

## MOFCOM Erects Signpost for Cross-border RMB FDI

On 22 August 2011, the PRC Ministry of Commerce (MOFCOM) released a draft circular (for public comments)<sup>1</sup> on issues concerning cross-border Renminbi (RMB) for foreign direct investment (FDI) (the Draft Circular).

The Draft Circular lays down, in greater detail, a much expected regulatory framework for foreign investors (including investors incorporated in Hong Kong, Macau and Taiwan) to follow in using RMB funds that they have “legitimately” obtained outside of the PRC for FDI projects.

### Background

There has been rapid accumulation of offshore RMB funds since a pilot scheme of using RMB to settle cross-border trades and services was introduced in July 2009. The pilot scheme is still developing as a few days before writing this Legal Update, another circular was jointly issued by the People’s Bank of China (PBoC), the Ministry of Finance, MOFCOM, the General Administration of Customs, the State Administration of Foreign Exchange (SAFE) and the China Banking Regulatory Commission, which has expanded onshore areas for implementation of the pilot scheme to all provinces and cities throughout mainland China.<sup>2</sup> Therefore, the scheme has now become full-fledged.

The rapid expansion and better-than-expected outcome of the pilot scheme have prompted the PRC government to find ways to make more productive uses of such large pool of offshore RMB funds. The 12th “Five-Year Plan” adopted at the session of the PRC National People’s Congress in 2010 outlined a general requirement for expanded uses of cross-border RMB funds. During a recent visit to the Hong Kong SAR, Vice Premier Li Keqiang announced that offshore RMB may be invested in FDI projects in mainland China. While MOFCOM, PBoC and SAFE issued a series of circulars in 2010 and the first half of 2011 to permit, in general terms, offshore RMB funds to be repatriated back to mainland China for FDI purposes (see our [Legal Update of 21 July 2011](#)), MOFCOM as the starter of the approval process for such FDI projects has not yet issued any specific regulatory guidelines on how to obtain required approvals and what factors will be taken into account in the approval process. It is probably against such background that the Draft Circular was released for public comments with a view to filling the gap.

### Definition of Cross-border RMB FDI

The Draft Circular defines “cross-border RMB FDI” as direct investment made by foreign investors according to law in the PRC by using offshore RMB funds legitimately obtained by the foreign investors.

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1. The period for public consultation closes on 31 August 2011.

2. The circular was published on the PBoC’s website without details on the date of issuance and the reference number.

## Legitimacy of Offshore RMB for FDI

Under the Draft Circular, offshore RMB funds that may satisfy the legitimacy requirements come from two principal sources as follows:

- **Offshore sources:** RMB funds that are legitimately obtained offshore by foreign investors, including without limitation:
  - » RMB-denominated payments for cross-border import and export transactions; and
  - » proceeds from offshore issuance of RMB-denominated bonds or shares.

As the definition appears to be non-exhaustive, offshore sources could also include:

- » RMB-denominated payments received by foreign investors from outbound direct investments by Chinese domestic investors in other countries;
  - » proceeds from RMB-denominated IPOs that are currently under contemplation in Hong Kong; and
  - » RMB-denominated shareholder loans by PRC domestic investors to their offshore subsidiaries.
- **Onshore sources:** RMB funds that are received by foreign investors from onshore foreign-invested enterprises (FIEs) in which they have invested, including:
    - » RMB profit distributed by such FIEs and repatriated abroad by the foreign investors;
    - » RMB payments received by the foreign investors from transfers of their equity/share holdings in such FIEs;
    - » RMB repayments from reduction in the registered capital of such FIEs;
    - » assets liquidation proceeds in RMB from such FIEs; and
    - » investment recouped in RMB by foreign investors ahead of the Chinese investors from Sino-foreign cooperative joint ventures (CJVs).

## Compliance with Relevant Legal Requirements

The Draft Circular requires any FIE projects or FIE-invested projects using offshore RMB funds to comply with, where applicable:

- PRC laws and regulations applicable to FIEs;
- foreign investment guidelines and policies;
- national security review of any mergers and acquisitions by foreign investors; and
- anti-trust review.

## Prohibited Areas

The Draft Circular expressly prohibits foreign investors from using offshore RMB funds to:

- purchase securities listed on stock exchanges in the PRC, whether directly or indirectly, presumably because such investments have been reserved for qualified foreign institutional investors (QFIIs) under relevant PRC laws and regulations until the proposed “RMB-QFII” or “RQFII” regime is officially launched in the future;
- purchase onshore financial derivatives;
- provide entrustment loans; or
- repay loans from onshore and offshore lenders.

## Investments in Real Estate Development Projects

As a standing-out exception to the prohibited areas under the Draft Circular, foreign investors are indeed permitted to invest offshore RMB funds in real estate development projects, but must comply with approval and filing requirements generally applicable to foreign-invested real estate development projects. The Draft Circular specifies that any such investment projects that have been approved or filed with MOFCOM will be announced in the MOFCOM’s website.

It is also noteworthy that PBoC's Circular 145, which was issued as recently as 3 June 2011, expressly prohibits foreign investors from investing offshore RMB funds in real estate development projects. It is not entirely clear why the Draft Circular is inconsistent with Circular 145 in this regard.

### Approval and Verification Process

The Draft Circular empowers local counterparts of MOFCOM to review and approve any applications for using offshore RMB funds for FDI projects in accordance with relevant laws and regulations generally applicable to FIEs. MOFCOM's verification of an application for such an investment is required, however, if the application involves:

- a project whose registered capital contribution amounts to RMB300 million or more;
- investments in financial security, financial leases, micro-credits or auctioneer business;
- investment holding companies, foreign-invested venture capital or private equity investments; or
- such an industry subject to macro-economic regulatory adjustments and controls as production of cement, iron and steel or electrolytic aluminium and ship building industry, etc.

Attached to the Draft Circular is a standard form information sheet, which must be filled out and signed by foreign investors applying for approval of the above-mentioned investment projects and will be submitted to MOFCOM (through its provincial counterpart) for verification. By signing the information sheet, the foreign investor undertakes not to invest offshore RMB funds in the prohibited areas outlined above.

### Supporting Documents

A foreign investor applying for approval of an FDI project using offshore RMB funds must also submit

the following documents, in addition to such other documents as may be generally applicable to an FIE investor:

- documentary evidence of legitimate sources of the offshore RMB funds;
- a statement of the uses of such funds; and
- a letter of undertaking not to invest such funds in the prohibited areas outlined above.

In respect of an existing FIE whose registered capital was initially contributed in a currency other than RMB, the foreign investors wishing to use offshore RMB funds for further capital contributions must also submit relevant resolutions adopted by the board or the equivalent body, and agreements for amendments to relevant joint venture contract and articles of association of such FIE, if applicable, approving the RMB-denominated capital contributions.

### Onshore RMB Profits and Receipts

The Draft Circular also affirms that FDI by using:

- onshore RMB profits received by foreign investors but not repatriated abroad;
- payments for equity/share transfers, repayments from reduction in registered capital or liquidation proceeds from their FIEs; and
- investment recouped by foreign investors from CJVs,

will remain subject to existing laws and regulations generally applicable to the uses and investments of such onshore RMB receipts.

### Conclusion

The Draft Circular witnesses another pleasing step towards the internationalisation of RMB as a currency to settle capital account transactions and has no doubt erected a clearer signpost for foreign investors who wish to use their offshore RMB funds

for FDI purposes. What remains to be seen, apart from the inconsistencies outlined above, is whether and when other PRC governmental authorities in charge of various respects of regulatory regime for such investments will issue compatible and operable measures for foreign investors to follow in implementing their FDI projects, so that foreign investors can expect that, once they have satisfied the approval authorities on the legitimacy of their holding of offshore RMB funds:

- their applications for such investments will be reviewed and approved on an across-the-board basis rather than on a case-by-case basis; and
- they will be able to invest the offshore RMB funds in FDI projects just as they have done with their onshore RMB profits and receipts.

## Contact Us

For inquiries related to this Legal Update, please contact the following persons or your usual contacts with our firm.

### **Hannah Ha**

Partner

T: +852 2843 4378

E: [hannah.ha@mayerbrownjism.com](mailto:hannah.ha@mayerbrownjism.com)

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