

China Corporate Bulletin

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Welcome to White & Case's monthly China Corporate Bulletin. This bulletin covers recent corporate regulatory developments and news in the PRC and Hong Kong, ensuring you stay up to date on the latest market issues.

New SAFE Rule Circular 19 Regulating Round-Trip Investment through SPV and Foreign Exchange Registration of FIE and Outbound Investment

On May 27, 2011, the State Administration for Foreign Exchange (**SAFE**) promulgated the *Circular on Operation Procedures on Foreign Exchange Administration on Financing and Round-trip Investment by Domestic Residents through Offshore Special Purpose Vehicles* ("**Circular 19**"), which was effective as of July 1, 2011.

Prior to Circular 19, the major regulations governing foreign exchange administration on round-trip investment are (i) the *Circular on Foreign Exchange Issues Related to Financing and Round-trip Investment by Domestic Residents through Offshore Special Purpose Vehicles* ("**Circular 75**", which was effective as of October 21, 2005), and (ii) the *Operation Procedures of Circular 75* ("**Circular 106**", which was effective as of May 29, 2007). Circular 19 sets out a simplified registration process for SPVs. It also addresses round-trip investments by non-SPVs and adds additional registration requirements for foreign-invested enterprises (**FIEs**) investing in real estate.

We summarize some notable features of Circular 19 below:

- Simplified Registration Process for Special Purchase Vehicles (**SPVs**)

"SPV" is defined under Circular 75 as an offshore enterprise directly established or indirectly controlled by domestic legal or natural person residents for the purpose of carrying out offshore equity financing (including convertible bond financing). Such an SPV will hold the assets or equity interests that the domestic resident investors have in domestic investee enterprises through the round-trip investment. A typical example is an SPV established for the purpose of oversea listing of a domestic enterprise. Circular 19 simplifies the foreign exchange registration process of SPVs in the following ways:



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- > Under Circular 75 and Circular 106, domestic resident investors must register with SAFE prior to the establishment of an SPV. Circular 19 now allows domestic investors to establish the SPV first and then register after establishment of the SPV, provided that no material change shall be made to the capital or equity of the SPV such as offshore financing, equity transfer or round-trip investment before completion of the registration.
- > Circular 106 provides that an unregistered round-trip investment can be retroactively registered after paying penalties. It appears, however, that SAFE effectively suspended this practice after the promulgation of an internal rule, Circular 77. Circular 19 re-opens the door for retroactive registration, and it specifies that after remedying certain non-compliance by paying a penalty, SAFE will approve retroactive registration.
- > Under Circular 19, the approval authority for establishment and control of SPVs is delegated from central level SAFE to provincial level SAFE, which may facilitate a faster approval process.
- > Domestic investors were previously required to submit a business plan of offshore financing which should include, among other things, a description of the three-year operating history of the domestic investee enterprise to be financed offshore for registration purposes under Circular 75 and Circular 106. This documentation requirement has been removed under Circular 19.

Circular 19 also expands its application from PRC residents (individual and entities) to non-PRC individuals who are habitual residents of the PRC. These individuals are also subject to the registration requirement under Circular 19. This appears to be an action by SAFE to eliminate the attempt to bypass SAFE registration through a nominee structure with foreign citizens.

■ Greenlight to Round-trip Investment by Non-SPVs

Since the promulgation of Circular 75, an SPV has been the only legal vehicle by which domestic investors may make a round-trip investment. A significant broadening of Circular 19 is that a round-trip investment made by non-SPVs may now become registrable with SAFE. A non-SPV under Circular 19 is defined as an offshore enterprise directly or indirectly held or controlled by a domestic resident person that does not fall into the scope of SPV. The distinction seems to be that a non-SPV is established without the "special purpose" of offshore financing of a domestic interest. An FIE invested by such SPVs will be noted as a "round-trip investment by non-SPV" when registering with SAFE upon its incorporation.

Existing FIEs of the same nature can make retroactive registration with SAFE after paying penalties.

■ Consolidation of SAFE Registration Requirements for FIEs and Outbound Investment by PRC Domestic Enterprises

Sections 2 and 3 of Circular 19 set out the foreign exchange registration procedures for both FIEs and outbound investment by domestic entities.

Under Section 2, an FIE is required to make a foreign exchange registration upon its incorporation, when it is converted from a domestic enterprise through acquisition by a foreign investor, or when it makes certain changes, including capital increases or decreases, equity transfers etc. This is a codification of existing practice.

Under Section 3, a domestic entity which makes an outbound investment must register with SAFE within 60 days after it establishes, acquires or invests in an offshore enterprise; and then again, if any material change takes place in the registered offshore enterprise, including capital increase or decrease, equity transfer or swap, merger or division, etc.

The foreign exchange registrations described above can be completed with SAFE at the provincial level, and SAFE may further delegate the approval authority to the branches within its jurisdiction.

■ Real Estate Related Foreign Exchange Registration

Section 2 of Circular 19 gives special attention to FIEs operating in the real estate sector. For example, every investor in a real estate FIE is required to submit a commitment letter to SAFE to confirm that the Chinese and foreign partners have not entered into any side agreement other than the approved articles of association and joint venture contract so as to ensure that neither party is guaranteed a fixed return. Some foreign and Chinese parties have allegedly used side agreements in the past to make equity investments in real estate function more like debt. This appears to be consistent with the recent trend of attempts to monitor and regulate "hot money" in the real estate sector.

In summary, Circular 19 is an important development for both onshore and offshore investors, as it appears to revive the ability to make round-trip investments. It also provides practical guidance on foreign exchange registration relating to FIEs and outbound investment. Although Circular 19 appears to be a welcome signal, it remains to be seen how it will be implemented by SAFE in practice.

For the full text of Circular 19, please visit the following Chinese language link:

http://www.safe.gov.cn/model_safe/laws/law_detail.jsp?ID=8040400000000000,31&id=4

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White & Case News

Virginia Tam joined White & Case as a partner in our Hong Kong office on Monday, July 4th. Virginia is a corporate finance practitioner, and was previously a partner with an international law firm in Hong Kong. Dual-qualified in Hong Kong and New York, Virginia is experienced in China and Hong Kong-based cross-border corporate and securities transactions, as well as in international corporate finance matters with US securities law and/or Hong Kong listing rules elements. These matters include pre-IPO private equity investments, initial public offerings, PIPE transactions, and follow-on public offerings for Chinese businesses in the US and Hong Kong.

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- Top International Arbitration Firm—*Chambers Global* 2011; *Global Arbitration Review* 2009
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- Top 5 M&A Firm in Latin America—*Latin Business Chronicle* 2010
- Top Tier in Global Project Finance—*Chambers Global* 2011; *Infrastructure Journal* 2010