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China outbound investment regulations and requirements

China's overseas investment has rapidly increased over the last few years as Chinese companies expanded into new markets, seeking to develop advanced technology and acquiring energy and resources and brand names.

Investment into the agribusiness sector from China is no exception as international investment focus turns to food security and food safety. Piper Alderman has acted on acquisition and joint venture investment transactions for both Chinese and domestic clients, most recently for Qingdao Gather Great Ocean Algae Industry Group Co., Ltd from Shandong Province on its acquisition of Australian Kelp products, and Peloris Global Sourcing on its collaboration with Chinese authorities and industry body Dairy Connect in developing and implementing a streamlined cold chain solution for Australian fresh milk imports to China. Potential Australian joint venture partners and vendors should be aware of the regulation which applies in China to capital coming out of that country because it can affect deal timeframes and deal logistics.

Regulations governing outbound investment

Investment abroad by Chinese companies is regulated by three governmental bodies: the Ministry of Commerce (MOFCOM), the State Administration of Foreign Exchange (SAFE) and the National Development Reform Commission (NDRC). In recent years, these agencies have sought to make expanding abroad easier for Chinese companies.

MOFCOM Regulation

MOFCOM is the main regulatory body governing outbound investment in China. It is responsible for formulating regulations in relation to outbound investment and coordinates the activities of the commercial counsellors in China's embassies in protecting and advancing the interests of Chinese companies. In March 2009, MOFCOM released the Measures for the Administration of Outbound Investment (the Measures), the Measures detail the level of review that various Chinese enterprises are subjected to in order to receive an Outbound Investment Approval Certificate. Chinese enterprises must receive an Outbound Investment Approval Certificate in order to complete foreign currency, banking and customs procedures with the relevant Chinese government agencies.

According to the Measures, the following kinds of outbound investment transactions require central-level MOFCOM review:

- Investing in a country that has not established diplomatic relationships with China.
- Investing in a specific country or region on a list to be determined by MOFCOM and the Ministry of Foreign Affairs as well as other relevant departments.
- Investing an amount greater than $100 million.
- Making an investment that involves the interests of multiple countries or regions.
- Setting up a special-purpose company overseas to enable a domestic company to gain the benefits of a foreign listing.

The following kinds of outbound investment transitions require provincial-level MOFCOM review:

- Overseas investment level of between $10 million and $100 million.
- Overseas investment in the fields of energy or minerals.
- Overseas investments that require capital to be raised from within China.

As a general rule, central – level and provincial – level authorities will deny permission to make an overseas investment under three circumstances:

- The transaction endangers the sovereignty, national security or public interests of China or violates a law or regulation of China.
- The transaction will likely violate any international treaty concluded by China with a foreign party.
- The transaction involves exporting any technology or goods prohibited by China.

The Measures call for central and provincial MOFCOM officials to consult the appropriate Chinese embassy or consulate where the investment will be made as to the security status of the target country and the probable effect of the proposed investment on bilateral economic, political and trade relations.

All other investment transactions by Chinese enterprises are not subject to central or provincial level MOFCOM approval, and the investor need only submit an Application Form for Overseas Investment and should receive approval within three days. The Measures mark a significant change from the previous approval procedures that subjected all investments to full review by central or provincial MOFCOM officials. The Measures make it clear that MOFCOM will not conduct or review feasibility studies of proposed investments, providing, in relevant part, that "economic and technical feasibility of an overseas investment shall be the sole responsibility of the enterprise."

The Measures streamline the approval process for Chinese outbound investment and make the process much more predictable. This should enable potential foreign sellers and joint-venture participants to select their preferred investors based on accurate predictions of the time necessary for governmental review.

SAFE Regulation

SAFE is responsible for, amount other things, handing China's significant foreign exchange reserves. In that capacity, SAFE drafts and implements the rules that determine the conditions under which Chinese companies can use foreign currency.

On 9 June 2009, SAFE issued the Notice on Certain Issues Relating to Foreign Exchange Administration on offshore Lending by Domestic Enterprises (the Notice), which became effective as of August 1, 2009. The Notice makes it easier for Chinese enterprises to finance their operations abroad by reducing qualification requirements for offshore lending, expanding the sources of funds for lending, and simplifying verification and remittance procedures for lending.

The Notice allows Chinese enterprises to use their own foreign currency holdings as well as government foreign exchange reserves to make loans to their foreign subsidiaries.

National Development Reform Commission (NDRC) Regulation

The NDRC supervise outbound investments to ensure they align with China's overall economic development policy. The Commission plays an active role in the approval of outbound investment, and its review includes the commercial and technical feasibility of proposed projects. It is particularly interested in investment transactions that relate to natural resource exploration and development as well as transactions that require a large amount of foreign currency reserves. According to the Measures, Chinese companies are required to obtain NDRC approval to make investments abroad under two conditions:

- when the investment transaction relates to natural resource exploitation and the investment amount is in excess of $30 million
- when the company requires a large amount of foreign currency to make the investment and the investment is above $10 million.

If investments meet either of the two following conditions they require both NDRC and State Council approval:

- the investment relates to natural resource development and the investment amount is above $200 million
- the Chinese company requires a large amount of foreign currency to make the investment and the investment amount is above $50 million.

The NDRC also require Chinese companies that intend to acquire overseas companies in transactions that are subject to NDRC approval to submit certain informational reports to the NDRC before they sign any legally binding contracts. The NDRC can then identify "apparent significant adverse factors" and notify the company accordingly.

Banking Regulations

Another regulation supporting increased outbound investment by Chinese enterprises is the guidelines on Risk management of loans Extended by Commercial Banks for Mergers and Acquisitions (the Guidelines). The Guidelines were promulgated in response to a call by the State Council to increase bank support for M&A transactions as part of a stimulus effort to combat the global financial crisis.

Under the Guidelines, banks incorporated in China (including locally incorporated subsidiaries of foreign banks) can lend to enterprises incorporated in China (including foreign invested enterprises) for a variety of M& A purposes, including purchases of existing equity interests, subscriptions for new capital, mergers, asset acquisitions, debt restructurings and other similar transactions, but excluding the purchase of non-controlling minority stakes.

The Guidelines include capital and other requirements that banks must meet before lending for M&A transactions. Specifically, banks must have:

- comprehensive risk management systems and effective internal control systems
- a loan loss special reserve ratio of 100% or above
- a capital adequacy ratio of 10% or above
- a general reserve balance of at least 1% of the loan balance over the same period
- professional management capable of performing credit due diligence and risk assessment.

In addition, the Guidelines place the following restrictions on M&A loans:

- An M&A loan cannot exceed 50% of the total acquisition price.
- A loan to a single borrower cannot exceed five years.
- The borrower must provide adequate security for the loan.

On top of these financial restrictions, the Guidelines require banks to perform due diligence regarding compliance, operational and commercial risks relating to the parties and the transaction. Banks must evaluate factors like potential synergies between the two enterprises. In order to comply with these requirements, Chinese banks will have to devote resources to developing expertise not only in the financial aspects of M&A transactions, but in other aspects of M&A deals as well.