

Alert

China Eases Restrictions on Outbound Investments with Publication of New Policy

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Beginning on May 8, 2014, outbound foreign investment from China will receive a substantial boost, as the *Administrative Measures for Verification and Filing of Outbound Investment Projects* will take effect. The Administrative Measures were issued by the State Council on April 8, 2014 following the issuance of the *Catalogue of Investment Projects Requiring Government Approval* (2013) at the end of last year. The Catalogue and the Administrative Measures promulgated thereunder contain binding rules designed by the Chinese government to help guide and control foreign investment (both inbound and outbound). It was first released in 1995 as China began opening its economy and has been periodically updated over the years. The revised rules related to outbound investment, which replace those set out in the 2004 Tentative Measures,¹ feature a significant shift from an approval-based regime to a largely filing-based regime, and that shift will provide Chinese corporate investors with quicker and easier access to investment opportunities around the world.²

Overview of the Change

Under the old regime, outbound investment projects involving sensitive industries (e.g., news media) or sensitive countries (e.g., countries at war or not recognized by China) and most outbound investments over \$100 million required approval from the National Development and Reform Commission (the “NDRC”). In addition to approval from the NDRC, Chinese investors (or the enterprises in which they were invested) were also required to receive approval from the Ministry of Commerce (“MOFCOM”) if an overseas entity was to be created, to register with the State Administration of Foreign Exchange (“SAFE”) and to seek approval from the State Council if the investment was \$200 million or more.

The new regulations trigger a complete paradigm shift. In lieu of the often required three-layered approval process, the majority of outbound investments under \$1 billion now require only filing with the NDRC (or its local counterpart if the investment is under \$300 million) and MOFCOM. Upon filing, the NDRC must notify filers of acceptance or of any required changes or additional materials within five business days. Approval from the NDRC (in lieu of filing) is only required once the \$1 billion threshold is passed or if sensitive industries or sensitive countries or regions are involved, and the State Council's approval is now only required for investments valued at \$2 billion and above. MOFCOM approval (in lieu of filing) does not have any kind of monetary threshold and is only required where sensitive industries or sensitive countries or regions are involved. These terms (sensitive industries and sensitive countries or

¹ As modified by the *Notice Relating to Delegation of Examination and Approval Authority for Overseas Investment*, issued in February 2011.

² The approval process for inbound investments in China did not change, although the investments subject to such approval process have changed over time.

regions) are not yet defined in the 2013 Catalogue, but they will likely be elaborated on in the implementing regulations that are expected to be promulgated soon. Chinese state-owned enterprises (“SOEs”) are subject to slightly different rules but should benefit similarly from the shift to a filing-based regime.

Consequences — An Analysis

It is anticipated that this change will spur a significant increase in outbound Chinese investment activity, which has been erratic year over year. Between 2012 and 2013, for example, outbound investment increased roughly 17 percent based on MOFCOM data, according to Reuters; over the past year (between 2013 and 2014), however, such investment decreased by 17 percent.³ With the added stability of a filing-based system, however, these fluctuations may level out, and growth does seem to be the most likely result, as time and risk, two factors that investors typically avoid, are enhanced in an approval-based regime but are avoided in a filing-based regime. Additionally, as Beijing has been pushing to diversify the \$4 trillion in foreign exchange reserves it currently holds, the fact that SOEs also benefit from the change could trigger substantial investment from those entities.

Some factors may mitigate the increase in outbound investment. First, as one research report revealed, only 27 percent of Chinese investors deem internal regulations within China to be hampering their investment abroad.⁴ Given that there were some time deadlines on the approval process in any event (20 business days to make a decision once they accept an application), that aspect of the change may not have a substantial impact. Second, numerous other regulatory hurdles remain. For example, various aspects of Chinese investment in foreign currencies still require authorization and approval from SAFE (e.g., repatriation of foreign currency, conversion of foreign debt into equity, etc.). Such approvals can take time and also preserve the risk involved in an approval-based regime for certain aspects of outbound investment. Finally, the new Administrative Measures provide that, whether filing or approval is required in a given case, that filing or approval must be completed or received before the parties enter into a definitive agreement. This requirement preserves some aspects of the timing issue, thereby potentially further dampening its effect on outbound investment.

Despite these factors, however, an uptick in Chinese investment appears likely given the appetite for such investments, as demonstrated by the 2012–2013 growth, and, perhaps more significantly, the change itself from an approval-based regime to a filing-based regime is potentially dramatic enough to catch investors’ attention and motivate action. Under the new regime, while there is the risk that the government may step in post-filing, the shift allows investors to act first and provide contingencies for such scenarios, rather than having to ask permission and wait for approval.

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If you have any questions concerning this *Alert*, please contact your attorney at Schulte Roth & Zabel or one of the authors.

³ “China to Ease Restrictions on Overseas Investments,” April 10, 2014; “China Economy Stronger than Data Suggests: Government,” April 17, 2014.

⁴ For more information, please see KPMG, *Chinese Outbound Investment in the European Union*, January 2013.

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