December, 2012

NEW SAFE RULES OF EXCHANGE CONTROL OVER INBOUND AND OUTBOUND INVESTMENT

On November 21st, 2012, China's State Administration of Foreign Exchange ("SAFE") issued the Circular Regarding Further Improvement and Adjustment of Foreign Exchange Administration Policy of Foreign Direct Investments (the "Circular"), which will become effective on December 17th, 2012.

The Circular's main aim is to improve the investing environment in China, by removing and simplifying some of the relevant administrative procedures and increasing their efficiency. In total, the Circular eliminates 35 administrative approvals and simplifies another 14. After these amendments, registration procedures will be more common than time-consuming administrative approval procedures, and banks will be responsible for some procedures based on the information provided by SAFE. Even though the reform is mostly procedural, the Circular will be very significant because of the extension of changes and the general lessening of the investing and foreign exchange control they entail.

The Circular is mainly a response from the authorities to the recent decline of foreign investment into China. Between January and October 2012, foreign investment amounted USD91.736 billion, down by 3.45% year on year, according to the Ministry of Commerce. However, the Circular also fosters Chinese outbound investment overseas, as some of the measures affect the investment by domestic companies abroad.

The following table summarizes some of the most important changes that are introduced by the Circular:

OPERATION	CURRENT RULES	AFTER THE CIRCULAR
Opening of foreign exchange bank accounts by foreign investors	SAFE's approval required	No approval required
Foreign investors' use of profits or other locally obtained funds for further investing in China	SAFE's approval required	No approval required
Onshore reinvestment by Chinese Holding Companies	SAFE's registration required	No registration required, with some exceptions
Domestic transfer of foreign exchange in recurring operations	SAFE's approval required	No approval required
FIEs' granting of loans to their foreign shareholders	Not expressly allowed	Allowed, subject to certain constraints*
FIEs' repatriation of income obtained through capital reduction, liquidation to foreign shareholders	SAFE's approval required	No approval required

OPERATION	CURRENT RULES	AFTER THE CIRCULAR
Conversion of FIEs' registered foreign debt to registered capital	SAFE's approval required	No approval required
FIEs' use of reserves and undistributed profits to increase their registered capital	SAFE's approval required	No approval required
Domestic companies' remittance of funds abroad for covering preliminary costs of outbound investment	SAFE's approval required	No approval required
Use of foreign exchange loans granted in China to extend loans abroad by domestic companies	Not expressly allowed	Allowed, subject to certain requirements

1. GRANTING OF LOANS BY FIES TO THEIR FOREIGN SHAREHOLDERS

According to the Circular, FIEs will now be allowed to grant loans to their foreign parent companies. Nonetheless, the amount of the funds is strictly regulated. If the FIE is an WFOE, the amount of the loan shall be less than the amount of dividends that could have been distributed to the foreign investors. If the FIE is a JV, the amount will be additionally limited to the share percentage of the foreign investors.

2. CONCLUSION

Circular 59 is undoubtedly a relevant milestone in the development of the Chinese foreign investment framework, thanks to the encouragement it embodies both for foreign investors interested in China and for Chinese enterprise willing to invest abroad. Furthermore, banks will play a more important role regarding foreign exchange, as the Circular relies on them for some procedures. Their commercial practice and internal policies will become increasingly relevant for actions like opening foreign exchange accounts.

However, the effects of the Circular will not be immediate and, therefore, it will be necessary to wait and closely monitor its implementation to fully evaluate its impact on the Chinese investment and foreign exchange legal frameworks.

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