News Focus
No.2 2017

Further Promote Reform on Foreign Exchange Administration

ANGEL FUNG

BUSINESS DEVELOPMENT OFFICE
HONG KONG BRANCH

T +852-2821-3783
E ANGEL_YT_FUNG@HK.MUFG.JP

The Bank of Tokyo-Mitsubishi UFJ, Ltd.
A member of MUFG, a global financial group

28 FEB 2017

The State Administration Of Foreign Exchange (hereinafter "SAFE") promulgated the "Circular on Further Promoting Reform on Foreign Exchange Administration and Improving Verification of Authenticity and Compliance"[1] (Huifa [2017] No.3, hereinafter "the New Circular") on 26 January 2017. The New Circular, with immediate effect, allows repatriation of funds raised from "offshore loans with onshore guarantees"[2] and also reiterates the restrictions on capital outflow.

BACKGROUND

A decreasing trend of China's foreign exchange reserves has emerged since it hit the peak level of US$3.99 trillion in June 2014 and the authorities have therefore taken a series of policies to strengthen the capital control so as to safeguard the reserves level.

Major policies released by the authorities which aim at encouraging capital inflow and controlling capital outflow include:

		Existing Regulations
Inflow	Huifa [2016] No. 16 Circular	Conversion of funds under capital account and funds obtained from foreign debt is allowed.
	Yinfa [2017] No. 9 Circular	Domestic borrower's foreign debt quota is increased to twice the enterprise's net asset value.
Outflow	PBOC Decree [2016] No. 3	Reporting threshold of cash transaction is tightened from RMB 200,000 to RMB 50,000. Any FCY-denominated cash transactions of USD 10,000 or above are required to report.
	Yinfa [2016] No. 306 Circular	The aggregate amount of offshore loans in RMB and FCY should be within 30% of an enterprise's owner's equity.
	Yinjianfa [2017] No. 1 Circular	Verification by banks on credit record and repayment capacity of enterprises is required before financing for overseas direct investment (hereinafter "ODI") projects.

[1] PBOC (26 Jan 2017). Retrieved from: http://www.safe.gov.cn/wps/portal/!ut/p/c4/04_SB8K8xLLM9MSSzPy8xBz9CP0os3gPZxdnX293QwMLE09nA09Pr0BXLy8PQyNPI_2CbEdFAKLWUno!/?PC_7_HCDCMKG108U5C0IAU3CM7730S5000000_WCM_CONTEXT=/wps/wcm/connect/safe_web_store/safe_web/zcfg/zhfg/qt/node_zcfg_qt_store/06ad61004fd6d8b2b8d6b88c78fc6d27

[2] "Offshore Loans with Onshore Guarantees " refers to the loans granted to overseas enterprises guaranteed by domestic enterprises or financial institutions.

However, such decreasing trend in reserves level has not been reversed despite the implementation of the above measures. According to the latest data of January 2017, China's foreign exchange reserves dropped below USD 3 trillion and recorded 7 consecutive months of falling.

Under such background, SAFE has introduced a series of measures via the New Circular to stabilize the reserves level as well as to promote the foreign exchange reform.

HIGHLIGHTS

The New Circular opens up more aspects of discretionary conversion to RMB and permits funds repatriation from offshore loans. Meanwhile, the New Circular restates the existing restrictions regarding profit remittances and outbound loans for the purpose of curbing further capital flight.

Main contents of the New Circular, comparing to the existing regulations, are listed as follows:

		Existing Regulations	The New Circular
Inflow	Conversion of FCY with Export Background	▪ FCY with export background provided by domestic banks may not be converted to RMB except for outward bill credit (Huifa [2002] No.125)	▪ FCY with export background provided by domestic banks can be converted to RMB ▪ Repayment should be made from export proceeds (Purchasing FCY for repayment is not allowed in principle)
	Offshore Loans with Onshore Guarantees	▪ Funds repatriation is not allowed without prior approval from the SAFE (Huifa [2014] No.29)	▪ Repatriation of funds is allowed by the way of domestic sub-lending or equity investments
	Conversion of FCY in Non-Resident Account (hereinafter "NRA")	▪ Conversion is not allowed without prior approval from SAFE (Huifa [2009] No.29)	▪ NRA Conversion in the Free Trade Zones is allowed ▪ Evidences shall be verified by the banks before being used by enterprises
Outflow	Profit Repatriation	▪ Profit shall be used to make up for the loss incurred in previous financial year before remittance (Article 166 of The Company Law)	▪ SAFE clearly specified the enforecement of the regulation
	Outbound Loans	▪ The aggregate amount of offshore loans in FCY and RMB shall not exceed 30% of an enterprise's owner's equity (Yinfa [2016] No.306)	▪ SAFE reiterated the regulation

The New Circular emphasizes that the enterprises shall settle foreign exchange transactions under the principle of "whoever export should collect, whoever import should pay" which has been upheld since 2012, showing the authorities' determination in cracking down illegal cash flight in the name of trade, such as irregular transit trade.

In addition, amid the global investment spree from China, the authorities urges the banks to conduct careful scrutiny for ODI projects before outbound remittances. Enterprises which apply to engage in ODI are required to provide details of the sources and usages of funds to the banks[3]. The purposes of such requirements are to ensure authenticity and compliance of the ODI funds, and to avoid capital outflow through false practice of overseas investment.

[3] Investments such as i) irrelevant to the core business, ii) by newly established companies, and iii) with a registered capital scale larger that of the domestic investor are strictly monitored.

COMMENTS

With a view to boost capital inflow, the New Circular has broadened the financing channels for domestic enterprises by means of permitting discretionary conversion of FCY generated from trade finance and allowing repatriation of “offshore loans with onshore guarantees”.

The New Circular reveals that the authorities has tightened the authenticity and compliance check before conducting outbound payment to avoid illegal capital flight. It is expected that the measures would reduce the capital outflow and mitigate the volatility of the foreign exchange reserves. However tightened control over capital outflow might slow the pace of financial liberalisation and RMB internationalisation. We will keep an eye on the impact of the capital inflow incentives and the capital outflow deterrents stipulated in the New Circular.