Client Alert.

December 21, 2012

SAFE Liberalizes Foreign Exchange Rules … Or Not?

Two recent circulars from China's foreign exchange regulator represent a welcome move towards streamlined forex transactions

By Paul McKenzie, Gabriel Bloch and Mac Fu

Is the State Administration of Foreign Exchange ("**SAFE**") finally loosening its grip on foreign exchange transactions? Not exactly - the baseline principle of control and scrutiny over the flows of money into and out of China seems here to stay. However, in an attempt to make inflows easier and balance out an increasing outbound stream of RMB, SAFE appears to be looking for ways to ease the process of effectuating foreign exchange transactions where doing so does not come at a material cost to their supervisory powers.

SAFE's "*Circular on Further Improvement and Amendment of Foreign Exchange Control Policies on Direct Investment*" ([2012] No. 59) ("**SAFE 59**"), effective December 17, 2012, eliminates many application requirements for standard forex-related activities (over 30 administrative examination and approval items were eliminated) and replaces them with a registration process that is largely based on electronic information maintained by banks.

SAFE's "*Notice on Issues in Relation to the Foreign Exchange Administration of Foreign-funded Partnership Enterprises*" ([2012] No. 58) ("**SAFE 58**"), also effective December 17, 2012, simplifies the administrative procedures necessary for foreign-funded partnership enterprises to register with SAFE in relation to many activities carried out by such partnerships, and clarifies that foreign exchange activities for such enterprises should be carried out chiefly through registration. SAFE 58 simplifies foreign exchange registration and foreign exchange account management, standardizes foreign exchange registration issues in foreign-invested partnership enterprises, and simplifies the relevant application documents.

Foreign investors will find the foreign exchange control apparatus has been streamlined in a number of ways, including:

- "Preliminary investment costs," which we understand refer to pre-establishment start-up costs for a new foreign invested enterprise ("**FIE**"), can be covered through RMB settlement without SAFE approval; preliminary accounts can be opened without SAFE approval.
- Profits, equity transfer proceeds, capital decreases and liquidation proceeds obtained in China can be used for reinvestment in China without SAFE approval.
- Capital reserves, profit reserves, undistributed profit, equity transfer proceeds and registered foreign debt can be used to increase an FIE's registered capital without SAFE approval.
- Acquisitions by a foreign company of a Chinese company's equity where the consideration is all cash will be automatically registered by SAFE's system (non-cash transactions will need to be registered with SAFE as before).
- Proceeds of capital reductions, liquidations and certain other transactions can be remitted to foreign shareholders without SAFE approval.

- Foreign exchange loans by domestic companies to foreign persons are now expressly permitted. FIEs can make loans to their offshore shareholders within certain limits.
- Domestic companies can now remit start-up costs for investments offshore without SAFE approval.
- Foreign invested holding companies (外商投资性公司), foreign invested venture capital enterprises and foreign invested equity investment enterprises (collectively "**Investment Holding Companies**") no longer need to register reinvestment with SAFE. Likewise, the companies in which Investment Holding Companies invest will no longer need to register with SAFE remittance of profits, interest and dividends to the Investment Holding Company.

By reducing administrative procedures required for various foreign exchange transactions, SAFE has likely reduced the time and energy needed to settle domestic FDI transactions and related activities using forex. This could represent a new focus on simplifying the bureaucracy around foreign investment. Cancellation of SAFE approval places approval in the hands of banks, so procedures that formerly took weeks ought to be processed much faster. We understand that banks will be meeting internally to reconcile their procedures with the new regulations. The widely reported decline in foreign direct investment into the PRC can be presumed to motivate this legislation, as outward investment continues to be robust and inward flows have declined for most of 2012. Banks may behave conservatively under the new system, but given the underlying policy goal, approvals should generally be forthcoming. The reforms featured in SAFE 58 and 59 may have been chosen because there are alternative means of monitoring the affected activities (*e.g.* automated bank monitoring). To the extent that the authorities can identify other means of streamlining the investment environment without major sacrifices to the supervisory status quo, further liberalizations may be issued in the near future. The reforms also appear to be part of a larger agenda: the People's Daily reported earlier in November of this year that Zhou Xiaochuan, China's central bank governor, has vowed to "accelerate financial reform by focusing on improving direct financing" and to reduce "the administrative examination and approval procedures and satisfy the variety of financing needs for SME's."

As a final note, the change to lending restrictions is significant, as loans are strictly regulated and this represents a clear relaxation.

Contact:

Paul McKenzie	Xiaohu Ma	Sherry Yin	Gabriel Bloch
86 10 5909 3366	852 2585 0868	86 10 5909 3566	86 10 5909 3367
pmckenzie@mofo.com	xma@mofo.com	syin@mofo.com	gbloch@mofo.com

About Morrison & Foerster:

We are Morrison & Foerster—a global firm of exceptional credentials. Our clients include some of the largest financial institutions, investment banks, Fortune 100, technology and life science companies. We've been included on *The American Lawyer*'s A-List for nine straight years, and *Fortune* named us one of the "100 Best Companies to Work For." Our lawyers are committed to achieving innovative and business-minded results for our clients, while preserving the differences that make us stronger. This is MoFo. Visit us at www.mofo.com.

Because of the generality of this update, the information provided herein may not be applicable in all situations and should not be acted upon without specific legal advice based on particular situations. Prior results do not guarantee a similar outcome.