

Cross-border Renminbi Financing

How are funds raised offshore remitted into China?

Accelerated by the increasing use of Renminbi (RMB) in the settlement of cross-border trade, offshore RMB markets, in particular Hong Kong, have developed speedily. The accumulation of offshore RMB has opened another door for cross-border financing. Yet, RMB capital account transactions in China, despite recent rapid de-regulation, are still strictly monitored. As a result, the remittance of funds raised offshore remains to be the key obstacle for developing cross-border RMB financing in China.

At present, PRC authorities are in the process of putting together the formalities and procedures for fund remittance for cross-border RMB financing. According to the People's Bank of China (PBOC), it has approved, on a case-by-case basis in 2010, foreign direct investment invested in RMB amounting to RMB42.7 billion (approximately US\$6.6 billion), and 16 cross-border RMB financing transactions amounting to RMB81.4 billion (approximately US\$12.6 billion), out of which RMB27.5 billion (approximately US\$4.3 billion) in 13 transactions have already been drawn.

In order to better manage the increasing number of applications and promote cross-border use of the RMB, PBOC and the State Administration of Foreign Exchange (SAFE) have formulated a set of operational rules under the current foreign exchange control regime that could be applied to capital account transactions in RMB. The accumulation of experiences from increasing practices would help PRC regulators transform the current case-by-case approval mechanism into a regular regime that would give more certainty to offshore investors. It should be noted, however, that currently onshore entities other than commercial banks and policy banks are still not permitted to issue debt financing instruments denominated in RMB in the offshore market. Here are some practical structures a foreign investor may consider in providing financing to its PRC onshore operation.

Key Issues

Capital Injection	2
Cross-border Loan	2
Offshore Financing Sources	3
Prospect	3

If you would like to know more about the subjects covered in this publication, please contact:

Beijing
[TieCheng Yang](#) +86 10 6535 2265

Shanghai
[Jiahua Ni](#) +86 21 2320 7206

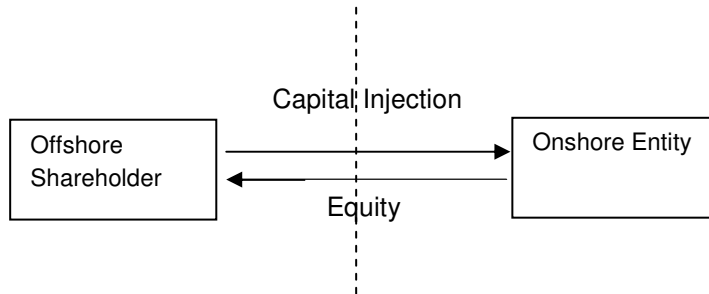
Hong Kong
[David Lam](#) +852 2826 2427

If you would like to know more about our China publications, please contact:

[Chlorophyll Yip](#) +852 2826 3426

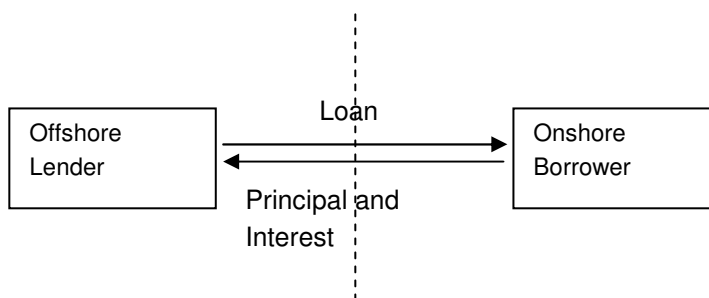
Clifford Chance, 28th Floor, Jardine House,
One Connaught Place, Hong Kong SAR
www.cliffordchance.com

Capital Injection



The most straightforward way to remit RMB funds raised offshore into China is through capital injection. Capital injection as an approach of foreign direct investment is subject to the review and approval of the Ministry of Commerce ("MOFCOM") or its local branch. In accordance with the *MOFCOM Circular on Relevant Issues in Foreign Investment Administration* dated 25 February 2011 (MOFCOM Circular), foreign investment in RMB must be approved by MOFCOM at the central level, and the investment currency (i.e. RMB) and amount must be specified in the approval letter issued by MOFCOM. In accordance with the *Circular of the General Affairs Department of SAFE on Relevant Issues on Regulating the Operational Procedures of Cross-border RMB Capital Account Business* dated 7 April 2011 (SAFE Circular), upon presenting the approval letter from MOFCOM to local SAFE branches and fulfilling relevant registration formalities, RMB capital funds could be remitted in accordance with the procedures of the current foreign investment foreign exchange system. Under the recent *PBOC Circular to Clarify Relevant Issues in Connection with Cross-border RMB Business* dated 3 June 2011 (PBOC Circular), PBOC's permission is also necessary to open the corresponding RMB settlement account for the remitted RMB capital funds. The obligation to seek PBOC's permission lies on the account opening bank. The prevention of "hot money" inflow is one of PBOC's primary considerations when reviewing relevant applications. PBOC may refuse such account opening applications for investment in restricted industries and key industries under China's macroeconomic policy. Where the onshore entity is a financial institution, the regulatory regime is less clear, but at a minimum, the approval from the competent regulator must be obtained.

Cross-border Loan



If the onshore entity is a foreign-invested enterprise ("FIE") (but not a Chinese-funded enterprise or financial institution, which is separately subject to the discussion below), it could borrow RMB loans from offshore lenders within the difference between its approved total investment amount and registered capital. In a typical case, the offshore shareholder of the FIE would act as the lender. In other cases, the offshore lender can also be a commercial bank or other institutions (e.g. the foreign affiliates of the FIE).

In accordance with the SAFE Circular, in principle, foreign debt denominated in RMB (which previously only included indebtedness denominated in a foreign currency incurred by a domestic entity and owed to a non-resident) will also be regulated under the current foreign debt regime (under which no MOFCOM approval or permission is required for SAFE to process the remittance of funds). However, under the MOFCOM Circular, cross-border shareholder's RMB loan constitutes foreign direct investment that is subject to the approval procedures discussed in the section on "Capital

Injection" above. An uncertainty therefore arises as to whether, in reality, MOFCOM approval would be a prerequisite for SAFE to attend to the formalities for processing cross-border RMB loan.

There are also uncertainties in the application of the law on shareholder's loan and loans extended by other lenders. The SAFE Circular does not specifically distinguish between these two kinds of loans. Rather, it only stipulates rules that generally apply to RMB-denominated foreign debt. As for the PBOC Circular, while it expressly applies to shareholder's loans, it is unclear whether it also applies to cross-border loans extended by other lenders. As a result, whether the taking out of cross-border RMB loans made by non-shareholder foreign institutions is permitted still remains unclear.

If the onshore entity is not a FIE, under the current foreign debt regime, it may obtain a short-term (less than 1 year) foreign debt quota from SAFE or seek approval from the National Development and Reform Commission to incur mid-term and long-term foreign debt in order to borrow loans from offshore lenders.

In accordance with the SAFE Circular, cross-border RMB loans must be registered with SAFE under the current foreign debt registration scheme in the same way as foreign debts denominated in foreign currencies do. However, there is no need to open a special foreign currency account for RMB-denominated foreign debt. An RMB account opened for cross-border loan granted to a non-financial institution FIE will require the same PBOC permission discussed above.

Offshore Financing Sources

Lower financing cost is often one of the primary commercial considerations driving cross-border RMB financing. For example, the 10-year treasury bills issued by the PRC Ministry of Finance in Hong Kong on 30 November 2010 bear an annual interest rate of 2.48%, while those issued in Mainland China on 16 December 2010 bear an interest rate as high as 3.77%. The appreciation of RMB must also be considered in the calculation of the actual financing cost. The borrowers are expected to repay the investors "appreciated" RMB upon maturity.

Although only PRC commercial and policy banks may obtain cross-border financing by issuing bonds, RMB bonds issued in Hong Kong (also known as "dim sum" bonds) have, as a result of active participation of offshore issuers, grown to become extremely popular since last year. According to the Hong Kong government, as at the end of January 2011, a total of 31 RMB bonds were issued with an issuance size of about RMB74.4 billion (approximately US\$11.5 billion). The range of issuers has expanded from PRC banks to multinational non-financial institutions. Moreover, the Hong Kong government is committed to further encourage overseas enterprises to issue RMB bonds in Hong Kong and expand channels for enterprises to invest the RMB capital raised in Hong Kong back in Mainland China.

As of May 2011, the RMB deposit in Hong Kong has accumulated to RMB548.8 billion (approximately US\$84.8 billion). The RMB liquidity of Hong Kong participating banks has also increased correspondingly. In addition, Hong Kong is improving its regulatory system to facilitate the conduct of RMB banking business. For example, the Hong Kong Monetary Authority issued a circular on 9 May 2011 to clarify the RMB fiduciary cash account arrangements. This circular enables participating banks to convert the counterparty risk of Bank of China (Hong Kong) Co., Ltd. (i.e. the RMB clearing bank in Hong Kong) into credit risk of the PBOC using the fiduciary cash account arrangements, and therefore provides participating banks more flexibility in conducting RMB business. Hong Kong participating banks with RMB liquidity and shareholders obtaining RMB from such banks could be another important source of cross-border RMB financing.

As RMB IPOs take off in Hong Kong, offshore RMB financing sources are likely to increase in the near future.

Prospect

The PRC government has committed to combat inflation and control the continued rise of the domestic price level. It is envisaged that PRC regulators would maintain a prudent view over capital inflow, whether in RMB or foreign exchange. In any case, practical opportunities exist under the PRC regulatory regime to effect RMB cross-border financings for onshore projects that makes investment in the encouraged industries and foreign investors are advised to make full use of them in the interim. It is expected that more avenues would ensue as Hong Kong further elevates into an offshore RMB centre..

This briefing is designed to provide a general commentary on aspects of the subject matter covered. It does not purport to be comprehensive and it does not constitute legal advice. We expressly disclaim any liability in respect of the consequences resulting from acting or refraining from acting on the basis of any matter contained in this publication. All rights are reserved.

The above is based on our experience as international counsel representing clients in their business activities in China. As is the case for all international law firms licensed in China, we are authorized to provide information concerning the effect of the Chinese legal environment, however, we are not permitted to engage in Chinese legal affairs in the capacity of a domestic law firm. Should the services of such a firm be required, we would be glad to recommend one.

www.cliffordchance.com

Abu Dhabi ■ Amsterdam ■ Bangkok ■ Barcelona ■ Beijing ■ Brussels ■ Bucharest ■ Budapest ■ Dubai ■ Düsseldorf ■ Frankfurt ■ Hong Kong ■ Kyiv ■ London ■ Luxembourg ■ Madrid ■ Milan ■ Moscow ■ Munich ■ New York ■ Paris ■ Perth ■ Prague ■ Riyadh* ■ Rome ■ São Paulo ■ Shanghai ■ Singapore ■ Sydney ■ Tokyo ■ Warsaw ■ Washington, D.C.

* Clifford Chance has a co-operation agreement