The SAFE Relaxes Control On Foreign Exchange Administration For Direct Investment

A financial brief   by Mary Zhu

For the purposes of streamlining the foreign exchange administration for foreign direct investment and of promoting investment and trade, the State Administration of Foreign Exchange ("SAFE") promulgated the *Notice of State Administration of Foreign Exchange on Further Improving and Adjusting the Foreign Exchange Administration Policies on Direct Investments (Hui Fa [2012] No. 59, "the Notice"),* which came into effect on 17 December 2012.

The Notice has improved the way of managing foreign exchange system for direct investments, and has switched the focus to the post-facto administration and supervision from the preliminary verification and approval.

Specifically speaking, the Notice abolishes certain preliminary verification mechanism in foreign direct investment, streamlines the current administrative procedures, and loosens some limitation on the funds under foreign direct investment.

The   main adjustments made by the Notice will be analysed.

Foreign Exchange Accounts under Foreign Direct Investment

The Notice streamlines the foreign exchange accounts under foreign direct investment. After the adjustment by the Notice, there are mainly five types of foreign exchange accounts:

Foreign exchange account of upfront expenses: it is used for depositing various upfront expenses relating to direct investment activities conducted by foreign investors in China.

Account of foreign exchange capital: it is used for depositing the foreign exchange capital of a foreign invested enterprise.

Dedicated account of security deposits remitted from overseas and dedicated accounts of securities deposits transferred domestically: they are respectively used for depositing foreign exchange security deposits remitted from overseas and foreign exchange security deposits transferred domestically.

Account of domestic assets realization and account of overseas assets realization: they are used for depositing foreign exchange earnings obtained by domestic entities from sale of domestic and overseas assets and equities respectively.

Dedicated account of domestic reinvestment funds: it is used for depositing the foreign exchange funds of domestic reinvestment.

According to the Notice, the opening of foreign exchange account of upfront expenses, account of foreign exchange capital, account of assets realization, and dedicated account of security deposits is no longer subject to the approval of by the SAFE.

At stages such as establishment, operation, and liquidation of a foreign invested enterprise, the foreign invested enterprise shall complete the necessary foreign exchange registration with the SAFE from time to time.

Banks shall be in charge of such formalities as account opening, fund transfer, foreign exchange purchase and sale for the foreign invested enterprise based on the registered information in the operation system of the SAFE. After completion of such formalities, banks shall file with the SAFE through the foreign exchange operation system.

Acquisition by Foreign Investors of Equities Held by Chinese Shareholders

Based on the Notice, when dealing with the formalities for the acquisition by foreign investors of equities held by Chinese shareholders, a company does not have to ask for the approval of the SAFE with regard to the opening of the account of domestic assets realization and the payment of consideration to that account.

If foreign investors remit the consideration into the account of domestic assets realization in full from overseas, after banks file such payment of consideration with the SAFE, the SAFE will automatically complete the registration formalities in its operation system for the confirmation of such acquisition. A company does not need to send its staff to SAFE to go through the foreign exchange registration formalities for such acquisition.

Otherwise, if the foreign investors pay the consideration or any part thereof in any forms other than monetary form, the company undergoing change of equities shall go through the registration formalities with the SAFE for the confirmation of such acquisition of equities.

Domestic Reinvestment by Foreign Invested Enterprises

The Notice has mainly made adjustment in two aspects.

The first one is that reinvestment with legal income of foreign investors in China is no longer subject to approval by the SAFE. If foreign investors convert the capital reserves, surplus reserves, undistributed profits or other legal income or their registered external loans into the increased capital of the foreign invested enterprises, they do have to (as what they did before) obtain the approval from the SAFE first.

The second one is that the administration of foreign exchange in reinvestment by foreign investment-oriented companies is simplified in the following way:

1. An enterprise invested by the foreign investment-oriented companies does not have to go through the foreign exchange registration with the SAFE;
2. Approval by the SAFE is no longer required when foreign investment-oriented companies transfer the investment funds domestically, or when an enterprise invested by the foreign investment-oriented companies transfers the foreign exchange profits, dividends or bonuses to such foreign investment-oriented companies domestically;
3. Capital verification and confirmation procedures are no longer required for the domestic capital contribution by foreign investment-oriented companies;
4. When foreign investment-oriented companies contribute foreign exchange capital to a domestic entity, such domestic entity shall complete the foreign exchange registration with the SAFE; and
5. The management of foreign-invested capital venture investment enterprises or foreign-invested equity investment enterprises is similar to that of the foreign investment-oriented companies

Capital Verification and Confirmation

Accounting firms shall carry out the formalities for capital verification and confirmation with regard to all kinds of capital contributions by foreign investors that are registered by foreign invested enterprises with the SAFE.

The Notice allows accounting firms not to submit paper materials for capital verification and confirmation at the SAFE. Instead, after obtaining the confirmation from banks, accounting firms may submit the materials in electronic form through the operation system of the SAFE, and may take the letters of confirmation from the operation system of the SAFE as the basis for capital verification and confirmation.

At the same time, the procedures for capital verification and confirmation have been abolished for the reduction of capital contributions by foreign investors to foreign invested enterprises. Accounting firms may take the foreign exchange registration information of the SAFE as the basis for confirming the capital contributions.

Conclusion

Foreign exchange has always been under strict control by the State in China. The current administration frame for foreign exchange for foreign direct investment was established in 1994 with periodic improvements to the system by SAFE.

However, there is still much space for further improvement and optimization, especially from the perspective of practical operational procedures. The issuance of the Notice geared towards this direction. The capital markets await the positive effects of the Notice on the practice of foreign exchange under foreign direct investment.