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New Investment Channel Opens: Offshore RMB Funds

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1. BACKGROUND

China, a country that has long been known to have the world's most rigorous control over cross-border currency movements, has slowly embarked on a journey towards the internationalization of its own currency. After its first attempt in July 2009, when it introduced a pilot scheme to allow Renminbi ("RMB") to settle cross-border trades¹, the offshore RMB market has exploded. Particularly, RMB deposits in Hong Kong ballooned to RMB553.6 billion yuan at the end of June 2011, according to the Hong Kong Monetary Authority. In response to calls for a direct investment channel to utilize the increasingly enlarged pool of RMB currency parked offshore to benefit China's domestic economy, China's Ministry of Commerce ("MOFCOM"), the People's Bank of China ("PBoC"), and the State Administration of Foreign Exchange ("SAFE") issued a series of circulars in 2010 and the first half of 2011 to allow offshore RMB funds to be repatriated back to mainland China for foreign direct investment ("FDI") purposes.

A recent visit of Vice Premier Li Keqiang to the Hong Kong SAR ushered two regulations on offshore RMB FDI, namely the *Circular concerning Certain Issues on Direct Investment Involving Cross-Border RMB*² by the MOFCOM ("MOFCOM Circular") on 12 October 2011 and the *Administrative Measures on RMB Settlement in Foreign Direct Investment*³ by the PBoC ("PBoC Measures") on 13 October 2011. These two regulations took another essential step towards the internationalization of RMB. The MOFCOM Circular further standardizes the offshore RMB FDI process, whereas the PBoC Measures greatly simplifies the approval process for repatriating RMB proceeds raised offshore into the PRC. Theoretically, the groundwork for new investment channels has been laid for raising and investing offshore RMB funds. This alert focuses on three aspects of the new regulations that are particularly relevant to this consideration: (1) approval for repatriation of offshore RMB funds into the PRC; (2) approval procedure for FDI of offshore RMB funds; and (3) the FDI investment scope.

2. DEVELOPMENT HIGHLIGHTS

2.1 Approval for repatriation into the PRC

The PBoC Measures greatly simplify the RMB repatriation into PRC approval procedure. According to the PBoC Measures, repatriation of offshore RMB to foreign-invested enterprises ("FIE") no longer requires the PBoC's approval, whether in the form of debt or capital contribution. The PBoC no longer stipulates any eligibility requirements for repatriation of offshore RMB into the PRC. Neither does the PBoC review the proposed onshore use of offshore RMB

¹ The first regulation of offshore RMB FDI is *Measures for the Administration of Trial Launch of Renminbi Settlement of Cross-Border Trade* Announcement No. 10 [2009] by the People's Bank of China, Ministry of Finance, Ministry of Commerce, General Administration of Customs, State Administration of Taxation, and China Banking Regulatory Commission.

² The Chinese title of the MOFCOM Circular is 商务部关于跨境人民币直接投资有关问题的通知.

³ The Chinese title of the PBoC Measures is 外商直接投资人民币结算业务管理办法.

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proceeds repatriated into the PRC, or cross-border RMB proceeds, but will merely monitor the use of proceeds on a post-remittance basis. Yet the role of the MOFCOM in the regulation of cross-border RMB debt remains unknown. The MOFCOM does expressly stipulate RMB equity FDI but is silent on cross-border RMB debt.

The removal of the PBoC's required approval repatriation of offshore RMB funds into the PRC on one hand simplifies the approval procedure. On the other hand the removal greatly empowers onshore receiving banks in repatriation applications. Application for the opening of an RMB settlement account is only required to be made with the onshore receiving bank, and the onshore receiving bank is only required to make a filing with the local branch of the PBoC after the account opens. Onshore receiving banks are now also entrusted with the primary responsibilities for monitoring use of the cross-border RMB proceeds repatriated into the PRC.

2.2 Approval procedure of FDI with offshore RMB

Offshore RMB funds could be repatriated back into the PRC through FDI and shareholder's loans. The MOFCOM Circular elaborates on the offshore RMB funds and the FDI approval procedure.

- **General approval**

The MOFCOM at all levels shall examine and approve offshore RMB FDI in accordance with the administrative provisions and authority on foreign investment examination and approval. An investor or an FIE shall submit the following documents to the relevant MOFCOM, in addition to the documents required by applicable laws and regulations: (1) certificate or supporting documents on the sources of RMB funds; (2) statement on the intended purposes of the RMB funds; and (3) a fact sheet of RMB FDI.

Even though the requirement to hand in "A statement of following the regulations on the prohibited uses of cross-border RMB" signed by investors or legal representatives has been removed, we still think the MOFCOM will pay close attention to the stipulations on prohibited uses of cross-border RMB.

- **Special industries**

The local MOFCOM shall input the fact sheet of RMB FDI into the foreign investment examination and approval management system. With regard to FDI falling under any of the following circumstances, the MOFCOM at the provincial level shall sign and affix their seals to the fact sheet of RMB FDI, and submit the same to the central MOFCOM for review where: (1) Where the RMB investment amounts to RMB300 million or more; (2) Where the investment is related to industries such as financing guarantee, financial leasing, micro-credit, auction, etc.; (3) the investment involves foreign investment-oriented companies, or foreign-invested venture capital or equity investment enterprises; or (4) the investment is to be made in cement, iron and steel, electrolyzed aluminum, shipbuilding or other industries under state macro-regulation.

The MOFCOM shall complete a review or put forward review opinions within five working days upon receipt of the fact sheet of RMB FDI submitted by a provincial MOFCOM. Once the application for FDI passes the review, the relevant local MOFCOM may give an official reply and issue the an approval certificate for an FIE.

2.3 Offshore RMB FDI investment scope

The FDI and the re-investment made by FIEs in which it is invested shall be in compliance with the laws, regulations and

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relevant provisions on foreign investment, and be in conformity with State industrial policies, as well as the provisions on anti-monopoly review and security review of foreign investment mergers and acquisitions.

- **No investment in negotiable securities and financial derivatives**

The offshore RMB funds shall neither be used, directly or indirectly, for investment in negotiable securities and financial derivatives in China (except for the circumstance stipulated in Article 11 of the MOFCOM Circular⁴), nor be used to provide entrusted loans.

The MOFCOM Circular draft prohibits FDI to repay outstanding domestic and foreign bank borrowings. The fact that the MOFCOM Circular removes the item implies that it is possible to use FDI RMB to repay outstanding bank borrowings. It thus appears that a foreign shareholder of an FIE may, subject to the MOFCOM's approval, repatriate offshore RMB into the PRC by way of an equity injection into the FIE to repay the FIE's RMB loans.

- **Investments in real estate development**

As a outstanding exception to the prohibited areas, foreign investors are in fact 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 MOFCOM Circular provides that a cross-border RMB FDI could be approved as long as it complies with existing FDI regulations. Accordingly, an RMB FDI in real estate with a total amount of USD300 million or less should be approved by local MOFCOM. The local MOFCOM is required to file such approval with the central MOFCOM, which will be announced on the website of the MOFCOM. We anticipate that this would allow the real estate developers to raise offshore RMB funds by issuing RMB bonds.

3. CONCLUSION

The MOFCOM's Circular and the PBoC's Measures are another big step towards the internationalization of RMB as a currency to settle capital account transactions, which will afford no doubt promises a greater role for RMB in global trade and finance but also enormous business and investment opportunities to foreign trading firms and banks. These two regulations are allowing further flexibility in offshore RMB FDI, which will enable offshore RMB funds for more diversified uses. Given the promises and opportunities, foreign and domestic investors who mean to take advantage of the regulations should be cautious about practical hurdles and uncertainties in the new investment channels.

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⁴ Article 11 of the MOFCOM Circular: The foreign investors participating in the equity private placement and equity transfer by agreement of domestic listed companies by using the offshore RMB lawfully obtained shall go through the relevant examination and approval procedures with the MOFCOM in accordance with the Administrative Measures on the Strategic Investment in Listed Companies by Foreign Investors.

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