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# China Eases Regulations on the Management of Cross-border Funds

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**In November 2014, the People's Bank of China (PBOC) released the "Notice Regarding Matters concerning Centralized Cross-border Renminbi Fund Operations by Multinational Corporation Groups" (Yinfa [2014] No. 324), thereby removing the restrictions on the centralized cross-border management of RMB funds. Cross-border RMB operations were previously limited to group companies with a subsidiary inside the Shanghai Free Trade Zone (Shanghai FTZ), and the newly issued notice expands the pilot program nationwide.**

**Although cross-border fund management is an embryonic structure that has only recently been made available, both in the Shanghai FTZ and nationwide, and has only been adopted by a handful of corporations to date, it is expected to facilitate efficient cash management for Japanese corporations that have subsidiaries in China and conduct cross-border trade. Moreover, with moves to further loosen the regulations expected to gather pace going forward, multinational corporations are advised to utilize the new scheme to achieve efficient cash management at the earliest possible opportunity.**

## Current Status of Regulatory Reforms in China

The recent easing of restrictions commenced in February 2014 with the opening up of cross-border RMB and foreign currency fund management to Shanghai FTZ-registered enterprises serving as the host company. This pilot program of cross-border foreign currency fund management was subsequently expanded nationwide in April, and in November, cross-border RMB fund management was likewise made available to enterprises throughout China. This decision implementing a gradual loosening of the regulations stems from the positioning of the Shanghai FTZ as a pilot area for various regulatory reforms.

However, the reforms introduced in the Shanghai FTZ and those applicable nationwide differ in certain respects. Accordingly, enterprises that are registered in the Shanghai FTZ can opt to introduce either the FTZ version or the nationwide version of the rules depending on their circumstances and cash management needs. The following paragraphs compare the Shanghai FTZ Rules (the “FTZ Rules” hereunder) with the Nationwide Rules on the new scheme that has been made available through these recent regulatory reforms.

## Cross-border RMB Cash Pooling

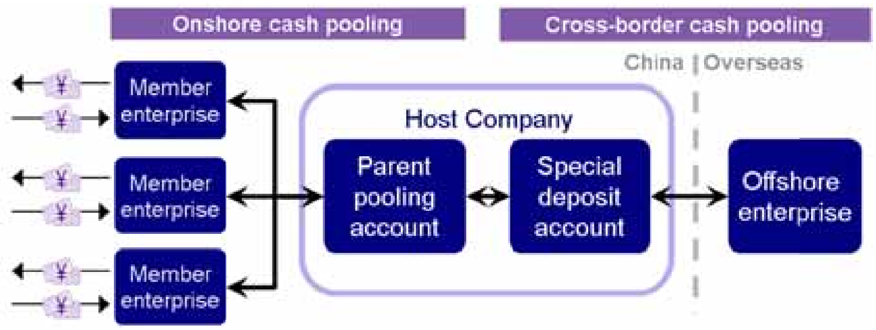
To prevent confusion between funds involved in a cross-border RMB cash pooling structure and other funds, enterprises are required to set up a special deposit account and to pool the relevant funds in this account (see Fig. 1).

Under the FTZ Rules, the RMB funds channeled into a cash pool must be cash flows generated by operating activities and/or business investment activities, and the use of cash flows from financing activities remains off limits for the time being.

The Nationwide Rules impose considerably higher hurdles to participation: in addition to the requirement for preliminary record filing with the PBOC, participating enterprises must meet the following requirements: (1) have been in business for at least three years, (2) the previous-year annual sales turnover of all onshore member enterprises must exceed RMB 5 billion, and (3) the previous-year annual sales turnover of all offshore member enterprises must exceed RMB 1 billion.

Whilst the FTZ Rules make no explicit provision with regards to the limit on the lending quota for Chinese-owned participants, the Nationwide Rules set an upper limit based on the following formula: [owner interests of onshore member enterprises (including registered capital, undivided profit, and capital reserves) × ownership ratio of the multinational corporation] × macro-prudential policy parameter (which has been set at 0.1 initially).

**Fig 1: Demonstration of the Cross-border RMB cash pooling (Nationwide Rules)**




Source: Compiled by Mizuho Bank, Ltd

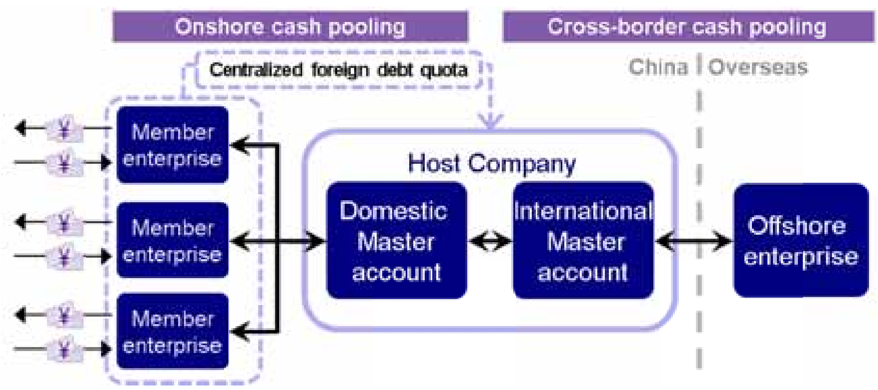
## Cross-border Foreign Currency Cash Pooling

Corporations that engage in cross-border foreign currency cash pooling are required to set up two accounts: a "domestic master account for foreign currency funds" and an "international master account for foreign currency funds" (the Nationwide Rules allow corporations to opt for one or the other), which are then used to channel funds to group companies located overseas. Moreover, whilst it is still necessary to make a preliminary record-filing with the State Administration of Foreign Exchange (SAFE), the introduction of a foreign currency cash pooling structure enables group enterprises to centralize all or part of their foreign debt quotas with the host company (see Fig. 2).

However, limits apply to the transfer of funds between the "domestic master account for foreign currency funds" and the "international master account for foreign currency funds", whereby the flow of funds from the international master account to the domestic master account must not exceed the combined foreign debt quota of domestic member enterprises, and the flow of funds from the domestic master account to the international master account must not exceed 50 percent of the combined owners' equity of domestic member enterprises (the Nationwide Rules allow enterprises with combined owners' equity exceeding 50% by applying to the SAFE for approval).

Moreover, as with the RMB cash pooling structure, the Nationwide Rules impose tougher eligibility criteria on participating enterprises, and require the scale of foreign exchange collections and payments in the previous year to exceed US$ 100 million.

**Fig 2: Demonstration of the Cross-border Foreign exchange cash pooling (Nationwide Rules)**

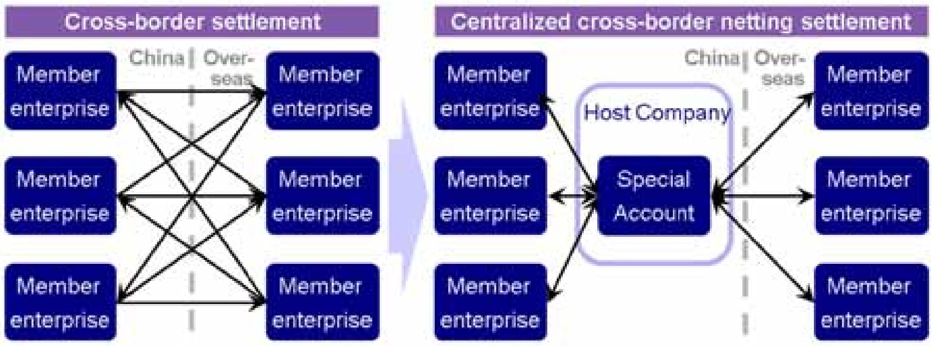



Source: Compiled by Mizuho Bank, Ltd

## Centralized Cross-border Settlement using RMB

According to the FTZ Rules, centralized cross-border collection, payment and netting settlement using RMB are handled by a host company, which should be registered in the Shanghai FTZ and is required to nominate a bank in the Shanghai area with which to open a special RMB deposit account. All parties are required to enter into a centralized collection and payment agreement, and to clarify responsibility for the authenticity of the underlying trade transactions (see Fig. 3).

**Fig 3: Demonstration of the Streamlining achieved through the Introduction of Centralized Cross-border Collection and Payment**




Source: Compiled by Mizuho Bank, Ltd

Although the Nationwide Rules require member enterprises to have been in business for at least three years, this version also allows special RMB deposit accounts for centralized collection and payment to be opened at multiple banks, and for member enterprises other than the host company to open accounts and handle centralized collection and payment transactions.

## Centralized Cross-border Settlement using Foreign Currency

Centralized cross-border collection, payment and netting settlement through foreign currency exchange are processed through the domestic master account for domestic foreign currency funds exchange. In addition to the requirement for preliminary record filing with the SAFE, netting settlements should, in principle, be made at least once a month.

Moreover, the Nationwide Rules impose a threshold of US$ 100 million on the foreign currency collections and payments of domestic participating enterprises in the previous year. International balance of payments statistics must be declared both prior to and following a netting settlement, and the declaration requirement still holds even if the netting settlement results in a balance of zero.

## Future Developments

As indicated above, the pace of regulatory reform with regards to cross-border fund management and centralized settlement has been gathering speed since last year, and the number of enterprises utilizing these structures is increasingly steadily. At the same time, enterprises that introduce the new structures are required to establish rigorous internal control systems and the Nationwide Rules have tightened certain of the eligibility criteria for participation (see Fig. 4), meaning that, in practical terms, the new structures are only available to major corporation groups, and further easing and/or standardization of the rules and eligibility criteria is expected. For Japanese corporations with a presence in China, the extent of the importance of: keeping a close eye on the moves of the relevant Chinese authorities, of seizing the opportunities presented by these changes in the regulations, and of looking into the greater efficiencies in cash management due to the new scheme, is expected to increase hereafter.

**Fig 4: Current Status of Reforms in Cross-border RMB & Foreign Exchange Fund Administration**

| | RMB | | Foreign Exchange | |
|---|---|---|---|---|
| | Cross-border cash pooling | Centralized/netting settlement | Cross-border cash pooling | Centralized/netting settlement |
| Shanghai FTZ | • No preliminary formalities, including record filing.<br>• Can be undertaken by an FTZ enterprise acting as host company<br>• Nomination of one bank in Shanghai<br>• Use of funds from financing activities not possible<br>• Not counted towards foreign debt quota | • Can be undertaken by an FTZ enterprise acting as host company<br>• Nomination of one bank in Shanghai | • Preliminary record filing with the SAFE required<br>• Can be undertaken by an FTZ enterprise acting as host company<br>• Nomination of up to 3 banks in Shanghai<br>• Foreign debt quota restrictions apply | • Preliminary record filing with the SAFE required<br>• Can be undertaken by an FTZ enterprise acting as host company<br>• Nomination of up to 3 banks in Shanghai |
| Nationwide | • Preliminary record filing with PBOC required<br>• Open to all enterprises nationwide (though terms apply, including a threshold of RMB 5 billion on the sales revenues of domestic enterprises)<br>• Use of funds from financing activities not possible<br>• Restrictions on fund inflows<br>• Only one bank, in principle. Record filing with PBOC HQ required for multiple cash pools | • Open to all enterprises nationwide<br>• Nomination of multiple banks possible | • Preliminary record filing with the SAFE required<br>• Open to all enterprises nationwide (though a threshold of US$ 100 million applies to foreign currency transactions in the previous year)<br>• Nomination of up to 3 banks in the area where the host company is registered<br>• Foreign debt quota restrictions apply | • Preliminary record filing with the SAFE required<br>• Open to all enterprises nationwide (though a threshold of US$ 100 million applies to foreign currency transactions in the previous year)<br>• Nomination of up to 3 banks in the area where the host company is registered |

Source: HKEx

[Remarks] This report is a translation of the original report in Japanese published on March 6, 2015. In the event of any discrepancy, the original report in Japanese shall prevail.