

Finance

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Welcome to the January issue of White & Case's China Finance Bulletin. This bulletin is a regular update on the PRC finance sector ensuring you stay up to date with the latest legal, regulatory and practice developments.

SAFE Further Tightens Lending Transactions in Foreign Exchange for Foreign-Invested Enterprises

On November 16, 2011, the State Administration of Foreign Exchange (SAFE) promulgated the Circular of the State Administration of Foreign Exchange on Issues Relating to Further Clarification and Regulation of Certain Capital Account Items under Foreign Exchange Control (关于进一步明确和规范部分资本项目外汇管理有关问题的通知) (Hui Fa [2011] No. 45) (**Circular 45**). Circular 45 clarifies some outstanding issues that are not clearly stated in the previous SAFE rules and further tightens SAFE regulation in the following areas.

Conversion of FIEs' Registered Capital in Foreign Exchange to RMB

Circular 45 is a supplement to the *Circular of the State Administration of Foreign Exchange on Issues Relating to the Improvement of Business Operations with Respect to the Administration of Foreign Exchange Capital Payment and Settlement of Foreign-invested Enterprises* (关于完善外商投资企业外汇资本金支付结汇管理有关业务操作问题的通知) (Hui Zong Fa [2008] No. 142) (**Circular 142**), which is a benchmark SAFE rule governing conversion of registered capital in foreign exchange into RMB for foreign-invested enterprises (**FIEs**).

Circular 45 further strengthens the restrictions provided in Circular 142 by providing express answers to some frequently asked questions:

- Repeating the restriction already provided in Circular 142, Circular 45 again emphasizes that an FIE is not allowed to convert its registered capital in foreign exchange into RMB for the purpose of equity investment. This exception is that those approved to engage in equity investments be regulated by reference to the equity investment by foreign-invested holding companies.
- Circular 45 also prohibits non-real-estate FIEs from converting registered capital in foreign exchange into RMB to purchase non-self-use real estate properties. Real estate FIEs may convert registered capital in foreign exchange to pay land use right grant fees, provided that the land use right grant contracts, and relevant payment notices are submitted, to the bank that handles the conversion for verification.

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- Circular 45 expressly prohibits FIEs from converting registered capital in foreign exchange into RMB for the purpose of granting entrustment loans, repayment of inter-company loans and repayment of bank loans which have been transferred to a third-party.
- Circular 45 makes it clear that FIEs are generally not allowed to convert registered capital in foreign exchange into RMB for payment of various types of cash deposits. Entities receiving such cash deposits may apply to SAFE to open a special account to receive deposits in foreign exchange, but the cash deposited in such account may only be returned to the original paying account and can not be converted into RMB.

Stricter Administration on Foreign Debt

An FIE must register with SAFE for the foreign debt (such as shareholder loan) it borrows from foreign entities. Under the current SAFE rules, an FIE is allowed to borrow foreign debt up to a headroom equal to the difference between its approved total investment and registered capital amount. Before promulgation of Circular 45, it was not clear and subject to local practice whether an FIE could borrow up to this headroom if its investor had not fully paid the registered capital. Circular 45 clarifies that the FIE's foreign debt headroom shall be calculated in proportion to its foreign shareholders' paid-in capital.

Circular 45 also provides that, if an FIE fails to update its SAFE registration for an overdue foreign debt, SAFE will not accept registration of any new foreign debt of the FIE. Furthermore, if a short term foreign debt with a term less than one year is extended or overdue, which prolongs the actual term of the loan (from the first withdrawal date to the current date or the extended due date) over one year, such short term foreign debt will be treated as a mid to long-term foreign debt, and the FIE's foreign debt headroom will be permanently reduced by the aggregate amount of such short term foreign debt as if it were a mid to long-term foreign debt.

Administration on Land Deposit Account

When payment of a deposit is required to procure land use right, foreign investors should pay the deposit in foreign exchange into a special land deposit account. The funds in such account may only be (i) transferred into the registered capital account of the FIE established by the foreign investor in the later stage, (ii) returned to the foreign investor that makes the payment, or (iii) returned to the foreign exchange registered capital account of the FIE that makes the payment. The funds in such account can not be converted into RMB.

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