The People’s Bank of China (“PBOC”) promulgated the Administrative Measures on RMB Settlement in Foreign Direct Investment (《外商直接投资人民币结算业务管理办法》) (the “PBOC Measures”) on 13 October 2011, whilst the Ministry of Commerce (“MOFCOM”) promulgated the Circular concerning Certain Issues on Direct Investment involving Cross-border RMB (《商务部关于跨境人民币直接投资有关问题的通知》) (the “MOFCOM Circular”) on 12 October 2011. Whilst both have the effect of formalising and simplifying the approval process for repatriating Renminbi (“RMB”) proceeds raised offshore into China (“PRC”) and contain some much welcomed breakthroughs and clarification, there remains a number of unanswered questions and uncertainties. Most of these uncertainties relate to the interaction between the rules and regulations promulgated by PBOC, MOC and the State Administration of Foreign Exchange (“SAFE”). There is also some guidance provided for specific industries such as real estate companies and banks.

**Breakthroughs and Clarification**

**Abolition of requirement for PBOC’s approval for repatriation into PRC**

Under the PBOC Measures, repatriation of offshore RMB to a foreign invested enterprise (“FIE”) by foreign investors into the PRC (whether in the form of debt or capital contribution) no longer requires PBOC’s approval. There will no longer be any merit-based or industry-based or other substantive review by PBOC.

PBOC no longer stipulates any eligibility requirements for repatriation of offshore RMB into the PRC. Instead, the PBOC Measures merely re-affirm the basic principle that foreign direct investment (“FDI”) made in the PRC in RMB must comply with the requirements under the PRC FDI laws. Going forward, PBOC will defer to other governmental agencies to set the eligibility requirement for different forms of FDI in RMB in different industries.

PBOC will no longer review the proposed onshore use of offshore RMB proceeds repatriated into the PRC, or cross-border RMB proceeds, but will merely monitor the use of proceeds on a post-remittance basis. Some of the more “controversial” usages such as using cross-border RMB proceeds for the repayment of onshore bank borrowings are not explicitly prohibited in the
PBOC Measures. As a further step, the original prohibition included in the consultation draft of the MOFCOM Circular on FIEs using cross-border RMB proceeds to repay onshore loans has been removed. It appears that a foreign shareholder of an FIE may, subject to 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.

The abolition of the requirement for PBOC’s approval of repatriation of offshore RMB proceeds into the PRC has radically simplified the regulatory process and removed one of the major sources of uncertainty in the repatriation of offshore RMB proceeds into the PRC.

**Empowering 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 PBOC after account opening.

Similarly, any debt servicing (repayment of principal and interest) by FIEs of cross-border RMB debt can be handled by banks directly without PBOC’s approval.

Onshore receiving banks are now also entrusted with the primary responsibilities for monitoring the use of the cross-border RMB proceeds repatriated into the PRC. They may exercise discretion in applying the “prudential” standards. It is probable that the banks may generally apply the same standards to the use of cross-border RMB debt and equity proceeds, and may apply similar restrictions to those applicable to FDI made in the PRC in a foreign currency under the current foreign exchange regulatory regime. However, it is yet to be tested as to how vigorous the banks’ review and monitoring process will be and whether PBOC or the SAFE may issue any implementing rules or guidance in the future for banks to follow.

For details of the new settlement account opening and monitoring process with the receiving banks, please see *Bank Account Opening and Monitoring* below.

**Clarification of foreign debt calculation**

The relevant rules issued by SAFE in April 2011 provide that cross-border RMB debt received by an FIE will generally be regulated by reference to the rules applicable to cross-border loans denominated in foreign currencies. These rules do not seem to have been affected by the PBOC Measures.

The PBOC Measures further provide that cross-border RMB debt of a FIE from its offshore parent and group affiliates and other offshore financial institutions should be aggregated with its other foreign currency loans, presumably for calculating its total “foreign” debt. This is in line with the general requirement for compliance with FDI laws and the understanding that cross-border RMB loans will continue to be subject to the relevant rules.
issued by SAFE – most notably the foreign debt quota and registration requirements.

However, it remains to be seen how the relevant foreign debt rules will be implemented in practice with respect to cross-border RMB debt. These uncertainties may continue to present difficulties for FIEs which do not have sufficient foreign debt quota or headroom (i.e. the difference between the total investment amount and the registered capital) to support the borrowing of cross-border RMB debt from its offshore parent or affiliates.

The Big Unknown

Uncertainty on MOFCOM’s regulation of cross-border RMB debt

Whilst it is clear that the repatriation of cross-border RMB debt or equity to an FIE no longer requires PBOC’s approval, the biggest unknown that remains is MOFCOM’s role in the regulation of cross-border RMB debt, if any. The MOFCOM Circular only expressly regulates RMB equity-related FDI (see MOFCOM Application Process below for details of the application process) and is silent on cross-border RMB debt. This differs from an earlier MOFCOM notice which specifically requires that MOFCOM’s approval be obtained for cross-border RMB debt provided by a foreign entity to an onshore entity. It is also interesting to note that a receiving bank is not required by the PBOC Measures to be provided with any proof of MOFCOM’s approval when opening a general deposit account for an FIE to receive cross-border RMB debt, whereas the PBOC Measures specifically require the receiving bank to be provided with the relevant approval or filing documents from the relevant government authorities when opening a specific deposit account for an FIE to receive capital contribution in RMB. As MOFCOM has opted to remain silent and did not clarify this issue in the MOFCOM Circular notwithstanding the requests of a number of commentators during the consultation process, the issue of whether MOFCOM’s approval is required for a cross-border RMB debt provided by a foreign investor remains one of the biggest unknown in the regulatory process.

Other Unanswered Questions

On-lending to lower level onshore subsidiaries

The PBOC Measures have not addressed the issue of the application of cross-border RMB proceeds by FIEs with onshore subsidiaries. Many multinational corporates and red-chips have through their FIEs established onshore subsidiaries to undertake projects onshore. In addition to operating projects directly, these FIEs typically also function as onshore holding companies and funding platforms. Their onshore subsidiaries are, however, not strictly regulated as FIEs and do not have any foreign debt quota or headroom. To the extent such an FIE opens a general or specific deposit account under the PBOC Measures, there remains considerable uncertainty as to whether it will be able to on-lend or otherwise transfer the cross-border RMB loan proceeds received to its operating subsidiaries onshore. The only clarification on this subject is that the MOFCOM Circular has expressly prohibited the use of proceeds from RMB capital contribution as entrustment
loans to project companies. The existing SAFE regulations on foreign currency debt generally do not allow FIEs to on-lend foreign currency debt proceeds to their subsidiaries. It is not clear whether a similar approach will be taken by SAFE or onshore banks in respect of cross-border RMB debt.

**Direct lending by offshore banks**

The requirement under the PBOC Measures for the aggregation of cross-border RMB debt from the offshore parent or a group affiliate of an FIE and cross-border RMB debt from “offshore financial institutions” for statistical purposes has led to suggestions that there may be a re-opening of the window for offshore financial institutions to provide RMB financings to onshore entities directly. This is an area which we believe would require further clarification by the PBOC and SAFE.

**A Few Special Industries**

The ban on repatriation of offshore RMB proceeds into the PRC for FIEs falling within the “restricted” category has been uplifted. This may open the door for a number of industries such as banks and real estate companies to utilise cross-border RMB proceeds, which was previously regarded as off limits. Repatriation will now instead be driven by the consent and approval requirements of the relevant industry regulators, with the PBOC taking a back-seat.

**Real estate companies**

Both the PBOC Measures and the MOFCOM Circular contemplate RMB FDI into the real estate sector. However, the current SAFE regulations generally do not allow the remittance of foreign currency shareholder’s loans to an onshore real estate company. It is likely that the same restrictions will apply to cross-border RMB debt. The MOFCOM Circular provides that cross-border RMB FDI in the real estate industry will be approved in accordance with the existing real estate FDI rules and regulations. As such, RMB capital injection by a foreign investor to a real estate project with a total investment amount of USD300 million or less can be approved by the local MOFCOM. The local MOFCOM is required to make a filing with the central MOFCOM in respect of each such approval. Projects in respect of which filings have been successfully made with the central MOFCOM will be published on MOFCOM’s website. It remains to be tested as to whether MOFCOM will approve repatriation of offshore RMB into the PRC real estate industries and whether there will be any variation in practice among the local MOFCOM in different localities.

**Banks**

As one of the initiatives announced by Vice-premier Li Keqiang during his official visit to Hong Kong in August 2011 to support the development of the offshore RMB market, the PRC government will study the feasibility of enabling foreign banks to repatriate offshore RMB into the PRC in the form of capital contribution to their onshore branches and subsidiaries. It appears that the key regulator will be China Banking Regulatory Commission (“CBRC”), the country’s watchdog of the banking industry.
**Auto financing companies**

The use of cross-border RMB debt by auto financing companies regulated by the CBRC is even more unclear. The business scope of auto financing companies does not include the borrowing of foreign debt and these companies do not have any foreign debt quota as such. The existing SAFE regulations prohibit auto financing companies from raising foreign debt. It remains unclear whether CBRC and SAFE will relax the existing rules to enable such remittance.
Bank Account Opening and Monitoring

Settlement Accounts
An FIE recipient is required to open a special onshore RMB settlement account to receive cross-border RMB proceeds from its foreign investor. A general deposit account will be required for receiving offshore RMB debt proceeds and a specific deposit account for capital contribution.

Approval Process
Application for the opening of the RMB settlement account will be processed and approved by the FIE’s onshore receiving bank. The receiving bank will be required to make a filing with the local branch of PBOC after account opening.

Application Documents
The application documents are as follows:

- Loan contract (for debt proceeds) or relevant government documentation (for capital contribution)
- Account opening application form
- Business licence
- Organisational code certificate
- Tax registration certificate
- Basic deposit account (account opening) registration certificate
- Identification documentation of legal representative; and if applicable, power of attorney and identification documentation of the attorney
- Other documents required by the receiving bank for verification of use of proceeds (see “Use of Proceeds” below).

Use of Proceeds
There is no specific restriction on use of proceeds. A segregation and monitoring system has been established as follows:

- Segregation: The use of general and specific deposit accounts ensures that the cross-border RMB proceeds will be segregated from other onshore RMB. No cash transaction can be conducted through any specific deposit accounts (for capital contribution).

- Supervision: Each receiving bank is required to investigate the truthfulness of the stated use of cross-border RMB proceeds by a FIE recipient and whether the use complies with applicable laws, and to supervise the lawful use of the cross-border RMB proceeds. In undertaking any settlement business, a receiving bank is required to obtain and review materials including payment orders and evidence of use of proceeds in accordance with the relevant prudential requirements, although no specific guidance has been given to the banks.
Reporting: The receiving bank must report to the PBOC the inward remittance and outward transfer through the general and specific deposit accounts on a timely basis.

PBOC will monitor the use of proceeds on a post-remittance basis.

MOFCOM Application Process

Scope of Application
The MOFCOM Circular applies to “cross border FDI in RMB”, which includes any onshore FDI activities by foreign investors using RMB lawfully obtained by them offshore. The MOFCOM Circular does not expressly refer to FDI in the form of debt (see The Big Unknown – Uncertainty on MOFCOM’s regulation of offshore RMB debt on page 2).

Foreign investors may only use cross-border RMB proceeds raised through “legitimate channels”, including:

- cross-border trade settlements;
- issue of offshore RMB bonds or securities; and
- profit distribution, sale of equity interests, reduction of registered capital and liquidation of, or early repatriation of investment from, an FIE.

Approval Process
Application will need to be made to the local MOFCOM by the FIE (or its sponsors in the case of the initial establishment).

In general, a cross border FDI in RMB can be approved by the local MOFCOM. However, if the cross border FDI in RMB:

- equals to or exceeds RMB 300 million;
- involves investment in finance guarantee, finance leasing, microfinance or auction industries;
- involves investment in foreign invested holding companies, venture capital enterprises or equity investment fund enterprises; or
- involves investment in any industry subject to national macro-control policies, such as cement, iron and steel, electrolytic aluminium and ship-building,

the local MOFCOM is required to refer its findings to the central MOFCOM. The central MOFCOM will then review the local MOFCOM’s report and provide its views within five working days following receipt of the report. If the central MOFCOM does not raise any objections, the local MOFCOM may complete its review and approve such application.
**Application documents**

In addition to the usual documents a foreign investor or FIE is required to submit for an FDI application, the following documents will need to be submitted:

- documentary proof or explanation of source of cross-border RMB proceeds;
- an explanation of the use of cross-border RMB proceeds; and
- a completed Information Form of Cross-border RMB Direct Investment (the prescribed form of which is attached to the MOFCOM Circulars).

In relation to an application for change in the approved currency of capital contribution to RMB, the FIE is required to submit the relevant board or shareholders resolutions and the amended constitution documents (such as joint venture contract and articles of association).

In respect of the application documents to be submitted to the MOFCOM evidencing the source of RMB for FDI, an applicant may now submit documents which can either evident or explain the source of RMB proceeds (instead of submitting documents explaining and evidencing the source of RMB proceeds as previously required under the consultation draft of the MOFCOM Circular). This change suggests that the obtaining of RMB proceeds is not a pre-requisite for applying for MOFCOM’s approval. An application letter or letter of intent explaining how the RMB proceeds will be raised offshore should suffice.

**Use of Proceeds**

Cross-border RMB proceeds cannot be used, directly or indirectly, in the PRC to invest in securities or financial derivatives, or for the purpose of entrustment loans. MOFCOM will require a written commitment to this effect from the investors as part of the approval process. The only exception for using cross-border RMB proceeds for securities investment relates to strategic investments in A-share listed companies by way of private placement or transfer by agreement approved in accordance with the MOFCOM rules on strategic investments in listed companies.