

Administrator's Message

In 2005, global economic growth slowed down moderately, yet still realized a relatively fast growth of 4.3 percent. China strengthened and improved macroeconomic adjustment. The national economy maintained steady and rapid development. The growth rate was 9.9 percent. China's external economy grew even faster. Foreign trade grew by 23.2 percent, exceeding US\$1.42 trillion. Foreign direct investment actually used remained at a high level of USD60.33 billion.

China's balance of payments continued to post a dual surplus under both current account and capital account. Specifically, trade surplus in goods increased substantially, trade deficit in service, income items narrowed. Current account surplus became the main part of balance of payments surplus. Outward direct investment, portfolio investment and other investment grew rapidly, the increase pace of external debt decreased. Capital and financial account surplus declined moderately. By the end of 2005, national foreign exchange reserves reached US\$818.87 billion, an increase of US\$208.94 billion over the end of the previous year. An important step was taken to reform the Renminbi exchange rate formation mechanism. After the July 21 reform, the flexibility of Renminbi exchange rate increased significantly. The exchange rate fluctuated in both directions within a narrow band. By the end of 2005, the Renminbi exchange rate against the US dollar appreciated by 2.6 percent over the beginning of the year, an increase of 0.5 percent after the July 21 reform.

In 2005, the State Administration of Foreign Exchange implemented the plans set forth by the Party Central Committee and the State Council in real earnest, and accelerated the establishment and improvement of a market-based mechanism to adjust and manage balance of payments. The SAFE took advantage of the reform of Renminbi exchange rate formation mechanism to speed up the reform of foreign exchange administration. By enlarging market participants, introducing new transaction approaches, promoting foreign exchange derivatives, and improving exchange rate administration system, the SAFE vigorously pushed forward foreign exchange market development and enhanced the market-based exchange rate formation mechanism. The ceiling of foreign exchange account opened for current account purpose and the upper limit of resident individual's foreign exchange purchase were further increased, and the procedures and documents required streamlined, with an aim to normalize foreign exchange supply and demand relations. Pilot program was carried out concerning centralized management of large enterprises' foreign exchange fund to facilitate enterprises' operation and financial management.

Domestic institutions and individuals' overseas equity financing and inward direct investment using fund raised through special purpose vehicles were standardized. Relevant policy was made to satisfy enterprises' financing demand for foreign exchange after their initial outward investment. A high-frequency debt monitoring and market expectation survey system was established to build monitoring and early warning capacity with respect to cross border capital movements. External debt management was further strengthened. The increase of short-term external debt was brought under strict control. Foreign exchange market order was further rationalized and regulated. Actions were taken to vigorously crack down on illegal foreign exchange transactions. The credit system in the foreign exchange market was promoted proactively. Scientific management of foreign exchange reserves was enhanced to ensure safety and profitability.

The year of 2006 witnesses the launch of the Eleventh Five-Year Plan. Substantive progress should be made this year in pushing economic and social development onto a scientific path. It is of great importance for the SAFE to help ensure a good start of the Eleventh Five-Year Plan. The foreign exchange administration agency will continue to be guided by Deng Xiaoping Theory and the important thought of Three Represents as our guide; implement overall development with a scientific outlook on development; earnestly carry out the strategic plans made by the Party Central Committee and the State Council since the Sixteenth Party Congress; deepen the reform of foreign exchange administration; adopt innovative approaches and methods; strenuously facilitate trade and investment; steadily move forward towards capital account convertibility; enlarge capital outflow channels; actively cultivate and develop foreign exchange market; further improve the Renminbi exchange rate formation mechanism; strengthen management of short term capital flows and monitoring and early warning of balance of payments so as to help achieve comprehensive, coordinated, and sustainable development of the national economy.

In face of the new situation and tasks of the New Year, we will continue to vigorously carry on the spirit of reform and innovation, make further progress through hard work, strive to promote equilibrium balance of payments situation, and make new contributions to the rapid and healthy development of the national economy!

A handwritten signature in black ink, consisting of the Chinese characters '胡晓婷' (Hu Xiaoping) in a cursive style.

Foreign Exchange Status Analysis

Balance of payments Position

In 2005, China's macro economy control achieved result; and the national economy grew steadily. Foreign trade grew rapidly and foreign direct investment maintained a considerable scale. China's balance of payments continued to record dual surplus under both current account and capital and financial account. Current account recorded a surplus of USD 160.818 billion, rising by 134.2 percent over previous year, while capital and financial account recorded a surplus of USD 62.964 billion, dropping by 43.1 percent over previous year. Foreign exchange reserves of China increased by USD 208.940 billion.

Drastic increase of surplus under current account, in creasing over USD 100 billion for the first time.

In 2005, surplus under current account reached USD 160.818 billion, an increase of 134.2% over the previous year. Radical rise of surplus on goods and shift of the income item from deficit to surplus were the main contributing factors of the rise of the surplus under the account.

Surplus on goods recorded a new historical high. In 2005, China's foreign trade maintained the momentum of fast growing. Based on international coverage of balance of payments statistics, surplus on goods reached USD 134.189 billion, an increase of 127.5 percent over the previous year, contributing 83.5 percent to the total surplus under trade account. China's exports reached UDS 762.484 billion and imports reached USD 628.295 billion, increasing by 28.5 percent and 17.6 percent respectively.

Contributing factors of the drastic increase of surplus on goods were: first, significant increase of national production capacity and relative lack of effective domestic demands pulled up increase in exports. Second, economic growth of China's main trading partner countries and areas was a strong external demand on goods imports from China. Third, transfer of global manufacturing industry to China acted as another contributing factor of the increase of surplus of China's trade, as the increase in surplus on goods for processing an important factor to the overall surplus increase on goods. Forth, slowdown of China's investment in fixed assets and rise of international petroleum price decreased China's demands for imports. Besides, increase in surplus on goods was also brought about by some short-term and contingent factors, e.g. some enterprises speeded up exports and deferred imports to evade exports restrict measures and RMB appreciation effect.

Trade in services recorded expansion in scale and decrease in deficit. With China's open-up of service sectors and contact with the rest of the world, the scale of trade in services increased steadily. In 2005, receipts of trade in services reached USD74.404 billion and payments reached USD 83.795 billion, rising by 19.2 percent and 16.2 percent respectively, while deficit on trade in services reached USD9.391 billion, decreasing by 3.2 percent. It is the first time in the past five years that deficit on trade in services recorded a decrease. As to the composition of services, transportation, insurance and royalties and license fees were the main contributing factors to deficit on trade in services. In 2005, deficit under transportation reached USD13.021 billion, rising by 4.4 percent; deficit under insurance reached USD6.650 billion, rising by 15.8 percent; deficit under royalties and license fees reached USD5.164 billion, rising by 21.2 percent. Travel and other businesses were the main surplus items. In 2005, surplus under travel reached USD7.537 billion, rising by 14.4%; surplus under other businesses reached USD7.497 billion, almost equal to that in 2004.

Balance on income shifted from deficit to surplus. In 2005, receipts on income reached USD38.959 billion, increasing by 89.6 percent, and payments reached USD28.324 billion, increasing by 17.7 percent. Balance on income recorded a surplus of USD10.635 billion, while it recorded a deficit of USD3.523 billion in 2004.

Surplus on current transfers increased rapidly. In 2005, receipts on current transfers reached USD27.735 billion and payments reached USD2.349 billion, increasing by 14.0 percent and 64.5 percent respectively. Surplus on current transfers reached USD25.385 billion, increasing by 10.9 percent.

Surplus under capital and financial account decreased.

In 2005, inflows under capital and financial account reached USD418.956 billion while outflows reached USD355.992 billion, increasing by 22.0 percent and 53.0 percent respectively. The surplus under the account reached USD62.964 billion, decreasing by 43.1 percent over the previous year.

Surplus on direct investment maintained a considerable scale. In 2005, surplus on direct investment reached USD67.821 billion. Specifically, inward foreign direct investment to China reached USD85.506 billion, while withdrawal of foreign direct investment reached USD6.380 billion. Net inflow of foreign direct

investment to China reached USD79.127 billion. Meanwhile, net outward direct investment reached USD11.306 billion.

Balance of portfolio investment shifted from surplus to deficit. In 2005, deficit on portfolio investment amounted to USD4.933 billion, while it recorded a surplus of USD19.690 billion in 2004. Specifically, outward portfolio investment (assets side) recorded a net outflow of USD26.157 billion, while it recorded a net inflow of USD6.486 billion in 2004. At liability side, China financed USD21.224 billion from the international capital market, increasing by 60.7 percent.

Other investment recorded deficit. In 2005, other investment recorded a deficit of USD4.026 billion, while it recorded a surplus of USD37.908 billion in 2004.

Reserves assets increased by a large margin

In 2005, China's international reserves increased by USD207.016 billion. Specifically, foreign exchange reserves assets increased by USD208.940 billion, SDRs increased by USD5 million and reserve position in the International Monetary Fund decreased by USD1.929 billion. At the end of 2004, foreign exchange reserves assets of China reached USD818.872 billion.

Net errors and omissions occurred at credit side

In 2005, USD 16.8 billion of net errors and omissions occurred at credit side, equivalent to 1.21 percent of the combined exports and imports of goods according to balance of payments statistical coverage. The ratio was within the internationally accepted benchmark of 5 percent.

Balance of Payments outlook for 2006

In 2006, the world economy will maintain its stably increasing momentum while some uncertainties may still exist. In view that oil price may remain at a high level or even rise further, that a wave of interest rate hike may be brought about by the Fed's continuous raise of interest rate, and that unbalanced development of main economies may occur, the growth of world economy may be negatively affected.

It is anticipated that China's current account will continue recording a relatively large surplus in 2006. Total amount of foreign trade is expected to exceed USD1.6 trillion, with surplus on goods remaining at large scale. Deficit on trade in services may decrease slightly, and balance on income may continue the 2005 trend with a slight increase of surplus.

China's capital and financial account is expected to maintain surplus in 2006. Foreign direct investment in China will maintain at relatively large scale. As financial reform deepens further, China will take bigger stride to attract international strategic investors. Meanwhile, there may exist uncertainty in balance of capital and financial account. For example, the rise of interest rate in the international financial market, together with the measures taken by the state to expand capital outflow channel, will have some effect on capital flow in 2006.

In conclusion, China's balance of payments in 2006 will maintain surplus, and foreign exchange reserves will increase further.

External Debt

At the end of 2005, China's outstanding external debt amounted to US\$281.045 billion (excluding that of Hong Kong SAR, Macao SAR, and Taiwan Province, the same below), an increase of US\$33.553 billion or 13.6 percent compared with that of the end of 2004. Of this total, the outstanding long-and- medium-term debt stood at US\$124.902 billion, an increase of US\$0.614 billion over 2004. The outstanding short-term debt was US\$156.143 billion, an increase of US\$32.938 billion over 2004 and accounted for 55.56 percent of the total external debt.

Of the total outstanding external debt, outstanding registered external debt was US\$190.245 billion, and outstanding trade credit was US\$90.8 billion. Of the registered external debt, US\$33.007 billion of sovereign debts were borrowed by government departments, US\$61.076 billion by Chinese-funded financial institutions, US\$50.513 billion by foreign-funded enterprises, US\$40.809 by foreign-funded financial institutions, US\$4.576 billion by Chinese-funded enterprises, and US\$0.264 billion by other institutions.

In 2005, the amount of registered long-and-medium-term external borrowing was US\$24.669 billion, with a decrease of US\$70 million against the previous year. The principal repayment was US\$20.751 billion, an increase of US\$ 4.596 billion, and interest payment was US\$3.082 billion, a decrease of US\$ 839 million, with 0.839 decreased compared with the previous year.

The main features of external debt in 2005 were as follows. Firstly, although the size of total external debt kept growing at a relatively high rate, the growth rate slowed down by 5.0 percentage points against 2004. Secondly, the growth of short-term debt was faster than the total and the ratio of the former to the latter continued to increase. In 2005, short-term debt increased by 26.7 percent, 13.1 percentage points higher than the growth rate of the total. And the said ratio was 5.8 percentage points higher than that of 2004. Thirdly, the rapid growth in trade credit was still one of the main source of the growth of short-term external debt. In 2005, trade credit increased by 38.8 percent compared with that of 2004 and was 12.1 percentage points higher than the growth rate of total short-term debt. Fourthly, the external debt of foreign-funded institutions (foreign-funded banks, non-bank financial institutions and enterprises) increased by 29.0 percent in 2005, 15.4 percentage points higher than the growth rate of the total external debt.

External Debt Statistic Coverage and Statistic Method Adjustment

China's previous external debt statistic coverage was set according to the then-prevailing international standards with the assistance of World Bank experts. After the Asian financial crises, international institutions including the IMF have, in light of the experience and lessons from the crises, been paying more and more attention to member countries' risk control on external debt, and made some adjustments in the external debt coverage and maturity structure. As approved by the State Council, China started the adjustment of the external debt coverage in 2001, and has been publishing external debt data according to the adjusted coverage ever since. The adjustments are as follows:

- Add the external debt of domestic foreign-funded financial institutions and deduct the liability of domestic institutions to domestic foreign-funded financial institutions
- Add three-month-and-less external trade credit
- Add offshore deposit absorbed by Chinese-funded banks
- In terms of maturity structure, add long-and-medium-term liabilities due within a year to short-term debt

The adjustments have put China's external debt statistics in line with international standards and bettered our understanding of China's external debt condition, and our estimate of China's ability in external payment and the impact of external debt repayment on foreign reserves.

In 2005, China adjusted the statistical method for trade credit. After trade credit was incorporated into external debt statistics in 2001, it was calculated by combination of estimate and sample investigation. In 2002, the mechanism of sample investigation was launched for trade credit; and statistics of trade credit were based chiefly on estimates, while the results of sample investigation were for reference. Since the second quarter of 2005, China has adopted the sample investigation method for trade credit statistics and adjusted relevant data in the previous years.

Inter-bank Foreign Exchange Market and Exchange Rate of RMB Against Major Foreign Currencies

In 2005, as the reform and infrastructure improvement of the inter-bank foreign exchange market speeded up, the market developed quite quickly. After reform of the RMB foreign exchange regime, exchange rate of RMB has become more flexible, with an overall stance of smooth and steady fluctuation and slight appreciation.

Inter-bank foreign exchange market

Introduction of new trading products to foreign exchange market

The foreign exchange spot sale and purchase trading in the inter-bank foreign exchange market cover USD/RMB, HKD/RMB, JPY/RMB and EUR/RMB. In 2005, the market launched inter-bank foreign currency pairs trading and foreign exchange forward trading.

The China Foreign Exchange Trade System (CFETS) piloted the foreign currency pairs trading system on May 18, 2005 and then officially introduced it to the market on June 20, 2005. At present, it covers 8 pairs including EUR/USD, AUD/USD, GBP/USD, USD/JPY, USD/CND, USD/ASF, USD/HKD and EUR/JPY. During the 159 trading days in 2005, the accumulative turnover of the 8 foreign currency pairs amounted to USD 52.133 billion. Among those 8, trading on EUR/USD, USD/JPY and GBP/USD pairs were relatively active.

Effective from August 15, 2005, qualified members of the CFETS are permitted to participate in the inter-bank foreign exchange forward trading. Counter parties trade via the central bidding system of the CFETS and conclude their deals either on a gross principal basis or on a netting basis on maturity days.

Increase of participants in foreign exchange market

The number of inter-bank foreign exchange market members increased over time. From August 8, 2005, more and more qualified non-bank financial institutions and non-financial companies are permitted to participate in the inter-bank foreign exchange spot market on a real demand basis. At the end of 2005, there were 384 members in the market, including 30 new-arrivals of the year. Besides, 64 members, including 15 domestic banks and 49 foreign-funded banks, have been permitted to participate in the inter-bank foreign exchange forward trading.

There are 11 market makers and 41 bank members in the inter-bank foreign currency pairs market.

Improvement of transaction and clearing mode

Transactions in the inter-bank foreign exchange market are settled through an electronic trading system. Inter-bank foreign exchange sale and purchase market adopts a bidding system in which deals are quoted respectively but matched on a centralized basis. That is, the electronic trading system follows the principle of price priority and time priority when making deals and settles transactions designated in RMB and foreign currencies on a centralized basis. From the first trading day in 2006, the SAFE will launch a bidding quotation system (OTC quotation) in inter-bank spot trading and extend the standard clearing speed of inter-bank spot trading to "T+2". Under the framework of bidding system, counter parties can also make deals on a "T+0" and "T+1" basis as both sides agreed to. After introduction of the bidding system, members of the inter-bank foreign exchange market can choose to conclude deals via either the bidding system or the offering system.

Trading between foreign currency pairs adopts an instruction-drive and quotation-drive combining trading mechanism and deals are settled on a centralized netting basis. The clearing speed for USD/ CND is "T+1", while the speed for all other foreign currency pairs is "T+2".

Introduction of market maker mechanism into inter-bank foreign exchange market

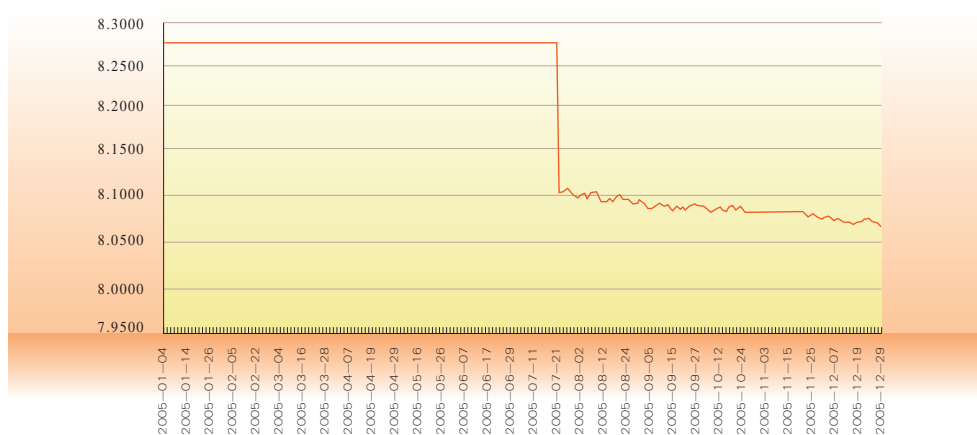
On November 24, 2005, the SAFE introduced a market maker mechanism into RMB/foreign currency trading in the inter-bank foreign exchange market. The market maker refers to a type of members who are approved to continuously provide bid/offer quotation on RMB and foreign currencies in the inter-bank foreign exchange market. It is an integrated measure to further develop the inter-bank foreign exchange market and improve the RMB exchange rate formation mechanism. It contributes to buoying the foreign exchange trading, increasing liquidity in foreign exchange market, making the central bank's monitoring more flexible, and giving full play to the market in resources allocation and RMB exchange rate. By the end of 2005, the SAFE had approved 13 institutions as the first batch of market makers, of which 8 are domestic banks and 5 are foreign-funded banks.

Exchange rates of RMB against major foreign currencies

Greater flexibility of RMB against USD

In the first half of 2005, the exchange rate of USD/RMB kept stable. The daily weighted average price of USD/RMB remained at 8.2765. On July 21, 2005, the central parity price of USD/RMB was adjusted to 8.11, with RMB appreciated by 2 percent. From July 22 to December 30, 2005, price of USD/RMB fluctuated slightly with RMB maintaining a tendency of slight appreciation. During this period, the closing price of USD/RMB announced by the People's Bank of China was slightly depreciated from original 8.11 on July 22 to 8.0702 on December 30, with RMB appreciating by 0.5 percent. The price of USD/RMB closed at the lowest of 8.0702 on December 30, while the highest was 8.1128 on July 27. The spread between the highest and the lowest reached 426 basic points, materializing a two-way fluctuation of the exchange rate of RMB (see chart 1).

Chart 1 Exchange rate of USD/RMB (unit:yuan RMB/USD)

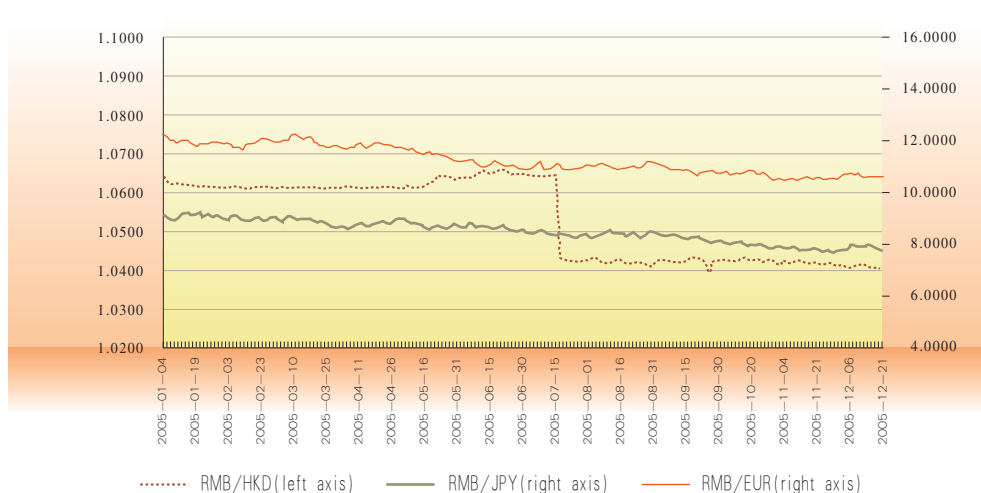


Note : Effectively from July 22, 2005, the People's Bank of China has been publishing the closing price of trading currencies (such as USD) against RMB in the inter-bank foreign exchange market on every business day as the middle price of the referred currency against RMB in the next business day. Accordingly, the price series demonstrated in this chart include daily weighted average price of USD/RMB demonstrated from January 4, 2005 to July 21, 2005 and closing price of USD/RMB from July 22, 2005 to December 30, 2005.

Overall trend of appreciation in spot transactions of RMB against other major foreign currencies

In 2005, exchange rates of EUR/RMB, JPY/RMB and HKD/RMB demonstrated a tendency of depreciation. Since the RMB exchange rate reform on July 21, 2005, the depreciation of EUR/RMB and JPY/RMB has speeded up. By the end of 2005, price of JPY/RMB closed at 6.8716, with RMB appreciating by 17.3 percent over the recorded 8.0573 at the end of 2004. Price of EUR/RMB closed at 9.5797, with RMB appreciating by 17.5 percent over the recorded 11.2588 at the end of 2004. Price of HKD/RMB closed at 1.0403, with RMB appreciating by 2.3 percent over the recorded 1.0641 at the end of 2004 (see chart 2).

Chart 2 Exchange rate of RMB/EUR, RMB/JPY and RMB/HKD



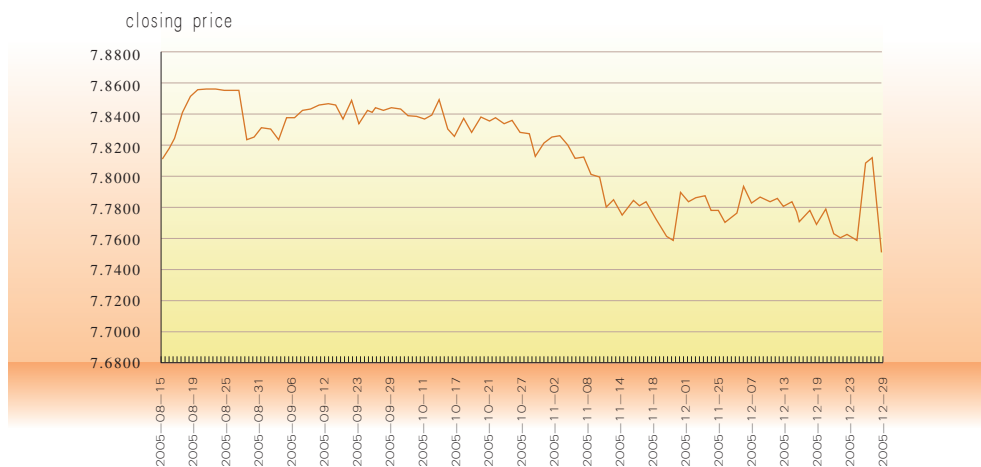
Start up of inter-bank foreign exchange forward market

On August 15, 2005, the inter-bank market formally launched forward trading for RMB and foreign currency pairs. In 2005, the market recorded USD/RMB forward deals with 7 maturities: one-week, one-month, two-month, three-month, six-month, nine-month and one-year; and JPY/RMB forward deals with 4

maturities, one -week, one-month, two-month and three-month. Those deals were delivered either on a gross basis or on a netting basis. In 2005, the market recorded 277 concluded deals between different currencies, among which 263 were concluded in US dollar and 14 in JPY. The one-year and one-month USD/RMB forward were the most active maturities with greatest turnover in the market. In 2005, the inter-bank forward foreign exchange market recorded 98 trading days, with total turnover amounting to USD2.69 billion and daily average turnover USD27.45 million.

As the tendency of quotation of one-year USD forward transactions demonstrated, forward exchange rate of USD/RMB kept relatively stable with slight depreciation. At the very beginning when the one-year USD forward was introduced in the market, the price went upward and then kept stable. In August, it came back to its original level and maintained stable over a relatively long period of time. The price revealed a declining tendency in November but stopped declining in December. Towards the end of December, it rebounded by a big margin and afterwards declined drastically, closing at a year-low of 7.75 (see chart 3).

Chart 3 Quotation on one-year USD/RMB forward in the inter-bank FX market



Reform of RMB Exchange Rate Mechanism

Improving the exchange rate formation mechanism of the Renminbi by giving full play to the market is always an unswerving objective of China. After the dual exchange rates were unified in 1994, China adopted a managed floating exchange rate regime based on market supply and demand. During the Asian financial crisis period, China narrowed the floating band of the RMB exchange rate so as to curb deterioration of the crisis.

From July 21, 2005 onwards, China started the implementation of a managed floating exchange rate regime based on market supply and demand with reference to a basket of currencies. The main content of this round of reform include the following three aspects:

First, change of exchange rate adjustment method. A managed floating exchange rate regime was adopted which is based on market supply and demand with reference to a basket of currencies. The exchange rate of the RMB is no longer pegged to the US dollar; instead, it is floated according to supply and demand of the market with reference to a basket of currencies. A "basket of currencies" here refers to some major currencies which are selected to form a currency basket endowed with corresponding weights according to the actual performance of China's external economy. The exchange rate of RMB is managed and adjusted in accordance with the economic and financial situation at home and abroad, and on the basis of market supply and demand; and the change of the multi-lateral exchange rate indexes of the RMB is calculated with reference to the said currency basket, so as to maintain the basic stability of the exchange rate of the RMB on an adaptive and equilibrium level. This will help increase the flexibility of the exchange rate, curb the one-way speculation, and maintain the stability of the multi-lateral exchange rate.

Second, change of parity formation and daily floating band. At the end of each business day after the market is closed, the People's Bank of China publicizes the closing price of the exchange rate on that day, which will act as the middle price for the transaction of the relevant currency against the RMB on the next business day. At the current stage, the daily floating band of the exchange rate of RMB/USD in the inter-bank foreign exchange market remains $\pm 0.3\%$ of the central parity of USD/RMB publicized by the People's Bank of China, while the floating band of non-USD currencies against RMB is $\pm 3\%$.

Third, adjustment of initial exchange rate. At 19:00, July 21, 2005, the central parity of the US dollar against the RMB was adjusted to RMB 8.11 per US\$ 1.00 as the middle price for trading among designated banks in the inter-bank foreign exchange market on the next business day; and from that time on, the designated banks could adjust the listing exchange rate for their clients. Reform of the exchange rate system of the RMB focuses on the exchange rate formation mechanism of the RMB instead of the quantitative change of its level. The scale of such an adjustment is mainly defined by China's trade surplus degree and the requirement of structural adjustment, with domestic enterprises' adaptability to structural adjustment being taken into consideration.

On January 3, 2006, another adjustments was made in the formation of the central parity of the RMB against the US dollar, regulating that the China Foreign Exchange Trading Center enquire prices from all market makers before the opening of the inter-bank foreign exchange market on each business day, and then calculates the weighted average of the remaining prices in the sample as the central rate of the RMB against the US dollar for the day, excluding the highest and lowest offers. The weights shall be determined by the China Foreign Exchange Trading Center in line with the transaction volumes of the market makers in the inter-bank foreign exchange market as well as other indicators such as the quoted prices etc. The designated foreign exchange banks may, on the basis of the said central rate, quote selling and buying prices of various currencies to customers at their own discretion within the specified limit of spread stipulated by the People's Bank of China.

After this round of reform, the overall operation of the foreign exchange market is smooth. The RMB exchange rate becomes more flexible, with small fluctuations and a slightly appreciating trend. The number of market participants keeps increasing; new products are introduced one after another; and the trading volume increases significantly.

Statistics and Monitoring of Balance of Payments

China's Balance of Payments Report made public for the first time. In order to help the public understand the general picture of balance of payments, to explain the data of balance of payments, and to analyze the balance of payments situation, *China's Balance of Payments Report* was made public in 2005 for the first time; and hereafter, it would be published semiyearly. The *China's Balance of Payments Report* of the first half of 2005 presented the major characteristics of balance of payments changes of the first half of 2005, analyzed the interaction between the international and domestic economic situation and balance of payments, evaluated the overall situation and major problems of the current operation of balance of payments, and forecast the trend of balance of payments and policy orientation of the next stage.

Improvement of the compiling methods and working system of Balance of Payments Statement and International Investment Position Statement. The quarterly Balance of Payments Statements (hereinafter referred to as BOP statements) were brought to perfection. The statistical methods and rules of some items such as the current transfer were improved. Working ideas were put forward for improving the BOP and IIP statistics. The statistical relationship between BOP statement and IIP statement were coordinated. The Renminbi business in Hong Kong and Macau was incorporated into statistics.

Further upgrade of the BOP statistical and monitoring system. A series of work came to an end such as the record of domestic banks' international receipts and payments documents, the analysis of the functional requirements of the new BOP system and the writing of the explanation for the functional and technical requirements, the development, testing and acceptance of the bank's data interface program, the update of the basic information and codes of the reporting units and financial institutions. The historical data in the existing system was dealt with and the conditions for running the new BOP statistical and monitoring system were fulfilled.

Update of the meta-data of the general data dissemination system (GDDS). According to the process of upgrading the BOP statistical and monitoring system, the meta-data of GDDS was updated and reported to the National Bureau of Statistics and the International Monetary Fund on time.

Improvement of the BOP risk early-warning system. The balance of payments risks were assessed quarterly, and the potential risk factors were analyzed in time. In light of the experience and theories of dealing with the crisis by other countries,

research on establishing the *market expectation survey system* was on the way and the responding plan for BOP crisis would be perfected.

Enhancement of the checking of the BOP indirect reporting data. Main tasks were to innovate new checking methods, enhance the frequency, enlarge the application of the checking software, improve the efficiency, and enhance the cross-check of the data, especially monitor the abnormal cross-border capital flows. The on-spot check of the banks and reporting units was enhanced to ensure the statistical data being reported in good order.

In 2006, the general thoughts on the work of BOP statistics are: to further upgrade the BOP statistical and monitoring system, to perfect the compiling methods of BOP statement and IIP statement, to enhance the monitoring and analysis of the abnormal cases in cross-border receipts and payments through banks, and to conduct the analysis of the abnormal cross-border capital flows and give early warnings in terms of the situation of capital inflows.

New BOP Statistical and Monitoring System

In September 1995, the People's Bank of China published *Regulations on Reporting of Balance of Payments Statistics* which requires that clients conducting international receipts or payments transactions through domestic banks (hereinafter referred to as reporting units) should make the balance of payments statistical reporting (hereinafter referred to as BOP indirect reporting). The present procedure is: the reporting units fill in the paper reporting form and hand it to the bank, and then the bank inputs the information into the BOP system. While the bank is burdened with heavy workload, there is the possibility of error inputting. More and more reporting units hope to utilize advanced technical means to expand the avenue of reporting so as to reduce burden and improve efficiency.

The requirements for bank's international receipts and payments data by BOP indirect reporting and imports and exports verification system have been taken into consideration when the new BOP statistical and monitoring system is designed. Uniform documents have associated the BOP indirect reporting, imports and exports verification system, bank's relevant business, and then bank's accountancy and international settlement system. The new system is helpful to ensure integrity and accuracy of the BOP indirect reporting data and verification data, and meanwhile to reduce the burden of banks, reporting units and SAFE branches, and to cut down the cost of documents.

The new system supports the data transformation between the BOP system and bank's own computer business system through the data interface program, which will change the status quo of manually inputting the data for a second time. In addition, the reporting/verifying units may, via the internet reporting system, choose to conduct BOP reporting and verification simultaneously, or make the BOP reporting before the verification, in both cases, the reporting procedure is simplified.

Foreign Exchange Administration under Current Account

The administration of import and export verification was improved and the verification procedures of enterprises were simplified. The procedures of verification of payments on import and export, supervision and filing of payments on import, approval of vouchers in payments on export were simplified; the range of balanced verification of payments on exports was expanded. The "networking reporting for verification approval system" was promoted in 16 SAFE branches including Guangdong, Tianjing, Liaoning, and Shandong. Up to the end of December, the system was in operation in 16 branches, 68,174 enterprises opened account in the system, 560,700 verification transactions were done, 5.5341 million verification statements had passed verification, the amount sum up to US\$151.7 Billion. Remote verification and substituting verification administrative methods were promoted. Up to the end of December, 95 SAFE sub-branches opened remote verification operations, 1,323 enterprises made 95,100 remote verifications, the amount sum up to US\$3.123 Billion. The verification under tourism items was cancelled and the inconsistency of goods flow and cash flow under this item was solved.

Limits on foreign exchange current account were adjusted and the needs of enterprises were met. In order to facilitate the enterprises in managing proprietary foreign exchange, the administrative policy on current account was adjust twice, in February and August. After adjustments, the proportion of foreign exchange cash retained in current account of domestic entities increased to 50 percent or 80 percent; allowance time of selling excess foreign exchange increased from 10 working days to 90 callender days; the range of entities with current account balance ceilings of 100 percent prescribed as last year foreign exchange income is expanded, import and export enterprises and manufacturing enterprises with actual needs can have current account balance ceilings of 100 percent prescribed as last year foreign exchange income with approval from the SAFE.

Documents and procedures of domestic individual purchase for private purpose were simplified and the standards of individuals' foreign exchange usage were increased. The guidance quota on foreign exchange purchase by domestic individuals for private purpose under current account is increased from the equivalent of US\$3,000 and US\$5,000 to the equivalent of US\$5,000 and US\$8,000 respectively. Meanwhile, the vouchers of individual foreign exchange purchase were greatly simplified, especially under self-financed overseas study item. Individuals were allowed to repay their overseas consumption or overdrafts using domestic bankcards with purchased foreign exchange. The standard of

deposit that self-financed students prepay for visa to a domestic bank was lowered to 2,000 RMB.

Pilot reform on foreign exchange administration under trade of service was promoted and efficient and appropriate methods of administration were explored. Experimental transnational corporations can collectively manage foreign exchange under current account, with approval from the SAFE. In Pudong District of Shanghai, regional headquarters of domestic- and foreign-invested transnational corporations can collectively deal with foreign exchange payment on import and export with treasury management center of the parent corporation outside the territory, with the trust from domestic member companies and subsidiaries. The verification power of SAFE branches and banks on “ item with no clear requirements in current laws and regulations ” was increased. Trade of service under the equivalent of US\$5000 is no longer required to submit a tax voucher. Small sum trade of service, which is too flexible to provide the contract or receipt one by one, is not required to submit voucher statements.

Trade financing behaviors were regulated and administration on foreign exchange trade capital flow was improved. The importer making foreign exchange payment, when the amount to be paid of a single declaration form is no less than the equivalent of US\$500,000 (including US\$500,000), and the planned date of payment is more than 90 days(including 90 days) beyond the date of import, shall go to the exchange administration agency concerned to go through the formalities of deferred payment registration(except that which has gone through the formalities of external debt registration). A remittance from overseas of advance collection of export proceeds and collection for entrepot trade equivalent to more than US\$200,000 (including US\$200,000) shall be transferred by the bank to a pending surrender account opened by the collecting units. For surrendering the foreign exchange funds in their pending surrender accounts, the collecting units shall submit to the banks a written explanation on the nature of the funds and relevant evidence and follow the relevant stipulations.

Foreign exchange administration in special areas was further developed. Pilot reform of foreign exchange administration policies in Shanghai Bonded Logistical Area and Suzhou Bonded Logistical Center was approved. The problem that goods flow cannot match capital flow in storage and logistics industry was solved. Deep processing and transfer in export processing areas between the transferor within the export processing areas and the transferees outside of the areas was regulated. Transfer of foreign exchange collected from overseas by the enterprise within the bonded areas to the enterprise beyond the bonded areas was regulated as well.

In 2006, the principal idea of foreign exchange administration under current account is to implement the measures of foreign exchange administration reform, including reforming the verification system of import payment and export proceeds, implementing new method of administration on foreign exchange transactions on trade of service, further decentralizing the jurisdiction, simplifying the procedure and reducing the requirement on documentation, differentiating the transactions between current account and capital account and improving the regulation of individual foreign exchange transactions, adjusting administrative policy on foreign exchange accounts under current account and improving the administrative information system for foreign exchange accounts, carrying out the policies on collecting payments in transnational corporations.

Historical Change of Verification System on Importing and Exporting

The verification of payments on importing is an administration system in which the SAFE, based on the amount of payment, conduct verification on the importing entities to check whether actual and enough goods has been imported. The verification of payments on exporting is an administration system where the SAFE, based on the value of export, conduct ex post verification on an exporting entity to check whether an appropriate amount of foreign exchange has been received into a domestic entity. Through the verification system of payments on importing and exporting, the SAFE can understand the authenticity of foreign exchange flows in the trading by enterprises; hold back such illegal activities as dodging, cheating, evasion and illegally holding foreign exchange abroad; prevent foreign exchange resources from losing, and helps the Custom and Tax functions in preventing illegal activities such as smuggling and tax evasion. In recent years, a series of reforming measures has been taken on the verification system on importing and exporting, in order to adapt to the developments of the economic and trading situations.

- The system is improved to facilitate the operation of enterprises. In January 1991, the verification system of payments on exporting was introduced. In July 1995, the supervision system was pegged up with the tax refunding system on exporting, and regulation coordination was enhanced. In December 2001, balance verification was introduced on enterprises that meet certain standards. In October 2003, based on the deal by deal verification, sector regulation was introduced such that batch verification and automatic verification were applied on different kinds of enterprises. In 2005, a remote verification system was introduced in Mid-West China.

In 1994, the verification system of payments on importing was introduced. In 1997, the verification function was transferred from banks to the SAFE to enhance its authority and effectiveness. In 1998, some categories of payments were required to be checked ex ante by the SAFE on the authenticity of trades, the supervision on payments on importing by high risky business and enterprises was enhanced. From 2000 to 2004, policies were carried out concerning categorized verification and payments based on custom declaration, differential verification, import record and reference management, and import payment verification with the vouchers of foreign exchange collection.

- The electronic administration methods were upgraded. In 1998, “The Supervision system of payments on importing” was set up, and the supervision of verification on the payments on importing by importing entities can be done electronically. In 1999, electronic data collecting of payments on importing was introduced, and banks send electronic verification data to the supervision departments. In the same year, the SAFE, in cooperation with the General Administration of Customs (GAC), developed the “networking Inspection system on Importing declaration” and conducted networking inspection on the authenticity of the importing declaration. In 2001, the importing and exporting payment system of China Electronic Port started operating, data could be shared among the SAFE, the Custom and enterprises, therefore illegal activities such as foreign exchange evasion and tax cheating by fake statements were hold back effectively and paper-based operations in enterprises were reduced. In October 2003, “the verification of exporting system” started operating; and electronic data collecting on verification information of exporting was realized. In 2005, a “net working verification of exporting system” was promoted, as a result, enterprises can be doing verification operations in Internet, and administration cost is reduced.
- Administration procedures were simplified. In 2003, policies on payments and verification of prepaid exporting were loosened; policy on “transit trade, goods used for projects abroad and excess proportion and amount of prepayment” was cancelled. In 2004, automatic verification of imports under the item of remittance on delivery was introduced. In 2005, the SAFE put on strength on simplifying the administrative procedures, cancelled “Import entity on custom declaration inconsistent with the payment entity” filling policy, loosened “Payment at different place” filling policy and “Importer List of External Payment in Foreign Exchange ” administrative policy. Verification procedures of payments on import under trade items and part of payments on export were simplified, and the balanced verification categories expanded.

In the next step, with the help of an advanced information system, the SAFE will construct a convenient and efficient administrative system on foreign exchange under trade item, develop an off-site surveillance system on payments of import and export; and on the basis of accurate and thorough electronic information of the goods flow and cash flow, carry out the reform on enterprise foreign exchange administration, from deal by deal verification to sum surveillance, from on site verification to offsite surveillance, from supervision on activities to regulation on entities; and further strengthen the statistical, monitoring, analyzing and warning functions on cross border payments under trade items.

“Nine Experimental Policies on Foreign Exchange Administration” Carried Out in Pudong, Shanghai

In order to facilitate trade and investment, deepen the experimental reform in Pudong, Shanghai, the SAFE and its Shanghai branch continue to cooperate with the Pudong local government. On Oct 21st, 2005, nine experimental policies on foreign exchange treasury management in transnational corporations were carried out.

- Under the current legal framework on loan trust, qualified transnational corporations can manage the foreign exchange of domestic member corporations collectively, in a daily collecting frequency.
- Regional headquarters of transnational corporations, who has set up financial or treasury management center in Pudong, can open offshore accounts in domestic banks to collectively manage foreign exchange from member corporations abroad, and foreign exchange of domestic member corporations that has been approved by the SAFE to be used as loan abroad.
- Qualified Chinese and foreign invested transnational corporations can use the RMB profit that has been allocated to the foreign investor but not remitted and the RMB profit that will be shared pro rata between foreign investors for lending as loan abroad. RMB forward conversion, sales and foreign exchange swap under such lending, is allowed.
- The limitation of foreign exchange use for lending abroad is appropriately eased for experimental Chinese-invested corporations that do have reasonable need; and the range of experiment on cross border management of funds is expanded to support corporations, pursuit of the “Go Global” strategy.
- With the trust from domestic member companies and subsidiaries, regional headquarters of Chinese and foreign invested transnational corporations are allowed to collectively deal with foreign exchange payment on import and export with treasury management centers of their parent corporations outside the territory.
- The procedures of sale and payment of foreign exchange under non-trade items were simplified; and efficient and appropriate regulating methods for non-trade items were explored. For the non-trade items which are not explicitly defined in current law and regulations, transactions under US\$100,000 (inclusive) or equivalent may be verified and done by banks, transactions over US\$100,000 or equivalent should first be verified by SAFE's Shanghai branch with the payment procedures being executed later in banks. The link of approval by SAFE head office is cancelled. Tax voucher requirement is cancelled for foreign exchange sale and payment under small sum non-trade items; and transnational corporations can directly execute exchange purchase and payment in banks, with contracts or receipts.
- Qualified enterprises are encouraged to enter the interbank foreign exchange markets and consolidated calculation is allowed for previous year's sum of cross border payments or of export and import of their domestic member corporations.
- Chinese and foreign invested banks are encouraged to make innovations in financial derivatives for the conversion of RMB to foreign exchange; banks that have been approved by the CBRC to trade financial derivatives can open RMB cross currency product business which has been examined and deemed to meet the requirements of foreign exchange administration by SAFE Head Office.
- A monitoring and evaluating system on foreign exchange flow in the regional headquarters of transnational corporations is to be set up, and the cost of exchange earned by export, the cross border cash flow and the result of experiments in all the experimental transnational corporations are to be monitored and evaluated.

Foreign Exchange Administration under Capital Account

Further deepening the reform of foreign exchange administration of overseas direct investment and supporting domestic enterprises' "going abroad". The pilot reform has been expanded to the whole country with increase of annual total quota of foreign exchange purchase and examining and verifying authority limits of SAFE branches at the provincial level. A more flexible policy has been adopted for external direct investment in the border areas by enlarging examining authority limits over such investment, simplifying procedures and providing facility for external direct investment in kind. As for the external financial guarantee by domestic banks for overseas direct investment enterprises, the policy of annual balance control has been put into effect; and the scope of guaranteeing banks and beneficiaries has been extended in order to help the "going-abroad" enterprises resolve the follow-up financing problems. Overseas equity financing and round tripping investment by domestic institutions and individuals in the form of special purpose vehicle is regulated. Raised capital is allowed to use abroad in accordance with the prospectus. In 2005, the SAFE approved 946 overseas direct investment projects, 31.94 percent higher than that of 2004; and negotiated investment amount was US\$ 6.641 billion, 99.38 percent higher. In the same year, the SAFE verified US\$4.569 billion for external direct investment, 2.3 times than that of the previous year, of which US\$2.661 billion was paid by purchase of foreign exchange, increased by 2.8 times.

Improving external debt control and strengthening capital flow monitoring. A registry and filing policy on import deferred payment was implemented and deferred payments over US\$ 200,000 with maturity over 180 days were incorporated into the coverage of external debt. External borrowing by certain types of foreign invested enterprises, including those with foreign investment less than 25 percent was normalized; and overseas relevant companies' capital used by transnational companies in China was put under external debt control. Research on external contingent liability and external debt analysis system was carried out vigorously; and a high-frequency debt monitoring and early-warning and analysis system is being developed, for strengthening foreign exchange risk monitoring.

Positively expanding the channel of capital outflow, and steadily promoting the liberalization of financial investment. The size and coverage of qualified foreign institution investors (QFII) was further enlarged, guided in making rational adjustment of the development of their assets; and investors' structure was improved so as to promote the development of the domestic capital market. Efforts were made on the administration of RMB bonds issued in China by international development institutions. In 2005, the SAFE approved 18 QFII

investment quotas, with a grand total of US\$ 2.22 billion, of which, US\$0.695 billion was 7 QFIIs' initial investment quota; and US\$1.525 billion was the increased amount of 10 QFIIs' quota. Total capital inflow by QFIIs over the year was US\$1.424 billion and total outflow was US\$1.2 million. In October 2005, approved by the State Council, the Asian Development Bank and the International Financial Company issued RMB denominated bonds in the inter-bank bond market with amounts equivalent to US\$ 1 billion and US\$ 1.13 billion respectively. The foreign exchange policy on overseas listing was improved and the time limit on the repatriating of capital raised abroad by listing companies was extended. With approval of the SAFE, capital raised abroad may be deposited abroad and be invested in structural hedging products issued by overseas account-opening banks.

In 2006, the main tasks and objectives of foreign exchange administration under capital account are as follows: further implementation of equilibrium management of capital inflow and outflow, and gradual promotion of capital account convertibility; improvement of the control of short-term debt to prevent speculative capital inflow; further deepening the liberalization of the capital market to promote the orderly and controllable capital outflow under capital account; intensification of statistic monitoring and early warning and exploration of the establishment of an overall administration system of external contingent liability.

Round-tripping Investment

Round-tripping investment refers to the investment by domestic residents in an economy who transfer their capital or equity abroad and reinvest the capital or equity back into the economy in the form of FDI. Round-tripping investment generally has the following features: firstly, the domestic and overseas company holding relationship is relatively complicated and domestic residents own the final holding. Secondly, the register place of the overseas company is usually in an international tax-evasion area or an offshore financial center. Thirdly, for various reasons, the relevant capital outflow usually does not follow normalized overseas investment approving and verifying procedures. Round-tripping investment may take different forms. For example, purchasing or replacing domestic enterprises' equity formerly owned by domestic investors; setting up foreign invested enterprises to purchase or control domestic assets by negotiation in the name of the enterprises; purchasing domestic assets through negotiation and setting up foreign exchange enterprises with the assets purchased; increasing investment in domestic enterprises and so on.

In recent years, the round tripping has been increasing remarkably. Due to lack of regulation and transparency of such capital flow, some enterprises or individuals conducted overseas financing through nontransparent channels. Although their financing needs had been met, there was no adequate legal protection for the domestic and overseas investors' rights and exist some obstacles to capital inflow and outflow due to high operation cost and insufficient legal protection. Meanwhile, such problems as the loss of rights and interests for the related enterprises, and illegal capital flight may be triggered off to the detriment of China's economic development.

In order to regulate the round tripping investment, the SAFE set forth some relevant regulation to make it clear that domestic individuals shall go through the registry procedure for setting up special purpose companies abroad. Domestic enterprises are allowed to make interest payment, settlement, equity transfer, capital reduction and so on with special purpose companies.

External Contingent Liabilities

In accordance with the definition by the IMF, contingent liabilities are obligations that arise from a particular, discrete event(s) that may or may not occur. A key aspect of such liabilities, which distinguishes them from current financial liabilities, is that one or more conditions or events must be fulfilled before a financial transaction takes place. The uncertainty is destructive and not easy to monitor in financial crises and turbulence. It is meaningful for promoting general balance of international payment and maintaining financial stability to make research on external contingent liability.

Classified according to the types of debtors, China's external contingent liabilities mainly conclude:

- (1) Off-balance business in commercial banks, such as loan guarantee, acceptance, standby L/C, credit overdraft and so on.
- (2) External contingent liability of the securities company, such as off-balance business loss, external guarantee.
- (3) External contingent liability of an insurance company, such as external guarantee, requirement for cross-border insurance, financial derivative instruments.
- (4) Potential cross-border capital flow by enterprises, such as undistributed profit and distributed but not-paid profit of foreign invested enterprises, loan by Chinese-funded overseas institutions and so on.
- (5) The contingent liability assumed by the government, such as external borrowing with government guarantee.

China has already set up a statistic system for the administration of some contingent liabilities such as external guarantee, overseas futures exchange of the domestic companies and the guarantee by overseas entities for the domestic borrowings. However, the administration and statistic system for external contingent liability is yet to be improved. The SAFE is making efforts to set up an overall management system for external contingent liabilities.

Development of Foreign Exchange Business of Financial Institution

Banking institutions

Loosening the limit to forward purchases and sales of foreign exchange, and introducing RMB against foreign currency FX swaps. The number of banks approved to engage in the business of forward purchases and sales of foreign exchange increased. Banks are permitted to engage in this business after registering for record if only they have the qualification for spot purchases and sales of foreign exchange and derivatives activities, and have not grossly violated foreign exchange regulations over the previous two years. A bank can quote price according to its capacity and risk management, and may determine on its own transaction term and the times of rollover. The business range was extended to all items under current account, and some items under capital and financial account. Banks are permitted to engage in RMB against foreign currency FX swaps not involving interest rate swap after registering for record only if they have had the qualification for forward purchases and sales of foreign exchange for more than 6 months. The transaction volume of forward purchases and sales of foreign exchange in 2005 came to USD 27.98 billion, up by 65.2 percent over the previous year.

Management of banks' overall position. In accordance with the principle of market orientation, risk controllability and gradual promotion, the supervisory emphasis of foreign exchange position was altered from turnover position to overall position of purchases and sales of foreign exchange since September 2005. Overall position of purchases and sales of foreign exchange was defined to include the transactions of purchases and sales of foreign exchange and inter-bank foreign exchange transactions. The principles of position supervision for Chinese and foreign banks were united, and the overall position limits were increased properly to enhance the flexibility and initiative of banks.

Improving the statistic supervision on the purchases and sales of foreign exchange by designated banks. With the development of the situation of foreign exchange receipts and payments and the change of foreign exchange administration, former statistics system of purchases and sales of foreign exchange was no longer adequate to meet the demand of off-site supervision on foreign exchange receipts and payments of banks whether in terms of transaction classification, transaction participants, and the design of statistical range or in terms of technical function for data analysis. In order to further enhance the efficiency of statistic supervision on the purchases and sales of foreign exchange, the SAFE upgraded the former statistics system in 2005; and officially launched the new version of statistics

system in January 2006.

Improving the supervision over the purchases and sales of foreign exchange by rural credit cooperatives. On the basis of administrative experience of purchases and sales of foreign exchange by pilot rural credit cooperatives, the supervision over the purchases and sales of foreign exchange by rural cooperative financial institutions was tightened according to general principle of steady promotion, classification of responsibilities and rights, strict approval of entry, and tightening supervision. At the same time, the SAFE attached importance to the overall planning and all-round consideration of such policy targets as supervision and administration, risk management and services in support of agriculture.

Supporting the reform of commercial banks, and resolving foreign exchange risk exposure of banks. The SAFE has made great efforts to resolve foreign exchange risk position caused by mismatch of different currencies in the balance sheets of commercial banks in line with foreign exchange administration policy, and to cultivate a favorable policy environment for the sound operation of commercial banks.

Standardizing and supporting the development of financing business of banks. The SAFE has endeavored to make policies and the environment favorable for the development of banks' financing business, and to encourage all kinds of product innovations which meet the demands of the market, aim at safety and profitability and tally with regulations of foreign exchange administration. The SAFE conducted compliant check on the cross-currency financing business of 8 banks in 2005.

By the end of 2005, 27000 financial institutions had been approved to engage in the business of purchases and sales of foreign exchange all over the country; 46 banks had registered forward purchases and sales of foreign exchange for record; and 7 banks had registered RMB against foreign currency FX swaps for record.

Securities institutions

The administration of foreign exchange related to securities companies was further standardized. The SAFE, together with CSRC (China Securities Regulatory Commission) and CICC (China International Capital Corporation Limited), approved its business of management of foreign exchange assets.

In 2005, 26 securities companies were newly approved to conduct foreign exchange business, or were approved to change their License for Securities-related foreign exchange Business when their former license expired. At the end of 2005, there were 114 securities companies nationwide qualifying for conducting foreign exchange business.

Insurance institutions

Improving the administration of overseas investment of insurance foreign exchange. In order to intensify the administration of overseas investment with insurance foreign exchange funds and regulate the operation of such investment so as to prevent market and operational risks, the SAFE together with China Insurance Regulatory Commission has defined the responsibilities for the supervision of overseas investment with insurance foreign exchange funds and worked out detailed regulations regarding the investment products and investment behavior.

Facilitating the development of foreign exchange business of insurance institutions. Insurance companies and insurance assets management companies are encouraged to enter the inter-bank spot foreign exchange market in accordance with their business needs. The procedure and the voucher for insurance companies and insurance agencies to make fee payment or advanced fee payment under service trade to overseas home companies are standardized; and the procedure for them to conduct some business under capital account is made clear.

At the end of 2005, there are 63 Chinese-funded and foreign-funded insurance companies that have been approved to conduct foreign exchange business.

Furthermore, the SAFE is energetically pushing forward with a pilot project of trust investment company doing foreign exchange trust business. It allows domestic institutional customers with relatively affluent foreign exchange capital to use their funds in a pool by way of entrusting the funds to a trust investment company under effective supervision. At the end of 2005, a total of eight foreign exchange trust plans run by five trust investment companies have been approved; and the raised funds are used in various areas such as loans, capital securitization, principal-hedge structural product investment and so on.

Supervision of Foreign Exchange Market

The range of participants in the inter-bank Foreign Exchange (FX) spot market was expanded. Qualified non-financial enterprises and non-banking financial institutions were allowed to directly trade in the inter-bank FX spot market. In the end of December 2005, a non-financial enterprise was approved to enter into the inter-bank FX spot market.

Transaction mode in the inter-bank FX spot market was diversified. The over-the-counter (OTC) approach was introduced into the inter-bank FX spot market, and members in the inter-bank FX spot market can engage in foreign exchange transactions either based on the original mode of centralized credit authorization, price bidding and net settlement or on the OTC market of bilateral credit authorization, bidding and settlement. Market maker system was introduced in the inter-bank FX spot market.

Trading products in the inter-bank FX market were increased. In 2005, transaction of the inter-bank foreign currency pairs was introduced. Transactions of eight pairs are available. Qualified members in the inter-bank FX spot market were permitted to trade in the inter-bank FX forward market. Meanwhile, members that had had the qualification to deal with FX forward transactions for more than six months were allowed to deal with inter-bank swaps transactions.

Management of the central price and quoted price to customers by designated foreign exchange banks was improved. On July 21, 2005, the floating band of RMB exchange rate against non-US dollar currencies in the FX spot market was unified. On September 23, 2005, the floating band of RMB exchange rate against non-US dollar currencies in the FX spot market was widened from ± 1 percent to ± 3 percent. Management of US dollar exchange rate quoted by designated foreign exchange banks to their customers was modified; and banks were allowed to practise multi-price and to widen the spread between the selling rate and buying rate. They could quote different US dollar prices rather than only one price to their customers within a business day. The limit on the spread between the selling and buying prices of non-US dollar currencies was abolished; and banks now have the discretion to decide the prices of non-US dollar currencies against the RMB within the specified limit on price spread. Banks may negotiate with customers on the quoted prices, or entitle their branches to determine the quoted prices.

The main thoughts of further developing the FX market in 2006 are: to improve the financial service of foreign currency exchange in small sums; to increase participants in the inter-bank FX market; to provide more institutional convenience to financial institutions for them to run their business independently so as to guard against exchange rate risks for themselves and for their customers; and to enhance the monitoring and management of systematic market risk.

Foreign Exchange Inspection and Regulation Enforcement

Illegal foreign exchange transactions were dealt with severely and the foreign exchange market was rectified and regulated. In 2005, 1398 cases involving illegal foreign exchange transactions were investigated nationwide, 1339 cases were wound up with the amounts of fines and confiscations totaling RMB101 million. In close cooperation with public security agencies, the SAFE cracked down on 47 underground money shops and dens of illegal foreign exchange transactions involving over 10 billion yuan of illegal transactions. Case seized was equivalent to RMB31 million, and fines and confiscation totaled over RMB10 million. The investigation and punishment of major and important cases improved the environment of the foreign exchange market and effectively maintained its order.

Special inspections were conducted with view of the foreign exchange payment situation. Some inspections aimed at the overall situation of foreign exchange capital inflow, covering foreign exchange sale of equity capital and external debt, advance collection of exports, and foreign exchange sale of individuals. The SAFE launched a special survey and inspection on foreign exchange payment between domestic residents and offshore companies in order to prevent illegal activities including fake foreign direct investment, foreign exchange purchase fraud and illegal foreign exchange transaction from spreading. The SAFE also launched a compliance inspection on the foreign exchange business by foreign-funded banks in China. Other special inspections were conducted on foreign exchange receipts and payment of international travel agencies, real estate companies and airline companies, and so on in light of the conditions in different localities.

Abnormal cross-border capital flow was monitored and anti-money laundering was intensified from the perspective of foreign exchange administration. A foreign exchange anti-money laundering information system was developed and implemented in the SAFE and its subsidiaries, which has improved the collection, aggregation, sorting out and analysis of anti-money laundering data. The SAFE actively coordinated with the People's Bank of China on integrated supervision of local and foreign currencies, and actively participated in international cooperation and communication in term of anti-money laundering. In 2005, The SAFE, by means of the anti-money laundering system, monitored 6.3185 million large-sum and suspicious foreign exchange transactions with a total amount of US\$2053.102 billion. By sorting out and analyzing relevant data, the SAFE investigated and dealt with 87 cases in violation of regulations on foreign exchange administration involving US\$115 million; and assisted the

judiciary and other law enforcement agencies in detecting 127 cases involving US\$536 million.

Great progress was made in the establishment of a foreign exchange credit system and positive advance was achieved in the experimental disclosure of (negative) information on illegal foreign exchange activities. The disclosure of (negative) information on illegal foreign exchange activities was launched when a pack of information of illegal foreign exchange cases dealt with by the SAFE and its branches in Liaoning, Hebei and Shenzhen was released on the SAFE website on August 1st. The information was disclosed by the way of public release and website search for society, an important step taken by the SAFE in making government affairs public and law enforcement transparent.

The principal ideas governing foreign exchange supervision and inspection in 2006 are as follows: conduct purposeful special inspections in light of new situation and problems emerging from foreign exchange payment and international payment, and intensify the inspection on short-term capital inflow and foreign exchange sale; further rectify and regulate foreign exchange market and severely crack down on various illegal foreign exchange activities; promote information disclosure of illegal foreign exchange activities nationwide and speed up the establishment of a foreign exchange market credit system.

Disclosure of (negative) information on illegal foreign exchange activities

As of August 2005, the SAFE disclosed the (negative) information on illegal foreign exchange activities on its website. The information to be disclosed would include the offender, the subject, the illegal act, the amount of illegal fund, the punishment and the execution of an illegal foreign exchange case. Two methods of disclosure are adopted: one is public disclosure; the other is website search. When the offence of an illegal foreign exchange case is outrageous, the amount of illegal fund is huge and its influence is widespread the former method will be used, that is, the case will be disclosed to the public on the SAFE website. The later will be used for the disclosure of information on general illegal foreign exchange cases that can be searched on the SAFE website when users input institution code of enterprises searched or ID number (or passport number) of individuals. The information of illegal foreign exchange activities first disclosed involved 34 enterprises and individuals, among which two cases were disclosed to the public and the other 32 cases can be searched on the website.

Management of State Foreign Exchange Reserves

Various operational activities were carried out actively with the portfolio investment benchmark as the core. Basing on deep-going researches, we carried out the optimization of the currency and asset allocation. We carried out dynamic operation by keeping a sharp eye on the trend of the foreign exchange and bond markets. Profitable transactions like the Repurchase Agreement and lending of securities were done vigorously. The investment of the reserves won good return.

Adjusting to the requirements of large-scale investment, the framework and process of reserve management and investment were further improved. The analytical framework for research on the fundamentals and financial markets were improved to reinforce our analysis and research on the international economy, the financial situation, hot issues and unexpected events in the financial markets. The investment decision-making committee mechanism and investment operational procedure were further improved, and enhance the support of the investment performance attribution analysis and risk management to the investment decision-making. International accounting principles were used to improve the accounting method and operational procedure of reserve management. The IT system construction was accelerated to increase the ability to cope with unexpected risks and events.

To assure the safety of reserve assets, the risk management framework was improved and the internal control regime was reinforced. Regulation construction to a larger extent was carried on, and risk analytical framework, index system and risk forewarning system were all further revised and improved. We strengthened the cross-examination and internal monitoring to ensure strict operational risk management. The internal audit and principal risk control were strengthened as well.

With "standardization, specialization and globalization" as the target of the team construction, more effort were made to build a professional team. Institutional culture was strengthened to maintain and inspire a stable professional team in reserve management. Comprehensive training was carried out for the whole staff to upgrade professional skill and quality. As required by the development of reserves management, human resources management was strengthened with more professionals joining the team.

Review of Global Economy in 2005

In 2005, the global economy maintained a steady growth, the rate of economic growth was 4.3 percent according to IMF estimation, slower than that of the previous year. Among the main developed countries, the U.S. economy performed best, but showed some sign of slowing down in the last quarter; the euro zone's economy was still sluggish in the first half of the year, and rallied somewhat in the second half pulled by export and consumption growth; Japan's economy maintained a stance of the recovery, mainly due to net export and capital expenditure of enterprises. The economic growth rate of the emerging economies in Asia, Eastern Europe and Latin America kept a moderate rate of growth.

The sharp rise of oil price brought significant pressure of inflation to the global economy. To avoid a cost-driven inflation caused by the rise of oil price, the FED raised the FED rate successively for 8 times from the year-beginning 2.25 percent to the year-end 4.25 percent; the CPI in the Euro Zone was relatively stable, however, at the end of the year, the ECB raised the benchmark interest rate to 2.25 from the historical low of 2 to control the rapid climbing price driven by oil price hike and strong growth of export and consumption; the BOJ still stuck to its loose monetary policy, though deflation in Japan has eased.

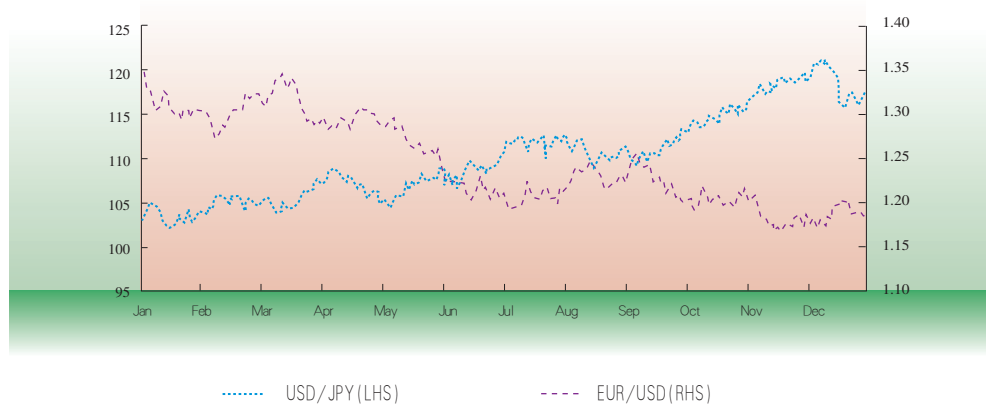
The imbalance of international trade remains unchanged. In 2005, the trade deficit of the U.S. reach a new historical high of USD 725.8 billion, and trade protectionism gained some new ground. Developed countries gained more comparative advantage in service trade, and manufacturing production was shifted to developing countries with a faster pace.

Review of Financial Markets in 2005

In 2005, there were no significant shocks in the financial market in general, but the trends of different markets showed quite big difference. The exchange rate of the US Dollar against other major currencies rebounded generally; the global bond market also experienced several obvious sideways movements, and overall returns went up somewhat; the major stock markets in the world showed a up trend, and the stock markets in Japan and Europe outperformed that in the U.S. The commodities prices especially the oil price rose sharply, and the crude oil price in the NYFE stayed around the historical high price of USD 60/barrel for a relative long period. The prices of gold and silver in the international commodity market went down first by a small margin and then reversed to rise significantly, reaching several historical new highs.

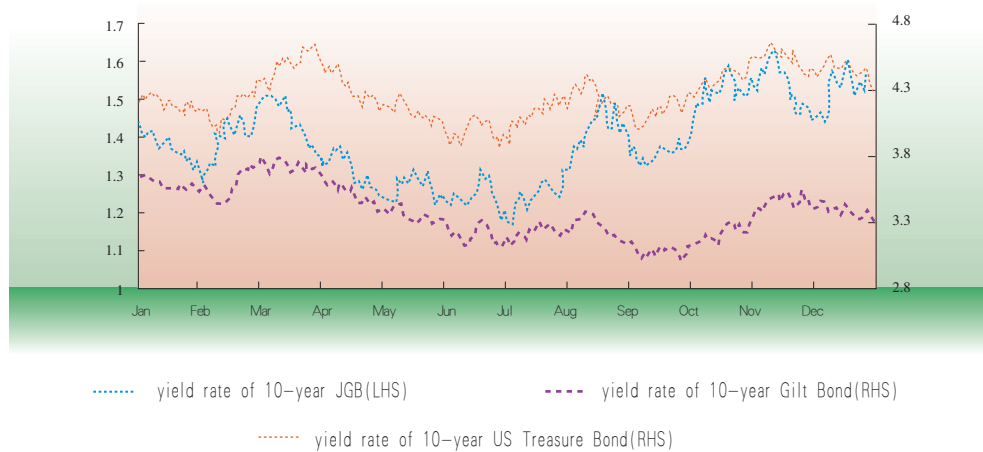
The US Dollar rebounded against other major currencies, and the foreign exchange market was highly volatile. The successive raising of the benchmark FED rate made the US Dollar a high yield currency with the ever-increasing interest rate difference over other major currencies, and the US Dollar turned into a strong currency against other major currencies. The Euro and the Japanese Yen fluctuated down. The commodity currencies like the Canadian Dollar, Australian Dollar and New Zealand Dollar showed relative resistance to falling. At the end of the year, EUR/USD was closed at 1.1849, 12.6 percent lower than 1.3554 at the end of the previous year, and USD/JPY was closed at 117.75, 14.7 percent higher than 102.63 at the end of the previous year. The Canadian Dollar against the US Dollar rose up by 3.3 percent; the Australian Dollar slightly fell by 6.1percent; the New Zealand Dollar fell by 4.1 percent.

EUR/USD & USD/JPY in 2005



The bond yield rate experienced sideways movements in the range. The yield rate in major international bond markets moved sideways and stayed at a relative low level generally. In 2005, the U.S. government bond experienced 3 rounds of up-and-down trend. At the end of the year, the U.S. 10-year treasury bond yield was closed at 4.391, 18.1 base points higher than 4.210 at the beginning of the year. The successive raising of interest rate made the short end of yield curve of the U.S. bond fluctuated up while the long end of the yield curve remained low, i.e. the yield curve was significantly flattened and even inverted, which means the rate of 2-year treasury notes became even higher than the 10-year treasury bond and the yield spread was narrowed to -0.85 base points at the year's end from 115.31 at the year's beginning. The trend in the European bond markets followed the U.S. bond market closely but the correlation has decreased. The yield rate of 10-year German Bond was closed 3.309, a drop of 37.4 base points from 3.683 at the year's beginning. In the first half year the JGB market performed well, but the yield in the market went down in the second half year. The 10-year JGB yield rate was closed at 1.480, 3.9 base points higher than 1.441 at the year's beginning. The bonds in the emerging markets outperformed other markets, and the spread between the J.P.Morgan's Emerging Market Bond Index (EMBI) and the U.S. treasury bond was narrowed from 348 base points at the year's beginning to 237 base points at the year's end.

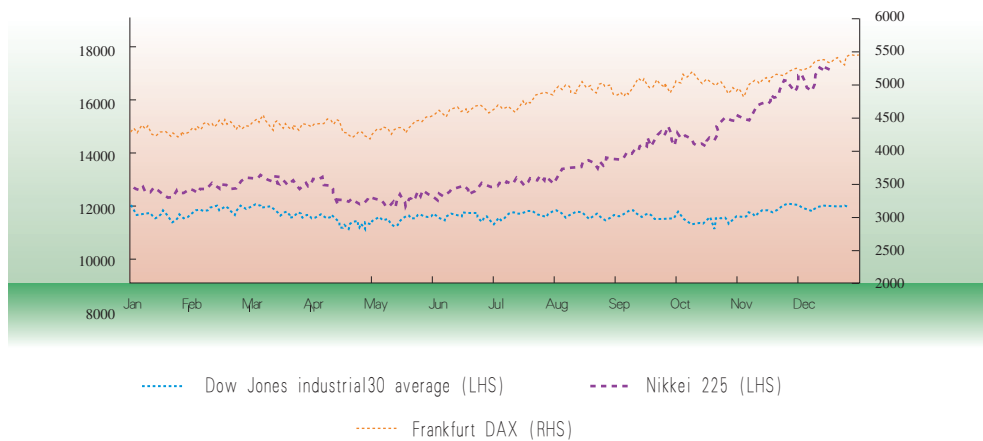
The trend of 10-year government bond markets in the U.S., U.K. and Japan in 2005



Major stock indices went up sharply in fluctuation. Impacted by both the positive factors like the economic growth and corporate profits improvement and negative factors like the oil price hike and nature disasters, the major stock markets showed an up trend in

fluctuation and the European and Japanese stock markets outperformed the U.S. stock markets. On December 31, 2005, the Dow Jones industrial 30 stocks average prices index closed at 10717.5, which declined by 0.6 percent from 10783 at the end of the previous year; the Frankfurt DAX index closed at 5408.2, 27.1percent higher than 4256.08 at the end of last year. The Nikkei-225 index was closed at 16111.43, which increased by 40.2% from 11488.76 at the end of last year.

The trend of major stock indices in the markets of the U.S., Germany and Japan in 2005



The prices in the international commodity markets surged sharply. Commodity price especially the crude oil price went up sharply under the influence of the relation between demand and supply, political events, speculative activities and natural disasters, etc.. In 2005, crude oil price in the COMEX reached USD 68.94/barrel in August. After a slight correction, the price closed at USD 61.04/barrel under the influence of the falling of temperature in most of the northeastern part of Northern America, an increase of 44.9 percent comparing with the price of USD 42.12/barrel at the end of the previous year. The Goldman Sachs Commodity Index (GSCI) of energy products and industrial metals climbed up by 31.2 percent and 36.3 percent respectively, while the prices of agricultural products remained almost unchanged.

The prices of gold and silver reached the historical new high. The gold market trend was influenced significantly by such factors like the US dollar exchange rate, the oil price, speculative capital and the relation between demand and supply. During the first 8 months in 2005, the gold price in international markets fell down slightly. Since September the gold price climbed up sharply and reached the historical new high price of USD 541/OZ on December 12, 2005, a new high within 25 years; the gold price closed at USD 517/OZ, an increase of 18.0 percent from the price of USD 438/OZ at the end of the previous year. The condition of the international silver market is similar to the gold market, and the silver price closed at USD 9.01/OZ, 40.3 percent higher than that at the end of the previous year.

Improvement of Rules and Regulations for Foreign Exchange Administration

Intensify the work on formulating rules supporting the Administrative License Law. Retained items subject to administrative license were cleared up in an all round way, and a subdividing sheet of foreign exchange administrative items subject to administrative license was published, which divided the retained 39 items to 173 sub-items; such items were further standardized, and the contents of such items and the form of applying materials were unified, and the legal basis for SAFE to accept and examine such items was clarified. At the same time, the openness and transparency of administrative license related to foreign exchange administration were materialized through various methods to facilitate the conduction of business subject to administrative license by parties concerned.

Strengthen the monitoring and management of the setting-up of items subject to the license. According to the requirement of different levels of law effectiveness for the setting up of administrative license, foreign exchange administration rules were amended or improved step by step. An internal control system for the setting up of administrative license was put in place; and new foreign exchange administration rules are subject to strict examination. SAFE branches and sub-branches are explicitly requested not to set up items subject to administrative license other than those set up by SAFE head office.

Ensure the timely publication of foreign exchange administration rules. Effective channel were established to disclose information such as of the State Administration of Foreign Exchange Proclamation. New foreign exchange administration rules will be published in time, and great efforts will be made on the publicity of adjustment and change of major policies, so as to enhance the transparency of foreign exchange administration rules and to facilitate the legal compliance of market participators.

Widen the ways for disseminating foreign exchange administration management rules. The ideas and contents of foreign exchange administration rules were popularized by making full use of traditional media such as TV, broadcasting and newspaper and so on. Adequate attentions were paid to new media such as the network by further enriching the contents on the web site of the SAFE. The coverage and influence of publicity and education on foreign exchange administration rules were effectively enlarged and enhanced.

Increase efforts on training in terms of foreign exchange administration rules. Training items of foreign exchange administration rules was intensified to help SAFE staff and the staffs of designated foreign exchange banks to be better understand the background, intention and principles of such rules so as to

promote their implementation. After the launch of the reform of RMB exchange rate forming mechanism, various forums and training courses were held to explain the reform and supporting policies, which achieved good results in terms of both social publicity and training.

The general idea governing the work on foreign exchange administration rules in 2006 is to revise *the Regulations on Foreign Exchange Administration of the People's Republic of China*, and with this as an opportunity to clear up current foreign exchange administration rules for the construction of a system of foreign exchange administration rules that is well organized, scientific easy for implementation so as to create a good, relaxed and orderly foreign exchange market environment for all types of economic agents. .

IT Application

Launching on-line operation to further facilitate trade and investment activities. In 2005, the on-line platform of the SAFE was formally put into operation. The platform provides the following services via internet: enterprises' access to on-line Export Verification Reporting System; banks' access to external debts reporting system on high frequency; banks' and enterprises' access to on-line reporting system of the new ITRS. The facility of carrying out business operation via the internet has laid down a technical foundation for realizing the transfer from on-site management to off-site management of foreign exchange administration as well as from in-the-process monitoring to after-the-event supervision.

Strengthening the construction of a supervision information system for foreign exchange administration to improve balance of payments statistics and monitoring. To accommodate business reform requirement, the SAFE developed, adjusted and improved the internal business information system according to Information Construction and Development Programming. The SAFE strengthened information system security and network constructions and promoted the establishment of an information sharing mechanism. In 2005, the following constructions were completed: development and test on new ITRS; development and operation of a new foreign currency sale and purchase statistics and monitoring system for banks; functional improvement on the external debts statistics and monitoring system to enable high-frequency external debt reporting system by banks. Above all, the experimental work to incorporate banks' foreign currency sale and purchase business into foreign currency account system for statistics and monitoring purpose has achieved initial results, with data quality improved and statistical analysis function strengthened.

Promoting the construction of management information system for government affairs. The SAFE has upgraded the official website to enrich its content. The SAFE has also extended functions of the internal information website to realize integrated and consolidated internal report transmission mechanism. Besides, the SAFE has enhanced transfer efficiency of government affairs and realized paperless distribution of publications within the SAFE system (including SAFE head office as well as its branches and sub-branches).

Consolidating hardware foundation and enhancing systems performance and process capacity. This includes: strengthening data center construction of the

SAFE, equipping data sub-centers located all over the nation with more computers to improve system performance environment, and enhancing data process capacity for the whole SAFE system. According to computer performance requirements, the SAFE has realized auto copy and reservation of information in data sub-centers to ensure data security. According to the Nation's network construction rules and security requirements, the SAFE has constructed its intranet, internet and website in accordance with high standards, providing reliable backup for systematic performance of interior information and external access to internet.

In 2006, the general idea governing the IT application of the SAFE is to push forward all items of work related to information construction to enhance foreign exchange management information system construction, to carry on the integration of data sources and comprehensive application of data to lay down a foundation for off-site supervision according to the Nation's requirement on electronic government affairs development and foreign exchange reform. The SAFE will also strengthen its security construction and complete information exchange among related government institutions according to progressing requirement of Nation's "Jinhong Project".

On-line Service Platform of the SAFE

According to the Nation's requirement on electronic government affairs construction of government agencies and the SAFE's plan of information construction development, the on-line service platform developed by the SAFE was put into operation in 2005. The platform provides uniform services to facilitate foreign exchange business of foreign trade entities and banks via the internet, effectively making it more convenient to carry out investment and trade activities. Meanwhile, to enhance efficiency of the SAFE, the platform has released a lot of manpower from front line foreign exchange administration and thus laid down a technical foundation for realization of transfer from on-site management to off-site management of foreign exchange administration as well as from in-the-process monitoring to after-the-event supervision.

The on-line service platform of the SAFE provides services free of charge to facilitate on-line foreign exchange business of enterprises and banks with the SAFE, acting as a "window" of electronic government affairs of the SAFE. The platform is composed of three parts: intranet, internet and website. Among them, the internet is responsible for network connection, ID certification and data transmission. The intranet connects data sub-centers of the SAFE and is responsible for disseminating data and receiving distributed and wait-for-approval data. The internet acts as the bridge between the intranet and the website and is responsible for segregation and security of the system. The on-line service platform adopts various technologies, i.e. PC application service concourse, hardware load equilibrium and software high application and information-based off-line data synchronization as well as data exchange technology. Those technologies help lower cost and guarantee high efficiency. Besides, such network technologies as firewall, physical segregation and beam exchange guarantee the safety and security of the system.

From April 2005 when the platform was put into operation till the end of 2005, it registered 67,000 enterprises that do export foreign exchange verification business via the platform and recorded 5 million batches of export verification business, with accumulative turnover reaching USD 13.88 billion. The number of banks that had registered to report external debts on line came to 290; and the number of users, to 1000. Over 20,000 reports on external debt were transmitted on line.

International Exchange and Cooperation

Training programs and business visit tours abroad were arranged with focus on current hot and difficult issues in the foreign exchange administration. To prepare for the reform of transaction methods and products in the domestic foreign exchange market and to strengthen supervision on cross-border capital flows, four overseas training programs were arranged with focus on fostering the derivatives market and strengthening capital flow supervision, and more than 100 staff took part in the programs. In addition, researches on some special hot topics, like the lessons and experiences from the adjustment of balance of payments, the development of Renminbi business of banks in Hong Kong and Macao, the supervision on cross-border corporate capital flows, the trade financing statistics collecting, and the content and method of off-site supervision, etc., and suggestions for policy-making were put forward accordingly in relevant fields.

Exchanges with relevant foreign financial organizations were strengthened to make China's foreign exchange administrative regulations and policies get better understood. Exchanges with foreign financial authorities, financial institutions and firms were actively developed through 377 meetings. Focusing on such hot issues like the reform of exchange rate regime and Renminbi exchange rate formation mechanism, the situation of the balance of payments and capital account liberalization, SAFE exchanged views and experiences with foreign guests concerned face to face, made known to them our current policies of foreign exchange administration, and acquainted ourselves with their comments and suggestions. SAFE intensified our "inviting-in" efforts, and invited senior professionals from the Monetary Authority of Singapore and the International Monetary Fund to visit the SAFE and give lectures.

International seminars were conducted domestically to promote the external exchange of international experiences. The "International Seminar on Effective Exchange Rate" was held by the BIS and the SAFE jointly, and many professionals from international organizations like the BIS, and the EU, and central banks like the U.S., Czech, India and Singapore went deep into discussion on topics concerned, especially the application of effective exchange rate as a policy target. The "Seminar on the Assessment of the Supervision and Forewarning on High Frequency Debt and the Assessment of the Survey System on Market Expectations" was held jointly by the World Bank and the SAFE, and professionals from the World Bank, Brazil and South Korea made assessment on the exploration of the systems and research products. The "International Seminar on Contingent Liabilities" was held jointly with the World Bank to draw on the experience of Sweden, Swiss and others in the management of contingent liabilities.

Cooperative programs with the World Bank and others were further pursued. Systematic researches were carried on by the World Bank & SAFE workshop on some hot topics like the vulnerability of capital flow in emerging markets, measures for prevention of debt crisis and risks, market expectations and capital flows, and so on. The workshop also developed a supervision system on high frequency debt and a survey system on market expectations which have improved the capability of capital flow supervision, and laid down a solid foundation for the comprehensive construction of China's forewarning system on cross-border capital flow. In addition, we actively applied for, among others, the program of UNDP on the topic of "impacts of the imbalance of China's balance of payments and counter-measures" and the World Bank's fourth technical cooperative program of "research on the control and adjustment of the balance of payment during China's reform and opening-up" in order to get more technical and financial aid.

The plan for international exchange and cooperation in 2006: according to the focus of foreign exchange administration in the year and requirements of financial diplomacy in current international situations, the SAFE will further consolidate the foundation and advance its external relations to a new stage by enhancing the cooperation and coordination among different departments and promoting the standardization of its work related external affairs.

Internal Management

Rationalize the structure and enhance the quality of the staff to promote vitality. Personnel management and exchange were vigorously advanced. Forty-six staff members with moral integrity, ability, reputation, and good performance were promoted to director and director-general level positions, giving full play to the initiative of the staff. Staff exchange and internship with SAFE branches were proactively implemented. Two staff members were assigned positions at SAFE branches. Nine newly enrolled cadres participated in internship programs. Working in branches has enriched their experience, improved their knowledge structure, enhanced their understanding of fieldwork, and enhanced their ability. Training of the staff was attached great importance to. A variety of contents and methods was incorporated with focus on specific areas. A training mode, which combines long term and short term training, professional and ability training, and training of the staff at the headquarters and that of the branches was formed. Twelve training courses were held in 2005 with 385 trainees from the headquarters and branches. High-level human resources were recruited to enhance the professional team. Thirty-nine university graduates joined the SAFE in 2005.

Proactively carry out internal audit and promote internal control in the SAFE headquarters and branches. Internal audit and inspection of foreign exchange business were carried out. On-site inspection was conducted on foreign exchange business to support the work of the Internal Audit Department of the People's Bank of China. The SAFE also participated in the special audit on capital account transactions, the internal audit and investigation on the foreign exchange clearing system, the internal audit system construction and performance inspection in some SAFE branches, and the comprehensive audit on the China SAFE investments Limited. Staff's awareness of risk prevention and internal control was enhanced through internal audit and inspection, and internal management standardized. The SAFE also strengthened the follow-up supervision and inspection concerning the implementation of the measures of rectification after audit to ensure their effectiveness. Training on internal audit and control was emphasized to improve staff quality and promote the work of internal control and supervision in the whole foreign exchange administration system.

In 2006, the main approach to the work of personnel management and internal audit and control in the SAFE is: with focus on foreign exchange administration, actively promote staff improvement and internal audit and control; with emphasis on the selection and appointment of cadres, staff training, internal control and self-improvement so as to enhance the overall quality of the cadres of all ranks of foreign exchange administration, improve the internal control; and ensure the sound development of foreign exchange administration.

Chronicle of Events in
China's Foreign Exchange
Administration in 2005

February

Feb. 1

The SAFE issued the *Circular on Foreign Exchange Administration Issues Related Overseas Listing*, which extends the time limits for keeping their funds raised abroad.

Feb. 4

The SAFE issued the *Circular on the Adjustment to Current Account Foreign Exchange Account Limits*, which extends the time limits on domestic institutions' purchase of foreign exchange beyond the quotas, and expands the scope of enterprises that are permitted to have their foreign exchange account quota under the current account checked and ratified according to real income in foreign currencies.

Feb. 26-27

The *Annual Working Conference of the SAFE* was held in Shenzhen. In the conference, the gist of the Central Government's Economic Working Conference and the Working Conference of the People's Bank of China was transmitted to the attendants, the current overall picture of the economy and the situation of foreign exchange income and payments were analyzed, and the major work and targets for 2005 were set forth.

March

Mar. 3

The SAFE issued the *Circular on Issues Related to Foreign Exchange Administration of Overseas Investment in Border Regions*, which broadens the limits of authority of

SAFE's branches in border regions on auditing the sources of foreign exchange capital used for overseas investment, and simplifies the procedures for such investment.

Mar. 24

Hu Xiaolian was appointed as Secretary of the SAFE's CPC leading member group; on Mar. 27, she was appointed as Administrator of the SAFE.

Mar.27

The State Council relieved Mr. Ma Delun from the post of Deputy Administrator of the SAFE.

Mar.28

The State Council relieved Mr. Guo Shuqing from the post of Administrator of the SAFE.

April

Apr. 28

the SAFE issued the *Official Reply to Approve China Everbright Bank on Issues Related to Foreign Exchange Administration on Its Pilot Transactions of Renminbi Cross-exchange Rate Derivatives Products*, which clarifies for the first time that banks shall abide by relevant foreign exchange administration rules in making financing products involving both domestic and foreign currencies.

May

May 18

The Inter-bank foreign exchange transaction system was put into trial operation with 8 pairs of foreign currencies. The currency pairs are as follows: EUR/USD, AUD/USD, GBP/USD,

USD/CHF, USD/HKD, USD/CAD, USD/JPY and EUR/JPY.

May 19

The SAFE issued the *Circular on Expanding the Pilot Program for the Reform of Foreign Exchange Administration on Overseas Investment*, which says the pilot program will be expanded nationwide, the total quota of foreign exchange purchase used for overseas investment will be raised and the authority of approval will be further shifted down to lower levels.

June

Jun. 2

Hu Xiaolian, Administrator of the SAFE, met Mr. David Dodge, Governor of the Bank of Canada. Mr. Dodge introduced the current economic situation of Canada, and they exchanged views on

issues related to China's foreign exchange regime reform and capital account management.

Jun. 8-9

The SAFE and the World Bank jointly held the "Seminar of assessment on the system of supervision and forewarning on high frequency debt and survey of market expectations". Initial results of system development and subject researched were assessed.

Jun. 10

Hu Xiaolian, Administrator of the SAFE, met Mr. Ren Zhigang, President of HKMA and his delegation. Mr. Ren introduced the development of RMB business in Hong Kong. Both sides exchanged views on relevant economic and financial issues.

Jun. 23

The SAFE and the General Administration of Customs

(GAC) signed official agreement on online data exchange. The GAC will transmit in batch to the SAFE electronic data of import customs declaration and data of non-declaring export customs declaration; while the SAFE will transmit in batch to the GAC electronic data which have been verified, so as to materialize two-way share of data.

July

Jul. 12

The SAFE issued *the Circular on Centralized Management of the Revolving Position of Foreign Exchange Purchases and Sales in Domestic Foreign Banks in China*, which further standardize regulation of position management for foreign bank in China. Qualified foreign banks in China or authorized branches to carry out centralized management on the position of foreign exchange purchases

and sales of all their branches in China.

Jul.21

the PBC issued *the Announcement on Improvement of the Reform of the RMB Exchange Rate Formation Mechanism*, which announces that effective on July 21, a managed floating exchange rate regime based on market supply and demand and adjusted with reference to a basket of currencies is put into practice; the exchange rate of the RMB is no longer pegged to the single currency of the U.S. dollar, and a more flexible exchange rate forming regime comes into being; at 7.00 pm. of July 21, the exchange rate of the U.S. dollar against the Renminbi was adjusted to USD 1: RMB 8.11.

Jul. 21

The PBC issued *the Circular on Issues Related to the Exchange Rate in the Inter-bank Foreign Exchange Market and Exchange Rates Listed by Designated Foreign Exchange Banks*, which adjusted the administration policy on exchange rates in the inter-bank market and listed by designed foreign exchange banks.

August

Aug.1

The SAFE publicized the first batch of (negative) information about violation of foreign exchange administration rules, and disclosed for the first time 34 pieces of information about violation of foreign exchange administration since January 2004, which were either inspected and punished by the SAFE directly or happened in the

three pilot provinces of Liaoning, Hebei and Shenzhen.

Aug.2

The PBC issued *the Circular on Expanding Designated Foreign Exchange Banks' Forward Purchases and Sales of Foreign Exchange and Launching RMB Swap against Foreign Currencies*, and the PBC decided to expand designated foreign exchange banks' business of forward purchase and sales of foreign exchange and launch RMB swap against foreign currencies.

Aug.2

The SAFE issued *the Circular on Loosening the Limits on Domestic Institutions' Income in Foreign Currencies Retained under the Current Account*, and raised once again the limits on foreign exchange accounts of domestic institutions under the current account.

Aug.3

The SAFE issued *the Circular on Increasing the Quotas and Simplifying Relevant Procedures of Purchases of Foreign Exchange by Domestic Resident Individuals*, and raised the guidance quota of foreign exchange purchase by domestic resident individuals under current account, simplified relevant verification documents, and permitted domestic credit card holders to purchase foreign exchange from domestic issuers of the cards to cover overdrafts arising from overseas consumptions under current account.

Aug.6

Hu Xiaolian was appointed as Deputy Governor of the People's Bank of China.

Aug.9

The SAFE issued *the Circular on Expanding Designated*

Foreign Exchange Banks' Forward Purchases and Sales of Foreign Exchange for Customers and Launching the Transactions of RMB Swap against Foreign Currencies, and decided to increase the number of banks that are designated to transact RMB swaps against foreign currencies. Banks with more than 6 months' experience of forward purchase and sales of foreign exchange transactions were allowed to conduct RMB swaps against foreign currencies for customers, excluding rate swaps.

Aug.9

The PBC issued *the Circular on Accelerating the Development of the Foreign Exchange Market*, announcing that the scope of market players in the spot foreign exchange market would be enlarged, and allowing market players that meet the qualifications to conduct forward foreign exchange transactions and

RMB swaps against foreign currencies. Forward transactions in the inter-bank market were officially launched on Aug.15.

Aug.16

The SAFE issued *the Circular on Adjustment to the Management Mode of External Financing Guarantee by the Domestic Banks for Overseas Investment Companies*, the management mode of external financing guarantee by the domestic designated foreign exchange banks for overseas investment by Chinese companies was adjusted; and both the scope of banks with the balance management of external financing guarantee and the scope of companies that can benefit from the policy on domestic guarantee were expanded.

September

Sept.22

The SAFE issued *the Circular on Adjustment to Management of Banks' Purchase and Sales of Foreign Exchange Positions*. Management of the comprehensive position of purchases and sales of foreign exchange is to be practiced, and the policies of position management and quota approval involving both Chinese and foreign banks are to be unified.

Sept.23

the PBC issued the *Circular on Further Improvement of the Management of Exchange Rates in the Inter-bank Market and Listed by the Designated Foreign Exchange Banks*. The flexibility and independency of designated foreign exchange banks in

determining listed exchange rates are enhanced.

October

Oct.12

The SAFE issued *the Circular on Printing and Distributing 'the Guidance for Operation Records by Designated Foreign Exchange Banks to Conduct Forward Purchase and Sales of Foreign Exchange and RMB Swaps against Foreign Currencies'*. Relevant guidance is given to SAFE branches and designated foreign exchange banks for smooth operation records of transactions of forward purchase and sales of foreign exchange and RMB swaps against foreign currencies.

Oct.21

The SAFE issued *the Circular on Issues Related to Improvement of External Debt Management*. Deferred

import payments beyond a certain time limit and amount and relevant funds of transnational companies from their overseas associated companies are to be included in the management of external debt. External debt management related to special types of foreign funded companies is regulated. Regulation on external guarantee under the entry of domestic loans is modified.

Oct.21

The SAFE issued *the Circular on Foreign Exchange Administration Related to Domestic Residents' Financing Activities via Special Purpose Vehicles and Return Investment*. Foreign exchange administration on overseas financing and return investment by domestic residents (both legal persons and natural persons) is thereby standardized.

Oct.28

The SAFE held a meeting to explain the follow-up policies and measures after the reform of the RMB foreign exchange forming regime. At the meeting, a series of follow-up policies and measures were explained to attending Chinese and foreign banks as well as huge enterprises whose volume of foreign exchange income and payment top the list.

November

Nov.24

The SAFE issued *the Notice on Printing and Distributing 'Guidance of Market Makers of the Inter-bank Foreign Exchange Market (Provisional)'*. The system of market maker is thereby introduced into China's inter-bank foreign exchange market.

Nov.24

The SAFE issued *the Notice on the Launch of Spot Price*

Enquiry in the Inter-bank Foreign Exchange Market. The mode of price enquiry with the feature of bilateral credit limits and bilateral clearing will be introduced into spot foreign exchange transactions starting from 2006, and the business time for price enquiry will be extended to 17:30.

Nov.27

The SAFE issued *China's Balance of Payments Report of the First Half Year of 2005*, which analyzes the interaction between international and domestic economic situations and China's balance of payments, makes assessment and comments on the current conditions of China's balance of payments and existing problems, and forecasts the trend of China's balance of payment and the policy direction in next phase. This is the first time for the SAFE to publicize the balance of payments report; and henceforth it will do so every half year.

December

Dec.1

The system of supervision on high frequency debt was put into practice nation-widely.

Dec.5

The SAFE issued *the Circular on the Launch of Purchases and Sales of Foreign Exchange by Rural Cooperative Financial Institutions* to standardize entry-permission and daily supervision on the business of purchases and sales of foreign exchange conducted by Rural Credit Cooperatives, and further improving the administration on their operations of purchases and sales of foreign exchange.

Dec.9-10

The SAFE and the World Bank jointly held the "International Seminar on External Contingent Liabilities" to learn international experiences of contingent

liability management from central banks of Sweden and other countries for reference in our policy-making.

Dec.22

The SAFE and the Ministry of Public Security jointly held a summing-up conference to commend the National Joint Office in Charge of Cracking Down on Criminal Activities of Illegal Purchases and Sales of Foreign Exchange for its uncovering of major criminal cases violating foreign exchange administration rules.

Dec.26

The SAFE approved the Sinochem Corporation to be the first non-financial enterprise member in the inter-bank foreign exchange market.

Dec.29

the SAFE approved 13 banks to be market makers in the inter-bank foreign exchange market, 8 Chinese banks and 5 foreign banks.

Dec.30

Zhou Xiaochuan, Secretary of the PBC's CPC committee and Governor of the PBC, and Hu Xiaolian, member of the PBC's CPC committee and Deputy Governor of the PBC and Administrator of the SAFE, came to the Reserve Management Department of the SAFE to visit the staff.

Dec.31

The SAFE issued *the Circular on Implementing Rules (Provisional) governing the Application for Membership of the Inter-bank Spot Foreign Exchange Market by Non-financial Enterprises and Non-banking Financial*

Institution, spelling out the detailed regulations on non-financial enterprises and non-banking financial institutions' application for membership in the inter-bank spot foreign exchange market and on the administration of transactions.

Dec.31

The Ministry of Trade, the Chinese Security Regulation Committee, the State Administration of Taxation, the State Administration of Industry and Commerce and the State Administration of Foreign Exchange jointly issued *the Decision of Administration on Strategic Investment by Foreign Investors in Listed Companies*.

Major Foreign Exchange Rules and Regulations Promulgated in 2005

A, General

- 1 [Circular of the State Administration of Foreign Exchange on Distributing the LIST OF ADMINISTRATIVE LICENSE ITEMS OF THE SAFE](#)

[D/C: Huifa \[2005\] NO.38](#)

Date of Promulgation: June 2, 2005

Effective Date: June 2, 2005

Gist: In order to perfect the administrative license work of foreign exchange administration, according to the regulations stipulated in *the Administrative License Law*, SAFE's retained 39 items subject to administrative license are divided into 173 items; the basis, contents, time limit, and application materials for the set-up and conduct of each item are made clear as well. At the same time, the behaviors of SAFE's branches and sub-branches in dealing with administrative license application are regulated.

- 2 [Circular of the General Affairs Department of the State Administration of Foreign Exchange on Purchase Foreign Exchange and Payment of Export Processing Bond Enterprises for Outside Further Processing of Goods](#)

[D/C: Huizongfa \[2005\] NO.66](#)

Date of Promulgation: June 2, 2005

Effective Date: June 2, 2005

Gist: In order to meet the need of the foreign currency for the enterprises' normal operation, and improve the further processing business, the procedures of purchase and payment of foreign exchange are regulated.

- 3 [Circular of the State Administration of Foreign Exchange on Issues Related to Foreign Exchange Administration of Duty-free Logistics Zones](#)

[D/C: Huifa \[2005\] NO.92](#)

Date of Promulgation: December 20, 2005

Effective Date: December 20, 2005

Gist: When buying goods from an enterprise inside a duty-free logistics zone, a domestic enterprise outside a duty-free logistics zone may make payment to the seller inside the duty-free logistics zone; or make overseas payment directly; or to another owner of the goods outside the duty-free logistics zone. For economic transactions with overseas enterprises, enterprises inside a duty-free logistics zone shall go through formalities of balance of payment statistical reporting as required. For economic transactions between domestic enterprises inside and outside a duty-free logistics zone, balance of payment statistical reporting is not required of the entities concerned.

B. Foreign Exchange Statistics and Regulation of the Foreign Exchange Market

- 4 [Announcement of the People's Bank of China on Reforming the Renminbi Exchange Rate Forming Regime](#)

[D/C: \[2005\] NO.16](#)

Date of Promulgation: July 21, 2005

Effective Date: July 21, 2005

Gist: Effective from July 21, 2005, a managed, floating Renminbi exchange

rate mechanism based on market supply and demand and adjusted with reference to a basket of currencies is launched; and at 19:00 of the same day, the exchange rate of the Renminbi against the US dollar is adjusted to 8.11 to 1.

- 5 [Circular of the People's Bank of China on Relevant Issues in Relation to the Administration of the Transaction Prices of the Inter-bank Foreign Exchange Market and the Listed Exchange Prices of Designated Foreign Exchange Banks](#)

[D/C: YinFa\[2005\] No.183](#)

Date of Promulgation: July 21, 2005

Effective Date: July 21, 2005

Gist: Effective from July 21, 2005, in the inter-bank foreign exchange market, the exchange rate of the Renminbi against the US dollar is to float in the range of 0.3 percent around the transaction middle price, and the exchange rates of the Renminbi against Non-US-dollar currencies are to float in the range of 1.5 percent around the transaction middle price. The spot exchange purchase and sale prices of US dollar against the Renminbi listed by designated foreign exchange bank shall not go above or below the transaction middle price by 0.2 percent, and the cash purchase and sale prices shall not go above and below the transaction middle price by 1 percent; while the listed spot exchange purchase and sale prices of non-US dollar currencies against the Renminbi shall not go above and below the transaction middle prices of spot exchange by 0.8 percent, and the price difference between cash purchase and sale shall not go above and below the transaction middle price of spot exchange by 4 percent. Designated foreign exchange banks may add the listing of exchange rates of the Renminbi against the currencies of neighboring countries in frontier trade areas in the provinces and autonomous regions of Heilongjiang, Jilin, Liaoning, Inner Mongolia, Sinkiang, Tibet, Yunnan and Guangxi; and they may decide the price difference on their own.

- 6 [Circular of the People's Bank of China on Widening the Business Forward Exchange Sale and Purchase of Designated Foreign Exchange Bank to Customers and on Launching the Swap Business of the Renminbi against Foreign Currencies](#)

[D/C: YinFa \[2005\] No.201](#)

Date of Promulgation: August 2, 2005

Effective Date: August 2, 2005

Gist: The range of banks involved in the forward transaction of the Renminbi against foreign currencies is extended to all banks qualified to do the business of spot sale and purchase of foreign exchange and to trade in derivatives so long as they have registered for such transaction. A bank may quote prices to its customers according to its business capacity and ability to manage risks ; and determine the maturity of transaction and the times of rollover on its own. Banks' business scope of forward foreign exchange sale and purchase is expanded and all items of current account transaction including current transfer are decontrolled; and some items of transaction under capital and financial account are added. Banks are allowed to conduct with customer swap business of Renminbi against foreign currencies excluding swap of interest rate. The banks that have been allowed to do the business of

forward foreign exchange purchase and sale over 6 months may do the said swap business after filing with the SAFE.

- 7 [Circular of the People's Bank of China on Expediting the Development of the Foreign Exchange Market](#)

[D/C: YinFa\[2005\] NO.202](#)

Date of Promulgation: August 8, 2005

Effective Date: August 8, 2005

Gist: The scope of participants in the inter-bank spot foreign exchange market is expanded, and qualified non-bank financial institutions and non-financial enterprises are allowed to participate in transactions of the inter-bank foreign exchange market in accordance with actual needs. Transaction modes of the inter-bank market are increased, the transaction mode of price enquiry is introduced to the inter-bank foreign exchange market to be used first in forward transactions. Transaction products in the inter-bank foreign exchange market are further diversified, and qualified participants in the inter-bank foreign exchange market are allowed to carry out inter-bank forward transaction of foreign exchange, and market members that have qualification for forward transaction over 6 months are allowed to carry out inter-bank swap transactions of Renminbi against foreign currencies in that combine spot and forward as well as forward and forward transactions.

- 8 [Circular of the State Administration of Foreign Exchange on Adjusting the Management of Banks' Position of Foreign Exchange Sale and Purchase](#)

[D/C: HuiFa \[2005\]No.69](#)

Date of Promulgation: September 22, 2005

Effective Date: September 22, 2005

Gist: It is made clear that current turnover position for foreign exchange sale and purchase includes foreign exchange position arising from banks' foreign exchange sale and purchase with customers in compliance with regulations of foreign exchange administration, from banks' own foreign exchange settlement and sale and also from transactions in the inter-bank foreign exchange market, and that general position management of foreign exchange sale and purchase shall be exercised. The quota of general position for foreign exchange sale and purchase of the current stage is zero at the bottom of the management band and the quota verified and fixed by the State Administration of Foreign Exchange, at the ceiling of the management band; and the aggregated quota offered to the banking system will be raised by quite a big margin.

- 9 [Circular of the People's Bank of China on Further Improvement of the Management of Listing Exchange Prices of the Inter-bank Foreign Exchange Market and Exchange Prices Listed by Designated Foreign Exchange Banks](#)

[D/C: YinFa \[2005\] No.250](#)

Date of Promulgation: September 23, 2005

Effective Date: September 23, 2005

Gist: Effective from September 23, 2005, in the inter-bank foreign exchange market, the exchange rates of Non-US-dollar currencies against the Renminbi

are adjusted to float 3 percent above and below the transaction middle price of the same day; designated foreign exchange banks may adjust on their own the prices of purchase and sale of spot exchange and banknote of the US dollar within the range of price difference listed below: the price difference between purchase and sale prices of spot exchange shall not exceed the middle transaction price of the US dollar by 1 percent; while that between the purchase and sale prices of US dollar bank notes shall not exceed the middle transaction price of the US dollar by 4 percent. The limitation on the price difference between the purchase and sale prices listed for non-US-dollar currencies against the Renminbi is removed, in terms of both spot exchange and bank notes..

- ¹⁰ [Circular of the State Administration of Foreign Exchange on Printing and Distributing “Guidelines for Filing operation by Designated Foreign Exchange Banks for Customers' Forward Foreign Exchange Sale and Purchase and Swap of the Renminbi against Foreign Currencies”](#) [D/C:HuiFa \[2005\] No.70](#)

Date of Promulgation: October 12, 2005

Effective Date: October 12, 2005

Gist: Filing materials requested and the procedure for accepting filing application and issuing of filing notice are prescribed, and relevant rules for filing the business of swap between the Renminbi and foreign currencies are also laid down.

- ¹¹ [Circular of the General Department of the State Administration of Foreign Exchange on Materials Related to the Declaration of Overseas Assets, Liabilities and Profit and Loss by Financial Institutions](#)

[D/C: HuiZongFa\[2005\]No.112](#)

Date of Promulgation: November 3, 2005

Effective Date: November 3, 2005

Gist: All SAFE Branches and domestic designated foreign exchange banks must make timely, accurate and complete declaration of overseas assets, liabilities and profit and loss of financial institution strictly in accordance with relevant rules. The time for declaration, the principal declarant, and the delivery method of the declaration form are also prescribed. Besides, amendment and further explanation are made to the contents of some declaration forms.

- ¹² [Circular of the State Administration of Foreign Exchange on Reinforcement of Statistics and Monitoring of Listed Foreign Exchange Prices and Positions for Foreign Exchange Sale and Purchase](#) [D/C: HuiFa \[2005\] No.84](#)

Date of Promulgation: November 21, 2005

Effective Date: December 1, 2005

Gist: Effective from December 1, 2005, all designated foreign exchange banks shall file their daily listed exchange rate form before 10:00AM every business day, and their daily general position report on sale and purchase by 13:00PM the next business day. Banks' daily reports on turnover position of foreign

exchange sale and purchase are no longer required. In their daily reports on general position of foreign exchange sale and purchase, emphasis should be given to explaining the situation of large-sum foreign exchange sales and purchases and large-sum transactions in the spot foreign exchange market.

- 13 [Circular of the State Administration of Foreign Exchange on Printing and Distributing "Guidelines for Market Makers of the Inter-bank Foreign Exchange Market \(Provisional\)"](#) [D/C: HuiFa\[2005\] No.86](#)

Date of Promulgation: November 24, 2005

Effective Date: November 24, 2005

Gist: The connotation signification of the market maker of the inter-bank foreign exchange market is defined and the basic requirements, rights and obligations of being a market maker and the regulation of market makers' transactions are made clear. According to the Circular, it is pointed out in the document that all qualified designated foreign exchange banks may apply to the State Administration of Foreign Exchange for the qualification of market maker with application materials required.

- 14 [Circular of the State Administration of Foreign Exchange on Launching Spot Price Enquiry Transactions in the Inter-bank Foreign Exchange Market](#)

[D/C: HuiFa \[2005\] No.87](#)

Date of Promulgation: November 24, 2005

Effective Date: November 24, 2005

Gist: Spot price enquiry transaction is launched in the inter-bank foreign exchange market on the first business day of 2006. On the basis of previous transaction mode of centralized credit extension and centralized price competition, participants in the inter-bank market may choose on their own the price enquiry transaction method of bilateral credit extension and bilateral liquidation, and in accordance with the floating of exchange rate range of inter-bank market transaction set by the People's Bank of China, conduct bilateral price enquiry foreign exchange transaction through the inter-bank foreign exchange price enquiry transaction system. To enable banks to make up their positions cash balance after close of the price competition system, transaction session of spot and forward price enquiry transactions is extended to 17:30 in the mean time.

- 15 [Circular of the State Administration of Foreign Exchange on Printing and Distributing of "Implementing Provisions \(Provisional\) on Application of Non-financial Enterprises and Non-bank Financial Institutions for Membership of Inter-bank Spot Foreign Exchange Market"](#)

[D/C: HuiFa \[2005\] No.94](#)

Date of Promulgation: December 29, 2005

Effective Date: December 29, 2005

Gist: The procedure of and materials required for the application of non-financial enterprises and non-financial institutions for membership of the inter-bank spot foreign exchange market are prescribed; and the regulation of transactions conducted by such institutions and the filing mechanism for statistical information thereto related are also defined.

C, Regulations on Foreign Exchange Administration under the Current Account

16 Circular of SAFE on Adjust the Foreign Exchange Account Ceiling under the Current Account D/C: HuiFa [2005] No.7

Date of promulgation: February 4, 2005

Effective Date: March 1, 2005

Gist: Prolong the time limit of selling the excess foreign exchange held by domestic institutions from the current 10 working days to 90 days under the current account. The range of entities with current account balance ceilings of 100 percent prescribed as last year foreign exchange income is expanded, import and export enterprises and manufacturing enterprises with actual needs can have current account balance ceilings of 100 percent prescribed as last year foreign exchange income with approval from the SAFE.

17 Circular of SAFE on Strengthen the Management of Deferred Import Payment and Foreign Exchange Payment in future D/C: HuiFa[2005]No.8

Date of promulgation: February 5, 2005

Effective Date: March 1, 2005

Gist: The importer should take scribed materials to a local SAFE branch of SAFE to conduct the procedures of registration for the deferred payment if the non-payment amount under the COD item exceeds the equivalence of USD 500,000 (inclusive) or if the payment date exceeds the import date stated in the custom declaration by 90 days (inclusive).

18 Circular of the SAFE on Improvement of the Management of Advanced Payment For Export and of Payment for Entreport Trade

D/C: HuiFa[2005]No.33

Date of promulgation: May 17, 2005

Effective Date: June 1, 2005

Gist: Upon receipt of a foreign remittance to a payee's foreign exchange account with a bank, the bank should examine and verify its nature. The bank should transfer the four types of foreign remittances whose amount in single deal exceeds the equivalence of USD 200,000 (inclusive) to the receiver's account of foreign exchange pending to be sold to the bank. If the receiver has stated in writing that the remittance is a receipt related to prior payment for entreport trade, the foreign exchange should be sold against copies of verification document inport payment and the entreport trade contract. If the receiver has stated in writing that the remittance is a receipt before payment for entreport trade, the foreign exchange should not be sold until the payment is made. After the payment, the receiver can sell the balance of the foreign exchange against the entreport of trade contract.

19 Circular of the SAFE on Relaxing the Limitation of Foreign Exchange Income under Current Account Retained by Domestic Institutions

D/C: HuiFa[2005]No.58

Date of promulgation: August 2, 2005

Effective Date: August 2, 2005

Gist: The proportion of retainable foreign exchange in the foreign exchange account of a domestic institution under Current Account is raised from 30 percent or 50 percent to 50 percent or 80 percent. The initial limitation of a new foreign exchange account under Current Account is raised from an account not exceeding

the equivalence of USD 100,000 to an amount not exceeding the equivalence of USD 200,000. Foreign exchange accounts under Current Account opened by domestic institutions under the item of interim receipt pending payment for donation, aid, international post remittance and international contracting projects as well as those of importers, exporters and producing enterprises may still retain 100 percent of receipt in accordance with their actual needs.

- 20 Circular of the SAFE on Adjusting the Limitation of Foreign Exchange Purchased by Domestic Resident, for Private Purpose under Current Account and Simplifying Relevant Procedures

D/C: HuiFa[2005]No. 60

Date of promulgation: August 3, 2005

Effective Date: August 3, 2005

Gist: The directive ceiling of foreign exchange purchased by resident individuals for private purposes under Current Account is raised. The directive ceiling of foreign exchange purchased for real overseas activities such as domestic resident travels, visits or investigation abroad for less than six months under ordinary passports was raised from an equivalence of USD 3000 to USD 5000. If the duration of the overseas activity exceeds six months (inclusive), the ceiling was raised from an equivalence of USD 5000 to USD 8000. The above-said domestic resident individuals may purchase the relevant amounts of foreign exchange against ordinary passports with their ID numbers and valid visas. Documentation for purchase of foreign exchange by students studying abroad at their own expense was also simplified. The RMB deposit of such students for purchase of foreign exchange to be purchased was decreased from the amount 2 times the amount of foreign exchange to RMB 2000 for each deal.

- 21 Circular of the SAFE and the General Administration of Customs on Excluding Goods Purchased during Travel Item Foreign Exchange Verification Management

D/C: HuiFa[2005]No. 91

Date of promulgation: December 7, 2005

Effective Date: December 1, 2005

Gist: The customs-monitoring mode for Good Purchased during Travel is incorporated into the monitoring mode not requiring export verification. Designated foreign exchange banks should not produce the export verification for exporters receiving (selling) foreign exchange under the travel purchasing items. The receiving (selling) of foreign exchange under the travel-purchasing item should not be used as the export verification of other trade modes.

D. Regulations on Foreign Exchange Administration under the Capital Account

- 22 Circular of the SAFE, the Ministry of Foreign Affairs, the Ministry of Public Security, the Ministry of Supervision, and the Ministry of Justice on Implementation of THE INTERIM METHODS FOR THE MANAGEMENT OF SALE AND PAYMENT OF FOREIGN EXCHANGE RELATED TO EXTERNAL TRANSFER OF PERSONAL EFFECTS

D/C: HuiFa[2005]No.9

Date of promulgation: January 27, 2005

Effective Date: January 27, 2005

Gist: It is prescribed that the State Administration of Foreign Exchange and its branches and the sub-branches are responsible for accepting the application and for receiving application materials, and conduct the examination and approval of the limit of administrative authority prescribed by the METHODS. Chinese embassies and consulates are responsible for writing out or verifying certifications of overseas settlement of applicants. Administrative organs of public security, supervision and justice administration are responsible for assisting the examination of the identity of applicants and the legitimacy of assets pending to be transferred.

- ²³ Circular of the State Administration of Taxation and the SAFE on Submitting Tax Certification or Tax Receipt When Personal Effects Are Transferred Abroad

D/C: GuoShuiFa[2005]No. 13

Date of promulgation: January 31, 2005

Effective Date: January 31, 2005

Gist: Tax Certification and tax payment receipt must be submitted when personal effects are transferred overseas. The tax administration should certify tax payment by the applicant; and tax payment receipt related to the assets to be transferred may be submitted directly to the relevant foreign exchange administration agency. The procedures for an applicant to get tax certification and materials to be submitted are also prescribed.

- ²⁴ Circular of the SAFE on Foreign Exchange Administration in terms of Overseas Listings

D/C: HuiFa[2005]No. 6

Date of promulgation: February 1, 2005

Effective Date: March 1, 2005

Gist: The time limit for domestic stock holding units of overseas listing foreign companies and Chinese holding companies to withdraw funds was extended to six months after the funds raised from overseas listing is received. The term of external special foreign exchange account was extended to 2 years from the opening date of the account. For overseas deposit of foreign exchange funds obtained from the change of various equities, application with documents required should be submitted to the SAFE; and relevant contents of foreign exchange registration of the overseas listed stocks may not be adjusted until the application is approved.

- ²⁵ Circular of the SAFE on the Administration of External Foreign Exchange Investment in Border Areas

D/C: HuiFa[2005]No. 14

Date of promulgation: March 3, 2005

Effective Date: April 1, 2005

Gist: The limit of authority of SAFE sub-branches in border area to examine and verify the source of external foreign exchange investment is enhanced; and it is made clear that external investment in border areas should follow the registration procedure for external investment in accordance with regulations.

- ²⁶ The Supplemental Circular of the SAFE on RMB Loans under Foreign Exchange Guarantee

D/C: HuiFa[2005]No. 26

Date of promulgation: April 15, 2005

Effective Date: April 15, 2005

Gist: The implication of the terms of overseas institutions, RMB Loan guarantee is clarified. Dealing principles for RMB loans under foreign exchange guarantee extended before April 1, 2005 and methods for the

disposal of rollover of RMB loans under foreign exchange guarantee after April 1, 2005 are prescribed. It is prescribed that if the signing date of the foreign exchange guarantee contract, the effective date of the RMB loan contract and the funds withdrawing date are inconsistent, the signing date of the foreign exchange guarantee contract shall prevail.

27 Circular of SAFE on Enlarging the Experimental Units of Foreign Exchange Management Reforming of Overseas Investment

D/C: HuiFa[2005]No.35

Date of promulgation: May 19, 2005

Effective Date: May 19, 2005

Gist: The pilot reform of foreign exchange administration over overseas investment is extended from 24 provinces, autonomous regions and municipalities directly under the Central Government to the whole country. The foreign exchange purchasing ceiling for overseas investment in 2005 is increased from USD 3.3 billion to USD 5 billion. The limit of authority of SAFE branches to examine the source of foreign exchange fund for oversea investment was raised from USD 3 million to USD 10 million per project.

28 Circular of the SAFE on Adjusting the Management Mode of External Financing Guarantee Provided by Domestic Banks to Overseas Investment Enterprises

D/C: HuiFa[2005]No. 61

Date of promulgation: August 16, 2005

Effective Date: September 1, 2005

Gist: The management mode of external financing guarantees by domestic designated foreign exchange banks to overseas investment enterprises is changed from case-by-case approval to annual balance management. The scope of banks that exercise balance management over external guarantee is extended from a selected few to all qualified domestic designated foreign exchange banks overseas. The scope of enterprises benefiting from the policy of domestic guarantee is extended from overseas Chinese enterprises to overseas investment enterprises set up by all domestic institutions.

29 Circular of the SAFE on Perfecting Foreign Debts Management

D/C: HuiFa[2005]No.74

Date of promulgation: October 21, 2005

Effective Date: December 1, 2005

Gist: Deferred payments with unpaid amount greater than the equivalence of USD 200,000(inclusive) and real or contracted time limit for payment more than 180 days (inclusive) are incorporated in foreign debt registering management and quota control. Foreign debt management is standardized for special foreign investment enterprises such as foreign investment enterprises whose foreign share is less than 25 percent, foreign investment enterprises whose investment amount is equal to registered capital or whose investment amount is not clearly stated, foreign holding companies of investment and foreign investment lease companies. It is also made clear that funds absorbed from oversea affiliates by transnational companies registered in China whose funds are centrally managed should be incorporated in foreign debt management when they are used domestically.

30 Circular of the SAFE on Issues Related to Foreign Exchange Administration in Terms of Financing via Overseas Special Purpose Companies and Return Investment by Domestic Residents

D/C: HuiFa[2005]No.75

Date of promulgation: October 21, 2005

Effective Date: November 1, 2005

Gist: Domestic residents (including artificial persons and natural persons) are explicitly allowed to establish overseas financing platforms in the form of special purpose company to carry out various equity-financing activities in the international capital market. At the same time, the related registering procedure is clarified, and the usage of funds and the sale of foreign exchange in terms of profit are also defined.

E, Regulation on Foreign Exchange Inspection

- ³¹ Circular of the SAFE on Printing and Distributing the Revised Report Forms for METHODS OF REPORTING AND MANAGEMENT OF LARGE-SUM AND SUSPICIOUS FOREIGN EXCHANGE TRANSACTIONS BY FINANCIAL INSTITUTIONS

D/C: HuiFa[2005]No. 30

Date of promulgation: April 28, 2005

Effective Date: June 1, 2005

Gist: In order to perfect the regulation and rule of anti-money laundering work in the foreign exchange fields, some parts of the format and filling-in requirements of the report forms for METHODS OF REPORTING AND MANAGEMENT OF LARGE-SUM AND SUSPICIOUS FOREIGN EXCHANGE TRANSACTIONS BY FINANCIAL INSTITUTIONS were revised when the new anti-money laundering information system was launched.

- ³² Circular of the Ministry of Commerce, the Propaganda Department of the CPC Central Committee, the State Commission of Development and Reform, the Ministry of Public Security, the Ministry of Labor and Social Security, the Ministry of Construction, the General Administration of Customs, the State Administration of Taxation, the State Administration for Industry and Commerce, the General Administration of Quality Supervision, Inspection and Quarantine, and the SAFE on Printing and Distributing THE WORKING SCHEME FOR THE SPECIAL OPERATION OF CRACKING DOWN ON FRAUDULENT ACT IN BUSINESS AND TRADE

D/C: ShangZhengGuiFa[2005]No. 269

Date of promulgation: May 18, 2005

Effective Date: May 18, 2005

Gist: The key points and mission of work, the measures for effecting a permanent cure, and the requirement and schedule of work of the special operation are made clear by constituting the working scheme; and an inter- ministry coordination mechanism for cracking down on fraudulent acts in business and trade is also established.

- ³³ Circular of the SAFE on Launching the Information System for Foreign Exchange Anti-money Laundering

D/C: HuiFa[2005]No. 45

Date of promulgation: June 28, 2005

Effective Date: June 28, 2005

Gist: The information system for foreign exchange anti-money laundering was launched on July 1, 2005. During the period from July to August in 2005, the main reporting body of each bank filed monitoring data on foreign exchange anti-money laundering the newly launched system and the original filing channel simultaneously. From September 1, 2005 onwards, monitoring data need only to be filed through the new system.

Terminology in reform of Renminbi exchange rate regime

1, **exchange rate**: the rate at which one country's currency is converted to another country's currency. It is the conversion rate of one country's currency expressed by another country's currency.

2, **exchange rate quotation method**: the method by which one currency will be chosen as basis before calculating the exchange rate between two countries' currencies. In foreign exchange market, there exist two different quotation methods: direct quotation and indirect quotation.

Direct quotation is the quotation method of exchange rate by which certain unit (one, one hundred or ten thousand) of a foreign currency is chosen as basis to calculate certain unit of domestic currency. The higher the rate is, the more the domestic currency will be converted with one unit of foreign currency and the lower the domestic currency's value is.

Indirect quotation is the quotation method of exchange rate by which certain unit of domestic currency is chosen as basis to calculate certain unit of foreign currency. The higher the rate is, the more the foreign currency will be converted with one unit of domestic currency and the higher the domestic currency's value is.

Renminbi exchange rate takes the direct quotation. For example, on August 17th, 2005, the central parity of Renminbi against US dollar is US\$100 for RMB ¥ 810.02.

3, **basic exchange rate and cross rate**: due to the great variety of foreign currencies, it is not convenient to determine the exchange rates between every foreign currency and domestic currency. Therefore, the usual practice is to choose an often-used currency in the country's external economic transactions and calculate the exchange rate between this currency and domestic currency. This rate is the basis rate. In China, the basis rate is the exchange rate of Renminbi against US dollar.

As for the exchange rate between other foreign currency and domestic currency, it can be calculated from the basis exchange rate. The rate calculated in this way is called the conversion rate, or cross exchange rate.

4, **spot exchange rate and forward exchange rate**: according to the difference in settlement maturity of foreign exchange transactions, the exchange rate can be classified as spot exchange rate and forward exchange rate. The settlement refers to the exchange of goods and money between the seller and the buyer under their

transaction contract. The settlement in foreign exchange refers to the transaction in which the foreign currency purchaser pays the domestic currency to the foreign currency seller; and the latter pays foreign currency to the former. The exchange rate is different from one settlement day to another.

Spot exchange rate refers to the exchange rate used in the settlement of foreign exchange within two working days after the contract between buyer and seller is signed.

Forward exchange rate refers to the exchange rate used in the settlement of foreign exchange on a certain future day predetermined in the contract between the buyer and seller.

5, **purchasing rate and selling rate**: purchasing rate is the rate at which banks buy a foreign currency. Selling rate is the rate at which banks sell a foreign currency.

The purchasing and selling rates are expressed from a bank's perspective. The selling rate is higher than the buying rate. The difference between selling rate and purchasing rate is the bank's benefit in foreign exchange transaction and is the risk premium for the bank. Generally speaking, the difference between these two rates is relatively small for such frequently transacted currencies as the US dollar, the Euro, and the Japanese Yen, while the difference is relatively remarkable for some other currencies that are seldom transacted.

6, **basis point**: according to general market practice, the quotation of foreign exchange consists of five figures. Counting from the right to the left, the first is called the basic unit of basis point that is the smallest unit in exchange rate movement, the second one is called tens of unit of basis point, and the rest is followed in the same way.

For example on a trading day, one Euro equals to 1.1010 US dollars and one US dollar equals to 110.11 Japanese Yen. If the rate of Euro against US dollar changes from 1.1010 to 1.1015, it is said that the rate of Euro against US dollar increases by five basis points. If the rate of US dollar against Japanese Yen changes from 110.11 to 109.61, it is said that the rate decreases by 50 basis point.

7, **at premium and at discount**: when forward exchange rate is higher than spot exchange rate, it is called 'at premium'. When forward exchange rate is lower than spot exchange rate, it is called 'at discount'.

In direct quotation, 'at premium' shows the devaluation of the domestic currency and 'at discount' shows the appreciation of the domestic currency. For example, if the spot exchange rate of Renminbi against US dollar is quoted as 100 against 810.02, 10 basis points of premium in forward rate means the forward rate is 100

against 810.12, that is, Renminbi devalues by 10 basis points, vice versa.

In indirect quotation, premium shows appreciation of the domestic currency and discount shows depreciation.

8, **spot foreign exchange market**: in the market, the buyer and seller settle the transaction with the negotiated foreign currency, amount and the prevailing market price.

9, **forward foreign exchange market**: in the market, the buyer and the seller make the settlement between different currencies according to the contracted foreign currency, amount, exchange rate and the predetermined future date.

10, **spot exchange transaction**: in the transaction, the buyer and the seller exchange two different currencies at the negotiated exchange rates and make the settlement within one or two business days.

11, **forward transaction**: in the transaction, the buyer and seller pre-sign the forward foreign exchange contract and predetermine the currency, amount, exchange rate and the future settlement date. On the contracted date, the buyer and seller make the settlement based on the contract.

12, **financial derivative instrument**: it is a financial contract the value of which depends on one or more underlying assets or index. The basic types of contract include forward, futures, swap and options. Derivative instruments also include structural financial products with one or more features of forward, futures, swap and options.

13, **foreign exchange derivative instrument**: it refers to a financial derivative instrument with foreign exchange as the media.

14, **forward**: it refers to a contract between the buyer and the seller to transact a financial product with a predetermined price and trading method on a certain future date.

15, **futures**: it refers to a contract reached by the buyer and the seller by way of open bid-ask trading in an organized exchange and the settlement of certain amount of financial products will be made on a certain future date.

16, **options**: it refers to a contract reached by the buyer and the seller to conduct or not conduct certain financial product transactions on the negotiated date. It is classified as call option and put option. The buyer of a call option has the right to buy a certain financial product at the contracted price on a certain future date or

within a certain future period of time. The buyer of a put option has the right to sell a certain financial product at the contracted price on a certain future date or within a certain future period of time.

17, swap: it refers to the arrangement whereby two or more parties exchange certain amount of payment within predetermined time under the negotiated conditions. Its main types are interest rate swap and currency swap. Interest rate swap is the swap between different interest rate (fixed and floating) of the same currency while the contracted principal is not swapped. Currency swap is the swap between different currencies and the principal is swapped.

18, forward foreign exchange transaction: the trading parties sign foreign exchange transaction contract in advance to determine the trading amount, exchange rate and future settlement time. On the settlement day (a day after the second working day of the contract-signing day), both parties make the settlement according to the contract.

19, forward purchase and sale of foreign exchange : a foreign exchange designated bank signs a forward contract with a domestic institution for future purchase and sale of foreign exchange in contracted currency, amount, exchange rate on ctracted date. For example, an import company will pay as planned a sum of US dollar to overseas exporter after three months. In order to lock the financial cost, the importer may sign a forward purchase and sale contract with a bank. In this case, no matter what happened to the exchange rate of Renminbi against US dollar after three months, the importer may buy US dollars from the bank for payment at the predetermined rate and the foreign exchange risk is lowered.

20, super-forward foreign exchange transaction: it refers to forward foreign exchange transaction with maturity over one year. That is, the customer entrusts a bank to buy one currency and sell another currency on certain date after one year.

21, optional forward foreign exchange transaction: it refers to forward transaction for which the contract does not specify the settlement date but sets the time limit of maturity. Before or at maturity, the customer may freely choose the date to settle the transaction at predetermined exchange rate and amount.

22, foreign exchange options: it refers to the arrangement whereby the customer pays a sum of option fee for the right to buy (sell) or not to buy (sell) certain amount of currency from (or to) bank at predetermined rate before or at maturity. It can be classified by the date of execution as European option and American option. The European option holder may, only on the date of maturity, determine and announce execution or non-execution of the contract, while the American option holder may determine the execution or non-execution of the contract on any business day within the valid maturity of the contract.

23, **foreign exchange futures**: it is the standard contract to exchange one currency to another at the exchange rate in a certain future time that are predetermined in the contract. To buy or sell the foreign exchange futures contract in the foreign exchange money market is called a foreign exchange futures transaction.

24, **currency swap**: the trading parties exchange liabilities of different currencies and interest rates in a time limit in order to evade foreign exchange risks and interest rate risk and to lower the financing cost.

The swap consists of three basic steps: both parties exchange the principal first at negotiated exchange rate, then exchange interest payments according to the interest rates of the original liabilities, and finally swap the original principal on the maturity date at negotiated exchange rate.

25, **foreign exchange futures option**: it refers to the arrangement whereby the option buyer may execute or renounce the right to buy or to sell at executive price on or before the date of maturity. The difference of the arrangement from currency option is that the buyer will acquire futures contract rather than currency when it is executed.

26, **non-deliverable forward (NDF)**: it is an offshore financial derivative product. The parties sign the NDF contract based on their different thinking of the movement of the foreign exchange rate. The forward rate, maturity and amount are determined in the contract. At maturity, only the spread between the agreed exchange rate and the spot rate at the time of settlement is settled or cleared and the transaction has no relation with the amount of principal and the real receipt and payment.

27, **mix sale of foreign exchange**: it refers to the arrangement whereby the enterprises with spot payment by purchasing foreign exchange combine or mix the foreign loans guaranteed by Renminbi deposits with the forward sale of foreign exchange in order to lower the cost. The enterprises with need of spot payment may take advantage of the favorable conditions of forward exchange rate and sign forward contract with the bank, and at the same time, use Renminbi deposit in the bank as guarantee for foreign loans with the same maturity and use the capital from the loan to make external payment. At maturity, they may repay the foreign exchange loan by using the capital from the purchase of foreign exchange at the negotiated forward exchange rate. The cost of the arrangement may be lower than the cost of spot purchase of foreign exchange. Whether it will reduce cost depends

on the spread between spot and forward exchange rates and the spread between the interest rates of the Renminbi deposit and the foreign loan. If the former spread covers the later one, the mix sale of foreign exchange transaction may lower the cost.

28, structural deposit related with exchange rate: it refers to the arrangement whereby the customer assumes certain risk of interest loss and signs a structural deposit contract with a bank in the form of option mix and on the basis of the customer's judgement on the movement of certain foreign exchange rate. The purpose of the arrangement is to acquire higher yield than that of the time deposit.

29, the investment and registered capital difference: it refers to the difference between a FDI company's total investment amount and registered capital amount. According to current debt management policy, the difference is the upper limit or highest possible quota for the company to borrow external debt.

30, external guarantee: it refers to the external guarantee by domestic entities in China in the form of letter of guarantee, standby letter of credit, bank check and bill of exchange; with external mortgage of property prescribed in Article 34 of *The Guarantee Law of The People's Republic of China*; or external hypothecation of personal estate prescribed in Section One, Chapter IV Of *The Guarantee Law* and external hypothecation of rights prescribed in Article 75, Section Two, Chapter IV Of *The Guarantee Law*, the guarantor entity commits itself to an entity out of China (creditor or beneficiary) to fulfill obligation if the debtor does not fulfill the obligation according to contract. The external guarantee includes financing guarantee, financial leasing guarantee, guarantee under the item of compensatory trade or under overseas project contract, and other guarantee with contingent external liability.

31, financing guarantee: this refers to guarantee by the guarantor to reimburse the accounts both principal and interest for the guarantee's financing from the beneficiary. Ways of financing include: loan, the issue of marketable securities (not including stocks), overdraft, deferred payment and credit granting limit granted by a bank. In *the Circular of the State Administration of Foreign Exchange on Adjusting the Administration Method for External Financing Guarantee by Domestic Banks to Overseas Investment Enterprises*, the case by case approval method was adjusted to an annual balance quota approval method. The coverage of guarantors was enlarged from several pilot banks to all qualified designated foreign exchange banks in China and that of policy beneficiaries of guarantee was also enlarged from overseas Chinese-funded enterprises to overseas investment enterprises funded by all domestic institutions.

32, **guarantee under the item of compensatory trade**: this type of guarantee includes both spot exchange performance guarantee and non-spot exchange performance guarantee. The spot exchange performance guarantee refers to the guarantee that is provided by the guarantor to the equipment provider. If the import party does not according to the contract provide the product to the equipment provider or the third party designated by the provider, nor is the importer able to repay with spot foreign exchange for equipment and relevant interests, the guarantor pays the amount, interest and other expenses to the equipment provider.

33, **special purpose vehicle**: this refers to an overseas company established directly or controlled indirectly by domestic resident legal persons or natural persons for the purpose of overseas equity investment (including convertible debt financing) with domestic enterprises' assets or equity that they owed.

34, **round-tripping investment**: this refers to investment conducted domestically by a domestic resident in the name of a special purpose vehicle. It includes but is not limited to the following modes: purchasing or replacing domestic enterprises' equity formerly owned by domestic investors, setting up a foreign invested enterprise and purchasing or controlling domestic assets by negotiation in its name; buying domestic assets negotiation and with the assets to set up foreign-funded enterprises; increasing investment into domestic enterprises and so on.

35, **the system of purchase and sale of foreign exchange of the bank**: the system was launched with China's reform on foreign exchange control in 1994. Since Jan. 1st, 1994, China abolished the system of foreign exchange retention and compulsory turning-over and implemented the system of purchase and sale of foreign exchange in banks under current account. Under the system, sale of foreign exchange refers to the sale of foreign exchange by its owner to designated foreign exchange banks and the banks make the Renminbi payment to the owner at the exchange rate of the transaction day. The purchase of foreign exchange refers to the transaction in which the bank sells foreign exchange to the user and receive equivalent Renminbi at exchange rate on the day of transaction.

36, **inter-bank foreign exchange market**: this refers to the market for exchange transactions between the Renminbi and a foreign currency or different foreign currencies that are conducted via the trading system of the China Foreign Exchange Trading Center by domestic financial institutions (including banks, non-bank financial institutions and foreign financial institutions) and non-financial

enterprises that have been approved to enter the market by the SAFE.

37, **central parity of Renminbi against US dollar**: the China Foreign Exchange Trading Center makes quotation inquiry to the inter-bank foreign exchange market makers before the foreign exchange market opens and takes all of quotations as samples to calculate the central parity of Renminbi against US dollar. The highest and lowest rates are taken out and the weighted average of the remaining quotations is the middle price of Renminbi against US dollar. The weights are determined by the Center in accordance with the comprehensive consideration of such indexes as quotation provider's trading volume in the inter-bank foreign exchange market, the quotations and other indexes. The People's Bank of China authorizes the Center to publicize the central parity of Renminbi against US dollar daily at 9:15 AM. It is the central parity for current day's inter-bank spot foreign exchange market (including OTC and match-making) and for banks' counter transaction. On the basis of the central parity, every designated foreign exchange bank sets its own quotations of selling and buying prices for different foreign currencies within the floating band prescribed by the People's Bank of China.

38, **the rate for foreign exchange in the remittable account**: it refers to the exchange rate at which the designated foreign exchange banks buy or sell foreign exchange in non-cash form from or to customers. A foreign currency remitted is remitted from abroad and is deposited in the bank without withdrawal. It includes the foreign currency remitted directly from overseas banks and the foreign currency received by residents from collection and discount of financial instruments by banks they have entrusted. The instruments include foreign government debt, treasure bill, corporation bond, financial bond, foreign banks' deposit certificate, commercial paper, banker' bill of exchange, private foreign currency check and so on.

39, **cash rate** : it refers to the exchange rate at which designated foreign exchange banks buy or sell bank notes of foreign currency from or to customers.

40, **position squaring**: this refers to transactions of buying or selling conducted by designated foreign exchange banks in the inter-bank foreign exchange market to liquidate position. In accordance with SAFE's regulations on quota control for sale and purchase of foreign exchange and in light of risk management requirement on position of foreign exchange purchase and sale.

41, **inquiry trading**: it refers to the transaction whereby the parties with lines of

credit to each other inquire and negotiate directly on the choice of currency, amount, exchange rate and the settlement time. The transaction is confirmed when both sides have reached an agreement.

42, the order-driven system: it is the method taken in foreign exchange transactions whereby several dealers in the market transact in accordance with certain order driven rules in a trading system or platform. For example, the prevailing trading method in China's present inter-bank foreign exchange market is that the trading is conducted with order-driven rules of time preference and price preference.

43, central line of credit: it refers to the practice that the foreign exchange market organizer as one unit gives certain trading quota to every transaction party in the market in accordance with its trading capital size. Every party also gives the central settlement party certain amount of trading quota.

44, bilateral line of credit: it refers to the practice that the parties in the foreign exchange market give each other a line of credit.

45, bilateral settlement: it is the settlement method whereby the parties in the market reach the foreign exchange transaction and remit the capital directly into each other's designated account other than through a settlement institution.

46, global line of credit: the banks extend the scope of use of the line of credit so that the transnational company can use it globally to meet financial need in global business development. Global line of credit takes the form of loan, guarantee, trade credit and other facilities.

47, the general position for sale and purchase of foreign exchange: it is the foreign exchange position held by a bank and formed from transactions between Renminbi and foreign exchange. The position comes from a bank's business such as the sale and purchase of foreign exchange for its customers and for itself and transactions in the inter-bank foreign exchange market in accordance with foreign exchange regulations. The concept has taken into consideration the foreign exchange risk exposure resulted from a bank's transactions on Renminbi and foreign exchange and is consistent with the internationally accepted definition.

48, inter-bank foreign exchange market maker: it is a member of the inter-bank foreign exchange market who has been approved by the SAFE to assume the

Overview of SAFE

Major Functions

1. Designing and implementing the balance of payments (BOP) statistical system in conformity with international standards, developing and enforcing the BOP statistical reporting system, and collecting relevant data to compile the BOP statement;
2. Analyzing the BOP and foreign exchange positions, providing policy proposals with aim to achieving an equilibrium BOP position, and conducting feasibility study on the convertibility of the renminbi under capital account;
3. Drafting rules and regulations governing foreign exchange market activities, overseeing the market conduct and operations, and promoting the development of foreign exchange market; analyzing and forecasting the foreign exchange supply/demand positions and providing the People's Bank of China (PBC) with propositions and references for the formulation of exchange rate policy;
4. Promulgating regulatory measures governing foreign exchange transactions under current account and supervising the transactions accordingly; monitoring and regulating the foreign exchange account operations both in China and abroad;
5. Managing and monitoring foreign exchange transactions under capital account, including inward and outward remittance and payments;
6. Managing foreign exchange reserves of the state in accordance with relative rules and regulations;
7. Drafting foreign exchange administration rules, examining the domestic entities' compliance with foreign exchange administration rules and regulations, and penalizing institutions engaging in illegal practices;
8. Participating in relevant international financial activities; and
9. Performing other duties and responsibilities assigned by the State Council and the PBC.

Head Office

Apart from its Communist Party of China (CPC) Committee, SAFE Head Office consists of 7 functional departments including General Affairs Department, Balance of Payments Department, Current Account Management Department, Capital Account Management Department, Supervision and Inspection

Department, Reserve Management Department, Human Resources Department (also known as Internal Auditing Department). There are also four institutions affiliated to the SAFE, including Central Foreign Exchange Business Center, Information Center, General Service Center, and Editorial Office for the Foreign Exchange of China Magazine.

General Affairs Department is responsible for: 1) Organizing and coordinating daily operations of the Head Office and managing the electronic system for administrative operations; 2) Providing propositions on major financial and foreign exchange policies based on research; 3) Legal affairs; 4) Press release, publicity and information management; 5) Accounting, international relations and activities; 6) Confidentiality and archives management, handling letters from and calls by people.

Balance of Payments Department is responsible for: 1) Designing and implementing the statistical systems for balance of payments, foreign exchange receipts and payments, foreign exchange sale and purchase with banks, foreign exchange accounts and other items under the administration of the SAFE, and compiling the relevant reporting forms; 2) Supervising the foreign exchange receipts and payments of banks; 3) Monitoring the execution of renminbi exchange rates, conducting research on the exchange rate formation mechanism and providing propositions on exchange rate policies; 4) Supervising the inter-bank foreign exchange market operations and foreign currency settlement in China; 5) Analyzing and forecasting the BOP and foreign exchange positions.

Current Account Management Department is responsible for: 1) Supervising the foreign exchange operations under current account; 2) Formulating and implementing rules and regulations governing the foreign exchange operations under current account; 3) Monitoring and performing off-site surveillance on the verification of export proceeds and import payments as well as the operations of foreign exchange accounts; 4) Performing other

duties assigned to the SAFE in relation to current account administration.

Capital Account Management Department is responsible for: 1) Supervising capital and financial account transactions; 2) Monitoring the foreign exchange receipts and payments, foreign exchange sale and purchase with banks, and foreign exchange account activities under capital and financial account; 3) Conducting statistical forecast and early-warning on capital and financial account; 4) Formulating and enforcing relevant business rules and regulations.

Supervision and Inspection Department is responsible for: 1) Preparing rules and regulations on examination and inspection of foreign exchange transactions; 2) Conducting investigations on unsound or illegal foreign exchange operations, and taking punitive actions accordingly; 3) Organizing and coordinating anti-money laundering work related to foreign exchange administration; 4) Deploying and guiding SAFE branches in examination and inspection of foreign exchange activities.

Reserve Management Department is responsible for: 1) Operating and managing the state foreign exchange reserves according to relevant national strategy and principles; 2) Operating the required reserves of foreign exchange deposit with the PBC's authorization.

Human Resources Department (Internal Auditing Department) is responsible for: 1) Formulating and enforcing rules and procedures in relation to personnel management, staff training and education, salary and benefit, overseas assignment and internal auditing; 2) Managing the organization structure, authorized size and staff management; 3) Managing the overseas assignments; 4) Conducting internal auditing in a manner as authorized.

SAFE CPC Committee is responsible for: Managing CPC party affairs and mass work in the SAFE Head Office and Beijing-based affiliated institutions.

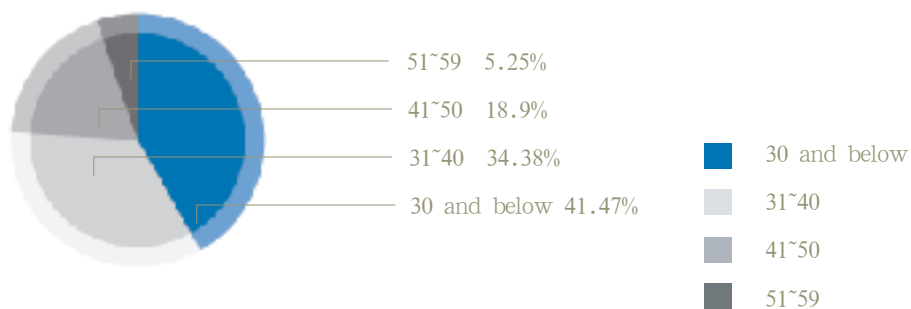
Central Foreign Exchange Business Center has the mandate mainly identical to the Reserve Management Department.

Information Center is responsible for: 1) Drafting the plan for electronic construction of the SAFE; 2) Designing, developing, operating and maintaining the application systems for foreign exchange administration; 3) Coordinating the requirements for IT services by the departments and business units of the SAFE; 4) Rolling out the application systems for foreign exchange administration.

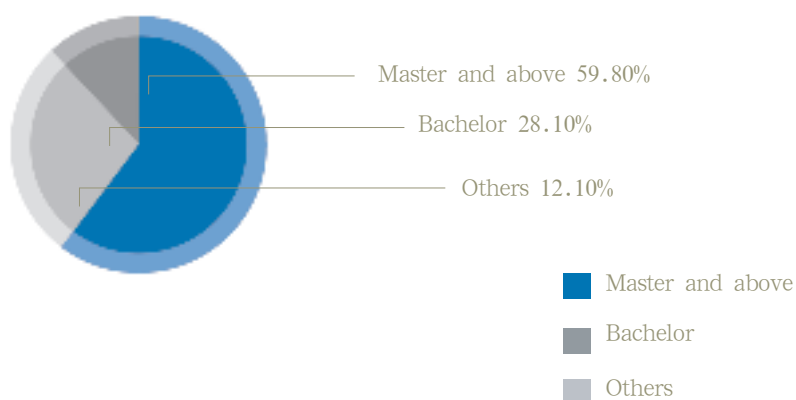
General Service Center is responsible for: 1) Formulating and enforcing the procedures, rules and regulations on the general logistics; 2) Conducting the logistics supply, asset and property management, document printing, transportation services, safety affairs, reception arrangement, security affairs and medical services.

Editorial Office for the Foreign Exchange of China Magazine is responsible for: Editing, publishing and distributing the Foreign Exchange of China Magazine.

SAFE Staff Age Structure (Altogether 381 Persons)



SAFE Staff Education Structure (Altogether 381 Persons)



Branch Network of the SAFE

The SAFE sets up branches and administrative offices in different provinces, autonomous regions and municipalities either directly under the Central Government or with a vice-provincial status. In addition, the SAFE establishes a number of central sub-branches and sub-branches in some cities and counties. These branches, central sub-branches and sub-branches operate in the same office premises with the local PBC branches and sub-branches.

By end-2005, the network of the SAFE was structured as follows:

Layers of organization	Head Office	Branches (Administrative Offices)	Central Sub-branches	Sub-branches
Number of institutions	1	36	298	509