Bank of Tokyo-Mitsubishi UFJ

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SAFE released new provisions on centralized management of foreign exchange funds by multinational companies

On Aug 5 2015, the State Administration of Foreign Exchange (hereinafter "SAFE") released "Provisions on the Centralized Operation and Management of Foreign Exchange Funds by Multinational Companies (MNCs)"(huifa [2015] No.36) (hereinafter "No.36 circular") which took immediate effect. According to No.36 circular, MNCs in China may process centralized foreign exchange fund management for its member companies, as well as centralized settlement or netting settlement under current account. In particular, No.36 circular proposed a new calculation method to centralize the foreign debt quota of member companies under China`s macro prudential operational rules. We will be introducing the highlights of No.36 circular in this report.

I Background

China has been undergoing a series of liberalization reform measures on the centralized foreign exchange fund management. On February 28, 2014 the Shanghai Branch of SAFE issued "Implementation Measures of Foreign Exchange Management for Supporting the Development of China (Shanghai) Pilot Free Trade Zone (hereinafter 'PFTZ')" (Shanghaihuifa [2014] No.26, hereinafter 'the No.26 circular'). According to the No.26 circular, a qualified entity in the PFTZ may apply to centrally manage foreign exchange funds as a host company; According to news from SAFE, on May 16, 2014 the reform stated in No.26 circular was officially launched, with the first batch of bank-enterprise cooperation agreements on centralized operations and management of foreign exchange funds for headquarters of MNCs in PFTZ being signed[1]. Later the "Notice concerning Centralized Management of Foreign Exchange Fund for Multinational Companies" (Huifa [2014] No.23, hereinafter as "No.23 circular")[2], was released on April 25 last year so that such foreign exchange reform has been elevated to a national level.

The newly released No.36 circular further revised provisions stated in No.23 circular while sharing most of the similarities in terms of host company threshold requirements for MNCs, application procedures with local SAFE and major management measures for centralization of foreign debt quota, outbound loans quota and centralized foreign currency conversion, and centralized settlement or netting settlement under current account. Drawing from the experiences of foreign debt management conducted on a pilot basis in regions and cities in China such as Zhongguancun Science Park of Beijing, Dalian city and rest of Liaoning province, No.36 circular innovatively proposed a new calculation model for centralization of foreign debt quota of member companies, which would provide MNCs in China with more financing flexibility. No.23 circular was abolished accordingly.

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[1] http://www.safe.gov.cn/wps/portal/!ut/p/c4/04_SB8K8xLLM9MSSzPy8xBz9CP0os3gTA4NgCydDRwMLU1djA0-30GBPFws_A4MAY_2CbEdFANhRXuo!/?WCM_GLOBAL_CONTEXT=/wps/wcm/connect/safe_web_store/shfj/node_shfj/shfj_fjdt/shfj_fjdt_pt/7e2a8180440446c4afc2efb2dd6ad380

[2] http://www.safe.gov.cn/resources/wcmpages/wps/wcm/connect/safe_web_store/safe_web/zcfg/zhfg/jbfg/node_zcfg_jbfg_store/7f56c68043c3be07915ad320e1240a3f/

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II Highlight

Compared with No.23 circular, there are notable changes stated in the No.36 circular as below:

1. New calculation method to centralize the foreign debt quota

Under China`s macro-prudential operational rules, MNCs are entitled to centralize their foreign debt quota applying the following 2 formulas:

(1) Total foreign debt quota ≤ ∑Net asset × leverage ratio (Currently as “1”) × macro prudential ratio (Currently as “1”)
(2) Debt to Asset ratio ≤ 75%

As explained in No.36 circular, net asset will be calculated as the audited net asset by the end of previous year (or special audited net asset of this year); foreign debt quota shall be calculated with net asset (consolidated basis) in principle. However, in case of the net asset (consolidated basis) doesn't apply or being inappropriate, the total net assets (non-consolidated basis) would apply in the formula. Also, under certain circumstance, the debt to asset ratio can be above 75% after filing-for-record with SAFE and deliberation from its local bureau. Both the leverage ratio and macro prudential ratio stated in the formula are subject to timely adjustment by SAFE based on the total foreign debt volume, tenor and foreign currencies structure, etc.

Previous No.23 circular allowed MNCs to consolidate quotas of foreign debts and outbound loans of its group companies, entirely or partially, to manage its foreign exchange funds supply and demand internally.

Foreign debt quota are usually managed on an occurrence basis within investment gap in general areas of China except for the pilot cities conducting foreign debt quota reform. No.36 circular mentioned that foreign debt quota can be calculated applying the new formulas above if the member company has used up its foreign debt quota within the investment gap; for member company who still has sufficient quota, it may choose from calculating the quota applying above formulas or the total amount of remaining applicable quota within the investment gap when centralizing foreign exchange funds, however no change shall be made once decision is made.

2. Foreign exchange settlement fund usage

The settlement fund usage scope has enlarged substantially in No.36 circular compared with those stated in No.23 circular. For example, No.23 circular promulgated that the settlement fund cannot be used for investment in securities and derivatives or RMB entrusted loans; repayment of inter-company borrowings (including third-party advances), etc; However the No.36 circular only forbids to use the settlement funds directly or indirectly beyond company`s business scope or for payment prohibited by laws and regulations in China.

For detailed comparison of No.36 circular and No.22 circular please refer to below table:

Measures		**No.36 circular(current)**	**No.23 circular(abolished)**
Centralized foreign debt quota	**Quota**	Total foreign debt quota ≤ ∑Net asset × leverage ratio (Currently as “1”) × macro prudential ratio (Currently as “1”) with debt to asset ratio not exceeding 75% *****For member company with sufficient quota, it may choose from calculating the quota applying above formulas or the total amount of remaining applicable quota within the investment gap	Total amount of company`s remaining applicable quota within investment gap
	Special account of host company	Allow to open an international foreign currency master account and a domestic foreign currency master account or one of those two accounts **via local banks or banks in different regions in China**	Allow to open an international foreign currency master account and a domestic foreign currency master account or one of those two accounts **via local banks**
	Settlement fund usage	1.Settlement fund cannot be used for payments beyond the business scope of companies or intended usages of foreign debt funds or payments prohibited by laws and regulations in China; **2.Settlement fund can be used for repayment of RMB loans or equity investment, etc**.	Settlement fund cannot be used for any of the following purpose: 1.Payments beyond the business scope of companies or intended usages of foreign debt funds or payments prohibited by laws and regulations in China; 2.Investment in securities and derivatives; 3.Direct or indirect issuance of RMB entrusted loans; repayment of inter-company borrowings (including third-party advances); repayment of RMB bank loans that have been sub-lent to third parties through banks; 4.Purchase of real estate that is not for self-use purpose
	Repayment	Company is allowed to choose currencies for repayment at will after registration with SAFE	No detailed regulations
Outward foreign exchange purchase and payment under both current and capital account		Allow to be handled by different banks	Must be handled by the same bank where the company opens relevant accounts
Definition of member company		1. Refers to companies within the MNC which hold each other`s shares directly or indirectly and possess independent legal person status. Domestic and overseas member companies are both included	Refers to companies within the MNC which hold each other`s shares directly or indirectly and possess independent legal person status. Domestic and overseas member companies are both included

	2. For companies not directly or indirectly holding each other`s shares, brother-sister companies owned by the same parent company are included; **3.Other related companies such as VIEs (Variable Interest Entity) approved by local SAFE under certain conditions are included**	

III Comment

No.36 circular demonstrated China`s aim to gradually reduce its foreign exchange restrictions. This would encourage MNCs to set up their regional or global headquarters in China with more flexibility in allocating their foreign exchange funds and reducing the overall financial costs. However, as stated in previous No.23 circular, certain filing qualifications required by SAFE for domestic member companies such as “volume of foreign exchange receipts and payments of previous year exceeding USD $100 million (calculated by the sum of all domestic member companies)”, and also the “upper limit of poolable outbound loans quota shall be 50% of the domestic members’ shareholders equity”[3] still stand. .

The interpretation and actual implementation of the No.36 circular should be worthy of attention. The up-to-date information will be provided continuously by our bank.

[3] Individual application to local SAFE required if exceeding the upper limit.