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Detailed guidelines of financial reform in Shanghai Pilot Free Trade Zone Released

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Key Points

- Non-financial firms within PFTZ will be allowed to freely convert cash raised from foreign debt into RMB;
- Foreign exchange settlement handling procedures would be substantially simplified;
- Threshold further lowered for qualified companies to join the cash pooling scheme.

On Dec 16 2015 the State Administration of Foreign Exchange (hereinafter "SAFE") Shanghai announced "**detailed guidelines to further promote foreign exchange reform of China's Shanghai Pilot Free Trade Zone ('PFTZ') on a pilot basis**" (hereinafter "the guidelines")[1]. The guidelines are the first batch of detailed rules after authorities launched 40 general measures for financial reforms and opening up pilot programs in PFTZ on October 30.

1. Background

On Oct 30 2015, the People's Bank of China ("PBOC"), together with six Chinese governmental bodies, jointly released "New policy on further pursuing financial innovation in PFTZ and developing Shanghai as an international financial center"[2]. It proposed to expand the FTA functions and allow Qualified Domestic Individual Investors (QDII2) to make overseas industrial, fixed asset and financial investment on a pilot basis, which was expected to take the country's financial reform journey into a new chapter.

Following closely on the heels of the guidelines for PFTZ, similar foreign exchange reforms were taking place in other free trade zones (FTZs) in China as well. On Dec 21 2015, a series of financial reform measures (hereinafter "the measures") featuring the foreign exchange reform of the FTZs in Tianjin, Guangdong and Fujian were announced by SAFE. The measures approved RMB convertibility on the capital account freely for entities within the FTZs. In addition, it supported FTZs to launch innovative financial businesses according to their own geographical and position advantages. Since FTZs serve as the experimental zones for various economic reforms to expand and replicate nationwide, it represents a significant step by China to open up its capital accounts.

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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_glxx/62feee804af8cbd7946ebf2bead6bf4e

[2] http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/2970998/index.html

2. Highlight

The guidelines aims to build Shanghai as an international financial center with freer trade and capital liberalization. PFTZ, as the testing ground for China' future economic reforms, is expected to be the pioneer of wider convertibility of RMB and more market-oriented interest rates.

Earlier in Feb 2014, a circular on 'Implementation Measures of Foreign Exchange Management for Supporting the Development of PFTZ' (Shanghaihuifa [2014] No.26, hereinafter as 'the No.26 circular') was released. No. 26 circular set out the administrative procedures regarding simplification of the direct investment related foreign exchange, the relaxation of foreign debt management, the improvement of the centralized management of foreign currency by headquarters of multinationals, as well as foreign currency cash pool and international trade settlement center. The newly released measures replaced No.26 circular with some noticeable changes compared as below.

Changes		**The guidelines (current)**	**No.26 circular (previous)**
Capital account business		Enterprises (including non-financial firms) within PFTZ will be allowed to **freely convert cash** raised from foreign debt into RMB.	Not mentioned
		Not mentioned; *As relevant rules in No.26 circular is abolished according to the guidelines, the quota for an enterprise in the PFTZ to extend outbound foreign exchange loans shall not exceed **30%** of the enterprise's shareholders' equity[3]. .	The administration of outbound foreign exchange loans provided by enterprises in the PFTZ shall be relaxed. The quota for an enterprise in the PFTZ to extend such loans shall be raised to **50%** of the enterprise's shareholders' equity.
Centralized foreign exchange management (Cross-border Pooling)	Applicable regulations	In compliance with "Provisions on the Centralized Operation and Management of Foreign Exchange Funds by Multinational Companies"(**national version rules**) released on in Aug 2015 by SAFE	In compliance with **national version rules** or relevant rules stated in **No.26 circular** specifically for entities within PFTZ
	Requirement for qualified companies	Threshold lowered for qualified companies to join the system with the requirement of "volume of foreign exchange receipts and payments of previous year exceeding **USD $50 million**"	For qualified companies to join the scheme with the requirement of "volume of foreign exchange receipts and payments of previous year exceeding **USD$100 million**"

[3] In compliance with "Notice on Further Improving and Adjusting Policies for Foreign Exchange Administration under Capital Accounts" issued by SAFE on Jan 24 2014.

3. Comments

China’s recent financial reforms in FTZs aims to ease curbs on capital account and facilitate corporate fund management, providing more financing options and efficient foreign currency settlement methods to companies in FTZs. By giving more flexibility to companies in terms of foreign exchange capital funds and foreign debt funds convertibility, companies can choose which currency to hold and optimize their fund management structure. Also the simplification of administrative procedures will substantially improve the efficiency and facilitate trade and investment, thus have long been one of the focuses to invigorating the financial markets in China.

Amid the turbulence in domestic and global markets, China is pressing ahead with more reforms in experimental areas such as FTZs where valuable experiences could be gained to be used for large scale adoption later. Although the reforms featuring different focuses on each FTZ respectively considering their regional positions and geographical advantages, in practice it might lead to confusions as to which versions of provisions to apply for particular entities. It is expected further explanations of the financial reforms be announced in the near future.