COMMENTARY

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Update on Chinese Outbound Investment Policies

IN SHORT

The Situation: In December 2016, several of China's governing entities introduced a set of rules to regulate overseas direct investment by Chinese businesses.

The Development: Questions subsequently raised by the public led to new Guidelines that classify ODI activities into three categories: Encouraged ODI, Restricted ODI, and Prohibited ODI.

Looking Ahead: While the new Guidelines provide needed clarity, the possibility remains that the Chinese government could take additional action relating to ODI investments.

China's State Council recently issued a new notice ("New ODI Guidelines") as a follow-up to the overseas investment control policy that it announced in December 2016. The New ODI Guidelines provide further guidance regarding the regulation of overseas direct investment ("ODI") by Chinese businesses and clarifies how the Chinese government will implement these restrictions on ODI activities.

The 2016 ODI Rules

In December 2016, the People's Bank of China, the State Administration of Foreign Exchange ("SAFE"), the Ministry of Commerce ("MOFCOM"), and the National Development and Reform Commission ("NDRC") issued a set of rules designed to enhance the approval and filing requirements for ODI projects ("ODI Rules"). The ODI Rules imposed three major requirements applicable to all ODI projects:

1. A meeting with the local branch of SAFE prior to any cross-border payment (without threshold) for an ODI project may be made.
2. Any cross-border payment for an ODI project with a purchase price of US$5 million or above requires a "significant amount report" to be submitted to SAFE; and
3. Approving authorities, including MOFCOM, NDRC, and SAFE, will scrutinize the following types of ODI transactions:
   - Irrational overseas investments (not defined in the ODI Rules or any other related rules, so what constitutes "irrational" is subject to the discretion of the Chinese government) in real estate, hotels, movie theaters, sports clubs, and the entertainment industry;
   - Large investments (not defined in the ODI Rules or any other related rules, but in practice it appears to refer to investments of US$1 billion or more) in business lines that are not related to the core business of the Chinese investor;
   - Outbound investments made by limited partnerships;
   - Investments in offshore targets that hold assets with a value that is greater than the Chinese investor's;

- Investments by newly established entities (i.e., in existence for less than one year); and
- Investments where the source of RMB funding is not "reasonable and valid" (not provided in the ODI Rules and subject to the discretion of the Chinese authorities) and may be considered in violation of Chinese law.

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Recently, the Chinese banking regulatory authority requested major banks in China to investigate the financing activities of four Chinese conglomerates—An Bang, Wanda, HNA, and Fosun—that have actively participated in outbound acquisitions in the past two years. These investigations have been highly publicized and illustrate the Chinese government's desire to send a message that compliance with the ODI Rules is a priority. Some government statistics indicate that these policies are having a quelling effect, with China's foreign direct investment lower by more than 40 percent in 2017.

New ODI Guidelines

Due to the number of questions raised by the public regarding the implementation of the ODI Rules, the New ODI Guidelines were issued to further explain how the government intends to enforce these regulations. The New ODI Guidelines classified ODI activities into three categories:

Encouraged ODI: Investments that further the "One Belt, One Road Initiative"—a Chinese economic and strategic agenda by which the two ends of Eurasia, as well as Africa and Oceania, are being more closely tied along two routes, one over land and one by sea—that enhance China's technical capabilities, or that are related to research and development, oil and mining exploration, agriculture, or fishing;

Restricted ODI: Investments in real property, the entertainment industry, sports clubs, obsolete equipment, private equity, investment platforms established offshore without actual business, or investments that contravene environmental standards; and

Prohibited ODI: Investments in core military technology, gambling, the sex industry, or investments contrary to national security.

The government has indicated that it will make efforts to facilitate Encouraged ODI through tax, foreign exchange, customs, and insurance directives. For the other categories, the government will provide guidance on a case-by-case basis for companies to "cautiously participate" in Restricted ODI and will "strictly monitor and regulate" Prohibited ODI.

Conclusion

While the New ODI Guidelines do not necessarily alter the ODI Rules, they provide the best guidance to date regarding how the Chinese regulatory authorities intend to implement them. Given the current political climate, however, the possibility that the Chinese government may take further actions to further limit ODI investments is not out of the question.

TWO KEY TAKEAWAYS

1. Chinese authorities have divided ODI investments into three categories and will take relevant action to encourage, monitor, or regulate activities in those areas.

2. Interested parties should continue to monitor the situation, as further action by the Chinese government cannot be ruled out at this time.

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