

Your Chinese Trading Partners' SAFE Status May Impact Your Payment Terms

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Chinese currency (renminbi or RMB) is not an internationally convertible currency. A Chinese company needs to convert its RMBs into internationally circulated currencies to pay for imported goods or convert foreign currencies it receives in payment for exports into RMBs. To do so, the company must apply to a bank to convert the currency. The payment, receipt, and conversion of foreign currency are subject to the regulations by the State Administration of Foreign Exchange of the People's Republic of China (SAFE).

SAFE recently issued new guidance and rules governing foreign exchange transactions in the export and import of goods. The Goods Trade Foreign Exchange Administration Guidance and Implement Rules (Regulations) became effective August 1, 2012. The Regulations apply to all companies organized under the laws of the People's Republic of China, including all foreign invested companies such as Sino-Foreign joint ventures and wholly-foreign owned enterprises (for the purpose of this article, Chinese companies). The Regulations govern all payments and receipts of foreign currencies in connection with the exportation and importation of goods by companies (Trade-related Forex Transactions).

Do Your China Trading Partners Have the Necessary Foreign Trading Rights?

To export and import goods, Chinese companies must first obtain foreign trading rights by registering with the MOFCOM corresponding commerce bureau after obtaining the proper business license and then registering with SAFE. SAFE sends its official list of Chinese companies registered for foreign trade activities to all banks via its Goods Trading Foreign Exchange Monitor System (Monitor System). If a Chinese company's name is not listed in the Monitor System, then a bank is not permitted to accept the company's request to receive or make payments relating to its trade activities. In that case, the Chinese company would need to engage a qualified import/export agent with proper business license and certificates for its foreign trade activities.

What is Your Chinese Trade Partners' Status with SAFE?

Previously, SAFE regulated all Trade-related Forex Transactions and applied the same rule to each transaction. However, effective August 1, 2012, SAFE switched from regulating "transactions" to regulating "subjects" (i.e., companies) that engage in the foreign trade of goods. SAFE regulates each Chinese company based on its registration status with the SAFE (SAFE Status). SAFE classifies Chinese companies with foreign trade rights into Class A, Class B or Class C, after completing a SAFE inspection and audit. The inspection can be conducted either on or off site and the frequency of the audits is at the discretion of SAFE. When conducting an off-site audit, the Chinese company is required to submit all foreign currency receipt, payment transactions documentation and custom documentation for the most recent 12-month period. For start-up Chinese companies, within 90 days from the date they engage in their first Trade-related Forex Transaction, SAFE will conduct training on the Regulations compliance and issue decisions on their SAFE Status.

Generally speaking, a company will fall into Class A status if it complies with the foreign exchange related regulations. If the company fails to provide information requested by SAFE within the prescribed period, the company will be classified as a Class B company. A company may be classified Class C if it is found to have seriously violated foreign exchange regulations during the 12-month audit period. When SAFE classifies a company as a Class B or Class C company, before such classification is sent to banks, SAFE must inform the company of its classification decision. Should

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the company disagree with SAFE's decision, it may file an opposition within 7 business days from the date it receives the SAFE decision on its SAFE Status. SAFE must review the opposition and may revise or confirm its decision. That decision is final unless adjusted by the SAFE. With respect to Class B and Class C companies, SAFE will impose a one-year term of supervision (Supervision Period) monitoring or regulating Trade-related Forex Transactions via the Monitoring System.

Registration Obligations

Prior to adoption of the Regulations, a Chinese company exporting and importing goods was required to separately register each Trade-related Forex Transaction. Under the Regulations, Class A companies are exempted from these separate registration obligations. Class B and Class C companies' Trade-related Forex Transactions are more closely scrutinized; they are required to apply to SAFE and register the following transactions:

- A Class B company is required to register a Trade-related Forex Transaction when the amount of the foreign currencies involved exceeds the amount previously certified by the SAFE (Cap). The Cap is predetermined by SAFE for a Class B company based on the volume of foreign trade such company previously registered with SAFE;
- A Class C company is required to register each Trade-related Forex Transaction.

Reporting Obligations

A Chinese company (regardless of classification) is required to report Trade-related Forex Transactions to SAFE via the Monitoring System:

- if the term of the prepayment and term to receive the payment is more than 30 days;
- if the term of the deferred payment and deferred receipt of the payment is more than 90 days;
- if the term of a letter of credit through which payment is made is more than 90 days or the payment is made by an off shore entity on its behalf; or
- if all prepayment and receipt of advance payments engaged by a Class B or Class C company during its Supervision Period.

If the counterparty of the Trade-related Forex Transaction is an affiliate of the Chinese company, the Chinese company is also required to provide specified information relating to the affiliate.

SAFE Status and Payment Terms

The Regulations also impose restrictions on payment and related terms applicable to Class B and Class C companies. For example, payment terms may not exceed 90 days and the amount of any prepayment or advance payment is limited to a specified percentage, previously 10%-30% of the purchase price. The regulations do not specify the specific range, rather, SAFE will determine the ratio at its sole discretion. In determining the specific ratio applicable to a particular company, SAFE will consider the nature the trade transaction involved and also consider the results from the off-site audit and inspection conducted by SAFE. Further, a Class B company must maintain a ratio between payment and receipt of the amount of foreign currencies pre-certified by the SAFE thereby potentially limiting its ability to import or export goods. If a Class C company makes an advance payment of more than \$50,000, its foreign seller must provide a so-called "Letter of Advance Payment Bank Guarantee."

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