

Recent Developments in RMB Cross-Border Settlements

To speed up the internationalisation of Renminbi (RMB) as a currency to settle cross-border transactions of capital account items, the Ministry of Commerce (MOFCOM), the State Administration of Foreign Exchange (SAFE) and the People's Bank of China (PBoC) have issued a series of administrative circulars since January 2011. These recent developments have put jigsaw puzzles together in respect of using RMB to settle not only such current account items as cross-border commodity trade and services but also such capital account items as inbound foreign direct investment (FDI), outbound direct investment (ODI) and shareholder loans.

Background

As RMB is not a freely convertible currency, conventional FDI by way of capital contribution and acquisition of shares, equity interests or assets of existing companies in the PRC may only be made in foreign exchange. The only source of RMB that foreign investors may use for FDI is post-tax RMB profits derived from their existing foreign-invested enterprises (FIEs). On the other hand, PRC domestic investors must rely on foreign exchange for their ODI projects.

RMB circulation outside of the mainland PRC has rapidly increased since the pilot scheme of RMB settlement for cross-border trade and services was introduced in July 2009 under Circular [2009] No. 10, which was jointly issued by six PRC ministries

and commissions, providing Chinese importers, exporters and service providers that were registered in certain pilot areas with a hedge against exchange losses resulting from fluctuation in the values of other major currencies ensuing the 2008 financial crises.

Following rapid and better-than-expected developments in the RMB cross-border trade and service settlement scheme after July 2009, PBoC, the Ministry of Finance and MOFCOM jointly issued Circular [2010] No. 186 in June 2010, which, for the purpose of settling RMB cross-border trade and service transactions, added 18 more onshore pilot areas and expanded the offshore pilot jurisdictions to all countries around the world.

Recent Developments

CROSS-BORDER RMB FOR CAPITAL ACCOUNT TRANSACTIONS

Onshore RMB Funds for ODI projects

The first step was taken by PBoC in its Circular [2011] No. 1 on 6 January 2011, which allows PRC non-financial investors registered in the pilot areas to remit onshore RMB funds out for investment in ODI projects, including payments for initial deposit and other expenses of such projects up to 15% of the approved total investment amount. Any domestic investors wishing to use onshore RMB funds to settle

ODI project expenses must go through the required verification of their ODI projects by the National Development and Reform Commission and MOFCOM or their respective local counterpart with the delegated power to verify such projects.

Offshore RMB Funds for FDI and shareholder loans

As a second step, MOFCOM issued Circular [2011] No. 72 on 25 February 2011, which permits a foreign investor to use offshore RMB proceeds from its cross-border trade and its “legitimately raised” offshore RMB funds to make new or additional capital contributions of FIEs, acquire shares/equity interests or assets of existing companies or provide shareholder loans to its onshore subsidiaries. Circular No. 72 requires any foreign investors using offshore RMB funds for FDI to apply to MOFCOM through its relevant provincial counterpart for written approvals to such FDI transactions and shareholder loans, and if MOFCOM so approves, the approval document will specify the amount of offshore RMB funds that may be used for such transactions.

Relevant foreign exchange registrations

Third, SAFE issued Circular No. 38 on 7 April 2011 ([see our earlier Legal Update dated 23 June 2011](#)), which lays down operating procedures for foreign exchange registrations and amendments to such registrations in the following respects, among others:

- remittance of onshore RMB funds out of the PRC for ODI projects;
- remittance of offshore RMB funds into the PRC for FDI projects;
- outbound shareholder loans by PRC domestic lenders to their offshore subsidiaries; and
- RMB-denominated foreign debts to PRC domestic borrowers.

Relevant banking settlements

Finally, PBoC issued a Circular for Clarification of Issues Relating to Cross-Border RMB Business (Circular 145) on 3 June 2011, which from the banking settlement perspective:

- regulates cross-border RMB inflows, outflows and banking settlements of such funds;
- specifies that offshore RMB funds legitimately raised by foreign investors may be repatriated back to mainland PRC for FDI projects but such funds may not be invested in real estate developments or financial sector; and
- requires that the banking settlement of capital account transactions be subject to approval by PBoC on a case-by-case basis.

Applications

PERMITTED USES OF CROSS-BORDER RMB FUNDS

With all the above-mentioned steps in place, cross-border RMB funds may now be used for:

- payments by foreign investors for new or additional capital contributions of FIEs;
- acquisitions by foreign investors of shares/equity interests or assets of existing companies in the PRC;
- inbound shareholder loans by foreign investors to their FIE subsidiaries;
- outbound shareholder loans by PRC domestic investors to their offshore subsidiaries; and
- payments by PRC domestic investors for their ODI project expenses.

PERMITTED TYPES OF RMB FUNDS TO BE USED FOR CROSS-BORDER TRANSACTIONS

Circular 145 states that only RMB proceeds that are “legitimately raised” by foreign investors may be used for capital account transactions. While there is no

official interpretation of the term “legitimacy” at present, it may be assumed that the following types of cross-border RMB funds will likely meet the legitimacy test as prior PRC governmental approvals would normally be required for raising or obtaining such RMB funds:

- onshore RMB funds deposited by foreign individuals and institutions in RMB settlement accounts of a PRC bank for settlement of cross-border trade and service payments;
- proceeds from offshore RMB-denominated bond issuances, such as “Dim Sum Bonds” and Synthetic Bonds issued in Hong Kong;
- RMB-denominated dividends distributed by H share companies in Hong Kong;
- RMB-denominated A share liquidation proceeds and dividends of A share companies repatriated to their foreign shareholders;
- RMB-denominated shareholder loans by PRC domestic investors to their offshore subsidiaries;
- RMB-denominated proceeds received by foreign governments or foreign companies from ODI projects undertaken by PRC domestic investors; and
- RMB-denominated IPO proceeds raised in Hong Kong.

CHANNELS FOR INFLOW AND OUTFLOW OF CROSS-BORDER RMB FUNDS

Channels for inflows

Under Circular 145, there are three channels through which cross-border RMB funds may be brought back by a foreign investor into the PRC for an FDI transaction:

- an onshore agent bank of an overseas bank participating in the cross-border RMB pilot scheme;

- an overseas clearing bank designated for the pilot scheme, e. g. Bank of China (Hong Kong); or
- a settlement account opened by the foreign investor with a PRC domestic bank; and the balance of such settlement account is “ring-fenced” and therefore may not be used for purposes other than settlement of cross-border transactions.

Channels for outflows

A PRC domestic investor undertaking an ODI project or providing shareholder loans to its offshore subsidiaries may only remit RMB funds required for such transactions through its onshore RMB bank account, and profits from an ODI project and repayment of principals and interest on any RMB-denominated shareholder loans must be registered with SAFE and therefore such retained RMB funds may serve as another channel for outflow of RMB funds for ODI projects with approval of SAFE.

Conclusion

The recent steps taken by MOFCOM, PBoC and SAFE to internationalise RMB for FDI and ODI settlements will enable both foreign and domestic investors to put their onshore and offshore RMB funds to more diversified uses, thus improving the liquidity of their financial resources. Foreign investors who wish to take advantage of this liberalisation, however, should remain wary of practical hurdles and uncertainties in investing their offshore RMB funds in the PRC until more detailed regulatory guidelines on how to obtain required approvals and what factors will be taken into account are issued by the MOFCOM, PBoC and SAFE.

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