RMB Comes Back Home

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— From the perspective of AGCO's acquisition of Dafeng by paying in RMB
By Liang Tao

More and more RMB funds are flowing out of China through various channels, including RMB international trade settlement, foreign-invested enterprises' profits, proceeds generated from their China business units, dim sum bonds and the contemplated RMB denominated stocks offering in Hong Kong. How to attract the RMB funds to come home will be an important issue for China's central government, especially under China's strategy of RMB internationalization.

With a view to "internationalizing" the RMB, among other efforts, China has embarked on its pilot RMB trade settlement scheme since 2009, and further expanded the RMB trade settlement scheme to cover the entire mainland China in 2011. By the end of June 2011, RMB deposits in Hong Kong had amounted to around RMB 553 billion. In order to utilize the increasingly accumulated offshore RMB funds, China's competent authorities issued a series of circulars in 2010 and 2011 to let RMB funds flow back to China. These circulars lifted various restrictions imposed on foreign investors, and paved the way for the repatriation of offshore RMB funds into China through direct investment channels. In particular, foreign investors have been permitted to purchase shares in Chinese domestic companies by paying in RMB. To take first-mover advantage, certain foreign investors have already tested the water.

Deal stories
AGCO is a worldwide farm machinery company listed on NYSE. AGCO Holdings (Hong Kong) Ltd. ("AGCO HK") is AGCO's subsidiary incorporated in Hong Kong, serving as an investment vehicle. Shandong Dafeng Machinery Co., Ltd. ("Dafeng") is a Chinese domestic agricultural machinery company located in Yanzhou City of Shandong Province. In April 2011, a share transfer agreement was made and executed by and between AGCO HK, Dafeng, and individual shareholders holding 80% equity interest in Dafeng ("Transferring Shareholders"). Under the share transfer agreement, AGCO HK acquired 80% equity interest held by the Transferring Shareholders in Dafeng which consequently turned into a Sino-foreign joint venture named AGCO Dafeng (Yanzhou) Agricultural Machinery Co., Ltd. ("AGCO Dafeng"). As full consideration to the 80% equity interest in Dafeng, AGCO HK paid the Transferring Shareholders in RMB. This deal could be simply illustrated as below:

Deal Structure of Acquisition by AGCO of 80% Equity Interest in Dafeng
Sources: Publicly Available Information

This deal is reportedly one of the pioneering cases under which offshore RMB funds are used by foreign investors to pay for the purchased shares in Chinese domestic companies. Actually, this acquisition would never be a high profile deal, unless the foreign investor opted to pay for the purchased shares by using RMB instead of foreign currencies as used in other common acquisition deals.

Breakthroughs
In China's over thirty years history of attracting foreign investment, the Dafeng-AGCO deal is one of the first batch of transactions in which RMB is used by foreign investors to purchase shares in Chinese domestic companies. These first movers benefit from a series of circulars and regulations issued by competent regulatory authorities.

On October 12, 2011, the Ministry of Commerce ("MOFCOM") issued the Notice on Relevant Issues on Cross-Border RMB Direct Investment ("MOFCOM Notice"), clarifying the regulatory regime over foreign direct investment in RMB. The second day, the People's Bank of China ("PBC") issued the Administrative Measures on RMB Settlement in Relation to Foreign Direct Investment ("PBC Measures"), setting forth the detailed procedures from the perspective of RMB settlement. Promulgation of the MOFCOM Notice and the PBC Measures represents that foreign direct investment settled in RMB has been successfully accepted by China's central government after around two years pilot program run in certain provinces and regions. It marks a spectacular breakthrough regarding the regulatory regime of the foreign direct investment, since RMB has been formally included in the feasible currencies which can be used by foreign investors to pay the consideration of purchased shares.

According to the MOFCOM Notice, the foreign investors shall use the "legally obtained" offshore RMB funds when conducting direct investment into China. The "legally obtained" RMB funds refer to RMB funds raised from: (i) international trade; (ii) dividend distributions and funds derived from share transfer, capital reduction and liquidation of foreign invested enterprises registered in China; and
The MOFCOM and local counterparts will ask foreign investors to provide relevant documents supporting and certifying the legitimate sources of the offshore RMB funds whilst reviewing and approving the foreign acquisition.

Although, the MOFCOM Notice and the PBC Measures aggressively remove various limitations imposed on foreign investors who propose to invest their RMB funds into China, the MOFCOM and PBC still leave some critical barriers. The MOFCOM Notice sets forth that the existing rules, regulations and policies applicable to foreign investments into China using other foreign currencies apply equally to RMB denominated investments. Therefore, some restrictions currently applicable to foreign investments will continue to remain for RMB denominated foreign investment, for example, industries limitations on foreign investment, the national security review regime and the merger review system. Fortunately, AGCO was not bothered by these problems. As an agricultural machinery sector is deemed as an “encouraged” industry for foreign investment under China’s foreign investment industries catalogue, AGCO HK goes through the procedures smoothly.

**What’s the difference?**

Before the MOFCOM Notice and PBC Measures have been issued, except in certain RMB investment settlement pilot regions, a foreign investor like AGCO HK is not permitted to use RMB to pay the price of purchased shares of Chinese domestic companies. In common cases in which foreign currencies are used to pay purchased shares, foreign investors shall go through the following procedures: (i) the foreign investor shall submit application documents to and apply for the approval with the MOFCOM or its local counterparts; (ii) within 30 days of receipt of the approval from the approval authority, the foreign investor shall register with the administration for industry and commerce and obtain the business of license for the newly established Sino-foreign joint venture; (iii) the established Sino-foreign joint venture shall conduct foreign exchange registration with the administration for foreign exchange and get the IC card of foreign exchange; (iv) upon verification by administration for foreign exchange, the transferring shareholder opens a receiving bank account for the purpose of receiving the consideration paid by the foreign investor; (v) upon another verification by administration for foreign exchange, the foreign investor remits the price of purchased shares into the transferring shareholder’ receiving bank account and obtain a certificate from the administration for foreign exchange proving that the foreign investor has completed its payment of the purchased shares and finished this acquisition.

For AGCO HK, the foregoing procedure was slightly changed. Upon obtaining the approval from the MOFCOM or its local counterparts and successfully registering with the administration for industry and commerce, the AGCO HK, as a foreign investor, was also required to conduct a registration with the local counterpart of PBC. It is crucial for a foreign investor, since the PBC registration is a requisite condition to the consequent account opening and wire transfer of price of purchased shares. Under the PBC Measures, injection of offshore RMB funds into Chinese domestic companies is not required to obtain the PBC’s case-by-case verification and approval; instead, a general and quite straightforward registration regime will be adopted by the PBC regarding the RMB denominated foreign investments.

The major difference between foreign currencies denominated foreign investment and RMB denominated foreign investment is the regulatory authorities governing the formation of the receiving bank account and wire transfer of price of purchase shares. For investment conducted in foreign currencies, the administration for foreign exchange will be in charge of relevant approval and verification. For the investment in RMB, in addition to the administration for foreign exchange, the PBC or its local counterparts will be also responsible for the verification relating to the wire transfer of the acquisition price.

In addition, compared with the foreign investment conducted by foreign currencies, onshore receiving banks with which transferring shareholders open receiving bank accounts are granted with more responsibilities on monitoring the wire transfer of price of purchased shares under the circumstances of RMB denominated foreign investment. However, it has not been tested as to how vigorously will the receiving banks review and monitor the wire transfer process.

It is worth noting that verification from the administration for foreign exchange is also necessary when RMB is used to pay the purchased shares by foreign investors. However, it is still not clear in which method the PBC or the administration for foreign exchange will exercise their regulatory power in practice, or whether the PBC or the administration for foreign exchange may further issue any implementing rules in the future on this.

**Outlook**

This is definitely good news for foreign investors with offshore RMB funds. However, it will take a long time for the new policies to be fully implemented in practice. According to our consultation with certain commercial banks and officials from administrations for foreign exchange or local PBC, it appears that most of them still have no idea about how to handle the RMB denominated foreign investment. In addition, how to divide the jurisdictions of PBC and administration for foreign exchange will become another practical issue. We also need to keep a close eye on whether the foreign investors have to duplicate the application and registration formalities with both the PBC and the administration for foreign exchange.