

# China Finance Bulletin

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**Welcome to this month's issue of White & Case's China Finance Bulletin. This bulletin offers you regular updates on the PRC finance sector ensuring you stay up to date with the latest legal, regulatory and practice developments.**

## Crucial New Regulation on Cross-Border RMB Settlement – Foreign Direct Investment in RMB officially on trial

On June 3, 2011, the People's Bank of China ("PBOC") promulgated a *Circular on Clarifying Certain Issues Relating to Cross-Border RMB Services* ("Circular").

According to the Circular, so long as banks follow certain procedures to report their provision of RMB settlement services ("Services") to the RMB Cross-border Receipt and Payment Information Management System, they may provide Services for cross-border trade, current accounts, offshore direct investment, offshore lending and any other cross-border RMB settlement service as approved by the PBOC. The Circular also specifies additional requirements to be met in order for foreign direct investment ("FDI") to obtain Services and for foreign participation banks to provide Services.

### RMB Settlement Services for FDI

Further to the various provincial trial programs launched earlier this year, the Circular sets out the country wide uniform Services approval process specific to FDI, emphasizing that Service for FDI is still in its trial period and is therefore subject to case-by-case PBOC approval.

The approval process requires that a foreign enterprise first obtain the certificate of approval in respect of its investment from the Ministry of Commerce ("MOFCOM"). The foreign enterprise will then ask their onshore settlement bank to submit an application for Services to a local PBOC branch office. If an application is approved by the local branch office, it will then be sent to the PBOC head office for review and final approval.

The approval requirements apply to merger and acquisition of domestic, onshore enterprises (excluding round-trip investment), establishment of new foreign-owned enterprises, equity transfers, capital increases and shareholder loans. The Circular notes that the PBOC does not accept applications for Services for FDI in "restricted" industries or sectors "regulated by policy".



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If you have questions or comments regarding this bulletin, please contact:

John Shum  
Partner  
+ 852 2822 8748  
jshum@whitecase.com

Xiaoming Li  
Partner  
+ 86 10 5912 9601  
xli@whitecase.com

Baldwin Cheng  
Partner  
+ 86 10 5912 9682  
bcheng@whitecase.com

## Foreign Participation Banks

The Circular stipulates that both onshore settlement banks and foreign participation banks may only engage in providing Services for transactions involving genuine cross-border RMB trade.

Foreign participation banks may only provide Services: (1) for transactions involving an onshore enterprise (as either direct payee or payer); (2) to enterprises that have real need for trade payment within three months. An enterprise which has obtained Services from a foreign participation bank must complete any subsequent related trade payment with that same bank.

Foreign participation banks are required to track clients' cash flow after providing Services, apply strict scrutiny to new clients and transactions in high amounts, and monitor any unusual transactions.

## Tightened Standards in Banks' Foreign Exchange Settlement and Sales

On June 16, 2011, the State Administration of Foreign Exchange of the People's Republic of China ("SAFE") issued the *Circular on Improving the Administration of Banks' Own Foreign Exchange Settlement and Sales* (国家外汇管理局关于完善银行自身结售汇业务管理的通知) ("2011 Circular"). The circular has (1) optimized provisions regarding banks' foreign exchange settlement and sales on behalf of an obligor issued in the 2004 *Circular on Principle and Procedure for Approving Foreign Exchange Settlement and Sales of Banks' Own Capital and Finance Projects* (国家外汇管理局关于银行自身资本与金融项目结售汇审批原则及程序的规定) ("2004 Circular") and (2) provided specific standards for banks' foreign exchange settlement and sales activities involving banks' capital.

## Requirements for Banks in Foreign Exchange Settlement and Sales on Behalf of Customers

Under the 2004 Circular, a bank may purchase foreign currency on behalf of its obligor with RMB income received from the obligor as long as it falls under one of four stipulated circumstances which are: (1) RMB received pursuant to court judgments or arbitration awards; (2) RMB received upon the realization of mortgage or other pledged interests; (3) receipt of RMB-based security guarantees; or (4) RMB acquired through other legitimate processes.

The 2011 Circular sets out specific requirements to allow a bank to perform foreign exchange settlement and sales on behalf of its obligor. They are: (1) the obligor cannot perform the foreign exchange settlement and sales itself due to bankruptcy, dissolution of the business, suspension of the business, mismanagement, a legal dispute with the bank or other similar reasons; and

(2) payment to the bank by the obligor or guarantor is from legitimate source, i.e., the four circumstances set out in the 2004 Circular. Therefore, the 2011 Circular further restricts the banks' performance of foreign exchange settlement and sales to cases where banks' obligors are unable to perform such activities themselves.

The 2011 Circular requires applications for such foreign exchange settlement and sales to be sent to the SAFE branch closest to the bank, which may lead to stricter scrutiny of such applications, while the 2004 Circular requires the application be sent to the SAFE location (a branch or sub-branch of SAFE) closest to the bank's obligor.

## Standards for Foreign Exchange Involving Banks' Capital

The 2004 Circular does not have explicit guidelines for standards of foreign exchange involving banks' capital. The 2011 Circular stipulates banks must ensure that "(the owner's equity in foreign exchange + operating funds in foreign exchange)/assets in foreign exchange" approximately equals "(the owner's equity in RMB + operating funds in RMB) /assets in RMB."

In calculating the above formula, a bank shall: (1) only use the balance sheets of its domestic branches; (2) not double-count operating funds and owner's equity; (3) deduct certain equities in foreign exchange acquired by policy reasons; (4) use the average of the end-dates of the last 4 calculating quarters for amounts due from the interbank market (存放同业) and amounts owed to the interbank market (拆放同业) when calculating its assets in RMB.

The 2011 Circular notes that Chinese banks beginning to engage in foreign exchange, and foreign banks beginning to engage in RMB exchange, may apply for currency conversion but it is limited to no more than 10 percent of their capital funds.

The 2011 Circular also allows foreign banks that establish branches or subsidiaries in China to open foreign exchange accounts with domestic commercial banks. However, the total amount of inward remittance of foreign exchange to the account shall not exceed 5 percent of the registered capital of the branch or subsidiary during the establishment period. Additionally, foreign banks are allowed to conduct the pre-settlement of foreign currency exchange on a monthly basis or an actual expenditure basis for RMB, but the amount of the pre-settlement cannot exceed 105 percent of the previous month's actual RMB expenditures.

For the full text of the 2011 Circular, please refer to the following Chinese language links:  
[http://www.safe.gov.cn/model\\_safe/laws/law\\_detail.jsp?ID=8050000000000000,96](http://www.safe.gov.cn/model_safe/laws/law_detail.jsp?ID=8050000000000000,96)

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- Tier One in China Banking & Finance (Foreign Firms)—*Chambers Asia* 2009

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