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China Publishes Official Guidelines on Overseas Investments

The National Development and Reform Commission ("NDRC"), the Ministry of Commerce ("MOC"), the People's Bank of China and the Ministry of Foreign Affairs of the People's Republic of China jointly formulated the Opinions on Further Guiding and Regulating the Directions of Overseas Investments (the "Guiding Opinions"), clarifying China's latest regulatory attitude towards Chinese overseas investments. The Guiding Opinions were published on August 17, 2017.

Current Overseas Investments Regulatory Regime and Developments

Under the existing overseas investments regulatory regime in China, NDRC and MOC are the two primary regulators overseeing overseas investments by Chinese investors (with state-owned enterprises, certain regulated institutions and listed companies being subject to additional supervision of other regulators). Filings with the two regulators are required for most overseas investments by Chinese investors, with investments in sensitive geographies (such as countries or regions that have not established diplomatic relations with China, sanctioned by the United Nations, at war, etc.) or industries (such as telecommunications infrastructure, power transmission and distribution infrastructure, news media, etc.) being subject to higher level of scrutiny and requiring approvals. In addition to the filings with or approvals by NDRC and MOC, Chinese investors will need to apply to its bank to remit its investment consideration offshore.

Since last year, China has increased its scrutiny over overseas investments in general to prevent capital outflow, with additional unofficial restrictions introduced and imposed in governmental departments and banks handling cross-border remittance of funds. Further, in an effort to reduce pressure on the Chinese banking system, internal memoranda were circulated to major state-owned banks to halt the provision of financing to large Chinese private companies that have been active in highly leveraged overseas investments. As a result, overseas investments made by Chinese investors has decreased by 42.9% year-on-year to RMB 331.1 billion in the first half of 2017.

As many of the restrictions imposed since the clamp-down of capital outflow are not fully transparent or officially formalized, there is great uncertainty in the market regarding the types of overseas investments that are discouraged or permitted, indiscriminatingly creating difficulties for and reducing the competitiveness of Chinese investors in overseas mergers and acquisitions. The Guiding Opinions will provide the much needed clarity on Chinese outbound investments.

Highlights of the Guiding Opinions

The Guiding Opinions acknowledged the importance of overseas investments, but also cautioned that overseas investments may face many risks and challenges.

The Guiding Opinions reiterated that filings with MOC and NDRC continue to be the primary means in regulating overseas investments and classified overseas investments into three categories: encouraged, restricted and prohibited.

Encouraged Overseas Investments

China will support domestic enterprises that with adequate capabilities and qualifications to:

- invest in the infrastructure that is beneficial to the "Belt and Road" initiative;
- invest in overseas projects that facilitate the export of industrial capacity, equipment and technical standards;
- increase investment in and cooperation with overseas new and high technological enterprises and advanced manufacturing enterprises and establish offshore research and development centers;
- participate in the exploration and extraction of offshore oil and gas, mining and other energy resources based on prudent assessment of cost benefits;
- expand investment and cooperation in agricultural projects; and
- promote investment in commerce and trading, the cultural sector, logistics and other service sectors in an orderly manner, and support qualified financial institutions to set up offshore branches and service networks.

Restricted Overseas Investments

Overseas investments that contravene China's foreign affairs strategy and macroeconomic regulations are restricted, including overseas investments:

- in sensitive geographies;
- in real estate, hotels, film studios, entertainment sector or sports clubs;
- by establishing overseas equity investment funds or investment platforms without underlying business operations;

- using obsolete production equipment that is not in compliance with the relevant target jurisdiction's technical standards; and
- that are not in compliance with the relevant target jurisdiction's environmental protection, energy consumption or safety standards.

The Chinese government will provide guidance and reminders to Chinese investors to make such investments prudently. The Guiding Opinions stated that the first three types of restricted overseas investments require regulatory approvals, whereas only the first type of investments in this category expressly requires regulatory approval prior to the promulgation of the Guiding Opinions.

Prohibited Overseas Investments

Chinese government will prohibit investors from making overseas investments that endanger or may endanger national interest or national security, including making overseas investments:

- that involve the export of core technologies and products of military industry unauthorized by the government;
- using technologies, techniques and products that are banned from export;
- in gambling or sex sectors;
- that are prohibited by any applicable international treaty; and
- that otherwise endanger or may endanger national interest or national security.

The first and third types of this category are newly added prohibited categories of investment while the other three types are substantially also prohibited under the existing regime.

The Guiding Opinions also introduced the concept of an overseas investment blacklist, which may potentially restrict noncompliant investors from making any future overseas investment.

Looking Forward

The Guiding Opinions provided more clarity to the market on the attitude of the Chinese government towards overseas investments and affirmed that China is still supportive of outbound investments in general.

Investments in the restricted category by Chinese investors will be subject to heightened scrutiny but it is not clear whether strategic investments in sectors such as real estate, entertainment and hotels with strategic value to a Chinese investor or which does not put pressure on the Chinese banking system with high levels of leverage will be approved. Further, it is unclear if banks handling cross-border remittance in overseas investments that do not fall within any of the three categories will continue to reject or prolong the remittance process in an effort to restrict capital outflow. In the past, it is generally accepted that Chinese companies which make overseas investments with funds that are offshore (for example, using offshore operating income or through equity or debt financing offshore) do not apply for Chinese regulatory approvals or filings. It is not clear whether the overseas investment blacklist will be used as a means by the Chinese government to regulate investments in the prohibited or restricted categories using offshore funds. The market will have more answers to these questions in the coming months with the implementation of the Guiding Opinions and further detailed related regulations that may be published.

Click here for an unofficial translation of the Guiding Opinions for reference.

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This memorandum is not intended to provide legal advice, and no legal or business decision should be based on its content. Questions concerning issues addressed in this memorandum should be directed to:

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