

Client Alert.

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MOFCOM and SAFE Announce Additional Rules on Foreign Invested Holding Companies

By Xiaohu Ma, Jun Deng, Shifeng Ni

On 8 December 2011, the Ministry of Commerce of China (“MOFCOM”) and the State Administration of Foreign Exchange (“SAFE”) promulgated the *Notice on Further Improving Management Measures Concerning Foreign Invested Holding Companies* (进一步完善外商投资性公司有关管理措施的通知) (the “Notice”).

A Foreign Invested Holding Company (外商投资性公司) (“FIHC”) refers to a foreign invested enterprise (“FIE”) in the form of a wholly foreign-owned enterprise (“WFOE”) or an equity joint venture established to engage in direct investments or to hold equity interests in other companies in China.

There are 2 key points in connection with the Notice that are noteworthy:

- **Leveraged Investment Prohibited.** The Notice specifically prohibits an FIHC from making any leveraged investments in China using domestic loans. This is in contrast to the *Circular Concerning Certain Issues on Direct Investment Involving Cross-border RMB* (the “MOFCOM Circular”) promulgated by the Ministry of Commerce on 12 October 2011¹, which does not contain this specific prohibition. Under the MOFCOM Circular, the scope of offshore RMB funds available for cross-border direct investments is defined more broadly to include all RMB funds obtained by a foreign investor through legal channels. However, under the Notice, only proceeds derived from the issue of RMB denominated bonds or shares are specifically mentioned, in addition to those derived from cross-border trades, dividend distributions, equity transfers, capital reduction, liquidation, or early capital return. It thus remains to be further clarified whether or not a foreign investor is prohibited from making cross-border RMB direct investments by leveraging offshore RMB loans.
- **Direct Reinvestment of Domestic RMB Incomes Without Capital Increase Permissible.** According to the Notice, subject to the verification and approval of a local SAFE branch, an FIHC may use income legally derived from the dividend distributions, early return of capital, liquidation, equity transfer, or capital reduction (which can be in RMB cash) to make any reinvestments in China. The requirements for the verification and approval of the local SAFE are consistent with the requirements set forth under the Circular Concerning Certain Issues on Direct Investment Involving Cross-Border RMB by the MOFCOM on 12 October 2011 and the Administrative Measures on RMB Settlement in Foreign Direct Investment by the People’s Bank of China on 13 October 2011. Alternatively, an FIHC may contribute such income to its own registered capital before making any investments in China. Notably, the Notice essentially constitutes an adjustment to SAFE’s previous position under the *Notice on the Implementation Guideline for Issues Relating to the Capital Verification for Reinvestment by the Foreign Invested Holding Companies* (Hui Zi Han [2011] No. 07) which required an FIHC to contribute all such domestic income to the increase of the FIHC’s registered capital before it can be used for reinvestment purposes.

¹ For more information, please see our Morrison & Foerster Client Alert titled, “New Investment Channel Opens: Offshore RMB Funds,” on 6 December 2011. <http://www.mofo.com/files/Uploads/Images/111205-New-Investment-Channel-Opens-Offshore-RMB-Funds.pdf>

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FIHC is a form of FIE that MOFCOM has been using to encourage multinational companies to set up regional headquarters in China and FIHC used to have several advantages over normal FIEs. The establishment of an FIHC is subject to MOFCOM's approval at the central level. The value of an FIHC has been diluted during the past several years, as there are more benefits now available to WFOEs and it is relatively easy to set up FIEs at the local level. It seems, however, that MOFCOM is still keen to regulate and promote FIHCs by focusing on reinvestment issues relating to FIHCs.

Contact:

Xiaohu Ma

Hong Kong

+852 2585 0868

xma@mofocom.com

Jun Deng

Hong Kong

+852 2585 0878

jdeng@mofocom.com

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