

client alert

FOREIGN EXCHANGE | CHINA |

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SAFE FURTHER RELAXES FOREIGN EXCHANGE CONTROLS

On January 24, 2014, the State Administration of Foreign Exchange (“SAFE”) released the *Circular on Further Improving and Adjusting Foreign Exchange Policies for Capital Accounts* (Hui Fa [2014] No.2) (“**Circular 2**”). Circular 2, which went into effect on February 10, 2014, removes or streamlines certain regulatory checks on capital accounts that existed under previous laws.

OVERVIEW

Over the past couple of years, SAFE has gradually allowed greater flexibility in using foreign exchange for investments in China¹. In this latest round of loosening controls, the following regulatory items have been deregulated:

- Offshore claims of domestic financial leasing companies;
- Transfers of domestic non-performing assets (“NPA”) to foreign investors;
- Pre-expenses of outbound investments of domestic entities;
- Offshore lending by domestic companies;
- Remittances of profits abroad by domestic entities;
- Forex sales and payments for transfers of personal property; and
- Securities Business Forex Operation Permits (“SBFOP”) of domestic securities companies.

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¹ *Circular on Further Improving and Adjusting Foreign Exchange Policies for Direct Investments* (Hui Fa [2012] No. 59), issued November 21, 2012, and effective December 17, 2012 (“**Circular 59**”); and *Circular on the Administrative Provisions for Foreign Exchange in Domestic Direct Investment by Foreign Investors* (Hui Fa [2013] No. 21), issued May 10, 2013, and effective May 13, 2013 (“**Circular 21**”).

KEY CHANGES

This section focuses on changes brought by Circular 2 that we believe are most relevant for foreign investors and operations in China:

- **Transfer of domestic NPA to foreign investors**

Old measure	Circular 2
Within 15 working days after filing or NDRC's approval, financial assets management companies must apply to SAFE for approval of foreign exchange payment and remittance for transfers of domestic NPA to foreign investors.	No SAFE approval necessary
SAFE approval of Forex income received by financial assets management companies for transfers of domestic NPA to foreign investors	No SAFE approval necessary; banks may directly process the settlement.
SAFE approval of exchanges and remittances of foreign investors' income generated from the disposal of NPA	No SAFE approval necessary; banks may directly process the transactions.

- **Offshore lending by domestic companies²**

Old measure	Circular 2
Domestic companies may provide direct lending to their (i) offshore wholly-owned subsidiaries, (ii) companies in which they have shares, and (iii) their offshore parent companies.	Domestic companies may provide direct lending to <u>offshore companies with which they have an equity relationship</u> ³ .
The balance of overseas lending cannot exceed 30% of such lender's owner's equity or its total investment amount in the borrower. Any lending extended over these limits must be reviewed by the local SAFE and approved by the central SAFE.	Overseas lending balances are no longer limited to a lender's total investment amount in the borrower. Any lending exceeding 30% of a lender's owner's equity must be approved by the <u>local</u> SAFE on the basis of collective consideration.
Overseas lending quotas approved by SAFE are valid for 2 years. Domestic companies may apply for an extension if they still need to use their quota after it expires.	Domestic companies may apply any reasonable term to their overseas lending quotas according to their business needs.
Not specified.	If a domestic lender cannot recover the principal and interest due on a loan because of objective reasons, it may deregister the loan with its local SAFE, which will approve the deregistration on the basis of collective consideration.

² Domestic companies refer to companies incorporated in the People's Republic of China, including domestic-funded companies and foreign-invested companies.

³ The scope of this "equity relationship" needs to be further defined by SAFE. We do not know, for example, whether it includes offshore indirect holding companies.

• **Remitting profits abroad by domestic companies**

Old measure	Circular 2
<p>Banks must review the following documents when remitting profits abroad for domestic entities:</p> <ul style="list-style-type: none"> i. Forex registration certificate; ii. Board resolution on profit distribution; iii. Latest capital verification report and audit report; and iv. Tax certificate. 	<p>Remittances of up to USD 50,000: in principle banks do <u>not</u> need to review any transaction documents;</p> <p>Remittances of more than USD 50,000: Banks must review all documents <u>except</u> the capital verification and audit reports.</p>
<p>The amount any entity may remit in a year is capped at the sum of “payable dividends” and “undistributed profits” belonging to the foreign shareholders in such entity’s latest audit report.</p>	<p>No annual remittance cap</p>

COMMENTS

Along with Circulars 59 and 21, Circular 2 demonstrates SAFE’s forward direction in terms of opening up capital account items. Continuing the trend of streamlining administration of foreign exchange transactions, Circular 2 removes certain redundant approval items and changes other regulatory formalities from a one-time approval to regular monitoring. The result of these changes should lead to more efficient administration and ease the administrative burden for many companies.

Although some policies still need further clarification on how to interpret and implement them in practice, Circular 2 is certainly a welcomed reform for foreign investors.

As always, Gide will closely follow any legal and practical developments in this area. Please contact us should you have any questions regarding this or other Forex issues in China.

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