

State Administration of Foreign Exchange Expands Pilot Scheme to Facilitate Incoming Capital Account Payments to Entire Region of Beijing and Shanghai

China Business Solution Office
RMB Internationalization Business Promotion Office

On March 6, 2020, the Shanghai branch of the State Administration of Foreign Exchange (SAFE) issued a circular on the Establishment of a Pilot Scheme to Simplify Incoming Foreign Exchange Payments under the Capital Account to the Entire Region of Shanghai (Shanghai Huifa [2020] No.8) hereinafter “Shanghai Circular No. 8”). This expands the pilot scheme from the Shanghai Free-Trade Zone (FTZ) to the entire municipality of Shanghai.

On March 10, 2020, the Beijing Foreign Exchange Administration Department of SAFE issued a circular on Further Advancements to the Facilitation of Capital Account Management in the Beijing Region (Jinghui [2020] No. 16, hereinafter "Beijing Circular No. 16"), and this expands the pilot scheme that simplifies incoming foreign exchange payments under the capital account from the Zhongguancun Zone 1 Lot 16 area to the entire municipality of Beijing.

Key Takeaways

- **Eligible companies in Beijing and Shanghai can directly make payment by using foreign exchange incomes or RMB-converted funds under the capital account through payment orders.**
- **Banks will conduct post-transaction inspections to check for compliance among the payments made by companies participating in the pilot scheme.**

1. Background of the Policy

The current foreign exchange management regulations require a company to submit a proof of authenticity to the bank on an individual basis in advance for making payments by using foreign exchange incomes or RMB-converted funds under the capital account (capital, foreign debt, and funds from overseas market listings). The removal of restrictions in 2016 on the conversion of foreign currency income under the capital account simplified the evidence verification process at the conversion stage, but the authenticity inspection at the payment stage remains in place considering the risk prevention.

In order to simplify the use of foreign currency, SAFE has been operating a "pilot scheme for simplifying payments made under the capital account" since 2017. The companies participating in the pilot scheme may make domestic payment by using the capital account income (including RMB-converted funds) through payment orders instead of submitting supporting documents to the bank on an individual basis in advance.

The pilot scheme for simplifying payments made under the capital account was gradually deployed in 12 FTZs in the four batches, the provinces of Fujian, Zhejiang, and Jiangsu, the municipalities of Shenzhen and Ningbo, and the Zhongguancun Demonstration Area.

On October 25, 2019, SAFE issued a circular on “Further Promotion of the Facilitation of Cross-border Trade and Investment” (Huifa [2019] No. 28, hereinafter "Circular No. 28") which declared that the pilot areas for facilitating payments made under the capital account will be expanded to the fifth batch of FTZ and the entire municipality of Shanghai. The recently announced Shanghai Circular No. 8, issued by the Shanghai

branch of SAFE, will define specific measures for plans mentioned in Circular No. 28.

In turn, Beijing Circular No. 16, issued by the Beijing Foreign Exchange Administration Department of SAFE, expands the scope of the pilot scheme in Beijing. As a result of these circulars, the pilot scheme was simultaneously expanded to the entirety of the respective municipalities of Beijing and Shanghai.

As the contents of the circulars issued by Shanghai and Beijing are similar, we will focus on Shanghai Circular No. 8 in our following explanation.

2. Main Contents

1) Operation Guidelines for the Pilot Scheme to Simply Incoming Payments under the Capital Account

[Fig. 1] Operation Guidelines	
Payment Facilitation	<ul style="list-style-type: none"> ✓ When companies eligible for the pilot scheme make payments by using foreign currency income or RMB-converted funds under the capital account, they may conduct such transactions with authorized banks through the payment order for facilitation of foreign currency payment under account capital funds, and do not need to submit proof of authenticity on an individual basis in advance to banks.
Scope of Foreign Income under the Capital Account	<ul style="list-style-type: none"> ✓ Foreign capital ✓ Funds from foreign debt ✓ Funds raised from overseas market listings
Eligible Companies	<p>Non-financial firms that are registered in the pilot area and meet the following conditions (excludes real-estate firms and government lending platforms):</p> <ul style="list-style-type: none"> ✓ The company has no foreign exchange control penalty recorded against it in the previous year (companies established within one year must have no Foreign Exchange Control penalty recorded from the date of establishment) ✓ If the company is listed on the list of enterprises engaged in foreign exchange receipts and/or payments, it must be classified as a Class A enterprise for Trade in Goods.
Upper Limit for Facilitation	<ul style="list-style-type: none"> ✓ The facilitation upper limit for an enterprise shall be calculated as: Capital Account Foreign Exchange Income Amount × Macro-Prudential Parameter. The Macro-Prudential Parameter is tentatively set to 1, and SAFE may adjust the Macro-Prudential Parameter according to foreign exchange transaction conditions. ✓ If the Macro-Prudential Parameter is adjusted to below 1, the current capital account payment management policy applies to the amount of foreign exchange incoming capital account payments not covered by the facilitation. Any revision to the current policy shall also take effect in the pilot area where applicable.
Storage Period for Evidence	<ul style="list-style-type: none"> ✓ It is necessary for inspection purposes to store relevant documents and evidence which can adequately certify the authenticity and meet compliance for a period of 5 years.

SAFE previously issued the “Circular on the Policies for Reforming and Standardizing Management of Foreign Exchange Settlement under the Capital Account” (Huifa [2016] No. 16, hereinafter "Circular No. 16"). Circular No. 16 stipulates that foreign exchange income under the capital account and funds converted to RMB for Chinese organizations may be used for current account expenditures within its scope of operations and

capital account expenditures where legally permitted, while the requirements of the prohibited fund use list below (Fig. 2) must be strictly adhered to. Companies participating in the pilot scheme must continue to comply with these requirements when utilizing the facilitation for foreign exchange payments under the capital account.

[Fig. 2] Prohibited Fund Use List for Foreign Exchange Income and Funds Converted to RMB under the Capital Account

- ✓ Funds must not be used directly or indirectly for expenses that **do not fall under the scope of the company's operations** or for expenses **prohibited by national laws and regulations**.
- ✓ Unless otherwise expressly stipulated, funds shall not be used directly or indirectly for **securities investments or other investments that are not principal-guaranteed products offered by banks**.
- ✓ Funds shall not **be lent to non-affiliated companies**, except in situations which are expressly permitted within the scope of business operations.
- ✓ Funds must not be used to build or purchase **real estate that is not for company use** (does not apply to real estate companies).
- ✓ If there is a contractual agreement that stipulates the use of capital-account income between a Chinese organization and another party, the funds concerned shall not **exceed the amount that is stipulated in that agreement**.

Additionally, in accordance with Circular No. 16, companies can use income from the capital account under the name of **reserve funds** each month, and it is not necessary to submit supporting documents to prove its authenticity. The cumulative total amount of monthly cash reserve fund payments (including discretionary conversion and conversion for payments) must not exceed an amount equivalent to USD 200,000 for a single organization.

2) Post-Transaction Inspections by Banks

Banks participating in the pilot scheme are generally required to conduct inspections on payments made in the previous quarter on “10% or more (by payment amount) of all payments for the quarter” by employing both random and focused inspections (selection criteria shown in [Fig. 3]) based on the risk level of the companies and the business operations.

[Fig. 3] Selection Criteria for Focused Inspections

- ✓ Purpose of converting capital account funds to RMB: Payments for security deposits under a different account name; purchases of real estate; purchases of financial assets in China such as stocks, bonds, funds and trusts; account transfers under the same account name; dividend payments for the investor's foreign securities investment; payments in cash; payments to individuals; special applications; others.
- ✓ The invoice number (*fapiaohao*) column for a domestic transfer involving an account with funds pending conversion is left blank or incorrectly filled. The section for describing the purpose of the capital account funds to be converted to RMB is left blank or incorrectly filled.
- ✓ A single payment exceeds USD 10 million or the total payment amount in one quarter for one entity exceeds USD 50 million.
- ✓ The company increases its total payment amount by 50% from the previous quarter, and this amount exceeds USD 1 million.
- ✓ Other activity that arouses equal or greater suspicion.

3. Impact on Companies

Companies participating in the pilot scheme have switched from submitting payment evidence on an individual basis to directly making payment orders and cooperating with post-transaction inspections by banks.

This has significantly improved administrative efficiency when making payments. The scope of this pilot scheme was thus expanded from sections of Beijing and Shanghai to the entire respective municipal areas, allowing more companies to participate in the pilot scheme. Please note that each bank may take different approaches to the inspections depending on the risk level of the companies and the business operations. We will continue to follow up on relevant information and share the latest information.

The simplification of payment for foreign exchange income under capital accounts includes foreign capital and foreign debt, both of which are commonly used to raise funds by foreign investment enterprises (FIEs).

Many companies that are resuming operations as the COVID-19 coronavirus outbreak subsides are facing the problem of deteriorated cash flow. As the above two methods are the main means of financing for FIEs, this pilot scheme provides greater benefits to FIEs as regulatory burdens relating to fund use are eased. With the diversification of choices in financing to companies, it is anticipated that the cash flow problems faced by companies resuming operations will be mitigated.

Disclaimer

This report has been prepared by MUFG Bank (China), Ltd. (the “Bank”), for information only and is not intended for use by or distribution to any person or entity in any jurisdiction or country where such distribution or use would be contrary to law or regulations. The Bank and/or any person/entity connected with it may make use of or may act upon the information contained in this report prior to the publication of this report to its customers.

Neither the information nor the opinion expressed herein constitute or are to be construed as an offer, solicitation, advice or recommendation to buy or sell deposits, securities, futures, options or any other financial or investment products.

This report has been prepared solely for informational purposes and does not attempt to address the specific needs, financial situation or investment objectives of any specific recipient.

This report is based on information from sources deemed to be reliable but is not guaranteed to be accurate and should not be regarded as a substitute for the exercise of the recipient’s own judgment. The recipient should obtain separate independent professional, legal, financial, tax, investment or other advice, as appropriate.

This report is based upon the analysts’ own views, therefore does not reflect the Bank’s official views. All views herein (including any statements and forecasts) are subject to change without notice, its accuracy is not guaranteed; it may be incomplete or condensed and it may not contain all material information concerning the entities referred to in this report. None of the Bank, its head office, branches, and affiliates is under any obligation to update this report.

Historical performance does not guarantee future performance. Any forecast of performance is not necessarily indicative of future or likely performance of the any product mentioned in this report.

The Bank and/or its directors, officers, and employees, from time to time, may have interest and/or underwriting commitment in the relevant securities mentioned herein or related instruments and/or may have a position or holding in such securities or related instruments as a result of engaging in such transactions. Furthermore, the Bank may have or have had a relationship (for example, the relationship of affiliate, strategic partnerships, etc.) with or may provide or have provided corporate finance or other services to any company mentioned herein.

The information contained herein has been obtained from sources the Bank believed to be reliable but the Bank does not make any representation or warranty nor accept any responsibility or liability as to its accuracy, timeliness, suitability, completeness or correctness. Therefore, the inclusion of the valuations, opinions, estimates, forecasts, ratings or risk assessments described in this report is not to be relied upon as a representation and / or warranty by the Bank. The Bank, its head office, branches, and affiliates and the information providers accept no liability whatsoever for any direct, indirect and/or consequential loss or damage of any kind arising out of the use of all or any part of this report.

The Bank retains copyright to this report and no part of this report may be reproduced or redistributed without the written permission of the Bank and the Bank, its head office, branches, or affiliates accepts no liability whatsoever to any third parties resulting from such distribution or re-distribution.