



## CHINA LIBERALIZES FOREIGN EXCHANGE FOR OVERSEAS INVESTMENTS

In April 2009, the Ministry of Commerce (“MOFCOM”) promulgated a new regulation, *Measures for the Administration of Overseas Investment* (the “Circular”), which simplified the application process for overseas investments by Chinese companies. Two months later, the State Administration of Foreign Exchange (“SAFE”) promulgated a draft *Notice on Issues relating to Administration of Overseas Loan by Domestic Enterprises* (the “Draft Notice”) on June 9, 2009, for public comment with the aim for it to become effective by August 1, 2009. “The new rule can help facilitate investment trade and support qualified companies to venture globally,” according to a statement by the foreign exchange regulator.

### PRIOR RULES PERMIT ONLY MULTINATIONAL COMPANIES TO FINANCE OVERSEAS OPERATIONS

Previously, only qualified foreign-invested companies were entitled to finance their overseas

operations with an intercompany overseas loan pursuant to the *Notice on Issues Relating to Administration of the Internal Operation of Foreign Exchange of Multinational Companies* (the “Circular 104”) issued by SAFE on October 18, 2004. The term “multinational companies” in Circular 104 refers to an enterprise with companies inside and outside of China whose global or regional investment management functions are exercised by one of its member companies within China. In practice, this definition is quite difficult to satisfy since most foreign-invested enterprises locate their investment management functions outside of China.

In addition, only large multinational enterprises that have more than three subsidiaries could make such intercompany overseas loans. Further, the China-based member company that exercises the investment management function had to make at least US\$5 million of investment into its overseas subsidiary, and such overseas subsidiary had to be rated

as Class II<sup>1</sup> or higher and had to fulfill other requirements before such overseas loans could be made. As a result, small and medium-sized enterprises could rarely comply with these requirements under Circular 104 to fund overseas expansion.

Circular 104 also imposed a limit on the amount of such overseas loan based on a percentage of the owner's equity or profit. Such loans also had to be repaid within two years and extensions had to be submitted to SAFE one month in advance for approval. The Draft Notice has loosened the amount of overseas loans as well as the loan period.

## **DRAFT NOTICE SIMPLIFIES PROCESS TO FINANCE OVERSEAS OPERATIONS**

Contrary to the special term of Circular 104, the Draft Notice permits all China-based enterprises to provide loans to their overseas wholly owned or partially owned subsidiaries. Under the Draft Notice, all Chinese-based cooperative joint ventures, equity joint ventures, and wholly foreign-owned enterprise can lend money to their overseas subsidiaries.

Compared with Circular 104, the Draft Notice has set up a less complicated mechanism to facilitate overseas loans. In order to qualify for an overseas loan to a group company, the following conditions must be met:

- Both the lender and the borrower shall have been lawfully registered and their registered capital fully paid up.
- Both the lender and the borrower shall have good track records as well as healthy and comprehensive internal control and financial systems. No foreign exchange violation activities will have been found during the past three years.

- All overseas investment projects of the lenders have been approved by the relevant governmental authorities and duly registered. Furthermore, the lender has obtained an appraisal above second level during the latest overseas investment joint inspection.
- If the lender has made any overseas loans, the previous loan is not out of the ordinary in any way and there is no breach of the contract.

The Draft Notice allows Chinese enterprises to fund their overseas loans from three kinds of fund sources: (i) self-owned foreign currency, (ii) foreign currency purchased with RMB, and (iii) capital from the foreign currency capital pool approved by SAFE. This last option of using the foreign currency capital pool is a new concept. However, no details about the approval conditions for the foreign capital pool have been provided in the Draft Notice. SAFE may need to issue further notice regarding this.

## **NECESSARY DOCUMENTATION TO FINANCE OVERSEAS OPERATIONS**

To apply for overseas loans, the following documents are needed:

- Written application for the overseas loan with basic information about the borrower and lender, the source of the fund, and a warranty letter. In the warranty letter, the lender must warrant that it shall take back the fund if the foreign exchange balance of China changes significantly.
- The lending agreement signed by the lender and overseas borrower, or by the lender and the entrusted financial institution within China. In such agreement, the parties shall clearly stipulate the amount, the period, the rate, the guaranty, and the method of repayment.

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1. MOFTEC and SAFE conduct joint annual inspections of overseas commercial entities and classify them into three classes, with Class I overseas enterprises enjoying certain preferential treatment. Class II has no preferential treatment, and Class III is subject to improvement and monitoring.

- The lender's latest financial audit report.
- The borrower's overseas investment foreign currency certificate and the latest financial audit report.
- Additional special requirements if the lender is a foreign investment company.

In the Draft Notice, the approval authority has been delegated to the local SAFE administration, and the whole process is intended to take 20 days after submission of all required materials, compared to the 30 days that it previously took.

Furthermore, a special account shall be opened by the lender in a designated bank after receiving the approval by SAFE. Both the foreign currency for lending or the payment must be deposited in this special account. SAFE and its counterpart will supervise the cash flow through this special account and control the whole process of foreign lending by the Chinese enterprise.

## SUMMARY

Chinese government has adopted a very stringent foreign currency policy for many years, especially outflows of foreign currency from China. This Draft Notice has eased the ability for Chinese enterprises, including foreign invested enterprises, to lend money to their overseas subsidiaries. Powerful discretionary control remains, including the ability to recover such foreign exchange if there is an imbalance in China's foreign exchange reserve. Nevertheless, the loosening of foreign exchange and overseas investment reflects the growing trend of Chinese companies going global and stepping up their overseas expansion and investment activities.

## LAWYER CONTACTS

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