LLINKS Law Offices
通力律师事务所

Shanghai
19F, ONE LUJIAZUI
68 Yin Cheng Road Middle
Shanghai 200120 P.R.China
Tel: (86 21) 3135 8666
Fax:(86 21) 3135 8600

Beijing
Units 902-903
Winland International Finance Centre
No.7 Finance Street, Xicheng District
Beijing 100033 P.R.China
Tel: (86 10) 6655 5050
Fax:(86 10) 6655 5060

上海
上海市银城中路68号
时代金融中心19楼
邮政编码: 200120
电话: (86 21) 3135 8666
传真: (86 21) 3135 8600

北京
北京市西城区金融大街7号
英蓝国际金融中心9楼02-03单元
邮政编码: 100033
电话: (86 10) 6655 5050
传真: (86 10) 6655 5060

www.llinkslaw.com
master@llinkslaw.com

Llinks Corporate Bulletin
April 2012

New Means for Foreign Investors to Invest in RMB Equity Investment Funds: An Alternative Application of RFDI

By David Yu, Nicholas Lou and Kevin Huang

Ever since the promulgation of the *Administrative Measures for the Establishment of Partnership Enterprises in the People's Republic of China by Foreign Enterprises or Individuals* and the *Administrative Regulations for the Registration of Foreign-invested Partnership Enterprises* in 2010, there has long been heated discussions in the industry on the possibility of the participation by investment management companies (commonly as the general partner, or "GP" of a limited partnership) and foreign investors (commonly as the limited partner, or "LP" of a limited partnership) in RMB equity investment funds (the "**EIF**"s) in the People's Republic of China (the "**PRC**"). Also, PRC legislation authorities have also taken a cautionary approach to such topic. Take Shanghai as an example, though the promulgation of the *Interim Measures for the Establishment of Foreign-Invested Equity Investment Management Enterprises in the Pudong New Area of Shanghai Municipality* (Pu Zheng Zong Gai [2009] No.2) legalized the setting up of foreign equity investment management enterprises in Pudong, foreign investors are yet permitted to participate in RMB EIFs (including PRC equity investment enterprises, or "**EIE**"s) as limited partners due to certain restrictions in the PRC foreigner exchange rules.

Current Situation of Foreign Investments in EIEs/EIFs

Barring all capital in foreign currency from being converted into RMB and used for equity investments, the *Notice of the General Affairs Department of the State Administration of Foreign Exchange on the Relevant Operating Issues concerning the Improvement of the Administration of Payment and Exchange of Foreign Currency Capital of Foreign-funded Enterprises* (Hui Zong Fa [2008] No.142) provides that foreign partners/investors may not have their foreign capitals exchanged into RMB to carry out any equity investments in the PRC. As around the year of 2011, relevant rules regarding the piloting of foreign investments in the EIEs (the "QFLP Rules") were adopted in cities including Shanghai, Beijing, Chongqing and Tianjin. According to such QFLP Rules, a foreign investor may be able to participate in the RMB EIF/EIFs in such above cities as a limited partner upon the approval by competent authorities.

如果您需要本出版物的中文本，请与下列人员联系：

郭建良: (86 21) 3135 8756
Publication@llinkslaw.com

If you would like other Llinks publications, please contact:

Roy Guo: (86 21) 3135 8756
Publication@llinkslaw.com

Llinks Law Offices
www.llinkslaw.com

The QFLP Rules of each of the above pilot cities enabled foreign investors to participate in the investment and establishment of foreign invested EIEs (the "**FIEIE**"s) or foreign invested equity management enterprises with applications submitted according to relevant rules. Enterprises passed the review and approval under the QFLP Rules will be entitled to have foreign capitals exchanged under certain circumstances in order to make equity investments in the PRC. However, enterprises of each pilot city are all subject to strict requirements in getting such approval. For example, the *Tianjin Interim Measures for Launching a Pilot Project of Foreign-invested Equity Investment Enterprises and their management Institutions* along with its implementation rules (collectively the "**Tianjin Pilot Measures**") requires the applicant to be an enterprise of no less than RMB 500 million (or any equivalent foreign currency) capital; the foreign investor or its affiliated entity shall have no less than 5 years' investment experience; and each foreign investor shall at least contribute US$ 10 million in the pilot EIE they apply for. Moreover, due to the "pilot" nature, the review processes of pilot EIEs are done in extreme scrutiny and only a limited number of enterprises have obtained the approval, which in fact shut most foreign investors out of the door of investment into the RMB EIF/EIEs.[1]

Foreign Investor's Chance to Invest in RMB EIE/EIFs by Means of RFDI

On 12 October 2011, the Ministry of Commerce of the PRC (the "**MOFCOM**") promulgated the *Notice of the Ministry of Commerce on Issues Relating to Foreign Direct Investment with RMB* (Shang Zi Han [2011] No.889, the "**No.889 Notice**"), allowing foreign investors to carry out direct investment within the PRC using RMB funds legally obtained from overseas (the "**RFDI**"). As such, foreign investors were provided with two means of investment by RFDI:

- ➢ The foreign investor invests in a fund established overseas, which being legally exchanged into RMB before carrying out investment in the PRC as a "foreign investor";

- ➢ The foreign investor has its money exchanged into RMB and makes direct investment in RMB EIEs.

The first means above makes the exchanging of foreign currency into RMB faster and easier for foreign EIFs to make equity investments in the PRC, though such EIFs will still be deemed as foreign investors. The second means provides foreign investors with an opportunity to invest in RMB EIEs in China other than following the QFLP Rule, which may just burst out as a new popular way to make equity investments in the PRC for foreign investors.

Policies Backing Up the Investments in RMB EIEs by means of RFDI

The permission granted to foreign investors to make RFDIs by the PRC government marks as one of the government's many measures in pursuing the globalization of RMB and lessening capital account restrictions. To elaborate, the No.889 Notice allows foreign investors to carry out direct investment in the PRC using RMB funds legally obtained overseas. In other words, investments made by means of RFDI in FIEIEs were among the scope of matters permitted under the No.889 Notice[2], which serves as the supporting policy of RFDI.

However, after the promulgation of the No.889 Notice, none of the relevant authorities including the National Development and Reform Committee (the "**NDRC**"), the State Administration of Industry and Commerce (the "**SAIC**") and the State Administration of Foreign Exchange (the "**SAFE**") have issued any implementation measures regarding the administration and operation of the investments using overseas-obtained RMB funds in FIEIEs. According to the current rules and regulations governing foreign investments, any equity investment enterprise that takes overseas RMB funds from foreign investors, shall be deemed as a foreign-invested enterprise, and any further investment by whom will constitute a "re-investment by a foreign-invested enterprise", thus subjecting to relevant restrictive rules.

The Source of Funds Used in RFDI

In accordance with the above No.889 Notice, "RMB Funds Obtained Overseas" in RFDI means: (1) RMB funds obtained by foreign investors through RMB settlement in cross-border trades, and RMB funds legally transferred overseas regarding profits, transfer of shares, capital reduction, liquidation and early recovery of investment obtained from within the PRC by foreign investors; (2) RMB funds obtained from outside of the PRC by foreign investors through lawful channels, including but not limited to RMB funds from overseas issuance of RMB-denominated debt securities or equity securities.

The above rules gave foreign investors the green light to finance RMB funds through legal means, or legally exchange the funds in foreign currencies into RMB and make use of such as capital contribution for RMB EIEs. As stated by the No.889 Notice, both RMB funds raised by offshore private equity funds, and RMB funds obtained through the exchange of funds raised in foreign currencies, shall be deemed as "overseas-obtained RMB funds" in RFDI.

Noteworthy Issues During Investment

Despite creating an alternative means for the investment in EIEs, the RFDI currently poses several noteworthy issues for the investors.

- Nature of the EIE

  According to the *Administrative Measures for the Establishment of Partnership Enterprises in the People's Republic of China by Foreign Enterprises or Individuals* adopted by the State Council on 1 March 2010, any partnership established by foreign enterprises or individuals within the PRC shall be deemed as a "foreign-invested partnership". The capital contribution of such "foreign-invested partnership" may be made in any freely exchangeable foreign currency or in the legally obtained RMB currency. As such, despite the fact that generally the investors of such partnership may make contribution in RMB, the partnership itself, as so established or formed, shall nonetheless be deemed as a foreign-invested partnership, which shall be subject to various industry guidelines and rules if it wishes to further invest within the PRC. Such partnership may, as a result, be subject to certain restrictions or even stricter review and supervision if it intends to make investment in the industries such as the real estate industry.

It is also noteworthy that though the funds of a foreign-invested partnership established by means of RFDI is free from onshore conversion of foreign currencies, and thus further evades all relevant QFLP Rules, such foreign-invested partnership itself is still subject to the registration rules of the SAIC and relevant filing requirements by the NDRC. In addition, in the event that the foreign investor is making contribution with funds raised overseas rather than with its own RMB funds, the NDRC may thoroughly review the entire family tree of any relevant foreign entity such as consolidated fund trust or partnership, and may count in each such entities in determining the "number of investors", as stipulated under the *Notice by Development and Reform Committee on Strengthening the Conformed Development of Equity Investment Enterprises* ([2011] No.2864).

➢ Determination of the Nature of the Investor

Article 3 of the No.889 Notice states that "the RMB foreign direct investment and the re-investment by the foreign-invested enterprise of such aforesaid investment shall comply with requirements of the laws and regulations regarding foreign investment and its relevant rules, and shall also comply with the foreign investment industry guideline and policy, as well as the security review and anti-monopoly review of foreign related mergers and acquisitions". Such provision is in accordance with the stipulations under the *Administrative Regulations for the Registration of Foreign-invested Partnership Enterprises* promulgated by the SAIC in 2010.[3]

However, the No.889 Notice did not clearly provide how to "comply with requirements of the laws and regulations regarding foreign investment and its relevant rules". Regarding such, officials from the SAIC foreign investment bureau held the view that the application, review and approval procedures of these enterprises shall follow those governing direct foreign investments, and that such related enterprises are to be deemed as foreign-invested enterprises as their investments within the PRC bears similarity to those made by foreign-invested investment companies and the foreign-invested venture capital enterprises. Nevertheless, authorities from the MOFCOM have yet to recognize the above. According to the Tianjin Pilot Measures, when investing in PRC enterprises, the exchange of capitals (in foreign currency) of pilot EIEs shall be subject to the administration of foreign-invested projects, and shall be subject to the approval by the local development and reform authority of where the investee enterprise is situated, as well as the approval for establishment of foreign-invested enterprises by commerce authorities.

Since no foreign exchange will be involved in RFDI, whether the further investments made by a FIEIE so established will be deemed as a re-investment within the PRC by a foreign-invested enterprise, or be deemed as foreign direct investment pursuant to rules governing foreign-invested investment companies is yet to be confirmed by the MOFCOM or its local counterparts of each level according to their understanding and practice.

➢ Account Administration

Though no foreign exchange is needed for the investors when carrying out RFDI, and that no administration by the SAFE will be involved, relevant rules issued by the People's Bank of China regarding the settlement of overseas-obtained RMB funds still need to be complied with.

According to the *Measures for the Administration on RMB Settlement in Foreign Direct Investment* (PBOC Notice [2011] No.23), investors who intends to make RFDI in EIEs shall bear in mind that in accordance with the *Measures for the Administration on RMB Settlement in Bank Accounts* and relevant bank rules on money settlements, when a foreign-invested partnership, whose primary business is making investments, legally carries out investment within the PRC with RMB funds, its target enterprises (investee) shall apply for the opening of a special RMB capital account in order to deposit the RMB investment funds and conduct relevant fund settlements, and that such account shall not be used for the paying and receiving of any cash. Furthermore, if any EIE is established by overseas-obtained RMB funds, all legit investments made by it using RMB currency, and all payments made and incomings of funds received by it through the special RMB capital account will be subject to the supervision and review by the bank.

- Review by Commerce Authorities

According to Article 6 of the No.889 Notice, when reviewing the application of a RFDI in FIEIE, the commerce authority at the provincial level shall submit to the MOFCOM for approval after signing on the *Registration Form of RMB Foreign Direct Investment*. Upon receipt of the Registration Form, the MOFCOM shall complete the approval or issue a review opinion within five (5) working days. Upon approval by the MOFCOM, local commerce authorities may issue an official document of recognition and issue the approval certificate for foreign-invested enterprise.

Therefore, establishing a FIEIE by means of RFDI will need the approval by the MOFCOM after the submission by the commerce authority at the provincial level. The review will take 5 working days and may involve stricter tests and more complicated communication process, which still impose uncertainties to RFDI in PRC EIEs.

Conclusion

As such, RFDI does offer new ways for foreign investment funds and foreign investors to be able to participate in PRC equity investment industry. Accordingly, a foreign investment fund manager may: (1) set up an EIE overseas using foreign currency and legally exchange the funds of such EIE into RMB, before making direct RFDI to participate in the equity investment business in the PRC; or (2) Upon recognition by the commerce authorities, legally establish an RMB fund in overseas regions (including Hong Kong) and raise funds in RMB, before making RFDI using such funds to participate in the equity investment business in the PRC. Correspondingly, a foreign investor may: (1) legally exchange foreign currency into RMB before investing such in an overseas RMB fund; (2) legally exchange foreign currency into RMB before investing such in a PRC EIE. However please note all the above investment means are still subject to the foreign investment industry guidelines and policies of the PRC, as well as all relevant laws, regulations and policies of foreign-invested partnerships.

LLINKS Law Offices 通力律师事务所

New Means for Foreign Investors to Invest in RMB Equity Investment Funds:
An Alternative Application of RFDI

Contact Details

If you would like to know more information about the subjects covered in this publication, please feel free to contact the following people or your usual Llinks contact.

Shanghai	**Beijing**
David Yu Tel: (86 21) 3135 8686 David.Yu@llinkslaw.com	**David Yu** Tel: (86 10) 6655 5050 David.Yu@llinkslaw.com
Ming Zhang Tel: (86 21) 3135 8777 Ming.Zhang@llinkslaw.com	**James Weng** Tel: (86 10) 6655 5050 - 1028 James.Weng@llinkslaw.com
Clare Lu Tel: (86 21) 3135 8667 Clare.Lu@llinkslaw.com	

1 Detailed information in the *Pilot Measures for Foreign-invested Equity Investment Enterprises in Shanghai* issued January 2011, and the *Tianjin Issues Pilot Measures for Foreign-invested Equity Investment Enterprises* issued December 2011 in Llinks Corporate Bulletin.

2 Article 6 of the No.889 Notice states that: "the local competent commerce authority shall input the *Registration Form of RMB Foreign Direct Investment* into the foreign investment examination and approval management system. In the event any RMB foreign direct investment using falls under any of the following circumstances, the competent commerce departments at the provincial level shall sign and affix their seals to the *Registration Form of RMB Foreign Direct Investment*, and submit the same to the Ministry of Commerce for review:

(1) The investment amounts to 300,000,000 or more in RMB;

(2) The investment is related to industries such as financing guarantee, financial leasing, micro-credit, auction, etc,;

(3) The investment involves foreign-invested holding companies, or **foreign-invested venture capital or equity investment companies**;

(4) The investment is to be made in cement, iron and steel, electrolyze aluminum, shipbuilding or other industries under the State macro-economic control."

3 Article 64 of the *Administrative Regulations for the Registration of Foreign-invested Partnership Enterprises* promulgated by the State Administration of Industry and Commerce stipulates that "investment within the People's Republic of China made by foreign-invested partnerships whose primary business are investments shall be in conformity with the relevant laws, administrative regulation and rules of the State regarding foreign investment".