



# CHINA MATTERS

Paul Hastings' Newsletter for Investing & Operating  
in the People's Republic of China

## New SAFE Circular 59<sup>1</sup>: Further Relaxation of Foreign Exchange Controls over Inbound and Outbound Investments

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Circular 59 simplifies foreign exchange procedures for foreign direct investments in China. It also relaxes certain requirements in relation to outbound investments by Chinese companies. This development may have a profound effect on inbound and outbound investments, including greenfield/brownfield projects, growth capital investments, and mergers and acquisitions.

We believe that SAFE is further relaxing foreign exchange controls because Circular 59 removed many of the approval requirements that have been put in place over the course of the last ten years. Although the changes brought by Circular 59 are predominately procedural, the elimination of such approvals has two significant effects. First, transactions can be expedited because fewer approvals are required. Second, banks in China have increased influence given its new authority under Circular 59 to review and process additional foreign exchange transactions directly without the involvement of SAFE.

In addition, we believe that Circular 59 signals a significant policy change for SAFE -- it is gradually shifting its focus from micro-administration to macro-supervision. We also view such further relaxation to be an indirect response to the notable decline in the volume of foreign direct investments into China in the past few months and the Chinese government's further promotion of outbound investments by Chinese companies.

### I. KEY CHANGES UNDER CIRCULAR 59

We summarize below the key changes for (i) foreign investors, (ii) foreign invested enterprises (**FI**Es), (iii) foreign invested holding companies (**HoldCos**), and (iv) domestic companies:

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<sup>1</sup> 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 (Circular 59)* on November 21, 2012. The circular will become effective on December 17, 2012. Circular 59 includes five appendices that set forth detailed guidelines for SAFE's local branches and banks, standard application forms, schemes for data transition, and a list of rules revoked by Circular 59.

## For Foreign Investors

Subject	Current	Circular 59
<b>Open foreign exchange bank accounts</b>	SAFE approval required	Approval no longer required; can open the accounts at banks directly
<b>Convert foreign exchange into RMB in accounts established for investment preliminary costs</b>	SAFE approval required	Approval no longer required
<b>Use profits, equity transfer proceeds and certain other funds obtained in China for making further investments in China</b>	SAFE approval required	Approval no longer required
<b>Pay equity purchase price to Chinese shareholders for cross-border equity acquisitions</b>	SAFE registration required to confirm foreign investor's completion of payment	<p>If consideration is all in cash, SAFE's system will <i>automatically</i> register the receipt of payment.</p> <p>If non-cash consideration is used, target companies will need to register with SAFE to confirm foreign investors' completion of payment.</p>

**For FIEs**

Subject	Current	Circular 59
<b>Use reserves and undistributed profits of an FIE to increase its registered capital</b>	SAFE approval required	Approval no longer required
<b>Convert its registered foreign debt to registered capital</b>	SAFE approval required	Approval no longer required
<b>Repatriate proceeds from capital reduction, liquidation or realized investments to its foreign shareholder(s)</b>	SAFE approval required	Approval no longer required
<b>Extend loans to its foreign shareholder(s)</b>	Not expressly permitted	Expressly permitted, with certain amount limits

**For HoldCos<sup>2</sup>**

Subject	Current	Circular 59
<b>HoldCo to wire money for re-investment in China</b>	SAFE approval required	Approval no longer required
<b>HoldCo's re-invested entities to complete foreign exchange registration</b>	SAFE registration required	Registration no longer required (unless the re-invested entity is a joint venture between HoldCo and foreign investors)
<b>HoldCo's re-invested entities to remit foreign exchange profits and dividends to HoldCo</b>	SAFE approval required	Approval no longer required

## For Domestic Companies

Subject	Current	Circular 59
<b>Remit preliminary costs for outbound investments to offshore</b>	SAFE approval required	Approval no longer required; can convert into foreign exchange and remit to offshore at banks directly
<b>Use foreign exchange loans obtained in China to extend loans offshore</b>	Not expressly permitted	Expressly permitted <sup>3</sup>

### II. EFFECT ON CROSS-BORDER M&A

SAFE Circular 142,<sup>4</sup> which was issued in 2008, infamously prohibits FIEs from converting their registered capital into RMB to (i) make equity investments in China (unless their business scope covers equity investments), (ii) purchase non-self-use real properties, or (iii) invest in securities (unless otherwise permitted by law). We believe that the restrictions under Circular 142 have not been lifted or relaxed by Circular 59. Therefore, for foreign investors who plan to use its existing FIEs in China to do share acquisitions, funding could still be an issue if the FIEs have not generated sufficient profits.

### III. CONCLUSION

Circular 59 further relaxes China's foreign exchange controls. We believe this is a signal that SAFE is transitioning its functional role to macro-administration. The simplified procedures are certainly encouraging for foreign investors and foreign invested enterprises in China, but the effective implementation of the circular will certainly take some time.

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<sup>2</sup> Under Circular 59, the rules that are applicable to HoldCos also apply to foreign invested venture capital enterprises and foreign invested equity investment enterprises.

<sup>3</sup> This permission reiterates the rules issued by SAFE in June 2012 to promote outbound investments by private companies (i.e., the *Circular on Foreign Exchange Administration Issues concerning Encouraging and Guiding the Healthy Development of Private Investment*), which were not widely noted.

<sup>4</sup> The *Circular of Operation Issues Related to the Perfection of Administration of Payment-Related Settlement of FIEs' Registered Capital from Foreign Exchange to RMB*.