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On November 19, 2012, the State Administration of Foreign Exchange (the "SAFE") issued a Circular on Further Improving and Adjusting the Foreign Exchange Policies on Direct Investment ("Circular No. 59") to simplify foreign exchange controls with regard to foreign direct investment matters.[1] This client alert is to provide you with a high-level summary of Circular No. 59 and its implications.

Background

The Chinese government has been trying to implement a series of measures to simplify foreign exchange procedures to facilitate trade and investment. The implementation of Circular No. 59 is part of these efforts.

Circular No. 59 was issued based on the principle that a registration system will be used for most of the conventional foreign exchange matters, in lieu of the existing approval system.

Summary of the major changes under Circular No. 59

Circular No. 59 became effective on December 17, 2012. The major developments under Circular No. 59 are summarized below.

1. **Opening of Foreign Exchange Accounts.** Under Circular No. 59, the opening of various special purpose foreign exchange accounts (e.g., pre-establishment expenses account, foreign exchange capital account, guarantee account etc.) no longer requires the approval of SAFE. Furthermore, multiple capital accounts for the same entity may be opened in different provinces, which is not possible before the issuance of Circular No. 59.
2. **Re-investment by Foreign Investors in China.** Under Circular No. 59, reinvestment of RMB proceeds by foreign investors in China no longer requires SAFE approval or verification.
3. **Exemption from Foreign Exchange Registration.** Under Circular No. 59, entities that (i) are invested by foreign invested holding companies and (ii) do not have any offshore shareholder will be exempted from foreign exchange registration; As such, local banks will be authorized to conduct relevant formalities for capital transfers within China between the foreign invested holding companies and their invested entities without any SAFE approval. It is noteworthy that the above simplified process applicable to foreign invested holding companies would also apply to foreign-invested venture investment companies and foreign-invested equity investment companies.
4. **Registration and Verification of Capital Contribution in M&A Deals.** Under Circular No. 59, if the entire payments for the M&A activities are transmitted to China in cash, SAFE will automatically complete the registration and verification on the capital contributed by the foreign investors. This will greatly reduce the timeline for the completion of M&A transactions undertaken by foreign investors.
5. **Offshore Loans by FIEs.** Under Circular No. 59, foreign invested enterprises will be allowed to make loans to their overseas parent companies, provided that the loan amount does not exceed the sum of distributed but un-repatriated profits of the foreign investor and its share of undistributed profits in the invested entity. This means that foreign investors could avail themselves of the surplus funds in the invested entities without having to have the profits distributed and taxed first, which provides flexibilities to foreign investors.

Conclusion

We believe that multinational companies and foreign-invested VC and PE funds with active direct investment and M&A activities in China will benefit more from Circular No. 59 than emerging companies that are new to China or have limited operations in China.

Circular No. 59 is viewed as a great development in China's foreign exchange control regime as it will significantly simplify the foreign exchange control system for direct investment. However, how Circular No. 59

will be implemented in practice remains to be seen. We anticipate that SAFE and/or its local counterparts will organize external trainings or provide further explanations in connection with the implementation of Circular No. 59. We will closely monitor any further developments in this regard and keep you apprised as appropriate.

Notes

1. View the full text of Circular No. 59 (in Chinese only)

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