
New Policies on China's Overseas Investments

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China's State Council on August 4, 2017, promulgated the Guiding Opinions on Further Guiding and Regulating Overseas Investment (Opinions). The Opinions were jointly formulated by the National Development and Reform Commission (NDRC), Ministry of Commerce (MOFCOM), People's Bank of China (PBOC) and Ministry of Foreign Affairs (MOFA). The Opinions divide China's outbound investments by sector into "encouraged," "restricted" and "prohibited" categories, providing a clearer and more authoritative regulatory framework for regulation of overseas investments by Chinese companies.

"Encouraged" Category

The Government continues to encourage qualified Chinese companies to engage in overseas investments to deepen international cooperation, promote the "Belt and Road Initiative," export excess domestic production capacity, high-quality equipment and technology, bolster R&D in technology and production capacity, and address shortfalls in China's energy and mineral endowments. In particular, overseas investments in the following areas are encouraged:

1. Infrastructure projects in connection with China's "Belt and Road Initiative";
2. Overseas investments to promote export of China's excess production capacity, high-end equipment and technology standards;
3. Collaboration with overseas high and new technology enterprises and enterprises engaged in advanced manufacturing (including encouragement to establish overseas technology R&D centers);
4. Participation in the exploitation and development of overseas oil and gas and mineral resources, subject to careful and prudent economic assessments;
5. Promotion of overseas agricultural cooperation, in particular investments and collaboration in agriculture, forestry, animal husbandry and fisheries; and
6. Promotion of overseas investments in service sectors, including commerce and trade, cultural and logistics services; and support for qualified domestic financial institutions to establish overseas branches and service networks to conduct business operations in compliance with law.

“Restricted” Category

1. Overseas investments in countries and regions that do not have diplomatic relations with China or countries and regions that are sensitive or subject to restrictions under relevant bilateral or multilateral treaties;
2. Real estate, hotels, movie theaters, the entertainment industry and professional sports teams;
3. Overseas equity investment funds/platforms or other investment platforms without tangible industrial projects;
4. Overseas investments involving outdated manufacturing equipment or technology standards that do not meet the target country's local standards; and
5. Overseas investments that do not meet the target country's local environmental protection, energy consumption or safety standards.

Projects falling under the first three restricted subcategories are subject to substantive examination and approval by the relevant authorities in charge of overseas investments.

“Prohibited” Category

Overseas investments which may impede China's national interest and national security are prohibited, in particular:

1. Overseas investments intended to export core technologies and defense industry products without permission;
2. Overseas investments intended to export technologies, artwork and products for which export is prohibited;
3. Overseas investments relating to gambling or pornography;
4. Overseas investments that are restricted under international treaties to which China is a party; and
5. Other overseas investments that may impede China's national interests or national security.

Overseas investments in the “encouraged” category will be supported by government in many respects, including accelerated regulatory review process, currency conversion and overseas remittance conveniences, and strong support by the domestic banking industry (including China's policy banks) with respect to debt financing and other items.

Overseas investment projects in the “restricted” category generally do not correspond to China's overall overseas investment strategies and therefore will be subject to closer government scrutiny, which in practice often means that these projects will not be approved or approval will be delayed for an indefinite period.

Projects that do not fall into the “encouraged,” “restricted” or “prohibited” categories are in practice viewed as “permitted,” which means that these projects will undergo normal regulatory review processes because they are neither favored nor disfavored by government. In this respect, the policy embodied in the Opinions is the overseas direct investment (ODI) counterpart to China's Guiding

Catalogue of Foreign Investment by Industry regulating foreign direct investment into China.

China began to clamp down on overseas investments to combat the surge in capital outflows from China in 2016 which placed downward pressure on the Renminbi and China's foreign exchange reserves. Several policies and rules were promulgated in 2016 and 2017 to tighten China's control and supervision on overseas investment activities. These policies impose a much stricter regulatory regime, raise hurdles for cross-border currency outflows and place particular emphasis on the following areas:

- NDRC and MOFCOM are now required to conduct substantive review and “authenticity” verification on overseas investment projects;
- Chinese companies that do not have substantive businesses or assets are restricted from making overseas investments;
- Chinese companies are restricted from investing in overseas projects that bear little or no connection to their main businesses;
- More limitations on Chinese companies' capability to borrow from overseas branches of Chinese banks to finance overseas greenfield investments or M&A projects;
- More demanding debt-equity ratio and borrowing limits requirements for companies intending to make overseas investments; and
- Stricter outbound investment regulatory review and foreign exchange filing/approval procedures.

In addition to the new policies, Chinese regulators are also targeting a number of China's largest and most active overseas asset buyers, including Wanda Group, Fosun and HNA, placing their overseas investments under closer scrutiny due to increased concerns over capital flight and investment security.

While the Chinese government is clearly moving cautiously with respect to overseas investments nowadays, it nevertheless continues to send a consistent message to the outside world, i.e., legitimate overseas investments with substantive business purposes benefiting Chinese domestic industries will continue to be supported and encouraged. The Opinions provide further clarification in this regard.

Foreign companies seeking Chinese investments now need to consider the following:

- Maintain a clear understanding of the “encouraged,” “restricted” and “prohibited” categories to understand what Chinese companies can or cannot do;
- Conduct background checks on Chinese investors, including whether they are engaged in substantive businesses and whether they have a good track record on obtaining Chinese regulatory approval for prior overseas investment projects (whether they are blacklisted or not);
- Determine whether businesses/assets to be invested/acquired by a Chinese investor complement or create synergy with its businesses;
- For overseas private equity/venture capital/hedge funds, be cautious about raising funds from Chinese investors which only have Renminbi funds sitting in China;

- Confirm whether the investor's local government supports the investment project and whether such project meets local government's development objectives—the majority of overseas investments are subject to local government rather than central government approval, making local government support critical;
- Other considerations, such as whether and how the transaction will benefit Chinese domestic industry and society (e.g., moving the manufacturing base to China, introducing new technologies, upstream and downstream vertical integration, etc.), which may help to facilitate China regulatory approval; and
- Finally, while the Opinions address Chinese domestic approvals, the heightened focus on targeted investments may make some foreign governments more suspicious of the underlying security and mercantilist motivations of Chinese ODI. If so, proposed Chinese investments may encounter greater regulatory scrutiny in target countries.

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