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SAFE expands liberalizing foreign exchange capital funds settlement for foreign-invested enterprises nationwide

On Mar 30 2015, the State Administration of Foreign Exchange (SAFE) issued the Circular on “*the Reform about the Administrative Method of the Foreign Exchange Capital Funds Settlement for Foreign-invested Enterprises (“FIEs”)*” (huifa [2015], No.19)¹ (hereinafter “Circular 19”), which will come into effect on Jun 1 2015. Circular 19 allows all the FIEs in China to settle the foreign exchange capital funds into RMB at will (hereinafter “the new settlement method”), and lifts the restrictions on FIE’s onshore equity investments with RMB funds from their capital account.

I Background

By a notice issued in February 2014, SAFE already introduced certain liberalization measures on the new settlement method for registered enterprises in the China (Shanghai) Pilot Free-Trade Zone. On Jul 4 2014, SAFE issued the *Circular on Relevant Issues Concerning the Pilot Reform in Certain Areas about the Administrative Method of the Foreign Exchange Capital Funds Settlement for FIEs*² (hereinafter “Circular 36”). Circular 36 stated a pilot reform of the new settlement method would be applicable to FIEs in certain areas in China, including Tianjin Binhai New Area, Shenyang Economic Zone, Suzhou Industrial Park, Donghu National Self-Innovation Demonstration Zone, Guangzhou Nansha New District, Hengqin New District, Chengdu High-Tech Industrial Development Zone, Zhongguancun National Self-Innovation Demonstration Zone, Liangjiang New Area, Heilongjiang Frontier Development Zone for the Foreign Exchange Pilot Reform, Wenzhou Pilot Region for Comprehensive Financial Reform, Pingtan Comprehensive Pilot Zone, China-Malaysia Qinzhou Industrial Park, Guiyang Comprehensive Bonded Zone, Shenzhen Qianhai Shenzhen-Hong Kong Modern Services Cooperation Zone, and Qingdao Pilot Zone for Comprehensive Reform on Wealth Management and Finance.

Drawing from the experiences of the previous pilot reform implemented in the 16 areas in China, Circular 19 represents a national version of the new settlement method stated in Circular 36, demonstrating a more loosened control in foreign exchange management in China.

II Highlights

- Main content of the new settlement method

The new settlement method means that foreign exchange capital funds in the FIE capital fund accounts, recognized by the local foreign exchange bureau or the settlement banks as the rights and interests of capital contributions, can be settled in banks according to their actual business operational requirements. According to Circular 19, the provisional percentage for the

¹http://www.safe.gov.cn/resources/wcmpages/wps/wcm/connect/safe_web_store/safe_web/whxw/ywfb/node_news_ywfb_store/f9c5418047efb2ce9cccbceee2a1794d/

²http://www.safe.gov.cn/resources/wcmpages/wps/wcm/connect/safe_web_store/safe_web/zcfg/zbxmwhgl/zjtzwhgl/node_zcfg_zbxm_kjtz_store/b863040044f9ac668af2ae04091e83bf/

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settlement of foreign exchange capital funds of FIEs incorporated is 100 percent. However SAFE may adjust the aforesaid percentage in due time according to the international receipts and payments situation.

FIEs can still choose between the existing settlement procedures against payments (hereinafter “current settlement method”) for the use of foreign exchange capital funds or the new settlement method. For each foreign exchange settlement transaction, based on the principle of current settlement method, the banks shall examine and verify the authenticity and compliance in the use of the funds for prior transactions of foreign exchange settlement (including those proceed from the new settlement method current settlement method).

Domestic remittances and transfers and cross-border outward payments of foreign exchange capital funds of FIEs shall be transacted pursuant to the relevant regulations on foreign exchange administration.

- Management of bank accounts for settled foreign exchange capital funds

FIEs shall open a designed account under capital item for the settled foreign exchange capital funds in RMB, and also for transactions of various payments through these accounts. The RMB proceeds of FIEs by current settlement method shall not be used for payments through the designed account.

The banks shall, according to the principles of “know your customers,” “know your businesses,” and “due diligence,” be responsible for verification of the authenticity of outward payments with capital funds and payments with RMB funds from the new settlement method by the FIEs. When handling each payment transaction with such funds, the authenticity and compliance of the certifying documents with respect to the prior payment transactions shall be examined and verified. The banks shall keep the relevant certifying documents for 5 years for future reference.

When FIEs fail to provide certifying documents for special reasons, the banks may make the relevant payments for enterprises, provided that the obligation of due diligence review has been performed and the authentic background of the transactions has been verified, and may file with the foreign exchange bureau through its relevant business system with respect to the special items on the date of payment. The banks shall collect and examine the full set of relevant certifying documents resubmitted by the enterprises within 20 working days upon completion of the payment and report to the foreign exchange bureau with respect to the resubmission of the certifying documents on the authenticity of the filing of special items.

- Utilization of FIEs’ Capital Funds

FIE capital funds and RMB funds settled from the new settlement method shall not be used for the following purposes:

(I) directly or indirectly used for expenditures beyond the business scope or prohibited under the laws and regulations of China;

(II) directly or indirectly used for securities investments, unless otherwise stipulated under the laws and regulations;

(III) directly or indirectly used for issuing RMB entrusted loans (unless permitted by the

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business scope), repayments of inter-enterprise borrowings (including third-party advances), and repayments of RMB loans that already relend to any third party;

(IV) payment of expenses relevant to the purchase of real estate not for one's own use, unless as a foreign-invested real estate enterprise.

- Facilitation of Domestic Equity Investments by FIEs with Funds from the new settlement method

Except for funds transfers of equity investments in the original currency, it is acceptable for FIEs with investment as their main business (including investment companies by foreign investors, foreign-funded venture capital enterprises, and foreign-funded equity investment enterprises) to transfer the foreign exchange capital funds from direct settlement or the designed account into the accounts of the invested enterprises, provided that the domestic investment project is authentic and compliant with the regulations. Capital funds other than the equity investment funds from aforesaid enterprise shall be handled in compliance with existing regulations.

III Comparison with Circular 36

General speaking, Circular 19 replicates measures stated in Circular 36 to all over China. However, there are notable changes between Circular 19 and Circular 36, for example:

- According to Circular 36, when FIEs use capital funds for the purpose of petty cash, the banks need not require submission of the aforesaid certifying documents regarding authenticity. The cumulative amount of payments for petty cash by a single enterprise in one month shall not exceed the value equivalent to RMB 600,000. However Circular 19 abolishes certain provisions stated in Circular 36 and adjusts the cumulative amount of payments for petty cash by a single enterprise in one month to not exceed US 100,000.
- Circular 19 promulgated that transactions of funds in the capital funds accounts of the same name opened by FIEs in the same branch of the bank, domestic accounts for assets liquidation, or accounts for domestic reinvestments can all be processed via the same designed account under capital item, while it was not mentioned in the Circular 36.
- Circular 36 prohibited funds to be transferred between the designed accounts under capital item of the same name for FIEs, while Circular 19 lifted the restriction.

IV Comments

According to remarks made by Zhou Xiaochuan, the head of PBOC, at the 2015 China Development Forum in Beijing on Mar 22 2015, China will accelerate reform and opening up of its capital market in 2015, aiming to make RMB convertible on the capital account. As China is taking steps in opening the country's capital markets to foreign investors, the issuance of Circular 19 serves for the purpose of further deepening the reform of the foreign exchange management system and better satisfying and facilitating the requirements for business and capital operations of FIEs. For FIEs, the reform of foreign exchange settlement management simplifies the verification procedures, saves time effectively and help to control the foreign exchange risks; for banks, by the rights being delegated to them, it will prompt them to strengthen the internal control.

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The interpretation and actual implementation of Circular 19 should be worthy of attention. The up-to-date information will be provided continuously by our bank.

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