

CHINA MATTERS

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

October 2006

China to Scrutinize Current Account Forex Transactions

China's State Administration of Foreign Exchange ("SAFE") has embarked upon a comprehensive effort to tighten control over foreign exchange, trade-related current account transactions. The SAFE is compiling a list of enterprises whose current account foreign exchange transactions will be closely monitored.

Current Account Transactions

China's currency, the Renminbi, is not a "hard" currency like the US Dollar, the Japanese Yen or the Euro, in that it may not (except for Hong Kong) freely circulate outside of Mainland China. China imposes a dualistic system for administering the Renminbi. Under this system, "capital account" transactions are subject to strict SAFE scrutiny. Capital account transactions are typically investment-related transactions, such as capital injections for the establishment of foreign investment enterprises in China, or foreign exchange loan facilities. "Current account transactions", in contrast, are basically, trade-related transactions. At a practical level, Chinese banks administer capital accounts and current accounts differently with capital flows for each type of transaction moving in and out of either capital account bank accounts, or current account bank accounts.

The practical effect of this system is that it is much easier to move foreign exchange in and out of China in the form of a current account transaction than as a capital account transaction. Given this situation, it is natural that China's system for administering current account transactions would be fertile ground for maneuvering around China's capital account foreign exchange controls.

Making a List (and Checking It Twice)

The current rectification campaign targeting current account foreign exchange transactions relies heavily

upon a watch list as an administrative tool. One such list that the SAFE has recently compiled is a list of 429 "Evasion-Type Enterprises" (逃逸类企业), which includes enterprises that have engaged in the re-sale of Foreign Exchange Verification Bills (核销单) in violation of foreign exchange import and export verification administrative regulations. Under China's current account regime, Chinese exporters must register with their relevant local SAFE branch and obtain from the SAFE "Export Foreign Exchange Collection Verification Bills" (出口收汇核销单), which are one of the requisite documents that must be submitted as part of the verification process to obtain foreign exchange. It appears that the re-sale of such verification bills has been a conduit for cross-border flows of foreign money into China.

Monitoring Current Accounts

SAFE efforts will focus upon monitoring the movement of funds in and out of current accounts (经常账户的资本流动). Further buttressing this effort is the "Notice of the State Administration for Foreign Exchange Concerning Issues Relating to Progressively Improving the Administration of the Purchase and Settlement of Foreign Exchange for Foreign Trade" (国家外汇管理局关于进一步改进贸易外汇与结汇管理有关问题的通知 汇发[2006] No. 49) ("Notice"). This Notice provides for the establishment of a watch list (关注企业) of enterprises whose current account transactions will be closely monitored by the SAFE. The Notice imposes rigorous documentary requirements and procedures for listed enterprises to undertake foreign exchange current account transactions.

The Notice subjects to closer SAFE scrutiny enterprises with an annual 10% or more differential in foreign currency receipts and foreign currency accounts re-

ceivable. The Notice provides that enterprises engaged in shipping, large-scale equipment exports and enterprises whose annual differential in foreign currency receipts and foreign currency accounts receivable does not exceed US\$500,000, upon approval, may receive more relaxed treatment.

The Notice also provides for more rigorous scrutiny of foreign exchange refunds, particularly following foreign exchange remittances to China.

According to news reports, one purpose of the Notice is to thwart the use of fraudulent trade finance transactions to move money into China to engage in back-door financing and speculative investment activities

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For further information about this article, please contact:

Beijing

David Livdahl: davidlivdahl@paulhastings.com

Hong Kong

David Grimm: davidgrimm@paulhastings.com

Brett W. King: brettking@paulhastings.com

Neil Torpey: neiltorpey@paulhastings.com

Shanghai

Mitch Dudek: mitchdudek@paulhastings.com

David Wang: davidwang@paulhastings.com

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