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Llinks Corporate Bulletin
November 2012

The Newly Issued Regulations on Foreign Exchange Administration of Direct Investment: Simplifying Several Approval and Registration Processes of Foreign Exchange Administration

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Recently, the State Administration of Foreign Exchange ("**SAFE**") promulgated the *Notice of the State Administration of Foreign Exchange on Further Improving and Adjusting Foreign Exchange Control Policy for Direct Investment* (Hui Fa [2012] No.59, the "**Notice**") to further promote the facilitation of trade and investment, which simplifies the approval and registration process of direct investment. The Notice will come into effect on 17 December 2012. This article briefly describes and comments on the Notice.

Brief of the Notice

➢ **Overview**

The purpose of promulgating the Notice is to improve the facilitation of direct investment and to optimize the foreign exchange administrative process of direct investment, so as to progressively establish a foreign exchange administration system to manage foreign direct investment mainly by registration processes. The main contents of the Notice can be summarized in the following three aspects:

- The Notice abolishes several previous SAFE's approval process for direct investment. The quotas of cross border cash flow and currency exchange for foreign investment enterprises will be set through registration process. SAFE delegates the examination authority to banks, and banks will process such cross border transactions and currency exchange activities according to the information registered in SAFE's information system. The processes to be abolished mainly include:

  i. the approval process of the relevant direct investment accounts' opening, transferring funds into account, settlement of exchange and currency purchase and payment;

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ii. the approval process of onshore foreign exchange transfer occurred in routine business of direct investment;

iii. the approval process of foreign investors' re-investment of their domestic income legally obtained;

iv. the process of inquiry and confirmation on capital decrease for capital verification purpose; and

v. the foreign exchange registration process of the onshore re-investment by foreign-invested companies with an investment nature (commonly known as "**Chinese Holding Company**"), and the process of inquiry and confirmation on such re-investment for capital verification purpose.

- The Notice further narrows the types of foreign exchange accounts for direct investment, and abolishes the former special foreign exchange accounts of foreign investors. The newly adjusted foreign exchange account types of foreign investment mainly include:

Name of Account	Main Purpose
Foreign Exchange Account for Early-Stage Fees	for depositing various early-stage fees on all direct investment related activities of foreign investors
Foreign Exchange Capital Account	for depositing the foreign exchange capital
Special Account for Deposits Remitted-in Offshore / Transferred-in Onshore	for depositing the guarantees in foreign currencies remitted-in offshore or transferred-in onshore
Account for Converting Onshore/Offshore Assets into Cash	for depositing the foreign currencies collected from selling onshore or offshore assets and interests by domestic entities
Special Account for Onshore Re-investment	for depositing the foreign currencies received from onshore re-investment

- The Notice eases the restrictions of capital use for direct investment, which include easing the restrictions of total numbers of foreign exchange account and of opening accounts in different regions for direct investment; easing the restrictions of purchasing and paying foreign exchange in different regions for direct investment; easing the restrictions of overseas loans funding resource and qualifications of lenders, at the same time allowing domestic entities to grant overseas loans with onshore loans in foreign currencies, and allowing foreign-invested enterprises to grant overseas loans to their foreign parent companies.

➢ **Simplifying the Foreign Exchange Administration on Onshore Re-investment by Foreign-invested Investment Companies ("Chinese Holding Company")**

The Notice abolishes the current foreign exchange registration process for the re-invested companies, the investor of which is a Chinese Holding Company. Accordingly, the Notice also abolishes SAFE's approval process for transferring onshore investment funds of the Chinese Holding Company, and abolishes the inquiry and confirmation process (for capital verification purpose) of the invested company, in the case of such invested company is wholly owned by the Chinese Holding Company. Regarding wholly-owned subsidiary companies founded by the Chinese Holding Company onshore, after such subsidiary companies completing SAFE's information registration process for receiving foreign currencies by onshore re-investment, the banks may rely on SAFE's registration information to directly open a special account for onshore re-investment for the subsidiary companies. Funds in the account should be managed by reference to the administration of foreign exchange capital of foreign-invested enterprises. For the jointly-funded enterprises by the Chinese Holding Companies and other foreign investors, the foreign exchange registration process is still required, and the Chinese Holding Companies will be registered as domestic shareholders.

With respect to the investor's identity of the Chinese Holding Company when it conducts onshore re-investment, the Chinese Holding Companies are no longer regarded as foreign entities. For those companies who already completed foreign exchange registration before the Notice comes into effect, when they apply for change of foreign exchange registration, SAFE will record a virtual share transfer from the foreign investor to Chinese investor, to adjust the identities of foreign investors (foreign entities) into Chinese investors (domestic entities) in the direct investment information system.

- **Clarifying the Process of Onshore Equity Investment in Foreign Currency Funds in the Domestic Entities' Converting-Assets-into-Cash Accounts**

The Notice provides that, the abovementioned registration process of receiving foreign currencies by onshore re-investment also applies to using foreign currency funds in domestic entities' converting-assets-into-cash accounts for onshore equity investment. In such case, domestic entities may transfer their foreign currency funds in the converting-assets-into-cash accounts in its original type of currency into the special account for onshore re-investment opened by the invested enterprises. The foreign currency funds transferred into the special account for onshore re-investment will be managed in accordance with the principle of the payment and settlement of foreign exchange capital of foreign-invested enterprises. Before the promulgation of the Notice, the settlement of the foreign currency funds in the converting-assets-into-cash account of domestic entities should be administrated by reference to the settlement of foreign currency capital of foreign-invested companies.

- **Simplifying the Foreign Exchange Registration Process of Foreign Investors' Acquiring Chinese Investors' Equity Interests**

According to the Notice, companies which to acquire Chinese investors' equity interests no longer require to apply for approval of opening a converting-assets-into-cash account for selling onshore assets and process of transferring funds into account; in the event that those foreign investors remit foreign currencies for the purpose of paying the full amount of equity purchase price, companies no longer require to pay a visit to SAFE to apply for the foreign exchange registration for foreign investors' acquiring Chinese investors' equity interests. SAFE will automatically complete the capital verification registration through its information system regarding foreign investors' acquiring Chinese investors' equity interests in a shortened period (3 working days), after the banks complete the activities of transferring funds into the converting-assets-into-cash account for selling onshore assets.

- **Simplifying the Inquiry and Confirmation Process for Capital Verification**

The current inquiry and confirmation process for capital verification can be summarized as two steps: after the accounting firm inquires and confirms with banks, the accounting firm takes the information provided by the banks to SAFE for verification; SAFE shall issue a confirmation letter, and the accounting firm will then issue the capital verification report accordingly. The Notice abolishes the requirement for the accounting firm to provide paper copies when conducing the inquiry and confirmation with SAFE. Instead, the accounting firm only needs to file such verification through SAFE's information system using electronic copies, and then the accounting firm can rely on SAFE's electronic confirmation letter to issue the capital verification report. Meanwhile, the Notice also abolishes the process of inquiry and confirmation on capital decrease for capital verification, which means that the accounting firm can also rely on the SAFE's registered information for capital contribution verification.

Therefore, the inquiry and confirmation process for capital verification purpose can be completed online. Accounting firms no longer need to visit SAFE, which greatly simplifies such process. Considering that usually the inquiry and confirmation process for capital verification purpose is the pre-procedure of applying and changing business license of the foreign-invested enterprises, the adjusted policy has also optimized the business registration of foreign-invested enterprises.

Comments

In summary, the Notice simplifies the foreign exchange administration system and relevant process. Meanwhile however, the Notice expressly stipulates that the banks will process the foreign exchange activities by relying on SAFE's registered information which determines the quotas for the receipt, payment, settlement and sales of the foreign currencies, meanwhile reviewing supporting documents (such as related tax payment certificates) according to authenticity principle. Furthermore, under specific conditions with respect to the receipt and payment of foreign exchange, SAFE has the authority to require applicants to explain the rationality behind the pricing of the related capital transaction. Based on this, the Notice can facilitate the administration process for foreign investments and can also maintain the necessary control over the same.

The promulgation of the Notice by SAFE indicates a significant revolution of foreign exchange administration of foreign direct investment, to optimize the operating system of foreign exchange administration of direct investment. However, in the current stage, foreign exchange administration authorities and related banks are still learning and deliberating the new rules specified in the Notice. We will follow up the interpretation of the relevant authorities and entities in their practice with respect to the Notice and make comments thereon.

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