

## Client Alert

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## SAFE issues new rules on cross-border cash pooling

On 15 March 2019, the State Administration of Foreign Exchange (SAFE) issued the *Administrative Provisions on the Centralized Operation of Cross-border Funds for Multinational Companies* (Hui Fa [2019] No. 7) (《跨国公司跨境资金集中运营管理规定》(汇发[2019]7号)) (the "**Circular 7**"), which came into effect on the same day. Circular 7 amends and supersedes the *Administrative Provisions on the Centralized Operation of Cross-border Foreign Exchange Funds for Multinational Companies* (Hui Fa [2015] No. 36) (《跨国公司外汇资金集中运营管理规定》(汇发[2015]36号)) (the "**Circular 36**"), with an aim to further optimize and relax the control over the centralized cross-border fund management scheme for multinational companies (the "**Centralized Fund Scheme**").

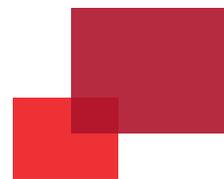
The Centralized Fund Scheme was first permitted by SAFE in 2014, so that multinational companies may manage their cross-border fund flows in a more efficient way. Pursuant to the Centralized Fund Scheme, onshore and offshore member companies within the same multinational group can enter into cross-border cash pooling arrangement with a PRC bank and designate a member within the group to be the pool header (as representative of all member companies to handle administrative and regulatory formalities), which, among others, will entitle such multinational company to the benefits of (a) having a centralized foreign debt quota and a centralized outbound loan quota, (b) centralizing cross-border payments for current account items (such as, payments for cross-border trades and services) via one bank account, and (c) netting the payments among different members of the group.

### 1. Covering both Renminbi and foreign currencies

Before the Circular 7, the Centralized Fund Scheme denominated in foreign exchange and Renminbi are regulated by SAFE and the People's Bank of China (the PBOC) respectively, pursuant to different legal regimes. Foreign exchange Centralized Fund Scheme was primarily regulated by SAFE under the Circular 36 on a nationwide basis, while there are several different versions of the Renminbi Centralized Fund Schemes in the market, which are nationwide scheme regulated by the PBOC, and schemes in free trade zones set up pursuant to regional rules applicable only in free trade zones (such as, the China (Shanghai) Pilot Free Trade Zone).

The Circular 7 now provides that multi-currency Centralized Fund Scheme covering both Renminbi and foreign exchange can be established pursuant to the Circular 7 under the authority of SAFE.

It is interesting to note that, despite of the Circular 7, the Renminbi Centralized Fund Scheme regimes published by the PBOC are still effective. As we understand it, until further rules are published by SAFE or the PBOC, there will be two parallel legal regimes governing the Centralized Fund Schemes in China, namely, (a) multi-currency Centralized Fund Scheme set up pursuant to the Circular 7 and regulated by SAFE, and (b) Renminbi



Centralized Fund Scheme regulated by the PBOC nationwide and in different free trade zones.

## 2. Eligibility criteria clarified

The Circular 7 clarified that financial institutions (other than finance companies (in Chinese language, 财务公司) when acting as the pool header), local-government financing platforms and real estate companies are not allowed to participate in the Centralized Fund Scheme set up pursuant to the Circular 7.

It is also worthwhile to note that, under the Circular 36, a company without shareholding connection with the group but is otherwise controlled by the group (which can be *de facto* control, or contractual control) may also participate in the Centralized Fund Scheme set up pursuant to it, provided that it is approved by SAFE on a case-by-case basis. Such rule is now repealed under the Circular 7, and only a company with shareholding relationship with the group may participate in the Centralized Fund Scheme under the Circular 7.

## 3. Account arrangement simplified

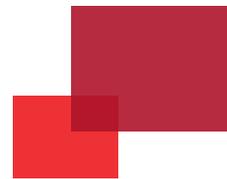
Under the Circular 36, two accounts are generally opened by the pool header, (a) one domestic foreign exchange master account with all domestic members' funds pooled to it, and (b) one international foreign exchange master account with all overseas members' funds pooled to it. When both master accounts are opened, all cross-border fund flows under the Centralized Fund Scheme are channelled via the domestic and international master accounts. However, the pool header may also elect to only open a domestic master account and all funds will be pooled to such domestic account only.

The Circular 7 simplified the account arrangement, and the international foreign exchange master account is no longer available. In case a multinational group still prefers to maintain a separate account for pooling the funds of its overseas members, it may designate an overseas member to open a non-resident account (NRA) with a PRC bank for such purpose.

## 4. Calculation of consolidated quotas

Under the Circular 36, the Centralized Fund Scheme enables multinational groups to consolidate all or a part of the foreign debt quotas and outbound lending quotas of their domestic member companies. Such consolidated foreign debt and outbound lending quotas shall be filed with SAFE by the pool header, and the outstanding inbound and outbound balance under the Centralized Fund Scheme shall not exceed the consolidated quotas filed with SAFE.

The Circular 7 now aligned the calculation formulas for the consolidated foreign debt and outbound lending quotas for the multinational company using the Centralized Fund Scheme with the macro-prudential foreign debt borrowing headroom formula published by the PBOC in 2017 according to the *Notice of the PBOC on Matters concerning the Macro-Prudential Management of Full-Covered Cross-Border Financing* (Yin Fa [2017] No. 9) (《中国人民银行关于全口径跨境融资宏观审慎管理有关事宜的通知》(银发[2017]9号)) (the "**PBOC Circular 9**").



#### A. Consolidated Foreign Debt Quota

*Consolidated Foreign Debt Quota  $\leq \Sigma$  The audited owner's equity of the header and the domestic member enterprises of the previous year  $\times$  Cross-border Financing Leverage Ratio  $\times$  Macro-prudential Adjustment Parameter*

where,

- (i) the initial Cross-border Financing Leverage Ratio is 2;
- (ii) the initial Macro-prudential Adjustment Parameter is 1.

#### B. Consolidated Outbound Lending Quota

*Consolidated Outbound Lending Quota  $\leq \Sigma$  The audited owner's equity of the header and the domestic member enterprises of the previous year  $\times$  Outbound Loan Leverage Ratio  $\times$  Macro-prudential Adjustment Parameter*

where,

- (i) the initial Outbound Loan Leverage Ratio is 0.3;
- (ii) the initial Macro-prudential Adjustment Parameter is 1<sup>1</sup>.

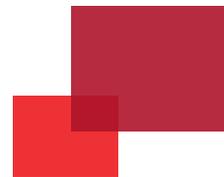
We also note several issues that require further clarification from SAFE under Circular 7:

- (i) According to the Circular 7, once a multinational group sets up the Centralized Fund Scheme, all its members cannot borrow or extend cross-border any financing unless the same is undertaken under the Centralized Fund Scheme. It seems to be a more stringent approach if compared with the Circular 36. Circular 36 allows the flexibility for members to only partially contribute its quotas to the Centralized Fund Scheme, as opposed to a mandatory all-in contribution.
- (ii) The Circular 7 also requires all member companies to clear existing cross-border borrowings and lending before participation of the Centralized Fund Scheme. This also seems to be a more stringent requirement, and as a matter of practice, such requirement might not be welcomed by the multinational companies in the market.
- (iii) The Circular 7 seems to exclude the application of the concept of "borrowing gap"<sup>2</sup> when calculating foreign debt quota for foreign invested enterprises (FIEs). "Borrowing gap" is still a calculation formula used by many FIEs in China, so this would also make it practicably difficult for the Centralized Fund Scheme under the Circular 7 to be implemented.

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<sup>1</sup> SAFE may adjust the leverage ratios and macro-prudential adjustment parameters from time to time.

<sup>2</sup> "**Borrowing gap**" refers to the difference between the total investment and registered capital of an FIE, which is used to calculate the foreign debt borrowing capacity of the FIE. After the issuance of the PBOC Circular 9, an FIE may elect to calculate its borrowing capacity based on the borrowing gap or the macro-prudential formula under the PBOC Circular 9.



## 5. Flexible management of consolidated quotas and simplified filing requirements

Under the Circular 36, the pool header is required to register each cross-border lending and borrowing transaction under the Centralized Fund Scheme with SAFE. If a multinational group engages more than one PRC handling bank for the Centralized Fund Scheme<sup>3</sup>, the pool header is also required to allocate the consolidated lending and borrowing quotas among the different handling banks and file such allocation with SAFE.

The requirements above have been relaxed under the Circular 7. Under the Circular 7, the pool header is only required to complete one registration for the consolidated foreign debt and outbound lending quotas, and is no longer required to register each individual transaction. No allocation of consolidated quotas among the handling banks is required any more either.

## 6. Simplified documentary and procedural requirements

Documentation requirements for the use of funds under the Centralized Fund Scheme is also simplified under the Circular 7. For example, for the use of foreign exchange incomes derived from capital account items (such as, loan and equity investments), the funds can be used directly without the necessity of providing the underlying supporting documents to the PRC bank for verification in advance.

## Conclusion

The further optimized Centralized Fund Scheme under the Circular 7 may attract more multinational groups to establish multi-currency and cross-border cash pooling schemes. However, how Circular 7 would impact the existing Renminbi cross-border cash pooling regimes (nationwide and regional), and whether SAFE would further clarify the issues set out under Section 4 above are yet to be observed.

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<sup>3</sup> The Circular 36 provides that the multinational group may engage no more than three PRC handling banks for the Centralized Fund Scheme.