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New Foreign Exchange Administration System for Trade in Goods: From Onsite Examination to Subsequent Supervision

By David Yu, Clare Lu and Shirley Hou

For the purposes of further deepening the reform of the foreign exchange administration system and facilitating the convenience of trade, the State Administration of Foreign Exchange (hereinafter referred to as "**SAFE**"), the General Administration of Customs (hereinafter referred to as "**GAC**") and the State Administration of Taxation (hereinafter referred to as "**SAT**") jointly promulgated the *Announcement on the Reform of Foreign Exchange Administration System for Trade in Goods* (hereinafter referred to as the "**Announcement**") on 27 June 2012, and decided to carry out reform of the foreign exchange administration system for trade in goods all over China as of 1 August 2012. For this purpose, SAFE issued on the same day the *Notice on Printing and Distributing Issues concerning the Regulations of Foreign Exchange Administration for Trade in Goods* (Hui Fa [2012] No.38) and printed and distributed the *Guidelines on Foreign Exchange Administration for Trade in Goods*, the *Implementing Rules for the Guidelines on Foreign Exchange Administration for Trade in Goods*, the *Operating Rules for the Guidelines on Foreign Exchange Administration for Trade in Goods (Edition for Banks and Enterprises)* and the *Administrative Provisions on Declaration of Information of Foreign Exchange Receipts and Payments for Trade in Goods* (hereinafter collectively referred to as the "**Regulations on New Foreign Exchange Administration for Trade in Goods**") to further specify the operation of new foreign exchange administration for trade in goods.

Background of the Reform of Foreign Exchange Administration for Trade in Goods

For a long time, foreign exchange for trade in goods in Mainland China has carried out an import and export verification system featured by "deal-by-deal verification, pre-filing, onsite examination and conduct regulation". The said system was established in the 1990s and accorded with the prevailing conditions of society economy and international balance of payment back then, with emphasis on controlling the outflow of foreign exchange and facilitating the

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collection of foreign exchange. However, in the wake of changes in the economy of Mainland China and the situation of international balance of payment, the focus of foreign exchange administration has begun to shift to combating "hot money" and preventing the over-growth of foreign exchange reserves. Therefore, the original import and export verification system can no longer accommodate the changes in situation, and has become more and more unfavorable for enterprises and banks to efficiently and conveniently handle foreign exchange transactions; it is also disadvantageous to the enhancement of convenience of trade and efficiency of foreign exchange regulation.

In order to comply with the developments of and changes in the scale, method and subject of foreign trade, SAFE, GAC and SAT have jointly carried out pilot reforms of foreign exchange administration system for trade in goods in Jiangsu Province, Shandong Province and other five provinces (cities) since December 2011. Currently, the foreign exchange administration system for trade in goods in the pilot areas is operating well with an outstanding effect. The conditions for national promotion of the reform are mature.

Overview of the Regulations on New Foreign Exchange Administration for Trade in Goods

There are numerous changes in the reformed foreign exchange administration system for trade in goods, and we have summarized the essential points of the Regulations on New Foreign Exchange Administration for Trade in Goods as follows:

Subject Administration. SAFE will carry out administration over enterprises by using the "Directory of Enterprises Involving in Foreign Exchange Receipts and Payments for Trade". Enterprises shall, after legally obtaining the foreign trade operation right, go through the formalities for Directory registration with SAFE upon the strength of relevant materials, and SAFE will implement coach-period administration over the enterprises newly added in the Directory. Through the "foreign exchange monitoring system for trade in goods" (hereinafter referred to as the "**Monitoring System**"), SAFE will distribute the national enterprise Directory to financial institutions, who may not directly deal with foreign exchange receipts and payments for trade for those enterprises not in the Directory.

Classification Administration. Based on the results from off-site and on-site examinations and combined with enterprises' conditions of compliance with foreign exchange administration rules, SAFE will categorize enterprises into Class A, B and C. Class A enterprises will be given convenience in receipts and payments for trade, while prudent administration will be imposed on Class B and Class C enterprises' foreign exchange receipts and payments for trade in terms of document examination, type of business, handling procedures and settlement method. SAFE will implement a dynamic administration over the classification of enterprises, and may at any time lower the classification level of any enterprise found to have any corresponding downgrading acts in its daily administration. The term for classification regulation of Class B and Class C enterprises shall be one year, and SAFE will re-confirm the classification level of such enterprises one month prior to the expiry of the regulation term after conducting comprehensive evaluation of the activities of such enterprises within their regulation terms.

Examination Administration on Foreign Exchange Receipts and Payments. Financial institutions engaged in settlement and sale of foreign exchange shall inquire the Directory status and classification status of enterprises through the Monitoring System and examine the authenticity of the documents for import and export of goods submitted by enterprises and the consistency between such documents and the foreign exchange receipts and payments for trade. The foreign exchange revenue from trade of enterprises shall be credited into the to-be-examined export revenue account, and the export revenue meeting the required conditions may be deposited overseas for administration.

Enterprise Report and Registration Administration. For specific trade credit, trade financing and receipts and payments of transit trade and other businesses, SAFE may demand enterprises to report through the Monitoring System such information as corresponding expected receipts and payments of foreign exchange or dates of import or export within 30 days of the actual occurrence of such business relating to receipts and payments of foreign exchange or import and export of goods. For foreign exchange receipts and payments for trade of Class C enterprises, foreign exchange receipts and payments for trade of Class B enterprises that are in excess of the receivable/payable quota, receipts and payments for transit trade of Class B enterprises that are in excess of the proportion or prescribed time limit and other businesses, SAFE may demand enterprises to register as required with SAFE with the written application and relevant certification materials; and enterprises may handle relevant businesses at the designated financial institutions within the registered scope of amounts upon the strength of the "registration certificate".

Off-site Examination. SAFE will rely on the Monitoring System to regularly or irregularly conduct aggregate comparison between the import/export data and the data of foreign exchange receipts and payments for trade of the enterprise within a given period, so as to examine the authenticity of the foreign exchange receipts and payments for trade of the enterprise and its consistency with the import and export of goods; and will conduct intensive monitoring and special monitoring on the basis of examination data obtained. SAFE shall effectively exclude any abnormal transaction activity or subject and confirm the enterprises in need of on-site examination by means of implementing a multi-dimensional and full-aperture monitoring.

On-site Examination. SAFE may implement on-site examination over enterprises with indicators of relatively large deviation or continuous deviation, or with contradictory indicators, within the examination period by enterprises' self-examination, invitation for interview or on-site investigation and other means, in order to verify any abnormal or suspicious situation. SAFE shall transfer the result thereof to the foreign exchange examination department.

Our Comments

In respect of the Regulations on New Foreign Exchange Administration for Trade in Goods, there are a number of changes in the foreign exchange system for trade in goods after the reform:

It changes the monitoring methods for foreign exchange for trade in goods. Before the reform, what SAFE implemented for the import/export of goods was a strict deal-by-deal on-site verification system. After the reform, the foreign exchange administration method for trade in goods by enterprises has been changed into an off-site aggregate examination, that is to fully collect deal-by-deal data of the import/export of goods and foreign exchange receipts and payments of enterprises via the Monitoring System, which will be used for regular comparison and evaluation of the overall matching condition of the flow of goods and the cash flow. The off-site aggregate examination will relax the on-site administration over the foreign exchange receipts and payments for trade in goods by compliance enterprises on one hand, and on the other hand conduct intensive monitoring over abnormal enterprises, and implement on-site examination whenever necessary.

It adjusts the document requirements for export and export rebate. After the reform, enterprises will no longer be required to provide the verification sheet when going through the formalities for export declaration and application for export rebate. It should be noted that, according to the Regulations on New Foreign Exchange Administration for Trade in Goods, the requirement on the provision of verification sheet for foreign exchange receipts from export by enterprises as provided in the *Administrative Measures for Value-added Tax and Consumption Tax on Exported Goods and Services*, which was promulgated on 14 June 2012 by SAT, will be no longer applicable after 1 August 2012. According to the Announcement, as of 1 August 2012 (subject to the date of export as indicated on the "Export Declaration (special for export rebate)"), when export enterprises apply for export rebate for goods declared to be exported, they are no longer required to submit the verification sheet; for goods declared to be exported before 1 August 2012, where the term for verification of the foreign exchange receipts from export is not expired as of 31 July 2012 and the verification thereof has not been completed, the export enterprises are no longer required to provide the verification sheet when applying for export rebate.

It strengthens the administration over high-risk enterprises on the basis of classification administration over enterprises. Under the verification system before the reform, the monitoring over enterprises by SAFE is throughout the whole process of import and export; under such system, though the enterprises realize the strictness of SAFE's regulation, the risks for their incompliance are relatively small. After the reform, SAFE will categorize enterprises into Class A, Class B and Class C, and implement prudent administration over the foreign exchange receipts and payments for trade in goods for Class B and Class C enterprises, while providing convenience for the same for Class A enterprises. Under this precondition, SAFE is able to concentrate more monitoring resources on high-risk enterprises. After the reform of the foreign exchange administration system for trade in goods, enterprises may notice SAFE's improvement in efficiency and its relaxation on the monitoring over enterprises. However, it is possible that enterprises may not immediately realize the potential incompliance, leading to an increase of potential risks; it may also lead to administrative punishment and the accompanying degradation in classification of enterprises in particular when the incompliance of an enterprise has not been timely corrected.

It strengthens the trans-departmental joint regulation. SAFE, GAC and SAT will establish an information and data exchange mechanism and trans-departmental case coordination mechanism so as to strengthen the cooperation across departments and form a regulatory resultant force. After the reform, the three departments may jointly combat various illegal cross-border flow of fund, smuggling, tax fraud and other illegal activities by regularly exchanging such information as data of sale and payment of foreign exchange in trade, declaration data and export rebate examination data, as well as mutually circulating any abnormal information found in daily monitoring and examination. The new foreign exchange administration system for trade is the product of paperless administration, and in this context, the data and information exchange of all regulatory departments will ensure an obvious enhancement in the completeness and reliability of the data obtained by each department, and the efficiency and effects in coordinated investigation of cases will also be greatly improved.

Reminder by Llinks

The reform of the foreign exchange administration system for trade in goods has simplified the formalities for receipts and payments of foreign exchange for trade for most enterprises. However, we believe that reform does not mean any relaxation on the regulation by SAFE, but rather, shifts the regulatory functions of SAFE from front-end to back-end, and changes the on-site regulation to off-site regulation on the basis of classification administration, entitling SAFE to conduct subsequent examination according to the analysis results of risks, thereby improving the efficiency of regulation by SAFE. After the reform, due to the establishment of the data and information exchange mechanism and the trans-departmental coordinated investigation mechanism for cases among SAFE and other departments, the various regulatory departments including SAFE may “allocate” more regulatory resources to high-risk enterprises, whereby reinforcing the regulation on high-risk enterprises. Thus, under the new foreign exchange administration system for trade in goods, enterprises should pay special attention to the compliance administration in the process of import and export, strengthen the cross-examination and internal management of the information and materials submitted and reported to all relevant regulatory departments, and especially examine the internal management process so as to avoid any fine or degradation of classification of enterprises or other risks arising from subsequent examination and coordinated investigation.

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