

Open gate

More new rules have been published that clarify the cross-border flow of *Renminbi* and they signal that China has formally opened the channel for cross-border and nation-wide *Renminbi* foreign direct investment

Since the launch of the pilot *Renminbi* (Rmb) settlement for cross-border trade in July 2009, the demand for Rmb foreign direct investment (RFDI) has skyrocketed due to the strong interest from foreign enterprises wanting to invest in Chinese companies and the eagerness of domestic enterprises for offshore investment and financing. Due to the narrow channel permitting offshore Rmb to flow back to the Mainland, offshore Rmb transaction hub Hong Kong has an urgent need to have widened channels for the backflow of Rmb. On June 3 2011, the People's Bank of China (PBoC) promulgated the *Circular on Clarification of Matters Relating to Cross-border Rmb Business* (Yin Fa [2011] No.145) (关于明确跨境人民币业务相关问题的通知) (银发[2011]145号)) (Circular 145) to initiate the pilot RMB settlement programme for foreign direct investment and made clear that the RFDI includes investments for establishing new enterprises, merging domestic enterprises (other than reserve mergers), equity transfers and capital increases for current enterprises, and providing stockholder loans. Later, Vice

Investment (Announcement [2011] No.23 of the PBoC) (外商直接投资人民币结算业务管理办法) (中国人民银行公告[2011]第23号) (PBoC Measures) which was promulgated the next day, officially allows foreign investors to make direct investment in China using legally-obtained offshore Rmb capital. It also signals that China has formally opened the channel for RFDI on a nation-wide and cross-border basis.

Qualified sources of offshore Rmb funds

According to Notice 889, qualified sources of offshore Rmb funds include: (i) those obtained by foreign investors through cross-border trade settlement; (ii) Rmb profits lawfully-obtained within the territory of China and remitted out of China; (iii) those obtained from share swaps, capital reductions, liquidations and early recoveries of investment; and (iv) those obtained outside China by foreign investors through lawful channels, including but not limited to overseas issuances of Rmb-denominated bonds or stocks, etc.

However, Notice 889 is not applicable where foreign investors make direct investments with the Rmb profits gained from their foreign-invested enterprises (FIEs) in China but not repatriated abroad and Rmb funds obtained from share transfers, capital reductions, liquidations, and the early recoveries of investment. According to the PBoC Measures, if an overseas investor uses Rmb funds acquired through Rmb profit distribution, an early recovery of investment, liquidation, reduction of capital, equity transfer, etc. to reinvest in China or to increase its registered capital,

the overseas investor may deposit the Rmb funds into the dedicated deposit account for the use of Rmb for reinvestment and handle relevant settlement business.

Furthermore, the PBoC Measures also prescribe that an FIE may, within its foreign debt quota, borrow Rmb and foreign exchange loans from its overseas shareholders, its affiliated enterprises within the same group and overseas financial institutions.

Scope of RFDI

Compared with Circular 145, Notice 889 and the PBoC Measures broaden the RFDI scope by no longer prohibiting RFDI from investing in projects in the restricted category or projects under the key control of the state. In order to ensure offshore RMB funds flow into the real economy rather than the speculative market, Notice 889 imposes restrictions that the Rmb funds of



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Premier Li Keqiang, during his visit to Hong Kong in August, put forward *Thirty-six Policies and Measures of the Central Committee to Facilitate the Economic and Social Development of Hong Kong* (中央挺港三十六条政策) including "to extend the scope of pilot Rmb settlements for cross-border trade to nation-wide so as to facilitate the use of Rmb by more enterprises in the business and direct investments, and further strengthen Hong Kong's position as the Rmb settlement centre".

In the context of the soaring market demand and the systematic arrangement by the governmental authorities, on October 12 the Ministry of Commerce (Mofcom) issued the *Circular on Issues Relevant to Cross-border Direct Investment in Renminbi* (Shang Zi Han [2011] No.889) (商务部关于跨境人民币直接投资有关问题的通知) (商资函[2011]第889号) (Notice 889). This notice, together with the PBoC's *Measures for the Administration of Renminbi Settlement Matters Relating to Foreign Direct*

the RFDI may neither be used, directly or indirectly, for investment in negotiable securities and financial derivatives in China, nor be used to provide entrusted loans. It also requires that the enforcement status of aforesaid restrictions be inspected by competent commerce departments every year during the time the enterprises attending the joint annual inspections.

Article 11 of Notice 889 stipulates that after going through the relevant examination and approval procedures with Mofcom in accordance with the *Measures for the Administration of Strategic Investments in Listed Companies by Foreign Investors* (外国投资者对上市公司战略投资管理办法) (Order 28), foreign investors may participate in equity private placements and equity transfers into domestic-listed companies by using offshore Rmb. Although this is allowed by Notice 889, the impact of RFDI on the Chinese stock market will be limited since Order 28 imposes very stringent requirements on the eligibility of investors.

It is worth noting that Notice 889 provides that with the approval of Mofcom, foreign-invested holding companies, foreign-invested venture capital or equity investment enterprises are allowed to accept Rmb investments made by foreign investors, while previously, qualified overseas limited partners may only set up Rmb funds in the Pudong District, Shanghai by way of equity investment through foreign exchange. In addition, pursuant to Notice 889, RFDI in real estate is permitted, which may further inspire property developers to raise funds by issuing RMB bonds.

Approval authority

According to Notice 889, RFDI shall be examined and approved by the competent commerce departments at all levels in accordance with the prevailing administrative provisions and authority on foreign investment examination and approval. However, where the original capital contribution currency of RFDI is changed from a foreign currency to Rmb, approval from Mofcom shall also be obtained.

Furthermore, RFDI falling under any of the following circumstances is subject to a preliminary review by the competent commerce departments at the provincial level, which in turn shall submit the same to Mofcom for a final approval: (i) where the Rmb investment amounts to Rmb300 million or more; (ii) where the investment is related to industries such as financing guarantee, financial

leasing, micro-credit, auction, etc.;(iii) where the investment involves foreign investment-oriented companies, or foreign-invested venture capital or equity investment enterprises; or (iv) where the investment is to be made in cement, iron and steel, electrolyse aluminum, ship-building and other industries under State macro-regulation. Since Rmb investments amounting to less than Rmb 300 million are only required to be examined



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PBoC's supervision

According to the PBoC Measures, an FIE (either newly-established or established through a merger or acquisition) shall, within 10 working days after obtaining its business licence, apply to the branch of the PBoC at the place where the enterprise is registered for the registration of enterprise information. Meanwhile, the PBoC adopts an accounts supervision system which is similar with that adopted by the State Administration of Foreign Exchange. Under the principle of dedicated account for special use, foreign investors shall open a dedicated deposit account for upfront expenses in Rmb for depositing Rmb funds used to pay for upfront expenses relating to the investment project. Separately, they should have a dedicated deposit account for the use of Rmb for reinvestment for depositing Rmb funds acquired through profit distribution, liquidation, capital reduction, equity transfer, early recovery of investment, etc. and used for re-investment in China. After the FIE is established, the balance of the upfront expenses should be transferred into the dedicated deposit account for Rmb capital funds opened in accordance with the PBoC Measures or returned through the original route.



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