NDRC reshapes regime on outbound investments

March 15, 2018

New NDRC regulations on the administration of Chinese outbound investment came into force on 1 March 2018. These regulations are also known as ”Circular 11. Across the board, and compared to its 2014 predecessor, the new regulations can be summarised as a less stringent procedural regime applied to a broader scope of entities. Similar to the previous regime, the new regulations can significantly impact transactions involving Chinese companies investing outside of mainland China. We recommend that parties to Chinese outbound investment take note of the changes in mandatory NDRC engagement. In terms of applicable China outbound transactions, these regulations should be factored into overall transaction planning and structuring; navigating them remains a time- consuming and uncertain process that can be influenced by all aspects of a deal.

On 26 December 2017, the National Development and Reform Commission (NDRC), China's macro-economic and state-planning agency, issued its new Measures for the Administration of Outbound Investment by Enterprises; commonly referred to as Circular 11. The Measures expand the scope of outbound investments subject to NDRC scrutiny and streamline the existing approval and filing procedure. The Measures, which came into force on 1 March 2018, replace their predecessor released in 2014, which were referred to as Circular 9.

Expanded scope

The Measures expand the scope of Chinese outbound investment subject to NDRC scrutiny. While the 2014 regime only applied to entities incorporated in the PRC (either directly investing themselves, or providing financing or guarantees), the scope of the new regime has been expanded to entities "controlled" by a PRC entity. In this regard, "control" means holding direct or indirect ownership of 50% or more of the voting rights of another entity, or the authority to manage the entity's operations, finance, personnel, technology or other important affairs. As a result of this expansion in scope, the use of offshore entities – which for this purpose includes Hong Kong, Taiwan and Macau – can now fall within the scope of the Measures, effectively closing off an often-used work-around to bypass the applicability of the 2014 regime. If clearance obligations apply to "controlled" offshore entities, the onshore parent is to engage with the NDRC.

Notably, for the first time, the outbound transactional regime now also applies to entities controlled by a Chinese individual. In addition, the Measures provide that financial institutions are now also subject to NDRC scrutiny when it comes to outbound investment activities, whereas in the past they were only subject to approval by their industry regulatory authorities.

Sensitive investments

The new Measures require all outbound investments considered sensitive to obtain NDRC approval. Sensitive investments include investments in sensitive countries (including countries with which China does not hold diplomatic ties, or countries at war) and sensitive industries. For the latter category, the NDRC published the List of Sensitive Industries for Overseas Investment on 11 February of this year. The list is expected to be updated regularly, and currently includes the following sensitive sectors: research, manufacturing and maintenance of weapons, cross-border water resources, and news media. Also, the list provides that sectors listed under the ”restricted" category in the guidelines on overseas investment (introduced in August 2017) also qualify as "sensitive". This category includes real estate, hotels, entertainment (such as cinemas and movie studios), sports clubs, and equity investment funds without any operating business. Importantly, the Measures introduce a catch-all provision allowing the Chinese government to adjust the scope of sensitive outbound investments at any time. Consequently, the new Measures allow for effective control over outbound investments which do not align with macro-economic planning and other government policies.

Removal of "Road Pass"

The 2014 measures required that companies contemplating an outbound investment with a value of more than USD 300 million obtain a pre-confirmation letter from the NDRC prior to beginning any substantive work, such as submitting a binding offer or signing a binding agreement. The pre-confirmation letter was also known as the "Road Pass". In practice, the Road Pass obligation created an administrative burden on the side of the investing PRC entity and, more generally, uncertainty when more than one Chinese entity participated in an auction project. The Measures abolish the Road Pass, creating more certainty on the timetable of a Chinese overseas investment and enabling Chinese investors to become more competitive in foreign project bids.

Approval, reporting and filing requirements

The Measures introduce several changes to the previous NDRC scrutiny regime. Depending on the nature and details of a foreign transaction (see below), the investment can fall into one of three categories of NDRC scrutiny: approval, reporting or filing. The reporting category has been newly introduced and was not present in the 2014 regime.

Action required by the investor	Type of outbound PRC investment
Approval	Investments in sensitive regions or sectors by an entity incorporated in China or controlled by a Chinese entity or individual.
Reporting	Investments by an offshore entity controlled by a Chinese entity or individual, which is non-sensitive and constitutes a value of more than USD 300 million
Filing	Non-sensitive investments made by domestic investors, regardless of the investment amount.
No Action	Investments by an offshore entity controlled by a Chinese entity or individual, which is non-sensitive and constitutes a value of less than USD 300 million

In order to obtain approval from the NDRC, an investor has to provide an impact analysis of the investment. Under the Measures, this analysis should now also cover both the impact of the outbound investment on China's national interest and national security. The NDRC will then conduct a comprehensive review of the application. In the case of reporting, the investor has to submit an online ”project report". On the basis of the report review, the NDRC can then request more information; if no additional information is requested, the requirement shall be considered to be fulfilled (in other words: no news is good news). The filing requirement, which has the lowest and most easily triggered threshold, is regarded as the least stringent and is easier to obtain. If all procedural steps are followed, a filing notice should be received.

On 11 February 2018, the NDRC published standard forms for the approval, reporting and filing application, which differ from the previous 2014 standard forms. Notably, the standard forms require a more comprehensive equity structure chart, which describes a structural overview of the investing entity. Preparation of the new comprehensive forms might require more time than was previously needed.

Penalties and enforcement

In comparison with its 2014 predecessor, the Measures also grant the NDRC more extensive disciplinary powers should an investor break the rules, such as by trying to conceal or falsify transaction information. The NDRC can refuse an application for Chinese overseas investment, which may result in the termination of the investment, or the cancellation of a filing. Moreover, the NDRC can carry out criminal proceedings against the responsible personnel if they commit a criminal offence. Sanctions are shared with other authorities, and are published online, in order to promote a more centralised approach against investors who break the rules.

Assessment

Across the board, and compared to the 2014 measures, the Measures and related legislation can be summarised as a less stringent procedural regime applied to a broader scope of entities. As such, the Measures could be characterised overall as investor-friendly. Transactions considered to be beneficial to the Chinese economy should be able to profit from the more streamlined regime. Accordingly, sellers of in-demand businesses or assets can use the Measures to their advantage. However, as the new regime also allows for significant discretion both in scope and in the actual review, the consequences for future Chinese outbound deal flow remain to be seen.

For individual transactions, we recommend that, similar to the 2014 regime, any seller to a Chinese domestic entity or Chinese-controlled entity take the Measures into account with regard to negotiating, structuring and timing of a China outbound transaction. If NDRC engagement or clearance is required, navigating the relevant regulations remains a time-consuming and uncertain process which will be heavily influenced by all aspects of a deal.