Hogan Lovells

China Moves to Further Relax Approval Requirements on Outbound Investments by Chinese Investors: A Step in the Right Direction

Contents

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1. Overview

Since the announcement of the "go global" ("走出去") policy in 2000, the People's Republic of China ("**PRC**" or "**China**") has achieved a tremendous acceleration in its overseas foreign direct investment, transporting China from a country punching well below its weight in the first two decades of reform post 1979 and the opening-up policy to being one of the world's largest exporters of capital[1]. The numbers coming out of China in the last few years bear witness to this phenomenal turnaround.

Based on Ministry of Commerce ("**MOFCOM**") statistics, the upward trend is very clear:

- In 2011, total investment was US$74.65 billion, involving investments into 177 countries and regions through 18,000 offshore entities;
- In 2012, total investment was US$ 87.8 billion, increasing 17.6%; and
- In 2013, total investment was US$ 90.17 billion in 5,090 enterprises in 156 countries and regions, increasing 16.8% (excluding investments in financial institutions).

2. Transactions

Record-breaking levels of transactional activities have been driven by high levels of liquidity both within private and state owned enterprises, lower valuations of foreign targets due to the global financial crisis and increased competition in the Chinese market. Several important themes of securing natural resources, access to and distribution of food and agricultural products and technology plays have emerged. There was the acquisition of AMC Entertainment, a US movie theatre chain operator, by Dalian Wanda Group, for USD2.6 billion in 2012 which highlighted the broad span of investments that have taken place in this area. This was followed in 2013, when the Chinese state-owned oil and gas giant, CNOOC Ltd. made its USD15.1 billion acquisition of Canadian oil and gas company Nexen Inc. in China's largest-ever offshore[2] acquisition to date. The acquisition by Shuanghui International Holdings Ltd, China’s largest pork producer, of Smithfield Foods Inc. for USD4.72 billion also in 2013 further illustrated China's purchasing power and appetite. China's Internet giants Alibaba, Tencent and Baidu, each of which are privately-owned home-grown tech start-ups have also ventured offshore to develop new markets and acquire new technologies, with debate continuing as to whether, following its US listing, Alibaba will be able to build on its platform in China to compete globally with players like Amazon and eBay.

3. Navigating the regulatory maze

One of the challenges faced by Chinese investors seeking to go global is navigating the regulatory maze to get the required approvals to invest offshore. Historically the outbound approval process started off as an 'obstacle course' where the competitors were effectively blindfolded as the requirements were often unclear, but in recent developments, many of the obstacles have been removed (as have the blindfolds), and there is a clear trend towards simplifying the approval maze to the point where only the largest or most sensitive transactions are now subject to actual approval, with record filing increasingly becoming the norm. Transparency has also increased with a number of new rules to guide investors.

The reforms have been affected pursuant to the following rules and regulations:

(a) the *Catalogue of Investment Projects subject to Government Approval (2014)* (政府核准的投资项目目录 (2014 年本)) issued by the PRC State Council effective 31 October 2014 ("**2014 Investment Approval Catalogue**") following the Fourth Plenary Session of the Eighteenth Congress of the Communist Party of China's Central Committee which replaced the *Catalogue of Investment Projects subject to Government Approval (2013)* (政府核准的投资项目目录(2013 年本)) (the "**2013 Investment Approval Catalogue**"). The 2014 Investment Approval Catalogue addresses both outbound and inbound investments. The State Council is the highest administrative body in China and other administrative bodies subordinate to the State Council such as MOFCOM will generally issue or render their rules consistently with those issued by the State Council.

(b) the *Administrative Measures on the Approval or Record Filing of Outbound Investment Projects* (境外投资项目核准和备案管理办法) issued by the National Development and Reform Commission ("**NDRC**") on 8 April 2014 ("**2014 NDRC Measures**") as amended

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[1] OECD Working Papers on International Investment 2013/01.

[2] In this note, "offshore" means outside of China and "domestic" means within China.

by the *Decision of the NDRC on Revising Certain Provisions of the Administrative Measures on the Verification and Approval or Record-filing of Outbound Investment Projects and the Approval and Record-filing of Foreign Investment Projects Administrative Procedures* (国家发展改革委关于修改《境外投资项目核准和备案管理办法》和《外商投资项目核准和备案管理办法》有关条款的决定) on 27 December 2014 ("**Amended 2014 NDRC Measures**"). These rules replaced the Interim Measures for the Administration of Approval of Overseas Investment Projects (境外投资项目核准暂行管理办法).

(c) the *Administrative Measures on Outbound Investments* (境外投资管理办法) issued by MOFCOM effective 6 October 2014 ("**2014 MOFCOM Measures**"). These rules replace the 2009 version of the *Administrative Measures on Outbound Investment* (境外投资管理办法) which was issued by MOFCOM effective 1 May 2009 ("**2009 MOFCOM Measures**").

4. **Key legislative developments**

4.1 Definition of outbound investment and key authorities

"Outbound investments" are defined broadly under both the 2014 NDRC Measures and 2014 MOFCOM Measures. Under Articles 2 and 3 of the 2014 NDRC Measures, "outbound investment projects" are generally defined as projects whereby the Chinese investor (a legal entity incorporated in China) acquires, either directly or through its offshore entity or organisation (by providing financing or security), ownership, rights to operate and manage, or other rights and interests in, an offshore target entities. This includes the establishment of new enterprises, as well as mergers and acquisitions, share purchases, capital increases and capital injection projects. Article 2 of the 2014 MOFCOM Measures includes the concept of acquiring 'control' as part of the definition of "outbound investments" as well as establishing new entities overseas and refers specifically to non-financial sector offshore target entities. The exclusion of offshore financial target entities under the 2014 MOFCOM Measures suggests that financial authorities (such as the China Banking Regulatory Commission or China Insurance Regulatory Commission) may have oversight in this area, but apart from this, all other outbound investments would generally fall within the scope of both the 2014 NDRC Measures and 2014 MOFCOM Measures.

In a typical case, a Chinese investor carrying out outbound investment may need to obtain approval, record-filing and/or registration with at least three government bodies, namely the:

(a) NDRC or its competent local counterparts, the central planning authority responsible for China's macro-economic development, for the filing/approval of an outbound investment project;

(b) MOFCOM or its competent local counterparts, the general examination and approval authority for inbound and outbound investment projects, for incorporation/acquisition of an overseas legal entity under an outbound investment project; and

(c) State Administration of Foreign Exchange or its competent local counterparts ("**SAFE**"), the authority responsible for the oversight of foreign exchange sourcing, conversion and remittance and importantly, for remittance of outbound investment funds. SAFE approval and/or filing is usually forthcoming provided that NDRC and MOFCOM approval/filing have been obtained.

4.2 Key changes

(a) Reduced acope of verification/approval and expanded scope of record-filing

The 2014 Investment Approval Catalogue simplifies the regulatory process for outbound investments by providing that <u>only</u> investments in sensitive countries, regions or industries are subject to central NDRC approval, while investments by centrally administered state-owned enterprises ("**CSOEs**") (other than in sensitive countries, regions and industries) and by all other enterprises (local enterprises) where the investment is US$300m or more are subject to (central) NDRC record-filing. All other investments are subject to record-filing with NDRC or local NDRC. This is quite a radical move towards reducing the transactions subject to formal approval. The Amended 2014 NDRC Measures have been amended to reflect the thresholds in the 2014 Investment Approval Catalogue but have subsequently also maintained the requirement under the 2014 NDRC Measures that where an outbound investment project in a sensitive country, region or industry involves Chinese investment of at least USD 2 billion, NDRC shall forward the matter to the State Council for approval. On the other hand, the 2014 MOFCOM Measures were consistent with the 2014 Investment Approval Catalogue when issued and based on our inquiries with MOFCOM, no further amendments are planned in the near future.

The interface and interaction between the 2014 MOFCOM Measures and the 2014 NDRC Measures on the one hand and the 2014 Investment Approval Catalogue on the other is rather subtle and not obvious on the face of the documents, but we have attempted to piece together the pictures based on our reading and telephone enquiries below. The general understanding is that an approval (核准) process is more complicated and onerous as it involves more voluminous documentation and grants the relevant authorities more discretion in determining whether or not to approve an application. Comparatively, in a record-filing (备案) procedure, the application should be accepted and filed if the materials submitted are in proper order, which is a more straightforward and transparent process.

The issuance of the 2013 Investment Approval Catalogue by the State Council, set the tone for a simpler regulatory process for outbound investments. NDRC and MOFCOM followed suit with the 2014 NDRC Measures and 2014 MOFCOM Measures. Then the State Council simplified them even further in the 2014 Investment Approval Catalogue which, in turn, led to the amendment to the 2014 NDRC Measures. We set out below a comparison of the new requirements against those under the previous outbound investment rules.

As shown in the table above, investors can expect a substantial reduction of outbound investments that need to go through formal approval procedures under the new rules. According to Fang Wei, the Vice Director of

APPROVAL AUTHORITY	**PREVIOUS RULES – 2013 INVESTMENT APPROVAL CATALOGUE**	**CURRENT RULES – 2014 INVESTMENT APPROVAL CATALOGUE**
NDRC		
Outbound investment projects[3] that are subject to **approval** by **central** NDRC and/or State Council	(i) Outbound investment projects by the Chinese investor(s) which (a) is at least USD 1 billion; or (b) involves sensitive countries and regions or sensitive industries (as discussed further below in Section 3) are subject to the approval of NDRC[4]; and (ii) Outbound investment projects by Chinese investor(s) which (a) is at least USD 2 billion and (b) involve sensitive countries and regions and sensitive industries are subject to central NDRC review and State Council approval and verification[5] (i.e. the largest and most sensitive types of transactions).	Outbound investment projects by Chinese investors which involve sensitive countries and regions and sensitive industries are subject to central NDRC approval.[6]

3 From the perspective of NDRC, "outbound investment projects" means the situation where "an investor (all types of legal persons within the PRC) by investing cash funds, marketable securities, tangible assets, intellectual property rights or technologies, equity, creditors' rights and other assets or rights and interests or by providing security obtains ownership, rights of business operations and management and other related rights and interests overseas". Types of outbound investment project include 'greenfield projects', M&A, acquisitions, minority stake acquisitions, capital increases and injections or other means and expressly includes outbound investment projects carried out by such investors through their overseas enterprises or institutions by providing financing or security and so forth. Please refer to Articles 2 and 3 of the 2014 NDRC Measures.

4 Article 7 of the 2014 NDRC Measures.

5 Article 7 of the 2014 NDRC Measures.

6 Article 7 of the Amended 2014 NDRC Measures.

Outbound investment projects that are subject to **record-filing** procedures with **central** NDRC	Outbound investment projects by (a) CSOEs, and (b) PRC enterprises in which the amount of investment by Chinese investor(s) is at least USD 300 million.[7]	No change[8]
Outbound investment projects that are subject to **record-filing** procedures with **provincial** NDRC	Outbound investment projects by PRC enterprises in which the amount of investment by Chinese investor(s) is less than USD 300 million.[9]	No change[10]
MOFCOM		
Outbound investment that are subject to **approval** by **central** MOFCOM	Outbound investment projects involving "sensitive countries and regions" or "sensitive industries" by CSOEs.[11]	No change
Outbound investments[12] that are subject to **approval** by **provincial** MOFCOM	Outbound investment projects involving "sensitive countries and regions" or "sensitive industries" by domestic non-CSOEs.[13]	No change
Outbound investments that are subject to **record-filing** procedures by **central** MOFCOM	Outbound investment projects made by CSOEs that do not involve" sensitive countries and regions" or "sensitive industries" by CSOEs.[14]	No change
Outbound investments that are subject to **record-filing** procedures by **provincial** MOFCOM	Outbound investment projects other than those involving "sensitive countries and regions" or "sensitive industries" by domestic non-CSOEs.[15]	No change

7 Article 8 of the 2014 NDRC Measures.

8 Article 8 of the Amended 2014 NDRC Measures.

9 Articles 8 and 37 of the 2014 NDRC Measures.

10 Articles 8 and 37 of the Amended 2014 NDRC Measures.

11 Articles 6 and 10 of the 2014 MOFCOM Measures.

12 From the perspective of MOFCOM, "outbound investments" means "the activities whereby an enterprise which is duly established within the People's Republic of China has ownership rights, rights to control, rights of operation and management and other rights and interests in a non-financial enterprise overseas, or obtains such ownership rights, rights to control, rights of operation and management and other rights and interests of an existing non-financial enterprise overseas through new establishment, mergers and acquisitions, and so forth". Please refer to Article 2 of the 2014 MOFCOM Measures.

13 Article 10 of the 2014 MOFCOM Measures.

14 Articles 6 and 9 of the 2014 MOFCOM Measures.

15 Articles 6 and 9 of the 2014 MOFCOM Measures.

the Department of Outward Investment and Economic Cooperation, based on current records, under the 2014 MOFCOM Measures, 99% of all outbound investments by Chinese enterprises would only need to go through the record-filing procedures, leaving only 1% of outbound investments requiring approval.

(b) Simplified filing system

Besides the expansion of the record-filing system, the Amended 2014 NDRC Measures and 2014 MOFCOM Measures have also revised the procedures and timelines for the various procedures with the aim of the outbound investment application process. For example, other than outbound investments by CSOEs, all applications for outbound investments by Chinese enterprises shall be submitted to the relevant provincial-level (i.e. province, autonomous region or municipality under direct central government administration) NDRC and/or MOFCOM authority, including those requiring approval by, or record-filing with, central NDRC. In such cases, the provincial counterpart of NDRC or MOFCOM will accept the application documents and then forward the application to their central level counterparts. Previously, the city level counterparts of NDRC and MOFCOM were involved in the application process, adding another layer of bureaucracy, red tape and delaying the process. Under the 2014 MOFCOM Measures, the timeline for MOFCOM approval has been shortened by 5 working days.

4.3 Other key takeaways

(a) Recognition of the autonomy of enterprises in outbound investment decision-making

The 2014 MOFCOM Measures provide that enterprises shall "make decisions on their own and assume sole responsibility for profits or losses in accordance with law" when making outbound investments. These provisions suggest that the Chinese government is clearly distancing itself from any implicit or tacit state guarantee when State-owned Enterprises engage in outbound investments.

Further, under the 2009 MOFCOM Measures, the contracts or agreements between Chinese enterprises and foreign parties for outbound investments were effective only upon obtaining approval from the relevant governmental authorities. Such restrictions no longer appear in the 2014 MOFCOM Measures, which is consistent with the principle above on granting autonomy to the enterprises involved.

Unfortunately, the Amended 2014 NDRC Measures do not follow suit, and adopt a more conservative approach, as they require enterprises to complete the approval or record-filing procedures before entering into any purchase, transfer agreement or binding document in relation to the outbound investment, or if such document were to be executed, its effectiveness would need to be conditional upon obtaining the approval document or the record-filing notice from the relevant authority. In light of these uncertainties, we recommend making any transfer agreement or other binding document conditional on obtaining the relevant approval and/or record-filing, which is the current market practice in outbound investments.

(b) Differences in key definitions

Although both the Amended 2014 NDRC

Measures and 2014 MOFCOM Measures regulate the process of Chinese companies making outbound investments; there are some critical differences in key defined terms which they apply in their determination of whether approval or record-filing is required. The critical differences are:

(i) Definition of "sensitive countries and regions":

The Amended 2014 NDRC Measures: countries with no diplomatic relations with China, countries subject to international sanctions, countries and regions affected by wars, civil strife, and so forth.

The 2014 MOFCOM Measures: countries without diplomatic relations with China and countries subject to sanctions from the United Nations. Further, MOFCOM may publish lists of additional countries and regions which are deemed 'sensitive' when necessary, so it is a moving definition.

(ii) Definition of "sensitive industries":

The Amended 2014 NDRC Measures: basic telecommunications operations, cross-border development and utilization of water resources, large-scale land development, main power transmission lines and power grids, news media and other industries.

The 2014 MOFCOM Measures: industries that involve export of products and technologies that are subject to PRC export restrictions, or industries which impact the interests of more than one country (region).

In telephone enquiries, NDRC and MOFCOM officials in both Beijing and Shanghai explained that they are aware of the differences in the definition of sensitive countries/regions and sensitive industries, but they continue to maintain the view that enterprises making outbound investments must go through application procedures with NDRC and MOFCOM separately. We were able to detect, not far below the surface, a sense of the continuing power struggle between the two authorities in trying to exert authority over such a critical component of China's economy, a story that has played out in a similar way in the inbound investment space[16].

5. Conclusion

The outbound investment regulatory regime is evolving so rapidly that Chinese investors may find it difficult to keep pace with the changes. The high-level changes introduced by the 2014 Investment Approval Catalogue, the Amended 2014 NDRC Measures and 2014 MOFCOM Measures are broadly welcome in terms of providing greater granularity and transparency than before, but we look forward to reviewing the implementing rules from the local counterparts of NDRC and MOFCOM in order to fully understand the entire process. How NDRC and MOFCOM put these new rules into practice will be the ultimate determinant in whether the continuing tension between NDRC and MOFCOM will act as a barrier to outbound investments.

However, the 2014 Investment Approval Catalogue and Amended 2014 NDRC Measures makes one key change that possibly exacerbates the issue: it removes the thresholds for outbound transactions involving amounts of US$ 1 billion or more that previously differentiated NDRC-approvable transactions from those subject to MOFCOM approval. Now the NDRC approval requirements are identical to those for transactions requiring MOFCOM approval i.e. for sensitive countries, regions and industries (except they define sensitive countries regions and industries differently - see above). This means that while you can argue they come at this from different angles (NDRC from the planning and project 'macro' angle, MOFCOM from the entity formation and overseas trade 'micro' angle); the two bodies are now essentially carrying out directly overlapping functions. The hope is that NDRC and MOFCOM will find a *modus operandi* that works for both of them and coordination between them will improve across the board (i.e. not just in the outbound arena). Notwithstanding these issues, overall, the direction from the top as set out in the 2014 Investment Approval Catalogue is clear: continue to encourage and reduce the regulatory and administrative hurdles to make it easier for Chinese companies to "go global". This is clearly a step in the right direction which should be generally welcomed by all potential recipient countries of Chinese investment and Chinese investors alike.

16 Please refer to our client note: "*NDRC revisits the approval requirements for foreign investment projects: but will they be enforced in practice?*" 4 November 2014.

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