



HAN KUN LAW OFFICES

# Legal Commentary



CHINA PRACTICE • GLOBAL VISION

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## Hui Fa [2016] Circular 16 - Further Reforming the Administration of Foreign Exchange Settlement Under Capital Accounts

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On June 9, 2016, the State Administration of Foreign Exchange ("**SAFE**") promulgated the *Circular of the State Administration of Foreign Exchange Concerning Reform and Specifying of Policies for the Administration of Foreign Exchange Settlement under Capital Accounts* (Hui Fa [2016] Circular 16, the "**Circular**"). In comparison to the *Circular of the State Administration of Foreign Exchange Concerning Reform of the Administrative Approaches to Settlement of Foreign Exchange Capital of Foreign-Invested Enterprises* (Hui Fa [2015] Circular 19, the "**Circular 19**"), the Circular expands the applicable scope of entities and sources of capital for the discretionary settlement of foreign exchange and further clarifies the administrative principles for the use of settled RMB funds.

Compared to Circular 19, the Circular further reforms the administration of foreign exchange settlement under capital accounts in the following aspects:

### Nationwide Application of Discretionary Foreign Exchange Settlement from Debt Financing by Domestic Enterprises

According to the Circular, domestic non-financial institutions ("**Domestic Enterprises**"), including both domestically-invested enterprises and foreign-invested enterprises ("**FIEs**"), may choose to settle their foreign exchange debt capital in RMB on a discretionary basis. Compared to Circular 19, the Circular expands the scope of discretionary settlement to include:

- a. FIE registered capital,
- b. repatriated funds obtained from overseas listings, and
- c. foreign exchange debt capital of domestic enterprises (including domestically-invested enterprises and FIEs).

The Circular's application of discretionary settlement for foreign exchange debt capital reflects the People's Bank of China's ("PBOC") initiative from earlier this year to transform the administrative principles for external debt. In January and April of 2016, PBOC released guiding regulations that have changed the approval system from pre-approval to record-filing for cross-border enterprise financing, which was a significant change to the external debt regulatory system. Discretionary settlement of foreign exchange debt capital can be considered a foreign exchange-related supplement to the PBOC regulations.

Capital account foreign exchange receipts for which discretionary settlement was already permissible pursuant to relevant policies (including foreign exchange registered capital, foreign exchange debt capital and repatriated funds obtained from overseas listings, etc.), may be conducted at banks based on the Domestic Enterprise's actual operating needs (subject to restrictions provided for in other existing laws and regulations with respect to capital account foreign exchange receipt settlement).

### **Shortening the "Negative List" for Uses of Capital Account Foreign Exchange Receipts and Settled Foreign Exchange Funds**

In comparison to Circular 19, the Circular does not make substantial changes to the operational requirements for discretionary settlement. Foreign exchange to be settled in RMB must still be deposited in an account for foreign exchange settlement pending payment, and use of the settled RMB is subject to the limitations provided in the Circular. Like Circular 19, the Circular continues to adopt a "Negative List" with respect to the use of capital account foreign exchange receipts and the settled RMB, which means that such funds shall only be used for purposes other than those listed in the Negative List.

The Negative List under the Circular is similar to that under Circular 19, with a few exceptions. The new list deletes certain previously prohibited uses, including "disbursing RMB entrusted loans to affiliated companies," "repaying inter-company loans (including third-party advances)" and "repaying RMB bank loans that have been re-lent to third parties," thereby even further liberalizing the use of capital account foreign exchange receipts and settled RMB funds.

### **Clarifying Principles for the Use of Capital Account Foreign Exchange Receipts and Foreign Exchange Settlement Funds**

Even with Circular 19 in place, in practice, banks may still reject FIEs from domestically reinvesting RMB settled from foreign exchange registered capital on the grounds that the business scope of such FIEs does not include "equity investment." This is because the Negative List under Circular 19 prohibits FIEs from, directly or indirectly, using RMB converted from registered capital for expenditures beyond business scope or expenditures prohibited by laws and regulations, and the banks therefore believe that FIEs may only use the converted RMB for domestic equity investment if the FIE's business scope includes equity investment. Thus, although Circular 19 provides operating

principles for non-investment FIEs to make domestic equity investments, such operations still face substantial obstacles in practice.

Compared to Circular 19, the Circular also makes clear the principles for using capital account foreign exchange receipts and settled RMB funds, i.e., “foreign exchange receipts under capital accounts and the resulting settled RMB funds **can be used for payments under current accounts that are within [the enterprise’s] business scope and payments under capital accounts that are permitted by laws and regulations.**” This suggests that current account payments are subject to an enterprise’s business scope, while capital account payments are subject to the relevant laws and regulations. In sum, compared to Circular 19, the Circular may actually facilitate non-investment FIEs to make domestic equity investments with settled RMB funds from foreign exchange capital. That being said, how the Circular is interpreted and carried out will need to be further confirmed in practice.

Please see next page.

## Major Differences between Circular 16 and Circular 19

	Circular 19	Circular 16
<b>Application Scope</b>	FIE capital funds	Foreign exchange registered capital, foreign debt capital and repatriated funds obtained from overseas listings of domestic enterprises
<b>Use of Foreign Exchange and Converted RMB</b>	<p>a. shall not, directly or indirectly, use for expenditures beyond its business scope or expenditures prohibited by laws and regulations of the State;</p> <p>b. shall not, directly or indirectly, use for investments in securities, unless otherwise prescribed by laws and regulations;</p> <p>c. shall not, directly or indirectly, use for disbursing RMB entrusted loans (unless it is within its business scope), repaying inter-company loans (including third-party advances) and repaying RMB bank loans that have been re-lent to third parties;</p> <p>d. shall not use for expenses related to the purchase of real estate not for self-use, unless by a foreign-invested real estate enterprise;</p>	<p>a. the foregoing capital and funds can be used for payments under current accounts that are within its business scope and payments under capital accounts that are permitted by laws and regulations;</p> <p>b. shall not, directly or indirectly, use for expenditures beyond its business scope or expenditures prohibited by laws and regulations of the State;</p> <p>c. shall not, directly or indirectly, use for investments in securities, or in other wealth management products other than the banks' principal guarantee products, unless otherwise prescribed by laws and regulations.</p> <p>d. shall not use for extending loans to the non-affiliated enterprise, except as expressly permitted in its business scope.</p> <p>e. shall not use for expenses related to the construction or purchase of real estate not for self-use, unless by a real estate enterprise.</p> <p>f. shall not exceed the agreed scope of usage specified in the agreement between the Domestic Enterprise and other parties. Unless as otherwise stipulated, such agreement shall not conflict with the Circular.</p>
<b>Monthly Limit of Petty Cash</b> (Payment of petty cash does not require proving documents)	The cumulative monthly payment of petty cash (including from discretionary settlement and from payment settlements) of a single enterprise shall not exceed an equivalent of USD 100,000.	The cumulative monthly payment of petty cash (including from discretionary settlements and payment settlements) of a single enterprise shall not exceed an equivalent of USD 200,000.

## ● **Important Announcement**

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