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This newsletter presents some highlights of the new regulations on Chinese overseas investment.

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New Rules on Chinese Overseas Investment

by Dr. Michael Tan, Shanghai*

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1. New Legislation

The new legislation includes the promulgation of the following rules:

- Overseas Investment Administrative Measures promulgated by the Ministry of Commerce ("MOFCOM") on March 16, 2009 ("Investment Measures");
- Notice on Relevant Issues Concerning Improving the Administration of Overseas Investment Project issued by the National Development and Reform Commission ("NDRC") on June 8, 2009 ("NDRC Notice"); and the
- Administrative Provisions on Overseas Investment by Domestic Institutions by the State Administration of Foreign Exchange ("SAFE") on July 13, 2009 ("Foreign Exchange Provisions").

Under the present regime, the procedures to be followed by a Chinese enterprise before it invests abroad include clearance with three different governmental authorities in the following sequence: Permission of the NDRC which is in charge of project planning, approval of the commercial contracts by MOFCOM and finally foreign exchange clearance with the SAFE. The above regulations reflect efforts of these authorities to keep pace with the increasing demand of Chinese enterprises to "go abroad".

2. Simplified Procedures versus Tightened Verification

Due to the strict control over foreign exchange outflow in the past, examination of the source of foreign exchange to be used for overseas investment was required to be completed as the very first step among the other approval procedures applicable to an overseas investment. After project and contract approvals were granted, the applicant previously needed to revert to the SAFE or its local branch again to complete a registration procedure. This SAFE registration was a precondition for transferring the foreign currency and capital abroad in order to implement the overseas investment.

Under the new Foreign Exchange Provisions such prior "foreign exchange source examination" procedure is now abolished and combined with the final SAFE registration procedure. However, an elaboration on the source of foreign exchange is still required to be submitted at this final step.

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This actual trend of procedural simplification was already initiated by other reforming measures undertaken by the SAFE in recent years: For example, the former requirement of depositing a 5% profit security before the Chinese investor could transfer its outbound investment amount was abolished as of November 15, 2002. Another example, introduced as of November 1, 2003, was the possibility to advance start-up costs or performance security before the investee company abroad had been established. The latter topic was further liberalized under the Foreign Exchange Provisions.

In contrast to the actual trend of procedural simplification, there have always been efforts of the Chinese government to (via NDRC clearance) better control risks of investments made by Chinese enterprises. Under the previous outbound investment project verification regime stipulated in the NDRC's Overseas Investment Project Verification Tentative Administrative Measures (promulgated on October 9, 2004), it was already stipulated that a Chinese investor shall first get NDRC's verification before an outbound investment deal can be finally signed in a legally binding manner. As regards overseas M&A or acquisition bidding projects, an information report had to be submitted to the NDRC for confirmation before an application for investment verification could be submitted to the NDRC. This information report had to give a description of the investor, the project background, the targets, the off-shore (liaison and negotiation) work, due diligences, acquisition or bidding plans, and the time schedule.

The new NDRC Notice now clarifies and stresses that such an information report should already be submitted

- as regards overseas M&A projects, before the signing of any binding agreement, submission of any binding bid and the submission of application for clearance with the host country government; and
- as regards overseas acquisition bidding projects, before the official bid is submitted.

In the event that a project falling into the above scope involves obvious negative elements, the NDRC will alert the related risks in its confirmation letter and will more strictly scrutinize the subsequent submitted application for project verification aiming at influencing the investor's decision as well as that of its financing sponsors.

3. More Projects to be Locally Approved

According to the Investment Measures, the MOFCOM further enlarges its provincial branches' power to approve outbound investment projects. As far as "fast track procedures" do not apply (see below Section 4), only the following kinds of overseas investment projects are subject to MOFCOM's jurisdiction:

- investment in countries having no diplomatic ties with China;
- investment in countries as defined jointly by MOFCOM and other authorities;
- investment of over USD 100 million;
- investment involving the interest of several countries or regions; and
- establishment of an off-shore special purpose vehicle (for the purpose of a listing abroad).

MOFCOM's provincial level counterparts however will be in charge of approving the below projects:

- investment of over USD 10 million and up to USD 100 million;
- investment in energy and mineral sectors;
- investment project which requires domestic promotion.

According to an official estimation of the MOFCOM based on 2008 statistics, about 85% outbound investment cases will be approved locally in future.

The SAFE delegated competencies to the local level accordingly. This means that foreign exchange registration procedures for outbound investment will be carried out with the SAFE branches at the local level in future.

4. "Fast Track Procedures"

The general approval deadlines under the Investment Measures remain unchanged: Both approvals by the MOFCOM and by its provincial counterparts shall be granted within 15 working days.

However, in the case of an investment project of up to USD 10 million which does not trigger the other criteria listed in the above Section 3, the Investment Measures provide for the possibility of "fast track

procedures". Under such procedures, the applicant only needs to fill out an application form, and an "Enterprise Overseas Investment Certificate" will be granted within 3 working days upon a pro forma review of the application. Compared with the previous regulations, this is a main breakthrough under the Investment Measures and shows the actual attitude of the MOFCOM to more efficiently release small and non-special outbound investment projects.

Under the "fast track procedures", applications of central level State-owned enterprises shall be handled with the MOFCOM while other applications shall be handled locally.

5. Requirements on Overseas Behavior

For the first time, the Investment Measures stipulate overseas investment behavior codes and stress that the enterprise shall "abide by laws and regulations of the host countries, assume social responsibilities".

The Investment Measures provide, amongst others, the following key requirements in this aspect:

- Qualification certificates shall be obtained in case domestic and foreign laws and regulations require so.
- The name of the investee company established abroad shall comply with both home and host countries requirements. Company names including terms like "China", "Chinese", or "national" shall not be used without required approvals.
- The investor shall undertake preventive measures as regards personnel and property safety, establish an emergency warning system and reaction plan, follow guidance of overseas Chinese embassies in this regard, and timely and properly handle emergency events which shall be reported to the Chinese embassies and Chinese authorities immediately.
- Personnel from the Chinese side who are in charge of the investee company abroad shall report and register with the local Chinese embassies.
- The trueness and accuracy of its business and statistics reports shall be ensured.

The Investment Measures also commit the MOFCOM and its local counterparts to an increase of its service level. This includes promulgation of the so-called "Outbound Investment Country (Region) Classification Guidance" which will introduce the investment environment of host countries and issuance of the "Outbound Investment Country (Region) Classification Industrial Guidance" in order to channel industrial preference of Chinese investors. The Investment Measures further commit MOFCOM to solving problems and difficulties arising during the investment process via bilateral economic, trade or investment cooperation mechanisms.

6. Open Questions and Round-Trip Investments

The new rules leave open questions as regards to issues of practical significance. For example, they only regulate outbound investment by Chinese enterprises, but stay silent on outbound investment activities by Chinese individuals. This means that outbound investment by Chinese individuals remains to be legally unregulated unless it touches the so-called "round trip investment". A "round trip investment" means the establishment of an off-shore special purpose vehicle for financing or listing purposes which subsequently acquires the related Chinese domestic business to be financed or floated. Such "round-trip investment" is subject to strict control by a complicated and cumbersome SAFE procedure.

The new rules on Chinese overseas investment do not liberalize "round-trip investments". Instead, SAFE and its local counterparts recently limited clearance for round-trip investments to projects aiming at off-shore listings but did not approve round-trip investments for other financing or restructuring purposes.

This seems to reflect from another angle the Chinese government's attitude to encourage Chinese investors to "go abroad" in order to alleviate pressures on China's substantial foreign exchange surplus and to restrict Chinese investors going abroad and back to China again to create new foreign exchange reserves.

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