

## CHINA RELEASES NEW OUTBOUND INVESTMENT RULES

### BACKGROUND

Over the past decade, China has implemented a national strategy that encourages Chinese companies to "go global". This strategy was reiterated in the country's official 12th Five-year Plan (2011-2015), which was endorsed by China's top legislature in March 2011. Notwithstanding this policy, for a long time, Chinese government approvals necessary for outbound investments have been one of the main challenges for Chinese investors in executing outbound transactions due to the lengthy timeframe (often 3-5 months) involved in obtaining these approvals and the significant uncertainty resulting from such approval process which most foreign counterparties would seldom be willing to accept, in particular where Chinese investors are competing for high quality assets in active markets.

To provide impetus for the government's drive to step up the implementation of its go-global strategy and in response to the Investment Project Approval Catalogue (2013 version) released by the State Council on 2 December 2013 to simplify the approval regime for investment projects,

- on April 8, 2014, the National Development and Reform Commission ("**NDRC**") promulgated the long-awaited Administrative Measures on Verification and Filing of Outbound Investment Projects ("**New NDRC Measures**"), which amends the *Interim Measures on Verification of Outbound Investment Projects* issued by NDRC back in 2004 ("**Existing NDRC Measures**"); and
- on April 16, 2014, the Ministry of Commerce of the People's Republic of China ("**MOC**") released its draft revised Measures on Verification and Record-filing of Outbound Investment (the "**Draft New MOC Measures**") to solicit public comments with a view to revising the Measures on Verification and Record-filing of Outbound Investment ("**Existing MOC Measures**") issued by MOC in 2009.

The New NDRC Measures will take effect on May 8, 2014 and the promulgation of the new MOC Measures is expected to take place in the middle of this year.

This article sets out some highlights of the New NDRC Measures and the Draft New MOC Measures and to share some insights on the associated practical impact on outbound investments.

## **OVERVIEW OF OUTBOUND INVESTMENT APPROVALS**

By way of background, China's outbound investment regulatory regime has been highly rigid due to China's tight control on cross-border investment flows. In general, Chinese investors must obtain approvals from three key regulatory bodies for their outbound investments, including NDRC or its competent local counterpart, MOC or its competent local counterpart and the State Administration of Foreign Exchange or its competent local counterpart ("**SAFE**").

NDRC approval is considered to be the most important approval and is an essential requisite to obtaining other approvals. The NDRC approval mainly operates from a public policy and macroeconomic point of view, such as the maintenance of financial safety, compliance with industrial policies, protection of public interest and management of capital projects.

MOC review, on the other hand, focuses greater attention on the commercial feasibility of a proposed investment, including local conditions in the target jurisdiction. MOC or its local counterpart must await NDRC approval before processing any outbound investment application submitted to it.

SAFE reviews the outbound investment from the point of view of foreign exchange controls. Once the NDRC and MOC or their respective local counterparts have approved an investment, SAFE would be required to conduct a review of the source and method of utilisation of foreign exchange funds needed for the proposed investment and SAFE review is typically more routine with more limited discretion.

## VERIFICATION VS. RECORD-FILING

Under the existing outbound approval regime, verification is the principal manner NDRC and MOC or their respective local counterparts administer outbound investments. Nearly every outbound investment project should be verified by NDRC and MOC or by their respective local counterparts at provincial level, except for those with Chinese party's investment amount less than USD 10 million.

The New NDRC Measures and the Draft New MOC Measures introduce the record-filing method as the new and primary procedure NDRC and MOC are going to administer outbound investments. Under those new measures,

- NDRC verification is now only required if (i) the Chinese party's investment amount in an outbound investment project is USD 1 billion or more, or (ii) the outbound investment project involves a sensitive country or a sensitive sector;
- MOC verification is now only required if the outbound investment involves a sensitive country or sensitive sector; and
- outbound investment projects not falling within the above are now subject to record-filing procedure with NDRC and MOC or their respective local counterparts at provincial level.

With respect to the definition of the "sensitive countries" and "sensitive sectors", the New NDRC Measures and the Draft New MOC Measures essentially retain the meanings as set forth in the existing measures. It is worth noting that the definition of "sensitive countries"<sup>1</sup> under NDRC measures and MOC measures generally overlap, whereas the definition of "sensitive sectors"<sup>2</sup> under NDRC measures and MOC measures are quite different which demonstrates the different administrative functions between the two government bodies.

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<sup>1</sup> It means those countries and regions which China has not established diplomatic relationships with or are internationally sanctioned, or where wars or civil unrests are taking place.

<sup>2</sup> Under the NDRC measures, sensitive sectors include basic telecommunication, cross-border exploration of water resources, large-scale land development, electric artery, power grid, press and media, etc., whereas under the MOC measures those include industries that (i) involve using products or technologies subject to export restriction; or (ii) involve interests of multiple countries or areas.

The New NDRC Measures and the Draft New MOC Measures also set out the level of authority at which the record-filing shall be made, specifically:

- investment by Central SOEs - record-filing with NDRC and MOC;
- investment by local companies (including local SOEs):
  - where the Chinese party's investment amount is USD 300 million or above - record-filing with NDRC
  - where the Chinese party's investment amount is less than USD 300 million - record-filing with NDRC's local counterpart at provincial level
  - regardless of the investment amount involved, record-filing with MOC's local counterpart at provincial level

NDRC has also for the first time clarified the concept of the "Chinese party's investment amount" in the New NDRC Measures, being the sum of all cash, securities, properties, intellectual properties or know-how, equity and debt the Chinese investor contributes to the project, thus giving clarity as to whether debt or loan shall be included in the calculation of the "Chinese party's investment amount".

On the one hand, the USD 1 billion threshold used to differentiate verification procedure vs. record-filing procedure has significant practical impact since a majority of the outbound investment projects would likely not exceed such threshold, thus making record-filing the predominant method going forward. On the other hand, with the clarified definition of "Chinese party's investment amount", debts and loans are now explicitly included (with no apparent differentiation as to the currency denomination of the debt or loan), thus larger deals with equity and debt financing exceeding USD 1 billion would be caught.

While there's no doubt that the introduction of the record-filing system significantly improves the existing outbound investment regulatory regime, it is noted that under these new measures the factors that NDRC and MOC or their respective local counterparts will take into account when reviewing a verification or record-filing application are more or less similar, and not significantly different from those under the existing measures. Furthermore, although it is expected that NDRC and MOC or their respective local counterparts will not conduct

substantive review on record-filing applications to the same extent as on verification applications, it is still possible for NDRC and MOC or their respective local counterparts to reject a filing application after review.

## **TIME FRAME FOR VERIFICATION AND RECORD-FILING**

In addition to the introduction of the record-filing regime, the New NDRC Measures and the Draft New MOC Measures also prescribe time limits for the verification and record-filing procedures as follows:

- in case of a verification project:
  - NDRC shall complete its review and make a decision within 20 working days from acceptance of application (and sometimes with an extra 10 working day period if appropriately approved);
  - MOC shall complete its review and make a decision within 35 working days (inclusive of the 10 working days prescribed for consultation with Chinese embassy in the destination country and 10 working days required for the preliminary review by the MOC's local counterpart at provincial level) for local companies, and 25 working days for central SOEs (inclusive of 10 working days required for consultation with Chinese embassy in the country); and
- in case of a record-filing project:
  - NDRC shall complete its review and make a decision within 7 working days from the acceptance of the filing. The New NDRC Measures are silent as to the timeframe for the record-filing with NDRC local counterpart at provincial level which would be left for the local regulation to prescribe but it is not expected that such time limit be longer than 7 working days;
  - MOC or its local counterpart at the provincial level shall complete its review and make a decision within 3 working days from acceptance of filing.

The time limits for the verification procedure with NDRC and MOC basically follow what had been stated in the existing measures. The most notable change is in the much-shortened

time limits set for the record-filing procedure, which should theoretically speaking only require 10 working days for a Chinese investor to complete the two key filings if the applications are well prepared in advance.

These new measures also provide that:

- if NDRC requires supplemental or amended documents or materials (no matter if it is a verification project or a record-filing project), it shall notify the applicant in one time within 5 working days; and
- if MOC requires supplemental or amended documents or materials in case of a verification project, it shall notify the applicant in one time within 3 working days. It is silent on the time frame to request for supplemental or amended documents or materials for a record-filing project.

The above-mentioned measures should noticeably enhance the predictability and manageability of the approval process. Previously, it was not uncommon to see the procedures being prolonged due to the numerous further information requests and questioning by NDRC, MOC or their respective local counterparts.

## **REQUIRED APPLICATION DOCUMENTS FOR RECORD-FILING**

NDRC and MOC also adopt a more standardised approach towards the newly introduced record-filing system, i.e., applicants only need to file a completed application form (as opposed to an application report in verification cases) along with the necessary supporting documents, and NDRC and MOC will issue prescribe formats for such application forms and further announce the required supporting documents.

It is also anticipated that both NDRC and MOC and their local counterparts would develop and adopt a national online record-filing system through which Chinese investors could submit their applications for record-filing and potentially even track the filing process. These changes should offer greater ease for Chinese investors to prepare the record-filing, however, the required supporting documents for record-filing are expected to be the same as those required under the verification procedure.

## **RE-INVESTMENT BY OVERSEAS SUBSIDIARIES**

Under the Existing NDRC Measures, re-investment through overseas subsidiaries shall be subject to NDRC verification even if no currency conversion or offshore fund remittance is involved. Under the New NDRC Measures, re-investments by offshore subsidiaries of Chinese companies are no longer subject to either NDRC verification or filing, unless such re-investment involves equity injection, financing or guarantee provided by the domestic parent.

Re-investment by offshore subsidiaries shall be subject to post-completion record-filing with MOC or its local counterpart.

Large outbound investment players with offshore subsidiaries which are well-funded or possess substantial assets will benefit from this relaxation which should enable them to more rapidly react and seize deal opportunities where time is of the essence, including the ability to raise offshore acquisition financing quickly without being subject to PRC approval conditions.

## **NDRC'S PRE-REPORTING MECHANISM**

For outbound M&A or bidding projects, NDRC's pre-reporting mechanism remains in place, i.e., Chinese companies need to report project information to NDRC and obtain its pre-clearance (to be issued within 7 working days from the acceptance of the reporting) before carrying out any "substantive work" in relation to an outbound project.

The New NDRC Measures clarify that:

- the NDRC's pre-reporting mechanism applies to outbound M&A or bidding projects where the Chinese party's investment is USD 300 million or more, increased from the previous threshold of USD 100 million; and
- with respect to outbound M&A projects "substantive work" means entering into any binding agreement, making any binding offer or lodging any application with any government or regulatory authority in the target jurisdiction by the Chinese investor, and with respect to outbound bidding projects, "substantive work" means formally submitting a bid for the project.

Consequences of failing to carrying out NDRC's pre-reporting are set out in the New NDRC Measures to include administrative penalties and legal liabilities on the person-in-charge of the investing company.

The NDRC's pre-clearance mechanism is commonly referred to as the “road pass” as it is generally understood that this procedure is designed to prevent multiple Chinese investors from competing against one another for the same assets and therefore NDRC will only issue one confirmation letter and allows it some say in picking the right bidder.

### **TIMING TO OBTAIN OUTBOUND INVESTMENT APPROVALS**

Under the Existing NDRC Measures, the Chinese investors shall obtain NDRC's verification or filing before entering into any legally binding agreements for any outbound projects. This requirement is generally maintained under the New NDRC Measures, with an option allowing a Chinese investor to enter into the transaction agreement before obtaining NDRC's verification or filing provided that such agreement will not become effective until obtaining verification from or completing filing with NDRC.

It can be seen from this newly added option that NDRC has made its effort to make its regulations more workable in the real world since it would be highly impractical for a Chinese investor to apply for verification or filing before there is an agreement in place. Having said that, from the foreign sellers' perspective, the great uncertainty surrounding the Chinese approval process inevitably drives foreign sellers to seek improved deal protection through mechanisms such as deal deposits, break fees, escrow accounts and other pre-closing security.

Therefore there is still room to improve the regulation to better reflect international market practice, such as making the Chinese regulatory procedures a closing condition, rather than a condition for effectiveness of the transaction agreement.

In practice, we have seen many cases whereby the NDRC has approved transactions where the parties enter into legally binding agreements with Chinese regulatory approvals being made a closing condition. This suggests that the NDRC in practice is willing to adopt a pragmatic approach and accommodate international deal-making practice.



## **PRELIMINARY EXPENSES**

The New NDRC Measures continue to allow Chinese investors to separately apply to NDRC for verification or record-filing for the remittance of preliminary expenses offshore to cover pre-deal costs such as deposit payments, bank guarantee fees, advisors' fees, and resource exploration costs. Such expenses may be remitted offshore in foreign currency after verification by SAFE, but will constitute part of the "Chinese party's investment amount" once the transaction is approved.

The New NDRC Measures also clarify that the procedure for verification or record-filing for preliminary expenses is the same as the procedure that applies to the actual outbound investment project. This leads to the questions as to how useful this provision would be in practice, since those Chinese investors that already have access to foreign currency which can readily be used to pay such preliminary expenses generally would not take the trouble to apply to NDRC and SAFE to make such remittance.

## **VALIDITY OF VERIFICATION AND RECORD-FILING**

The New NDRC Measures provide that the validity term of the verification document and record-filing notice shall be two years for construction projects and one year for other projects. If a Chinese investor fails to complete relevant formalities with the foreign exchange, customs, entry and exit administration, and tax authorities within the validity term, they may apply for an extension within thirty working days before the expiry date.

The Existing MOC measures and the Draft New MOC Measures provide that the verification document and record-filing notice issued by MOC in respect of all the outbound investment projects shall be valid for two years.

In practice, where the investment timescale of an outbound project is somewhat lengthy, in particular property development projects carried out in phases, a Chinese investors might consider dividing the project into phases and only apply for the verification or record-filing for the imminent phases to avoid repeated extensions of the validity term of the approval documents. This approach may also serve to reduce the Chinese party's investment amount for each application thereby each application would only be subject to more streamlined

record-filing procedure. How such an approach would be viewed by the Chinese regulators is however difficult to gauge but we've seen successfully approved cases in practice.

## **CONCLUSION**

The introduction of record-filing as the primary manner by which NDRC and MOC and their respective provincial counterparts administer outbound investments, together with the shortened time limits for undertaking verification/filing procedures, the relaxation of approvals for re-investments by overseas subsidiaries, and other reforms highlighted above signal the Chinese government's recognition of the need to relax existing controls and create a more streamlined procedure to regulate outbound investments. Chinese investors who have long been suffering from burdensome, uncertain and time-consuming government procedures should benefit significantly from these reforms that are expected to improve regulatory certainty and efficiency, and provide a boost to Chinese investors' ability to successfully execute outbound transactions. However, it is apparent that NDRC and MOC still intend to retain meaningful oversight with regard to Chinese offshore investment activities, and how the new regulations would be applied in practice remains to be seen. Meanwhile, compared to their overseas peers, Chinese investors are still likely to continue to face domestic regulatory constraints when competing for higher quality assets in the global M&A scene.

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