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SAFE of the PRC Issues New Rules Regulating Cross-Border RMB Capital Account Related Transactions

On 7 April 2011, the State Administration of Foreign Exchange of the PRC (SAFE) issued the *Notice on the Issues relating to the Regulation of the Practice of Cross-border RMB Capital Account Related Business (Circular No.38 of 2011)* which became effective as from 1 May 2011.

The Notice introduces significant changes to the current regime of Renminbi (RMB) cross-border capital account transactions. Under the new regulations, RMB can be used in a wider range of transactions which involve the inflow or outflow of RMB debt or equity. The promulgation of the Notice is a further attempt of the PRC government to promote the use of RMB in international transactions after the introduction in 2009 of trial measures to use RMB in international trade settlement.

Main Points

The main points of the new rules are as follows:

Outbound Direct Investment

1. Instead of using foreign currency, subject to prior registration and filing with SAFE, domestic institutions (exclusive of financial institutions) can conduct outbound investment using RMB directly. RMB funds can be remitted outside of the PRC in the form of up-front fee or share capital investment.
2. RMB proceeds of domestic institutions generated from (i) liquidation, (ii) reduction in capital or (iii) share transfer to a foreign assignee relating to offshore investments can be remitted back to the PRC directly, subject to prior registration and filing with SAFE.

Foreign Direct Investment

1. Capital contribution to a PRC company or payment of equity or share purchase price to a domestic assignor can be made by a foreign investor using RMB funds located inside or outside of the PRC. Before the promulgation of the Notice, except for re-investment by a foreign investor using dividends denominated in RMB obtained from its other foreign invested projects in the PRC, no RMB funds, whether inside or outside of the PRC, could be used for such purposes. However, the foreign invested enterprise so incorporated or acquired should still go through foreign exchange registration with SAFE.
2. RMB proceeds of foreign investors generated from (i) liquidation, (ii) reduction in capital, (iii) share transfer to a domestic assignee or (iv) recovery of investment ahead of time (including dividend and profit distribution) relating to foreign invested enterprises can be remitted outside of the PRC directly, subject to filing with SAFE.

Outbound Lending

1. Domestic enterprises can lend cross-border RMB loans to its offshore subsidiaries, subject to prior registration and filing with SAFE;
2. RMB proceeds generated from RMB loans (including principal and interest) can be remitted back to the onshore lender directly, subject to filing with SAFE.

Foreign Debt

1. Domestic institutions (including financial institutions) can borrow RMB loans from offshore lenders. The RMB loan so borrowed will be regulated by SAFE as if it were a foreign currency debt of such domestic institution. It follows that the existing rules

- governing foreign debts will apply to cross-border RMB loans as well.
2. However, unlike a foreign debt denominated in foreign currency, there is no need for the domestic institution to open a foreign debt account for the purpose of transacting RMB foreign debt.
 3. Security denominated in RMB provided by domestic institutions (including financial institutions) for RMB foreign debts should be approved by and/or registered with SAFE as foreign security of such domestic institutions. Similarly, the existing rules governing the provision of foreign security by domestic institutions will be applicable.

Conclusion

The new regime will definitely further promote the use of RMB in international transactions and be welcomed by investors and institutions, whether foreign or domestic. It is also a significant step towards the full convertibility of RMB as the PRC government has always been very conservative in managing its capital account, especially RMB related transactions.

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