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C H A N C E

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SAFE Blazing A Trail to Boost Private Outbound Investment

On 15 June 2012, the State Administration of Foreign Exchange (**SAFE**) promulgated the *Notice on Relevant Foreign Exchange Issues in relation to Encouraging and Guiding the Healthy Development of Private Investment* (Hui Fa [2012] No. 33) (**Notice**) which became effective as of 1 July 2012. In accordance with the *Certain Opinions of the State Council in relation to Encouraging and Guiding the Healthy Development of Private Investment* (Guo Fa [2010] No.13), the Notice aims to relax foreign exchange administration in respect of fund remittance and offshore loans, and loosen control over foreign security provided by domestic individuals..

Why the relaxation?

The relaxation of SAFE's foreign exchange administration introduced by the Notice is part of China's strategy to encourage domestic enterprises to "go global" in order to tap opportunities in the midst of the downturn of the US and European markets. At the recent fifth meeting of the Eleventh Session of the National People's Congress, Premier Wen Jiabao re-emphasized this strategy and formally announced China's entry into an era in urge of expediting overseas investment, hence the need for strengthened policy support and simplified approval procedures. In February 2012, a study group led by Sheng Songcheng, head of the Statistics Department of PBOC, confirmed that the time has arrived to liberalise capital account transactions. The encouragement of overseas investment was marked as the first step in realising this broader goal of "going global".

Key issues

The new SAFE Notice has introduced the following three major relaxations on foreign exchange administration:

- fund remittance for offshore direct investment simplified
- relaxation on the grant of loans to offshore companies by domestic parent enterprises
- loosened control over the provision of foreign security by domestic individuals

Fund remittance for offshore direct investment simplified

Previously, under the *Notice on the Promulgation of the Rules on Foreign Exchange Administration of Offshore Direct Investment by Domestic Institutions* (Hui Fa [2009] No.30) issued by SAFE, foreign exchange income arising from capital reduction, share transfer and liquidation, etc. of offshore companies that are invested by domestic enterprises must be remitted into a special foreign exchange account. As a result, it was necessary for the domestic enterprise to seek prior approval from the relevant local SAFE branch for such remittance.

The Notice has now eased the process by lifting this approval requirement. Offshore direct investment funds within the "gap" between the total investment remitted by the domestic enterprise and the registered capital of the invested offshore company may now be directly repatriated into China upon registration with the local SAFE branch. Hence, domestic enterprises are no longer required to seek SAFE's approval for such repatriation or attend to formalities in respect of capital reduction or capital withdrawal of its offshore companies.

Foreign exchange administration of offshore loans relaxed

Generally, domestic enterprises may only extend offshore loans to their wholly-owned or invested offshore companies within the quota approved by SAFE. The funding sources for such offshore loans were restricted under the *SAFE Notice on Issues relating to the Foreign Exchange Administration of Offshore Loans Extended by Domestic Enterprises* (Hui Fa [2009] No. 24). In essence, they could only lend using their own foreign exchange funds, foreign exchange funds they purchased with their RMB funds and their foreign exchange cash pool as approved by SAFE. Moreover, they must attend to certain approval and verification process with the relevant local SAFE branch before they may remit funds offshore and receive repayment.

With a view to facilitating outbound investment by private enterprises, the Notice has relaxed these procedures by expanding the funding sources of offshore loans to include domestic foreign exchange loans borrowed by the domestic enterprises. The Notice has also removed the approval and verification procedures for purchase and payment of foreign exchange. As a result, once a domestic enterprise obtains the quota for extending offshore loans and effects the required registration, it may directly remit foreign exchange funds in the form of loans and receive repayment at the relevant banks.

Administration of foreign security by domestic individuals loosened

Under the *Administrative Measures on Foreign Exchange of Individuals* issued by the People's Bank of China in 2006, domestic individuals must comply with relevant regulations and attend to certain registration procedures when providing foreign security. Accordingly, domestic individuals were, in theory, able to provide foreign security. SAFE then promulgated the *Implementing Rules of the Administrative Measures on Foreign Exchange of Individuals* which provided that the provision of foreign security by domestic individuals would be gradually loosened in line with liberalising RMB convertibility under the capital account. However, when SAFE issued the revised *Foreign Exchange Administrative Regulations* in 2008 (**FX Regulation**), it became clear that all types of foreign security were subject to the prior review and approval of SAFE, including the provision of foreign security by domestic individuals. In reality, however, domestic individuals have confronted serious difficulty in obtaining such approval when seeking to provide foreign security.

The Notice is much welcomed as it has materially loosened this requirement. A domestic individual may now provide foreign security as a joint security provider together with a domestic enterprise, while such foreign security will be registered along with that of the domestic enterprise. The relevant SAFE branch will not conduct any substantive review on the individual's eligibility to provide such security or the terms of the security. The Notice further stipulates that the security may be provided by way of guarantee, mortgage, pledge or other means as may be permitted by law.

Observations

SAFE is not the only regulator designated with the responsibility to promote outbound investments of private enterprise. On 29 June 2012, thirteen central authorities (including China Securities Regulatory Commission, China Banking Regulatory Commission, Ministry of Commerce, Administration for Industry and Commerce, the People's Bank of China and SAFE etc) led by the National Development and Reform Commission jointly promulgated the *Circular to Encourage and Guide Overseas Investment by Private Enterprises* (NDRC Circular) to reinstate the principles and implementing steps. Among others, the following envisaged measures are worth noting. First, a mechanism will be devised to enable private enterprises to create mortgage/charge over their offshore shares and assets for financing purpose. Second, the regulators will support key private enterprises in issuing offshore RMB or foreign currency bonds, and encourage eligible private enterprises and institutions to set up private equity funds for outbound investment. Third, they will streamline the relevant administration and approval procedures. It is expected that the coordinated efforts of these regulators will create a powerful impetus to boost outbound investments by private enterprises.

Outlook

The recent regulatory developments clearly indicates China's determination in realising its "go global" policy. Not only does the Notice facilitate domestic parent enterprises to finance their offshore companies, it also strengthens the ability of offshore companies in seeking third party financing by allowing domestic individuals to provide foreign security jointly with domestic enterprises. While outbound investments by domestic private enterprises still face many challenges, the effort China has taken so far is positive and encouraging. The potential market appetite for the development of private enterprises should not be underestimated.

Contacts

Yang TieCheng
Partner, Regulatory
Beijing

E: tiecheng.yang@cliffordchance.com

Ge Yin
Senior Associate, Finance
Shanghai

E: yin.ge@cliffordchance.com