China removes key restrictions on investment by FIEs and cross-border funds flows

29 October 2019

In a surprise move, SAFE\(^1\) introduced 12 broad reform measures on 25 October 2019 to boost inbound investment and rejuvenate the economy. To facilitate cross-border trade and investment, on 25 October 2019, SAFE:

- introduced 6 measures to streamline the process of cross-border trade in goods, and another 6 to relax controls on settlement and use of foreign exchange (FX) capital; and
- consolidated the relevant categories of FX account.

**Investments by FIEs**

Foreign invested enterprises in China (FIEs) stand to benefit from the main reform announced by SAFE which greatly helps investment by FIEs engaged in non-investment businesses, who will now be permitted to make equity investments with their registered capital. Before this change, such FIEs were required to have “investment” in their business scopes in order to make equity investments. For these FIEs:

- obtaining regulatory consent to include “investment” in the business scope had been practically very difficult; and
- the limited available means to engage in investment business were to set up a foreign invested holding company, venture capital enterprise or equity investment enterprise (i.e. the QFLP\(^2\) fund) - all subject to stringent requirements and restrictions.

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\(^{1}\) The State Administration of Foreign Exchange of the People’s Republic of China (“PRC” or “China”).

\(^{2}\) The Qualified Foreign Limited Partner.
As a result of the change, foreign investors may now invest in multiple PRC entities through an FIE as a quasi PRC holding vehicle. FIEs can further invest in domestic enterprises using either foreign currency or RMB, so long as the proposed investment (i) is genuine and compliant and (ii) complies with the restrictions in the national negative list.

It remains to be seen how the two conditions above will be implemented in practice (especially in sectors within the national negative list). On the other hand, the onset of the reforms means that foreign invested holding companies and QFLPs may become slightly less attractive options.

**Inbound Capital Flows Encouraged**

SAFE has made it more attractive for domestic sellers of PRC assets to deal with buyers paying in FX. The reforms enable direct conversion of cross-border deposits into RMB to settle the purchase price or damages and (as the restrictions on the number of special bank accounts one may open no longer apply) facilitate multiple cross-border transactions. New rules also enable sellers (who are required to open special bank accounts to receive sale proceeds in FX) to directly convert these proceeds into RMB at banks, without needing to substantiate how the proceeds will be used.

These reforms accompany the geographic expansion of a pilot programme (already introduced in 12 free trade zones, including China (Shanghai) Pilot Free Trade Zone) which allows qualified enterprises to convert FX capital raised through overseas loans, bond issuances and listings into RMB through the banks, without per-transaction use of proceeds verification by SAFE. The expanded geographic coverage will include the six new free trade zones approved this year, and the entire city of Shanghai.

**Encouraging Inbound Foreign Debt**

In Guangdong-Hong Kong-Macau Greater Bay Area and Hainan, SAFE plans to introduce reforms permitting PRC borrowers, including FIEs, who have pre-filed with SAFE (for a cap up to two times net assets) to utilise and repay cross-border loans without needing to register each individual fund flow with SAFE. This would extend the March 2019 pilot programme (currently applied to multinationals’ cross-border cash pools), for national rollout at a later stage.

Further, nationwide, PRC borrowers will no longer need to apply to SAFE for deregistration of foreign debts upon making full repayment. Instead, they can do so with the banks directly. This aims to reduce the procedural burden of cross-border financing by PRC enterprises.

**Accelerating Credit Asset Transfers**

The scope of credit assets transferable to foreign investors has been expanded to include non-performing loans from banks, and trade financing.
(to be piloted in Guangdong-Hong Kong-Macau Greater Bay Area and Hainan). Distressed asset players should watch this space.

**Promoting E-Commerce**

The reforms boost China’s leading position as a hub for e-commerce, by exempting small e-commerce enterprises with annual foreign exchange transactions of less than USD200,000 from complying with name list registration (which would otherwise require an information submission to SAFE).

**Facilitating FX Cross-Border Payment**

SAFE will also boost the competitiveness of China’s exporters with reforms including digitisation of certain reports and filings (including verification of FX income from trade in goods, and SAFE reporting of reconciliation of import/export volumes with FX payments and receipts) and making the use of interim accounts for income derived from exports voluntary rather than mandatory, allowing exporters the option of directly remitting the income into their main FX clearing account.

The reforms as a whole show the authorities’ resolve to improve the ease of doing business in China, by reducing regulatory interference and progressively removing restrictions disproportionately affecting foreign investors.

In interviews following publication of the reforms, SAFE officials indicated they would continue to focus on cross-border RMB capital flows by encouraging investment, and orderly management of transactions, in the STAR new issues market, the Stock Connect, Bond Connect and Shanghai-London Connect schemes, and the issuance of panda bonds by foreign issuers in the PRC.

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<th>95%</th>
<th>of cross-border e-commerce enterprises would benefit from the exemption from name list registration rules (Source: SAFE)</th>
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<td>31</td>
<td>Ranking assigned by the World Bank to China for ease of doing business (up from 46 in 2019)</td>
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