

China Forex Liberalization Unlocks Massive M&A Opportunities for Foreign Invested Enterprises

by Karen Yiqin Fan

On October 23rd, 2019, the State Administration of Foreign Exchange ("**SAFE**") issued a *Circular on Further Promoting the Facilitation of Cross-border Trade and Investment* (Hui Fa [2019] No.28) (《关于进一步促进跨境贸易投资便利化的通知(汇发[2019]28号)》, "**Circular 28**"). The Circular 28 sets out 12 reform measures aiming to streamline the foreign exchange process in cross-border trade and ease controls over cross-border investments. But the highlight clearly is the relaxation of foreign exchange controls over foreign-invested enterprises ("**FIE**") utilizing funds converted from foreign exchange in their capital account ("**Converted Capital**") to make investments locally in China. This means that FIEs can invest in and acquire other companies in China by drawing upon their foreign exchange denominated registered capital. Previously they were limited to only using the RMB funds that they generated from their own business activities to make such investments. Up until the release of Circular 28, only foreign-invested investment companies or private equity and equity investment enterprises, whose establishment is subject to a host of conditions that are challenging to satisfy, could use their own registered capital to make local investments. Now any FIE irrespective of its business scope can draw on their own registered capital to make investments.

The prohibition on FIEs applying converted capital for investment can be traced back to the *SAFE Circular on the Relevant Implementing Issues Concerning the Improvement of the Administration of the Payment and Settlement of Foreign Equity Capital of Foreign-Invested Enterprises* (Hui Zong Fa [2008] No.142) (《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(汇综发[2008]142号)》, "**Circular 142**"). Then there was a significant shift in 2015 when SAFE issued the *Circular on Reforming the Administrative Approach Concerning the Conversion of Foreign Exchange Capital of Foreign-Invested Enterprises* (Hui Fa [2015] No. 19) (《国家外汇管理局关于改革外商投资企业外汇资本金结汇管理方式的通知(汇发[2015]19号)》, "**Circular 19**"). Circular 19 relaxed settlement of funds from a FIE's capital account and removed the prohibition on FIEs using their converted capital to make equity investments in China. However, Circular 19 also prohibited use of the converted capital for purposes not included in a FIE's scope of business set out in its business license. So FIE equity investment was still

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limited to the three FIE vehicles permitted to include ‘investment’ in their scope of business – (i) a foreign invested holding company (外商投资性公司), (ii) foreign invested venture capital enterprise (外商投资创业投资企业) or (iii) foreign invested investment enterprise (外商投资股权投资企业, i.e. the Qualified Foreign Limited Partner, aka “QFLP”), which are all subject to challenging establishment requirements and regulatory scrutiny.

With the new Circular 28, foreign investors may make domestic equity investments in China through any of their manufacturing or service FIEs. According to Circular 28, as long as the proposed domestic equity investment (i) does not violate the negative list of foreign investment; and (ii) is genuine and compliant, any FIE can use its converted capital for such investment. Where an FIE is investing in a target, the target should first complete a ‘filing of re-investment’ process and open a special account of “capital item - settled to be paid (资本项目-结汇待支付账户)” in order to receive the converted capital. Moving forward, we expect to see considerable capital that was locked up in FIE capital accounts deployed to take advantage of the acquisition opportunities emerging in the local PRC market as first generation founders of private companies enter their twilight years, and in the absence of a family successor, decide to sell off their businesses.

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