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The Ministry of Commerce and the People's Bank of China Promulgate New Rules for Foreign Direct Investment with RMB

By David Yu and Sam Feng

On 12 October 2011, the Ministry of Commerce (the "MOFCOM") promulgated the *Notice of the Ministry of Commerce on Issues Relating to Foreign Direct Investment with RMB* (the "Notice"), allowing foreign investors to carry out direct investment in China using RMB funds legally obtained from overseas. On 13 October 2011, the People's Bank of China promulgated the *Measures for the Administration on RMB Settlement in Foreign Direct Investment* (the "Implementation Rules"). As follow-up to the Notice, the Implementation Rules provides detailed implementation rules for banks to provide RMB settlement services for direct investments by foreign investors in China.

Background

In order to promote the international influence of RMB, China has promulgated a series of laws and regulations to allow RMB settlement in cross-border trades, and further permission of RMB settlement in the financial market also seems inevitable. On 6 January 2011, the People's Bank of China promulgated *The Measures for the Administration of Pilot Program on Settlement of Outbound Direct Investment with RMB* to regulate RMB settlement in outbound direct investments. Further, on 3 June 2011, the People's Bank of China issued the *Notice on Clarifying Issues Relating to Cross-border RMB Transactions*, making public the pilot rules of RMB settlement in foreign direct investments. It is the promulgation of the Notice and the Implementation Rules that marks China's official permission for foreign direct investments with RMB funds.

Definition of the RFDI

The Notice defines the foreign direct investment with RMB (the "RFDI") as: "the direct investment in China lawfully made by foreign investors with RMB funds legally obtained from outside of China".

The Notice further elaborates "RMB funds legally obtained outside of China" as:

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- RMB funds obtained by foreign investors through RMB settlement in cross-border trades; RMB funds legally transferred overseas regarding profits, transfer of shares, capital reduction, liquidation and early recovery of investment obtained from within China by foreign investors; and

- RMB funds obtained from outside of China by foreign investors through lawful channels, including but not limited to RMB funds obtained from overseas issuance of RMB-denominated bonds or stocks etc.

Restrictions

According to the Notice, MOFCOM issued two requirements with respect to the RFDI:

As the RFDI is of foreign direct investment nature, it shall comply with all relevant laws and regulations regarding foreign direct investment in China. Thus, the RFDI and re-investments by foreign-invested enterprises that carry out the RFDI shall comply with the laws and regulations governing foreign investments, and conform to China's foreign investment industrial policies, as well as the provisions on security review of mergers and acquisitions regarding foreign investment and anti-monopoly review.

Moreover, MOFCOM sets out specifically that RMB funds of the RFDI shall not be invested, directly or indirectly, in negotiable securities and financial derivatives in China, nor shall it be used to provide entrusted loans. However, foreign investors may, according to *Administrative Measures for Foreign Investors' Strategic Investment in Listed Companies*, use RMB funds for the purchase of shares directly issued by domestic listed companies or on the transfer of shares under agreements executed with domestic listed companies. In addition, foreign investors may invest in China's real estate industry with RMB funds only if they have completed the approval and filing requirements in accordance with the prevailing administrative provisions,

Supervisions from Approval Authorities

- General Supervision

  Generally, competent departments of commerce at various levels shall review the RFDI for approval in accordance with the relevant prevailing administrative provisions as well as their respective authority levels. A foreign investor or foreign-invested enterprise shall further submit the following documents to the competent department of commerce, along with the documents commonly required by the laws and regulations regarding foreign investment and other applicable rules:

  - A certificate or supporting documents to prove the sources of its RMB funds;

  - A statement on the intended purposes of its RMB funds; and

  - The Registration Form of RMB Foreign Direct Investment.

➢ Special Supervision

Any RFDI that falls within the following circumstances shall be reviewed by MOFCOM under special supervision:

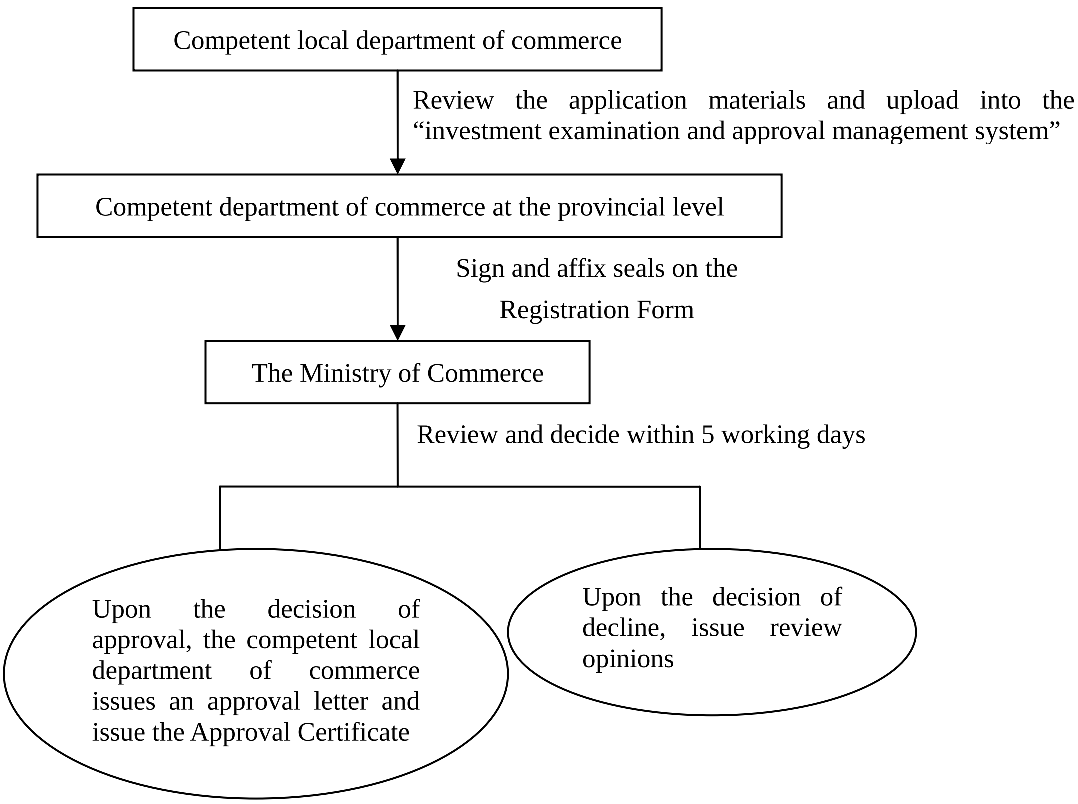
- The RMB investment amounts to RMB300,000,000 or more;

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

- The investment involves foreign invested holding companies, or foreign-invested venture capital or equity investment enterprises; or

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

Below is the process for the special supervision:



Though the piloting of RMB settlement for foreign direct investment according to the *Notice of People's Bank of China on Clarifying Issues Relating to Cross-border RMB Transaction*s did not include projects in the restricted industries or under the centralized control of the state, the new Notice now allows foreign investors to carry out RFDI in the domestic real estate market if approved by the relevant government authorities. However, the RFDI carried out in the domestic real estate industry must follow the approval and filing requirements under the prevailing administrative regulations. Investments that have completed the approval and filing process will be announced to the public through website of MOFCOM (www.mofcom.gov.cn). Upon such public announcement, the relevant foreign-invested enterprises may submit the published information, the approval letter from competent department of commerce and the Approval Certificate of Foreign-invested Enterprises to the competent foreign exchange departments to proceed with the relevant investment procedures.

Implementation Rules

The Implementation Rules set forth detailed regulations regarding: the opening of the RMB settlement account for foreign institutions (including the special deposit account for upfront RMB expenses and the special deposit account for the use of RMB funds for re-investment), the registration of foreign-invested enterprises, the opening of the RMB settlement account and capital account of foreign-invested enterprises, the opening of the special deposit account for RMB funds in mergers and acquisitions and the special deposit account for equity transfer conducted in RMB by Chinese shareholders, accounts for the remitting of foreign investment RMB funds into China, conducting capital verification, utilization of RMB capital, and the remitting of RMB profits out of China, etc..

Regarding the utilization of RMB capital funds, the Implementation Rules require that the banks, in accordance with the relevant administrative provisions on foreign direct investment, shall supervise the use of RMB capital funds of foreign-invested enterprises, and shall review the payment requests made through the special deposit accounts for RMB capital funds. In addition, as the RFDI model was just officially initiated, it is anticipated that specific supervisions on the utilization of RMB capital are yet to be clarified and improved in further practices and governmental rules.

Prospect

Since the initiation of RMB settlement in cross-border trades, the amount of RMB funds returning to China pales in comparison with its huge amount of RMB funds that had flowed into offshore markets. As such, the promulgation of the Notice and the Implementation Rules establishes a solid foundation for the backflow of China's RMB funds and at the same time improves the circulation of capital and benefits for resolving a series of problems such as the overseas existence, utilization and back-flow of RMB. Furthermore, as the global economic is currently facing a great challenge, the official allowance of the RFDI not only reduces the investors' cost of investments by eliminating the currency exchange cost, but also improves the administration of RMB settlement and investment, and facilitates the internationalization of RMB.

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