risk being taken, in the pilot period, a National SME credit guaranty institution is not established at this time. The commercial guaranty institutions and the enterprise mutual guaranty institutions engaged in SME guaranty operations are supplementary to the SME credit guaranty system and they are authorized to perform according to this opinion.

(a) Funding source for City Institution

1. Such funds that may be budgeted by the city treasury.
2. The land usage right and other operational and non-operational national real estate transfers from the city government.
3. The land usage right contributed by the district and county government.
4. The funds raised by society in general.
5. Membership dues (risk guaranty fund) or subscriptions received.
6. Donations from home and abroad.

7. Other sources

(b) Funding source for Provincial Institution

1. Such funds as may be budgeted by the provincial treasury.
2. The land usage right and other operational and non-operational national real estate transfers from the provincial government.
3. The funds raised by the society in general.
4. Re-guaranty fees deposited by the city institution as provided for in agreements between the City and Provincial institutions.
5. Donations from home and abroad
6. Other sources

V. The forms, guaranty objects and guaranty types of SME credit guaranty Institution

(a) The forms of SME credit guaranty institution

In accordance with the Guaranty Law and the relevant regulations, the legal form of an SME credit guaranty institution may be an enterprise corporation, not-for-profit corporation or a juridical association.

In order to standardize operations and control risk, city credit guaranty institutions may practice the system of membership, thereby serving those SMEs that are eligible. Provincial SME Re-guaranty Institutions may also practice the system of membership and serve the city SME credit guaranty institutions within their Province.

- (b) The forms that provincial SME credit guaranty institution may choose include: SME credit re-guaranty center (not-for-enterprise corporation), SME credit re-guaranty association (juridical association).
- (c) The forms of National SME credit re-guaranty or insurance institution will be confirmed after the approval of the State Council.

VI. The objectives of SMEs credit guaranty

The objectives of the SME credit guaranty program include services to all SMEs that:

- (a) Embrace technological progress and innovation.
- (b) Are beneficial to enlarging the urban and country employment.

- (c) Fit the national industry policy and have the products and market development potential.

VII. The guaranty types of SME credit guaranty

The guaranty types of SME credit guaranty mainly include SME short-term, medium and long-term bank loans, the financing of leases as well other guarantees that benefit economic progress. In the pilot period, SME credit guarantees will emphasize short-term bank loans.

VIII. The function and operational procedures of the SME credit guaranty Institution

In organizing the SME credit guaranty institution, the City's SME credit guaranty institution's internal operation should address the evaluation the credits being presented for a guaranty and the further development of its guaranty operation. The Provincial SME credit re-guaranty institution will emphasize the evaluation of the credit standards employed by the City's credit guaranty institution, and the program and supervisory controls employed by the institution.

IX. The operational procedures of the SME credit guaranty and re-guaranty Program

(a) Guaranty Procedures

- (i) The debtor, (the SME) presents the guaranty application and encloses the opinion signed by the creditor, (the lender).
- (ii) The guaranty institution makes the credit evaluation and prepares the guaranty.
- (iii) The creditor, (lender) and the debtor, (the SME) signs the loan contract and the guaranty institution and the creditor sign the guaranty contract.
- (iv) The guaranty fee is paid according to the agreement.
- (v) If the SME defaults on the obligation, the guaranty institution compensates the lender according to the agreement.
- (vi) Once the guaranty has been paid, the guaranty institution carries out any recourse against the SME.

X. The re-guaranty procedures

- (a) The guaranty institution presents the re-guaranty application.
- (b) The re-guaranty institution makes a credit review according to the credit standard of the institution.
- (c) The guaranty company and the re-guaranty institution sign the re-guaranty contract.
- (d) The guaranty company pays the re-guaranty fee according to the agreement.
- (e) If the Contract does not perform as specified by the agreement the re-guaranty institution pays the re-guaranty. After payment the re-guaranty institution undertakes all responsibility under the contract, except that:
- (f) The re-guaranty institution and guaranty institution together take recourse against the debtor.

XI. The selection of the cooperative bank and the management of the guaranty Fund

- (a) The selection of the cooperative bank

Under the direction of the Economic and Trade Commission, Treasury and the People's Bank at the province and the city levels, the guaranty institution should select as participants those commercial banks having the initiative and good credit standards to make the program successful.

The guaranty institution and the cooperative bank should sign the cooperative contract, the guaranty agreement form and agree on such items as the loan multiplier that will be used in the guaranty fund, the guaranty amounts to be implemented, and the credit evaluation standards to be used. The cooperative contract should be reported to the Provincial and City Economic And Trade Commission and the People's Bank.

XII. The management of guaranty funds

- (a) The guaranty funds will be deposited in the Economic and Trade Commission and the People's Bank of the Province and the City. It also may be deposited in the cooperative bank according to the cooperative contract.
- (b) The guaranty institution will deposit all fees paid by the members, (the borrowers), as provided for in the guaranty agreement, into the guaranty fund.
- (c) The guaranty fund, made up of cash, may purchase a treasury bond according to the provision of the state.

- (d) The guaranty fund, made up of non-cash items may be managed according to the rules of the state.

XIII. The guaranty fee

In order to lessen the financial burden of SMEs, the guaranty charge of the SME credit guaranty institution is generally controlled at less than 50% of the bank loan interest rate in the same period, however the actual rate should be approved by the relevant governmental department. The interest charged on a loan under this program may be based on a floating rate upon the approval of the governmental price department.

XIV. Risk control and responsibility sharing

(a) Risk control

- (i) The selection of the amplification multiplier, (the amount in lending that will be supported by a particular reserve allocation is generally less than 10%. The re-guaranty amplification multiplier may be bigger than the guaranty multiplier, the actual multiplier is arranged by the guaranty institution and the cooperative bank and is reported to the provincial economic and trade commission and the relevant department for approval.
- (ii) Controls are implemented through utilizing acceptable credit standards and depositing the guaranty fund according to the stipulated proportions, and an on-going project review.
- (iii) Daily supervision and the monitoring of the re-guaranty measures will take place with a constant oversight of the adequacy of the reserve fund and the monitoring of losses to assure that the multiplier used in the program is adequate to cover the losses.
- (iv) Monitoring of liquidation processes and the recoveries on paid guarantees will take place thereby reducing net losses.

XV. Responsibility sharing

- (a) The guaranty institution, according to the principle of diversifying the risk, may provide a partial guaranty to a bank for a loan made to a qualified SME. The amount of the guaranty is arranged between the guaranty institution and the cooperative bank.
- (b) The principle focus of the re-guaranty program will be the sharing of risk between guaranty institution and the re-guaranty institution. The guaranty

institution will take the major portion of the risk while the re-guaranty institution takes a lesser portion. The actual percentages will be determined through a discussion between the Provincial and city SME credit guaranty institution and is reported to the Provincial Economic and Trade Commission for approval.

- (c) To limit the risk taken by the guaranty organization, in most cases, the debtor will be held responsible for the debt incurred through an issuance of a personal guaranty.

XVI. The internal and external supervision of the guaranty institution

- (a) The supervision of the government to SME credit guaranty
 - (i) In order to strengthen the supervision the SME credit guaranty activity and limit the risk being taken, the Province and City are to set up a SME credit guaranty supervision commission constituted by the Economic and Trade Commission, the People's Bank, the Industrial and Commercial Administrative Management and those commercial banks responsible for the supervision and management of the guaranty and re-guaranty operations and institutions.

XVII. The restrictive mechanism inside the guaranty institution

Each SME credit guaranty institution and re-guaranty institution should set up an internal supervision responsible for the internal operations. The personnel structure and the rules and procedures used by the internal supervision unit will be structured according to the relevant provisions set out by each institution.

XVIII. The organizational implementation and the working procedure of pilot SME credit guaranty system.

- (a) Requirement, scope and policy

The Economic and Trade Commission of each Province and City may make local pilot guide opinions and policies addressing the SME credit guaranty institution and select the cities for the pilot program. The Provinces may also determine the participants in their program.

In order to standardize the operation, SETC will select several provinces and cities as the national participants with each province having the right to also select several cities as Provincial participants.

XIX. The procedures of the pilot

The pilot procedures include three stages:

The first stage is the stage of creating procedures to be used in the pilot program. The provincial and city economic and trade commissions will draft the pilot guide opinions, the supporting policy and the pilot procedures according to the uniform requirement of SETC and will forward to the provincial economic and trade commission for approval and will implement them after securing the agreement of the government.

The second stage is the stage of organizing and implementation. Organizing an SME credit guaranty institution will include the securing of the guaranty fund sources, selecting the cooperative bank and several SMEs to participate in the pilot.

The third stage is the evaluation and adjustment stage where amendments will be made as needed to improve the overall guaranty program.

XX. Pilot organization

The responsibility of establishing the pilot system of a national SME credit guaranty is under the direction of SETC. The implementation work of the provincial re-guaranty and city guaranty pilot system is under the direction of the Provincial Economic and Trade Commission.