

# ClientAlert

## China Bank Finance

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### PBOC Formulates Further Policy Initiatives to Promote RMB as an International Currency

On 2 December 2013, the People's Bank of China ("PBOC") issued its *Opinions on Financially Supporting the Development of the China (Shanghai) Pilot Free Trade Zone* (《中国人民银行关于金融支持中国（上海）自由贸易试验区建设的意见》) (the "**Opinions**").

The Opinions represent latest steps by PBOC to formalize the policy framework within the boundaries of which we expect applicable PRC government authorities to implement detailed rules to further promote the use of RMB in transactions carried out with Shanghai Free Trade Zone ("**Zone**") residents.

This client alert highlights the following important features of the Opinions:

#### Free Trade Accounts

Paragraph 2 of the Opinions permits an individual or company which is a resident in the Zone (a "**Zone Resident**") to establish and maintain a RMB- or foreign currency-denominated 'resident free trade account' ("**Resident FTA**") with banks in the Zone for the purpose of carrying out certain types of cross-border direct inbound and outbound investments and financings (as described below). A non-PRC resident may also establish and maintain a RMB- or foreign currency-denominated 'non-resident free trade account' ("**Non-Resident FTA**") with banks in the Zone for the same purpose.

Funds flow between a Resident FTA and (a) another Resident FTA; (b) a Non-Resident FTA; (c) an overseas account; or (d) a non-PRC resident's PRC account established and maintained outside the Zone will be permitted freely. Funds flow between a Resident FTA and a PRC resident's PRC account established and maintained outside the Zone will, however, be regulated as cross-border funds flow (for example, loans made by a Zone Resident to a PRC resident outside the Zone via a Resident FTA may be regulated under the foreign debt regime, unless the purpose of this loan falls within the exemptions set out in the Opinions).

	Resident FTA		Non-Resident FTA	
	From	To	From	To
Another Resident FTA	✓	✓	✓	✓
Another Non-Resident FTA	✓	✓	✓	✓
Overseas account	✓	✓	✓	✓
Non-PRC resident's PRC account outside the Zone	✓	✓	✓	✓
PRC resident's PRC account outside the Zone	Regulated as cross-border funds flow		Regulated as cross-border funds flow	



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We observe that a Resident FTA is designed to enable a PRC individual or company that is a Zone Resident to establish, maintain and operate a qualified type of synthetic 'offshore' account for certain types of cross-border capital account transactions without requiring further government approvals. This represents a significant step in the liberalization of PRC's capital account control regime.

### Cross-border Direct Investments

Paragraph 3 of the Opinions contemplates that qualified domestic and foreign individuals who are working in the Zone and companies and financial institutions which are Zone Residents will be permitted to engage in the following categories of inbound and outbound investments and other transactions:

- Qualified domestic individual—overseas investments including offshore securities
- Qualified foreign individuals—domestic investments including onshore securities
- All companies and financial institutions—investments and trading in Shanghai securities and futures
- Qualified companies—overseas investments in offshore securities and derivative products

We observe that these cross-border investments will be subject to compliance with further 'relevant regulations' to be clarified in due course. Nevertheless, it is important to note that prior to the issue of the Opinions, these types of cross-border capital account transactions would have been possible generally only on a limited basis under specific regulatory regimes such as the Qualified Domestic Institutional Investor or Qualified Foreign Institutional Investor regimes.

### Direct RMB Borrowings from Offshore

Paragraph 15 of the Opinions contemplates that a Zone Resident that is a financial institution or company may borrow RMB from offshore provided that such borrowed RMB funds cannot be used to invest in securities or derivative products or make entrustment loans. The Opinions are silent on any quantitative limitations, or approval, gearing or thin-cap requirements. Prior to the issue of the Opinions, a domestic PRC company – which, unlike a foreign-invested PRC company, does not have a foreign debt quota – would need to obtain SAFE's approval for such direct RMB borrowings from offshore.

This is important for domestic PRC companies because they would – if incorporated in the Zone – have an alternative source of financing available to them. As the offshore market for RMB continues to evolve (e.g. liquidity, rates and credit preference), such direct RMB borrowings from offshore could prove to be a more attractive financing proposition for domestic PRC companies than domestically-sourced financings.

### Cash-pooling

As highlighted above, funds flow between a Resident FTA and a PRC resident's onshore account established and maintained outside the Zone will be regulated as cross-border funds flow (i.e. subject to requirements of existing current and capital account control regimes).

Paragraph 16 of the Opinions, however, provide a useful exception – a company that is a Zone Resident may enter into a two-way cash pooling arrangement with its domestic and overseas affiliates for the purpose of centralized current account payments. Again, the Opinions are silent on any quantitative limitations, or approval or quota requirements for such an arrangement.

Shortly after the Opinions were issued, many leading PRC commercial banks (including the 'Big 4') launched the first batch of cross-border RMB cash-pooling programs for a variety of companies that are Zone Residents, including state-owned enterprises.

Such two-way cash pooling arrangement is important for PRC or foreign companies because it essentially opens up a new (and potentially administratively easier) channel for onshore-offshore (or vice versa) movement of funds within group companies that are Zone Residents. For example, a PRC group of companies with a subsidiary that is a Zone Resident can potentially borrow RMB from offshore directly and fund other onshore group companies' working capital requirements through cash pooling arrangements. That subsidiary can potentially also serve as a conduit to channel liquidity support to offshore group companies. We expect such two-way cash pooling arrangements to become an important credit or credit support feature when structuring PRC inbound or outbound financings.

In the context of debt financing, the potential of the additional cross-border RMB financing possibilities made available to Zone Residents under the Opinions should be explored further taking into account parallel development of RMB-denominated credit support, which we highlighted in our [China Finance Bulletin issued in August 2013](#) with respect to PBOC's "Circular on Simplifying the Cross-Border RMB Business Procedures and Improving Relevant Policies" (《关于简化跨境人民币业务流程和完善有关政策的通知》)(the "Circular").

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