

State Administration of Foreign Exchange Shanghai Branch Announcement of Version 4.0 of the Detailed Rules on Foreign Exchange Administration Reform in the Shanghai Pilot Free Trade Zone

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On July 10, 2019, the Shanghai Branch of the State Administration of Foreign Exchange announced the fourth version of the Detailed Rules on Foreign Exchange Administration Reform in the China (Shanghai) Pilot Free Trade Zone (Shanghai Foreign Exchange Circular No. 62 [2019], hereinafter “Shanghai Pilot Free Trade Zone Rules version 4.0”).

1. Background on Policy

On November 7, 2018, the State Council of the People’s Republic of China announced the Circular of the State Council on Several Measures to Support the Deepening of Reform and Innovation in Pilot Free Trade Zones (State Council Circular No. 38 [2018]) to support deeper reforms and innovation in the Pilot Free Trade Zones to further open up trade and curb the negative effects of the U.S.-China trade war. The Shanghai Pilot Free Trade Zone Rules version 4.0 specifies the demands of this circular with regard to reforms of foreign exchange administration and is an important measure that promotes the development of Shanghai’s international finance center.

Figure 1 shows all of the rules on foreign exchange reform that have been announced since the Shanghai Pilot Free Trade Zone was created on September 29, 2013:

[Fig. 1] Timeline of foreign exchange reform rules in the Shanghai Pilot Free Trade Zone

No.	Date	Notification No.	Title
1.0	February 28, 2014	Shanghai Huifa [2014] No. 26	Notice regarding the announcement of detailed rules on foreign exchange administration that support the development of the China (Shanghai) Pilot Free Trade Zone.
2.0	December 17, 2015	Shanghai Huifa [2015] No. 145	Detailed rules that further promote reforms in the foreign exchange administration of the China (Shanghai) Pilot Free Trade Zone.
3.0	January 2, 2018	Shanghai Huifa [2018] No. 1	Detailed rules that further promote reforms in the foreign exchange administration of the China (Shanghai) Pilot Free Trade Zone.
4.0	July 10, 2019	Shanghai Huifa [2019] No. 62	Detailed rules that further promote reforms in the foreign exchange administration of the China (Shanghai) Pilot Free Trade Zone (version 4.0).

In addition, Shanghai will soon add a new area to Pilot Free Trade Zones, and will be “the most internationally recognized as the most competitive free trade zone”. Shanghai Pilot Free Trade Zone Rules

version 4.0 has also laid the groundwork for the reforms in the foreign exchange administration.

2. Main Points of the Rules

Shanghai Pilot Free Trade Zone Rules version 4.0 mainly carried out new reforms in the following four areas: ①Simplification of administration delegation of authority, ②Facilitation of trade and investment, ③Head office economy development and ④Offshore financial services.

[Fig. 2] Main reforms contained in the Shanghai Pilot Free Trade Zone Rules version 4.0

No	Area	Main points
①	Simplification of administration delegation of authority	1. For the following operations, entities within the zone will be able to apply, receive document pre-screening, and check the status online through the State Administration of Foreign Exchange service website: ✓ Registration of import and export units in the directory. ✓ Participation by domestic individuals in the incentive stock option plans of foreign-listed companies.
		2. Permits direct handling at the bank and scraps application deadlines for cancelling the registration of foreign debt for companies within the zone.
②	Facilitation of trade and investment	1. Allows measures to make settlement of foreign currency receipts under the capital account in the zone simpler.
		2. Assuming the authenticity and compliance of foreign-invested enterprises within the zone that do not have investment included in the scope of their business activities, and in accordance with the actual amount of investment, foreign exchange receipts under the capital account or capital converted to RMB may be used for domestic equity investments.
		3. Allows companies in the zone who have chosen to finance foreign debt through the investment gap method to be able to switch to the macroprudential management of cross-border financing model (note, however, that if it is changed, it cannot be changed again).
		4. For corporate cross-border financing, the requirement for the contract currency, withdrawal currency, and repayment currency to be the same will be loosened to allow the withdrawal currency and repayment currency to be different from that of the contract currency for companies in the zone. However, the withdrawal currency and repayment currency must match.
③	Head office economy development	1. The threshold for multinational companies in the zone to be able to apply to establish cross-border cash pooling will be lowered from a minimum of USD 100 million for the international balance of RMB/foreign currency payments for the previous FY to a minimum of USD 50 million.
④	Offshore financial services	1. When banks in the zone are handling trade finance loans for foreign institutions in accordance with the law, the banks are permitted to deposit foreign currency in the foreign exchange NRA account that the foreign institution will open at the lending bank.
		2. When extending foreign currency loans to foreign institutions in accordance with the law, banks in the zone are permitted to establish a right of pledge on the funds in the foreign exchange NRA account, but the lending bank must supervise the use of the loaned capital within the country's borders.

Reform efforts for the four areas above are described in detail below.

① Simplification of administration/Delegation of authority

1. Entities in the zone will be able to apply for certain operations (including registration of import and export units and participation by domestic individuals in the incentive stock option plans of foreign-listed companies), receive document pre-screening, and check the status online through the State Administration of Foreign Exchange service website.¹

Previously, relevant regulations² required those in the zone to bring relevant documents and conduct procedures at the State Administration of Foreign Exchange to **(1) register import and export units in the directory and (2) participate in the incentive stock option plans of foreign-listed companies.**

As a result of the Shanghai Pilot Free Trade Zone Rules version 4.0, it is now possible for those in the zone to **apply, receive pre-screening for documents, and check the status online through the government affairs service website of the State Administration of Foreign Exchange.**

¹URL for the State Administration of Foreign Exchange government affairs service website ⇒ <http://zwfw.safe.gov.cn/asone>

²Relevant regulations refers to:

(1) Article 1 1 § 1 of Appendix 1 “Foreign Exchange Administration for Trade in Goods” of the “Notification on Issues Concerning the Regulations on Foreign Exchange Administration for Trade in Goods” (Huifa [2012] No. 38): “In accordance with the law, companies must bring relevant documents and register them at the State Administration of Foreign Exchange after obtaining the right to conduct foreign trade business. If changes to registration details arise, the procedures to amend the registration must be done at the State Administration of Foreign Exchange. If the right to conduct foreign trade is revoked or the company ceases to operate, the procedures to delete registration entries must be done at the State Administration of Foreign Exchange.”

(2) Article 3 of the “Notice on Issues Concerning Participation by Domestic Individuals in the Incentive Stock Option Plans of Foreign Listed Companies” (Huifa [2012] No. 7): “A PRC institution acting on behalf of the domestic individual will bring the documents below to a branch of the State Administration of Foreign Exchange or foreign exchange management department (hereinafter, “local foreign exchange branch”) to consolidate them. The domestic individual must then register the foreign currency incentive stock option plan of the foreign listed company...”

2. Permits direct handling at the bank and scraps application deadlines for cancelling the registration of foreign debt for companies within the zone.

Previously, when companies in the zone wished to cancel the registration of foreign debt, the company had to go to the State Administration of Foreign Exchange within one month of the final principal and interest repayment according to relevant regulations.³

With the Shanghai Pilot Free Trade Zone Rules version 4.0, **direct handling at the bank is permitted for the purpose of cancelling the registration of foreign debt, and the deadline for companies to carry out the relevant procedures has been removed.**

³Relevant regulations refers to:

Screening principle 1 of Item 7 “Cancellation of Foreign Debt Registration” in Appendix 2 “Operational Guidelines for the Management of Foreign Debt Registration” of the Administrative Measures for the Registration of Foreign Debt (Huifa [2012] No. 38) states, “Non-bank borrowers whose balance of unpaid loan repayments is 0 and no further funds will be withdrawn must cancel the registration of foreign debt at the local foreign exchange branch within one month of the final principal and interest repayment.”

② Facilitation of trade and investment

1. Allows measures to make settlement of foreign exchange receipts under the capital account in the zone simpler.

The State Administration of Foreign Exchange Shanghai Branch announced the “Detailed Rules on Simplified Procedures for RMB Settlements under the Capital Account in the China (Shanghai) Pilot Free Trade Zone” (Shanghai Huifa [2019] No. 7, hereinafter, “Notification No. 7”) on January 16, 2019, which allows pilot companies to **make direct transactions at the bank for RMB settlement of foreign exchange receipts under the capital account using the “Foreign Exchange Capital Account Payment Order,”** removing the requirement to submit proof of authenticity beforehand for each transaction.

The Shanghai Pilot Free Trade Zone Rules version 4.0 used the above as a basis and adjusted the scope of foreign exchange receipts and the conditions for pilot companies.

➤ The scope of foreign exchange receipts under the capital account is:

- (1) Capital funds in foreign currency
- (2) **Capital in accounts for converting domestic assets to cash (new addition)**
- (3) **Capital in dedicated accounts for domestic reinvestment (new addition)**
- (4) Foreign debts in foreign currency
- (5) Reversal of capital funds due to overseas listing

➤ The conditions for pilot companies have been eased as follows:⁴

- (1) Non-financial industry companies within the zone (excluding the real estate industry and government financing platforms).
- (2) **No record of administrative punishment with regard to foreign exchange laws and regulations within the past year (if it has been less than one year since the company was established, then there must be no record of administrative punishment related to foreign exchange since the day of establishment).**
- (3) If the company is listed in the directory of foreign exchange balances for trade in goods, it must be listed as a “Class A” company for trade in goods.

⁴The easing of conditions refers to:

Article 3 of Notification No. 7: Pilot companies that “are registered in the Shanghai Pilot Free Trade Zone, **have no record of administrative punishment related to foreign exchange in the past two years**, and are non-finance industry companies that are Class A for trade in goods (if applicable) (excludes real estate companies and government financing platforms).

2. Assuming the authenticity and compliance of foreign-invested enterprises within the zone that do not have investment included in the scope of their business activities, and in accordance with the actual amount of investment, foreign exchange receipts under the capital account or capital converted to RMB may be used for domestic equity investments.

Previously, in accordance with the relevant regulations⁵, foreign-invested enterprises whose primary business activity is not investment were unable to make domestic equity investments using foreign exchange receipts in the capital account or capital converted to RMB.

On March 29, 2019, the Monetary Policy Department II of the People’s Bank of China announced the “Explanation of Relevant Regulations Regarding the Domestic Reinvestment of Capital by General Foreign-Invested Enterprises,” opening the way for reinvestment in the PRC by general foreign-invested enterprises using RMB capital.

The Shanghai Pilot Free Trade Zone Rules version 4.0 takes the above into account and **opened up equity investment to foreign-invested enterprises that do not include “investment” in their scope of business using foreign exchange receipts in the capital account or capital converted into RMB.**

Company type	Capital account items		Domestic investment use permitted
FIEs whose primary business activity is investment ✓ Foreign-invested investment enterprises ✓ Foreign-invested venture capital enterprises ✓ Foreign-invested equity investment enterprises	Foreign currency	Capital	○
		Foreign debts	
	RMB	Capital	
		Foreign debts	
Shanghai Pilot Free Trade Zone FIEs whose primary business activity is not investment	Foreign currency	Capital	×⇒○ (this change)
		Foreign debts	*Includes foreign exchange receipts in the capital account and funds converted to RMB.
	RMB	Capital	×⇒○ (March 29, 2019)
		Foreign debts	×

^{*5} Relevant regulations refers to:

1. “Interim Provisions on the Administration of Domestic Foreign Exchange Transfer” ([97] Huiguanhanzi No. 250) Article 5: “With the exception of circumstances specified in Articles 6, 7, and 8, no domestic settlement shall be made by an individual or entity denominated in a foreign currency. Financial institutions must also not conduct foreign exchange transfers.”

2. Screening principle 3 of “6.6 Registering and Amending Basic Information on Receiving Domestic Reinvestments,” contained in the “Operational Guidelines for Foreign Exchange Business under the Capital Account (2017 ver.)”: When domestic institutions receive RMB reinvestment capital or the equivalent equity transfer (including RMB that is directly converted and RMB in the account for foreign exchange settlement and pending payment) from a general foreign-invested enterprise (in principle, companies should include “investment” in the scope of their business activities, and companies that are not wholly foreign-owned enterprises and whose primary business activity is the investment of foreign-invested investment enterprises, foreign-invested venture capital enterprises, foreign-invested equity investment enterprises, etc.), the domestic reinvestment basic information will be registered where the receiving party’s bank (the location of its assets) is located, and after opening an account for foreign exchange settlement and pending payments, the investing company must transfer the RMB capital in accordance with the actual investment amount into the foreign exchange settlement and pending payment account that the non-investing company opened.

3. Allows companies in the zone who have chosen to finance foreign debt through the investment gap method to be able to switch to the macroprudential management of cross-border financing model (note, however, that if it is changed, it cannot be changed again).

Previously, companies in the zone, in accordance with relevant regulations⁶, were required to select either the investment gap model or the macroprudential management of cross-border financing model, and once a decision was made, it was permanent.

The Shanghai Pilot Free Trade Zone Rules version 4.0 **allows companies who have chosen the investment gap model to finance foreign debt to change to the macroprudential management of cross-border financing model. However, if the selection is changed, it may not be changed again.**

⁶ Relevant regulations refers to:

Question 1 of the “Macro-Prudential Management of Comprehensive Cross-Border Financing Q&A (first session)”: When a foreign commercial investment company files for a foreign debt contract (registration) for the first time after the Q&A for this

policy is announced, it must report on its filing in writing to the State Administration of Foreign Exchange branch that has jurisdiction over the area. The company must also make clear which cross-border financing management model it chooses during the transition period. If the macroprudential management model is selected, then the company must report the net assets for the most recent term that has gone through screening. Once the cross-border financing management model has been confirmed, it cannot be changed.

4. **For corporate cross-border financing, the demand requiring the contract currency, withdrawal currency, and repayment currency be the same will be relaxed to allow the withdrawal currency and repayment currency to be different from that of the contract currency for companies in the zone. However, the withdrawal currency and repayment currency must match.**

Previously, in accordance with relevant regulations⁷, companies in the zone were required to use the same currency for the contract, withdrawals, and repayment. The Shanghai Pilot Free Trade Zone Rules version 4.0 eases the regulations by **allowing the withdrawal and repayment currencies to differ from that of the contract, while the withdrawal currency must still be the same as the repayment currency.**

⁷ Relevant regulations refers to:

People's Bank of China Notification on Items Related to the Macro-Prudential Management of Full-Scale Cross-Border Financing (Yinfa [2017] No. 9) Article 7: The contract currency, withdrawal currency, and repayment currency of cross-border financing between banks and corporations must always match.

③ Head office economy development

1. **The threshold for multinational companies in the zone to be able to apply to establish cross-border cash pooling will be lowered from a minimum of USD 100 million for the international balance of RMB/foreign currency payments for the previous FY to a minimum of USD 50 million.**

Previously, in accordance with Chapter 2, Article 4 of the Regulations on the Centralized Operations and Management of the Cross-Border Funds of Multinational Companies (Huifa [2019] No. 7), **multinational companies in the zone applying for cross-border cash pooling were required to have an RMB/foreign currency balance of payments of at least USD 100 million in the previous fiscal year** (the total amount for domestic member enterprises participating in the cross-border cash pooling arrangement).

The Shanghai Pilot Free Trade Zone Rules version 4.0 has lowered the required amount to **USD 50 million.**

④ Offshore financial services

1. **When banks in the zone are handling trade finance loans for foreign institutions in accordance with the law, the banks are permitted to deposit foreign currency in the foreign exchange NRA account that the foreign institution will open at the lending bank.**

There is no clear regulation on how to handle trade finance loans for foreign institutions included in the Notification Regarding Issues Concerning the Administration of Overseas Organizations' Foreign Exchange Accounts in China (Huizongfa [2009] No. 29, hereinafter, "Notification No. 29"), which is the primary regulation for foreign exchange NRA accounts (non-resident accounts). However, in reality, there are financial institutions with track records of trade finance lending using foreign exchange NRAs.

The Shanghai Pilot Free Trade Zone Rules version 4.0 **explicitly permits the handling of trade finance loans for foreign institutions via a foreign exchange NRA account.**

2. **When extending foreign currency loans to foreign institutions in accordance with the law, banks in the zone are permitted to establish a right of pledge on the funds in the foreign exchange NRA account, but the lending bank must supervise the loaned capital that is used within the country's borders.**

According to Notification No. 29⁸, the bank will **establish a right of pledge on the funds in the foreign**

exchange NRA account and may handle loans for domestic institutions, but there are no regulations on handling loans for institutions outside of the zone.

With the Shanghai Pilot Free Trade Zone Rules version 4.0, banks within the zone are permitted to establish a right of pledge for foreign institutions, but the loaning bank must monitor the domestic use of the loaned capital.

⁸ Relevant regulations refers to:

Notification No. 29, Article 9: The balance funds in the foreign exchange account of a foreign institution, ..., when it is used as a pledge for the loan obtained by the domestic institution from the domestic bank, it shall be handled in accordance with the foreign exchange management regulations for the overseas guarantee under the domestic loan.

3. Impact on companies

The Shanghai Pilot Free Trade Zone Rules version 4.0 responds to market demands for a single circular that can explain all policies, and the relevant reform measures touch upon current account items, capital account items, domestic and international companies, head office institutions, and ordinary companies. We will continue to follow up on relevant information and reveal the details as they come.

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