

SAFE LIBERALISES RENTAL CURRENCY DENOMINATION UNDER DOMESTIC LEASES

In October 2017, the State Administration of Foreign Exchange ("**SAFE**") of the People's Republic of China ("**PRC**") promulgated The Circular on Relevant Issues of Foreign Exchange Administration of Financial Leasing Business ("**Circular 21**") which allows lease rentals under domestic leases to be denominated in USD if certain conditions are satisfied.

Key issues

- Background and developments
- Eligibility requirements

BACKGROUND AND DEVELOPMENTS

As a general rule under the PRC's current foreign exchange control regime, onshore transactions are required to be denominated and settled in the local currency.

However, as part of the PRC government's ongoing efforts to promote a domestic leasing industry, SAFE began allowing onshore lease rentals to be denominated in foreign currencies in 2012.

In 2012, SAFE issued *The Reply on China Banking Regulatory Commission ("**CBRC**")-approved Leasing Companies to Receive Foreign Exchange Denominated Finance Lease Rentals ("**Circular 80**")*, which permitted financial leasing companies approved by CBRC to receive rental payments denominated in foreign currencies under domestic finance leases, provided that the financial leasing company in question complied with the "50% requirement" (as defined below). Circular 80 further specifies the requirements for processing such foreign currency denominated rental payments, pursuant to which, the lessee is required to provide the local bank which processes the foreign currency rent payment with a notice¹ issued by the lessor regarding the payment of lease rentals denominated in a foreign currency, along with other supporting documents.

In 2013, after the Shanghai pilot free trade zone (the "**Shanghai FTZ**") was established, SAFE's Shanghai branch (the "**Shanghai SAFE**") issued *The Circular on the Implementation Rules of Foreign Exchange Administration to Support the Development of the Shanghai FTZ ("**Circular 26**")*, which allowed financial leasing companies (other than CBRC-approved financial leasing

¹ Circular 80 has not, however, prescribed a form of such notice.

companies) registered in the Shanghai FTZ to receive domestic finance lease rentals in foreign currencies.

In 2015, the Shanghai FTZ replaced Circular 26 with *The Circular on the Implementation Rules for Further Promoting Pilot Foreign Exchange Administration Reform in the Shanghai FTZ* ("**Circular 145**"), expanding the scope of application to all PRC financial leasing companies (including CBRC-approved leasing companies, foreign-invested financial leasing companies approved by the Ministry of Commerce ("**MOFCOM**") and domestic financial leasing companies jointly approved by MOFCOM and the PRC State Tax Bureau) on the condition that they are registered in the Shanghai FTZ.

Similar circulars (collectively, the "**2015 SAFE Circulars**")² were issued by the Guangdong, Fujian and Tianjin branches of SAFE in 2015, respectively, which allowed financial leasing companies to receive domestic finance lease rentals denominated in foreign currencies as long as they are registered in the relevant free trade zones, i.e. Guangzhou Nansha and Zhuhai Hengqin areas of the Guangdong pilot free trade zone (the "**Guangdong FTZ**"), the Fujian pilot free trade zone (the "**Fujian FTZ**") and the Tianjin pilot free trade zone (the "**Tianjin FTZ**").

In 2015, SAFE issued *The Reply on Pilot Receipt of Foreign Exchange Denominated Operating Lease Rentals in Tianjin Dongjiang Bonded Port Area* ("**Circular 12**"), which, for the first time, allowed operating lease rentals to be denominated in a foreign currency in the Tianjin Dongjiang Free Trade Port Zone ("**DFTP**") with a trial period of two years. Such policy was continued after such two-year trial period ended, as confirmed by SAFE in August 2017.

The significance of Circular 21 is that it confirms, on a nationwide basis, that financial leasing companies (including CBRC-approved leasing companies, foreign-invested financial leasing companies approved by MOFCOM and domestic financial leasing companies jointly approved by MOFCOM and the PRC State Tax Bureau) are allowed to receive lease rentals denominated in foreign currencies under domestic finance leases if they comply with the 50% requirement (please see below). Circular 21 further specifies the requirements for processing such foreign currency denominated rental payments, pursuant to which, the lessee is required to provide the local bank which processes the foreign currency rent payment with (i) a notice³ issued by the lessor regarding the payment of lease rentals denominated in a foreign currency, (ii) supporting documents which evidence that the lessor meets the 50% requirement and (iii) other materials as requested by the relevant bank for its authenticity check.

² Such circulars include *Implementation Rules for Promoting Pilot Foreign Exchange Administration Reform in China (Fujian) Pilot Free Trade Zone* issued by SAFE's Fujian branch on 22 December 2015, *Implementation Rules for Promoting Pilot Foreign Exchange Administration Reform in Guangzhou Nansha and Zhuhai Hengqin Areas, in China (Guangdong) Pilot Free Trade Zone* issued by SAFE's Guangdong branch on 21 December 2015 and *Implementation Rules for Promoting Pilot Foreign Exchange Administration Reform in China (Tianjin) Pilot Free Trade Zone* issued by SAFE's Tianjin branch on 18 December 2015.

³ Circular 21, however, has not prescribed a form of such notice.

ELIGIBILITY REQUIREMENTS

Set out below is a summary of the key eligibility requirements under the various rules.

	Eligible lessors	Eligible lease type	Requirements
Circular 80	CBRC-approved leasing companies or their project companies in the bonded areas in the PRC	Finance lease	At least 50% of the purchase price is financed with money borrowed in a foreign currency from offshore or onshore lenders (" 50% requirement ")
Circular 145	Financial leasing companies incorporated in the Shanghai FTZ	Finance lease	50% requirement
2015 SAFE Circulars	Financial leasing companies incorporated in the Tianjin FTZ, the Guangdong FTZ and the Fujian FTZ	Finance lease	50% requirement
Circular 12	Leasing company incorporated in the Tianjin FTZ	Operating lease	Either (a) the 50% requirement is satisfied; or (b) the underlying asset is leased from an offshore lessor and the foreign currency rental payments are required to be paid to the offshore lessor
Circular 21	Financial leasing companies in PRC	Finance lease	50% requirement

CONCLUSION

Circular 21 reflects the continued efforts of the PRC government to promote the development of a domestic leasing industry. The flexibility provided for the denomination of lease rentals will help PRC lessors better manage the risks associated with any currency mismatch against their sources of funding and financing. It would also facilitate cross-border financing for PRC lessors.

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