

Client Alert

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SAFE issues new circular to further liberalize cross-border investment and trade

On 23 October 2019, the State Administration of Foreign Exchange of China (SAFE) issued the *Circular on Further Promoting the Facilitation of Cross-border Trade and Investment (Hui Fa [2019] No.28)* (《关于进一步促进跨境贸易投资便利化的通知(汇发[2019]28号)》, the "**Circular 28**"). The Circular 28 aims to further liberalize and streamline the foreign exchange control over cross-border investments and trades. Measures are introduced to:

- (a) simplify the foreign exchange control requirements under both current account and capital account items, and more importantly,
- (b) relax the long-standing domestic equity investment restriction imposed on foreign-invested enterprises (FIEs).

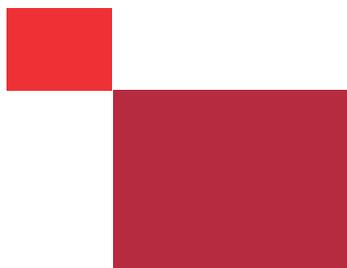
I. Relaxation on Equity Investment by FIEs

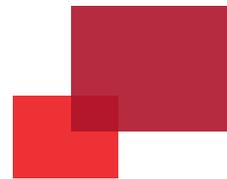
Before the Circular 28, only FIEs with the explicit wording of "investment" in their business scope, e.g., a China investment holding company ("**CHC**") were allowed to utilize their registered capital for further equity investment in China. Normal FIEs, without an investment business scope, were generally forbidden from doing so.

The Circular 28 has repealed this restriction. Now, normal FIEs (without an investment business scope) are also allowed to utilise and convert their capital received from foreign investors for making equity investment in China (by way of (i) capital injection into another PRC entity; and/or (ii) acquisition of equity interests in another PRC entity), provided that:

- (a) the investment does not fall under the forbidden industries listed in the *Special Administrative Measures for Access of Foreign Investment (Negative List) (2019 Edition)* (《外商投资准入特别管理措施(负面清单)(2019年版)》); and
- (b) the investment is for a genuine project and complies with the applicable laws.

While the requirement under (a) is clear, the Circular 28 does not elaborate on the criteria of "genuineness" and "compliance" under (b). However, the test are expected to largely focus on the commercial reasonableness of the equity investment (by taking into consideration the existing business scope of the FIE), as well as the industrial licensing and other regulatory restrictions relating to the investment. We tend to take the view that SAFE sets these tests to prevent speculative investment or any investment which is not for the purpose of genuine business operation and/or totally irrelevant to the current business operation of the proposed FIE investor.





This regulatory development gives foreign investors additional options in structuring their investments in China. In particular, for China M&A deals, having an FIE as the acquiring entity can help to achieve a more flexible payment arrangement. In the past, an offshore acquirer could only pay after the completion of the share transfer registration and SAFE filing for the new shareholder. This is definitely not attractive to Chinese sellers who have to give up their registered title to the target without receiving a penny. This development may also be attractive to those foreign investors (i) who operate in a business sector where forming a CHC is not possible or practically difficult (such as real estate), (ii) who work on multiple projects with the same Chinese partner, or (iii) who simply want to have an investment vehicle in China without paying a high price.

We expect that the implementation of Circular 28 will bring challenges to the traditional forms of FIEs with an investment business scope, such as CHC. Some of them might have to lower their requirements or provide additional benefits to maintain relevance or to regain popularity.

II. Relaxation on the Use of Funds under Capital Account Items

Under the Circular 28, PRC companies in pilot areas¹ are no longer required to provide supporting documents to banks for verification before using the funds received under capital account items (including capital, foreign debt and the proceeds of an overseas listing) on a case-by-case basis.

The Circular 28 has also simplified the use of funds under certain foreign directed investment related accounts:

- (a) The restrictions on the conversion of funds in the asset realization accounts (资产变现账户) are now lifted. Account holders may now directly apply to convert funds therein into RMB without showing the intended uses.
- (b) In respect of the deposit accounts opened by foreign investors (保证金账户), the funds in such accounts may: (i) after the underlying transaction is completed, be directly used for other onshore investment or payment of consideration for another transaction; and (ii) be converted into RMB for payment of consideration or monetary remedies of the underlying transaction.

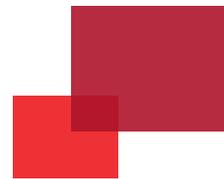
III. Simplification on Foreign Debt Formalities

The Circular 28 has also significantly simplified the foreign exchange procedures in relation to the borrowing of foreign debts by PRC non-financial companies in pilot regions².

In the past, PRC non-financial companies have always been required to complete a foreign debt registration with SAFE for each cross-border borrowing. The Circular 28 now permits PRC non-financial companies in pilot regions to complete a one-off foreign debt registration up to an amount equal to their foreign debt quota. Companies may thereafter undertake

¹ The exact scope of such pilot areas are to be further clarified by SAFE.

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foreign debt transactions directly at their banks as long as these are within the foreign debt quota already registered with SAFE.

IV. Other Developments

The Circular 28 also sets out other changes, including the following:

- (a) Simplification of the documentary and reporting requirements in relation to the payments under cross-border trade.
- (b) PRC contractors engaging in overseas construction projects, after completing the registration with SAFE, are now permitted to open an overseas account for the centralized management of the funds and payments involved under the projects.

V. Conclusion

The issuance of the Circular 28 echoes the commitment of the PRC government in deepening the reform of its administration over the foreign exchange control regime (also known as "放管服"). It also reflects a more liberalized policy stand which would benefit multi-nationals that have business operations in China.

However, it is also noted that how certain provisions under the Circular 28 can be implemented in practice are yet to be tested or supported by implementing rules to be further promulgated by SAFE.

We will certainly monitor the developments and continue to keep you updated.

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