THE PILOT FREE TRADE ZONE IN SHANGHAI

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Recent reform developments

Shanghai's pilot free trade zone (FTZ) was officially launched on September 29, 2013. The FTZ aims at test-running the opening up of free trade and economic reforms which will, if successful, be implemented nationwide. Under the FTZ scheme, certain restrictions on foreign investments will be eased. Some relaxations have already been implemented, while other announced improvements are yet to come.

Facilitated company setups

An implemented improvement is that the procedure to set up foreign-invested enterprises (FIEs) has been eased. To set up an FIE, only registration, rather than administrative approval, is required. Outside of the FTZ, company set ups are usually complicated, involving interaction with various authorities, taking up copious amounts of time, and expensive. Only enterprises whose business areas are not on the so-called "negative list" for foreign investments will benefit from this relaxation. All business areas not on the negative list (which at the moment is very long) are exempt from the approval requirement. The publication of a new negative list with fewer restricted sectors has been announced for the first half of this year.

Foreign exchange and cross-border finance reforms

The People's Bank of China (PBOC) published a paper (Opinion) on December 2, 2013, containing various principles in the area of bank account systems, facilitations in the conversion of foreign exchange, cross-border usage of RMB, and the speeding-up of interest liberalisation. These principles need to be implemented by detailed provisions.

PBOC Opinion partly implemented

The State Administration of Foreign Exchange (SAFE) issued implementation provisions with regard to some principles of the PBOC Opinion on February 28, 2014. Qualified entities in the FTZ are now allowed to:

- Open a domestic bank account through which foreign exchange funds of its domestic affiliates may be pooled and centrally managed;
- Open an international bank account through which the flow of funds between this account and overseas is free from restrictions and controls. Funds may be freely transferred between this and domestic accounts (foreign exchange funds paid from overseas still require registration)[1];

[1] Citibank pioneered to create such a possibility with its "RMB cross-border pooling solution" in China already before SAFE published the implementation provisions.

- Foreign exchange funds in capital accounts may be freely converted into RMB (a transfer of such amounts to another RMB account, however, is still subject to certain requirements).

Furthermore:

- The ceiling for offshore loans denominated in a foreign currency is raised from 30-percent to 50-percent of the entity's total equity capital.
- Providing securities to offshore parties and payments of fees for such securities to offshore security providers are not subject to SAFE approval anymore.
- Qualified financial leasing companies are subject to registration requirements rather than SAFE approval with respect to their foreign currency receivables from the foreign lease business. They may freely accept lease payments in foreign currencies from domestic parties.

Finally, an FTZ resident can now make foreign exchange registrations with respect to foreign direct investments with banks rather than SAFE, which is less time-consuming and onerous. Further administrative relaxations are expected.

Enterprises outside of the FTZ may only make foreign exchange settlements according to "actual needs", which will be determined by SAFE in a cumbersome procedure.

Other forthcoming reforms

The following reforms announced in the PBOC Opinion still need to be implemented:

- FTZ residents (in particular individuals) may invest offshore, including in foreign securities, and convert RMB into foreign currencies for such investments without SAFE approval.
- No SAFE approval is required for FTZ resident entities with respect to loans to their offshore subsidiaries.

The last months since the official launch of the FTZ have shown that nationwide applicable regulatory restrictions will be gradually removed. It is not predictable when and how other announced reforms will be implemented. If the PBOC guidelines are fully implemented, the FTZ will give real and considerable improvements to foreign investors and Chinese persons investing offshore. Investors should now closely observe further developments in the FTZ.

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