

New Ways to Use Your Offshore RMB: MOFCOM and PBoC Join Hands to Put Finishing Touches on RMB FDI Rules

In a clearly concerted effort, the PRC Ministry of Commerce (“**MOFCOM**”) issued on 12 October 2011 a Circular on Relevant Matters concerning Direct Investment using Cross-border RMB (“**Circular No. 889**”) and the People’s Bank of China (“**PBoC**”) announced on 13 October 2011 the Administrative Measures on RMB Settlement for Foreign Direct Investment (“**PBoC Measures**”). These new rules were both promulgated on 14 October 2011 and have clarified, from the regulatory and banking settlement perspectives, a number of remaining issues left by previous rules of these two central governmental authorities in respect of foreign direct investment (“**FDI**”) using cross-border Renminbi (“**RMB**”).

The promulgation of Circular No. 889 and the PBoC Measures has provided more outlets for using an increasing pool of RMB funds in Hong Kong. It is widely believed that these new rules would expedite the development of offshore RMB business in Hong Kong. We will explain below the key points of the new rules and their implications on RMB fund raising activities in Hong Kong.

Circular No. 889

This Circular is substantially based on a previous draft issued by MOFCOM on 22 August 2011 for public consultation (see our Legal Update entitled

“[MOFCOM Erects Signpost for Cross-border RMB FDI](#)” of 29 August 2011) (the “**Consultation Draft**”).

COMPARISON WITH THE CONSULTATION DRAFT

It appears that there are three major differences between Circular No. 889 and the Consultation Draft in respect of permitted areas for cross-border RMB investment.

- **Strategic investment in listed companies**

Under the Consultation Draft, no cross-border RMB funds may be invested directly or indirectly in any securities and financial derivatives whereas under Circular No. 889, such funds may be used by foreign strategic investors to purchase shares in PRC listed companies by way of private placement of new issues, or off-exchange share transfers under agreement, subject to the approvals under the Administrative Measures on Foreign Investors with Strategic Investments in Listed Companies (the “**Strategic Investors Measures**”).

The carve-out of strategic investment from the prohibited investment areas is probably due to relatively stringent requirements under the Strategic Investors Measures, including:

- » a minimum of 10% shareholding in an invested company;
- » a three-year lock-up period; and
- » strong financial resources required for strategic investors,

all of which would minimize (if not prevent) possible speculative (hot money) RMB investment by foreign investors in PRC domestic stock market.

- **Repayment of onshore and offshore loans**

Circular No. 889 also permits the use of offshore RMB funds to repay onshore and offshore loans (presumably including shareholder loans), which was listed in the Consultation Draft as one of the prohibited areas for use of cross-border RMB funds.

- **No requirement for letters of undertaking**

Circular No. 889 removes the requirement in the Consultation Draft for a foreign investor to submit a letter of undertaking not to invest cross-border RMB in prohibited areas.

PBoC Measures

RMB SETTLEMENT ACCOUNTS

Any foreign investor wishing to bring in and use its legitimately raised RMB funds to settle payments for FDI transactions must open an RMB settlement account (人民币结算账户), which is a current account for RMB receipts and expenditures. For the purpose of making cross-border RMB FDI transactions, the principal rules governing the opening and operation of RMB settlement accounts include:

- » the Measures on Administration of RMB Settlement Accounts (issued by PBoC on 10

April 2003) (the “**RMB Settlement Account Measures**”) and their Detailed Rules for Implementation (issued by PBoC on 19 January 2005); and

- » the Measures on Administration of RMB Settlement Accounts for Foreign Entities (effective as from 1 October 2010).

CIRCULAR NO. 145

Earlier this year, PBoC issued Circular [2011] No. 145 (“**Circular No. 145**”), which set out in general the banking settlement of capital account transactions using cross-border RMB (see our Legal Update entitled “[Recent Developments in RMB Cross-Border Settlements](#)” of 21 July 2011). However, Circular No. 145 fails to provide sufficient guidelines for foreign investors to follow in opening and operating their RMB settlement accounts for FDI projects.

ROLE OF PBOC MEASURES

The PBoC Measures aim to fill the gap left by Circular No. 145 and have specified on a comprehensive basis:

- the procedures for opening RMB settlement accounts for various FDI transactions;
- the documents required to open and operate RMB settlement accounts; and
- restrictions on operation of RMB settlement accounts.

Relevant matters under the PBoC Measures on opening and operation of settlement accounts for RMB FDI transactions are summarised in the table below.

Transaction	Settlement account type	Account holder(s)	Required documents to be presented to banks	Restrictions on account operation
Initial capital costs for greenfield FIE	Dedicated account for RMB initial capital costs	Foreign investor(s)	<ul style="list-style-type: none"> • Payment instructions; • statement of fund uses; and • letter of undertaking on fund uses 	Any balance will be transferred to RMB capital account or refunded to the investors after FIE is incorporated
Capital contributions of greenfield and existing FIE	Dedicated RMB capital account	Foreign investor	<ul style="list-style-type: none"> • FIE Approval Certificate; • Business Licence; • Organization Code Certificate; • Registration with PBoC's local counterpart • For investment in real estate projects, filing with MOFCOM 	No cash deposits or withdrawals are permitted
Incorporation of greenfield FIE through merger and acquisition of domestic enterprise	Dedicated RMB account for merger and acquisition	Domestic seller	As per the RMB Settlement Account Measures and other relevant rules	No cash deposits or withdrawals are permitted
Payment for transfers of share/equity held by Chinese investor in existing FIE	Dedicated RMB account for share/equity transfers	Chinese investor	As per the RMB Settlement Account Measures and other relevant rules	No cash deposits or withdrawals are permitted
Reinvestment or increase in capital contributions using onshore RMB fund ¹	Dedicated RMB account for reinvestment	Foreign investor	<ul style="list-style-type: none"> • RMB reinvestment approval and filing documents; and • tax payment certificates 	
RMB equity investment by FIE holding/venture capital/equity investment company	Dedicated RMB capital account	Equity investor	As per the RMB Settlement Account Measures and other relevant rules	No cash deposits or withdrawals are permitted
Offshore-sourced RMB loans borrowed by FIEs	Dedicated RMB loan deposit account	FIE borrower	<ul style="list-style-type: none"> • RMB loan agreements; • payment instructions; • statement of fund uses; and • tax payment certificates 	

¹ The "onshore RMB fund" refers to RMB funds derived by foreign investors from post-tax profit distribution, investment recouped by foreign investors ahead of Chinese counterparts in a Sino-foreign cooperative joint venture, FIE liquidation proceeds, FIE capital reduction and FIE share/equity transfers.

OTHER KEY POINTS

To monitor inflows, uses and outflows of RMB funds, the PBoC Measures also specify the following key points:

- Each FIE using cross-border RMB funds must file required information with relevant local counterpart of PBoC and amend the filed information in case of any material changes;
- Each FIE using cross-border RMB funds must arrange for qualified PRC accountants to verify any RMB-denominated capital contributions by foreign investors and issue capital verification report, which is a key supporting document for any fund transfers from an RMB settlement account;
- RMB-denominated loans borrowed by any FIE from its shareholders, affiliated companies or offshore financial institutions must be aggregated with its foreign exchange loans to determine the total borrowing amount of the FIE; and
- Relevant account-opening banks must perform supervisory duties to ensure the genuineness and compliance of uses of RMB capital and loans; to report inflows and outflows of RMB funds to the monitoring system for cross-border RMB receipts and payments; and to combat against any money-laundering and counter-terrorist financing transactions.

Implications for RMB Fund Raising Activities in Hong Kong

EXPANSION OF RANGE OF OFFSHORE RMB USES

In recent years, the Hong Kong government has been paying considerable effort to expand the width and depth of RMB fund raising activities in Hong Kong. In particular, RMB-denominated corporate bonds (“**Dim Sum bonds**”) have become very popular and the range of participating issuers has expanded significantly from predominantly the sovereign and

banks in mainland PRC to Hong Kong and multinational companies and international financial institutions. In fact, the Dim Sum bond market of Hong Kong is the largest outside the mainland. Besides Dim Sum bonds, The Stock Exchange of Hong Kong Limited is also promoting diligently RMB equity offerings in Hong Kong including RMB initial public offerings (“**IPOs**”) and RMB follow-on offerings such as placing, rights issue and open offer, etc. and various measures have been implemented to cope with such development.

CONSTRUCTION OF OFFSHORE RMB FUND RAISING PLATFORM

Until the promulgation of Circular No. 889 and the PBoC Measures, issuers participating in such cross-border RMB financing activities had faced a major obstacle: remittance of RMB from Hong Kong to mainland PRC was not streamlined and required case-by-case governmental approvals. Also, RMB funds raised offshore could only be used for limited purposes. With the new rules in place, RMB funds in Hong Kong will have more investment channels in mainland PRC as explained above. Permitting Hong Kong entities with RMB funds to finance direct investments in mainland PRC would certainly encourage the holding of offshore RMB funds, thus increasing the pool size of offshore RMB funds and RMB liquidity. It would also increase the appetite of Hong Kong enterprises to make use of the RMB fund-raising platform in Hong Kong to raise funds in RMB through debt (such as Dim Sum bonds) and/or equity (such as RMB IPOs and RMB follow-on offerings).

Conclusion

Circular No. 889 and the PBoC Measures clearly reflect the awareness by MOFCOM and PBoC of an increasing demand for concerted rules by regulatory authorities concerning cross-border RMB fund for FDI projects. These new rules provide clearer and

more concrete guidelines for making FDI in mainland PRC in RMB. It is anticipated that such measures would not only facilitate the development of the mainland's real economy, they would also provide huge opportunities for Hong Kong to enhance and promote its RMB fund raising platform.

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