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CHINA TO ENCOURAGE OUTBOUND INVESTMENT BY PRIVATE COMPANIES

Following waves of investments and acquisitions made outside of China by large state-owned enterprises principally in the area of natural resources, the PRC government is now turning to formulating and implementing policy that would encourage outbound investment and acquisition by Chinese private companies.

On June 29, 2012, the National Development and Revolution Committee (NDRC), the Ministry of Commerce (MOC), the State Administration of Foreign Exchange (SAFE) and ten other regulatory authorities jointly released the *Implementing Opinions on Encouraging and Guiding the Active Outbound Investment by Private Enterprises* (the Opinions). The Opinions are policy documents intended to lay the foundation for more detailed regulations to be promulgated in the future concerning cross-border investment and M&A activities by Chinese private companies. The Opinions are complemented by a detailed regulation issued by SAFE in mid-June entitled *Circular on Foreign Exchange Administration in Relation to Encouraging and Guiding the Healthy Development of Private Investment*, which relaxes certain aspects of foreign exchange control as it relates to outbound investments by Chinese private companies. The Opinions come on the heels of a series of policy statements intending to legalize and unleash, albeit gradually, financing from the private sector.

Together, these developments may signal the beginning of a new wave of overseas investment and acquisition activities by Chinese private companies, many of whose owners wish to diversify their investments and wealth geographically. This trend may be of particular interest to mid-size, privately owned companies in Europe and the US whose owners seek an exit strategy, and to active financial investors in China looking to team up with Chinese strategic buyers on international acquisitions.

While detailed implementation regulations are still to come, the Opinions provide, in general terms, some key directions and incentives.

Preferred Sectors for Outbound Investment

Outbound investments in the energy and resources, high-tech, advanced manufacturing, infrastructure, agriculture, and service industries are encouraged.

Tax Incentives

- Foreign tax credits are available to offset the PRC enterprise income tax applicable to offshore revenues.
- China is expected to enter into tax treaties and arrangements with more countries to avoid double taxation.

Facilitation of Financing

Financing has always been one of the most significant challenges for Chinese outbound investments. The Opinions outline several approaches for facilitating debt and equity financing for outbound investments.

- Favorable policy will be adopted with respect to loans provided by Chinese domestic banks to facilitate outbound investments. Pledging offshore assets and equity to secure domestic loans will be permitted.
- Policy and approval requirements with respect to the issuance of offshore bonds will be liberalized, especially when the issuer is a Chinese private company. Currently, most of the issuers of dim sum bonds are state-owned enterprises. The Chinese government will likely green-light private issuers and adopt supportive measures to improve the ratings of such issuers.
- Equity investment funds should be formed by strategic and financial investors to focus specifically on outbound investments. Outbound "club" deals where private equity funds team up with Chinese companies to make outbound investments are highly encouraged.

Streamlining of Regulatory Approval Process

The approval process for outbound investments will be streamlined; the authorities in charge of reviewing and approving outbound investments, mainly NDRC and MOC, are expected to promulgate new regulations to this effect. NDRC and MOC have already issued regulations to ease the filing and approval process for outbound investments by Chinese companies. Future legislation by these two authorities will likely focus on better coordination of their respective review and approval processes, with a view to promoting a simpler and more expeditious regulatory process for outbound investments.

Loosening Foreign Exchange Control

The Opinions contain general principles regarding foreign exchange issues as they relate to outbound investments, which principles are consistent with and supplementary to the SAFE Circular.

- Onshore foreign currency loans from Chinese domestic banks are added as a source of funding for outbound investments.
- When a Chinese company provides external credit support to secure financings for its offshore subsidiary, it is now permissible for a PRC individual (*e.g.*, the founder or other affiliates of the Chinese company) to be the co-guarantor for these financings. So long as the external credit support by the Chinese company has been approved by SAFE, SAFE will not perform a separate substantive review of the credit support provided by the Chinese individual. As external credit support given by a Chinese individual is a grey area and has previously been rejected by SAFE, this new regulation is a breakthrough in the specific context described above.

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