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PRC STATE COUNCIL ISSUES GUIDELINES ON OVERSEAS INVESTMENTS

On 18 August 2017, China's State Council, together with other regulatory bodies, issued guidelines on regulating overseas investments. The guidelines form part of a much tightened regulatory regime for overseas investments implemented by the Chinese government since last November, aimed at stemming capital outflows and the rate of depletion of China's foreign exchange reserves.

Key highlights

- The PRC State Council has issued new guidelines regarding overseas investments.
- These guidelines formalise various previously published rules as well as unofficial measures, and classify types of investment and sectors as "encouraged", "restricted" or "prohibited".
- Whilst certain sectors are "restricted" or "prohibited", outbound transactions consistent with China's 'Going Out' policy or reflective of the Chinese Government's 'One Belt One Road' strategy will continue to receive strong support.

NEW GUIDELINES

The guidelines formalise previously published piecemeal rules and classify certain types of investment as either "encouraged", "restricted" or "prohibited".

The **"encouraged"** sectors under the guidelines include, among others, infrastructure projects that facilitate the "One Belt and One Road" initiative; projects promoting the export of China's advanced production capacity, equipment and technical standards, energy and mining exploration companies, agricultural projects, and commerce, culture, logistics and other sectors in the service industry.

The "**restricted**" sectors include, among others, investment in sensitive countries and regions with which China has not established diplomatic ties, or are restricted for investment by bilateral or multilateral treaties signed by China; real estate, hotels, the entertainment industry, movie studios and sports clubs; some equity investment funds or platforms; investment involving obsolete equipment and investment that violates the target country's environmental, energy or safety standards.

The "**prohibited**" sectors include, among others, projects involving the export of China's core military technology and products; investments with techniques or products that are prohibited from export; gambling and sex industry; investment that violates the international treaties signed by China and investment that harms China's national interests or security.

The guidelines do not specify whether an investment that does not belong to one of these sectors should be permitted for overseas direct investment. It is also unclear whether any restricted investments, previously subject to close scrutiny of the PRC regulators (as described below in the section "Closely Scrutinised Sectors") and that are not specifically mentioned in the guidelines are subject to rejection by relevant PRC regulators, as was the case in practice before the guidelines were issued. It remains to be seen how the guidelines will be implemented in practice and in particular whether they will replace the previous policies of the PRC regulators imposing restrictions on outbound investments.

APPROVAL OR FILING REQUIREMENTS

The guidelines need to be read together with the existing regulatory regime in China governing outbound investment by Chinese investors.

Generally, an outbound investment (including the acquisition of overseas businesses or assets, or the making of Greenfield investments) by a Chinese investor requires the approval of the relevant Chinese authorities.

An outbound investment by a Chinese privately-owned enterprise has to be either approved by or filed with the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) at either central or local level, depending on the nature and size of the transaction and the jurisdiction where the funds are to be invested.

In the case of an outbound investment by a Chinese state-owned enterprise (SOE), the SOE may also need additional approval from the State-owned Assets Supervision and Administration Commission (SASAC).

In addition to the above generic regulatory regime applicable to Chinese investors, regulated entities in China are subject to additional approval or filing procedures with their respective regulators in China. For example, in the case of an outbound acquisition by a Chinese bank, the bank needs to obtain the approval of the China Banking Regulatory Commission, as the regulator for the banking sector in China. Furthermore, if a Chinese investor is a PRC listed company and if the proposed outbound transaction is of such a size that it would constitute a "major assets restructuring" transaction for the listed investor under PRC law, then the Chinese investor would need to go through additional regulatory procedures and approvals under the applicable listing rules.

CLOSELY SCRUTINISED SECTORS

The new guidelines form part of what has been a significant tightening of the rules on outbound investments since late 2016. This appears to be aimed at stemming the massive capital outflows and the rate of depletion of China's foreign exchange reserves that has accelerated in part due to the continued depreciation of the Renminbi.

In November 2016, minutes were leaked of what was said to be a national level Chinese government authority that suggested that China's regulators were about to implement temporary measures to tighten controls over the outbound investment regime, which would stay in place through this month (September 2017). Media reports suggested that certain large outbound investment transactions were likely to be rejected (Restricted Investments). These include, among others, large investments of more than US$10 billion; large investments of more than US$1 billion in a business not related to the core business of the Chinese investor; outbound investment by limited partnerships; and investments with the purpose of taking an overseas listed Chinese company private.

On 6 December 2016, NDRC, MOFCOM, the People's Bank of China (PBOC), and the State Administration of Foreign Exchange (SAFE) held a joint press conference and issued a press release stating that that the Chinese government had observed some irrational investment activities in real estate, hotels, movie studios, entertainment industry, and sports clubs (Closely

Scrutinised Sectors), indicating that outbound transactions involving these sectors would be subject to additional scrutiny by the Chinese regulators.

The press release also highlighted potential risks associated with certain Restricted Investments reportedly mentioned in the minutes of the meeting and cautioned Chinese companies to carefully consider before embarking on such investments.

In particular, the press release indicated that, as part of its internal review process, provincial MOFCOM would have to seek the consent of central MOFCOM before issuing a certificate for the completion of the approval or filing process for any outbound investment that, among others, falls within one of the Closely Scrutinised Sectors; exceeds US$300 million; is a large investment which is not related to the core business of the Chinese investor; an investment made by a limited partnership; is in an offshore target with an asset value greater than that of the Chinese investor's own value; or is conducted by a newly-established entity which has no business substance.

FOREIGN REMITTANCES

In respect of the regulatory control over the remittance of funds by a Chinese investor for outbound investment purposes, the formal position is that a Chinese investor who intends to remit US$5 million or more out of China is required to engage in a "conversation or consultation" with the relevant branch of SAFE before it can remit funds offshore. More recently, it has been rumoured in the market that the restriction has been relaxed by some local branches of SAFE. It remains to be seen how far this will extend in practice, particularly after the promulgation of the latest guidelines of the State Council.

Annex 1 to this note contains a flowchart of the approval or filing procedure.

OUTLOOK

Not surprisingly, the recent restrictions are causing concern for both Chinese buyers and foreign sellers as deal uncertainty involving Chinese buyers has significantly increased. On the one hand, we expect more and significant uncertainty and deal execution challenges on those types of transactions that fall into the restricted areas as classified by the PRC regulators. On the other hand, the guidelines of the State Council make it clear that continued support will be given by the Chinese government for its ‘Go Global’ policy and ‘One Belt One Road’ strategy. Chinese authorities will likely reign in overzealous investments in non-strategic areas, while strategic investments by Chinese companies that fall in line with the Chinese government's broader strategy will more likely to continue to get done.

As the outbound regulatory regime continues to evolve, please check with your usual contacts at Clifford Chance on the current practice.

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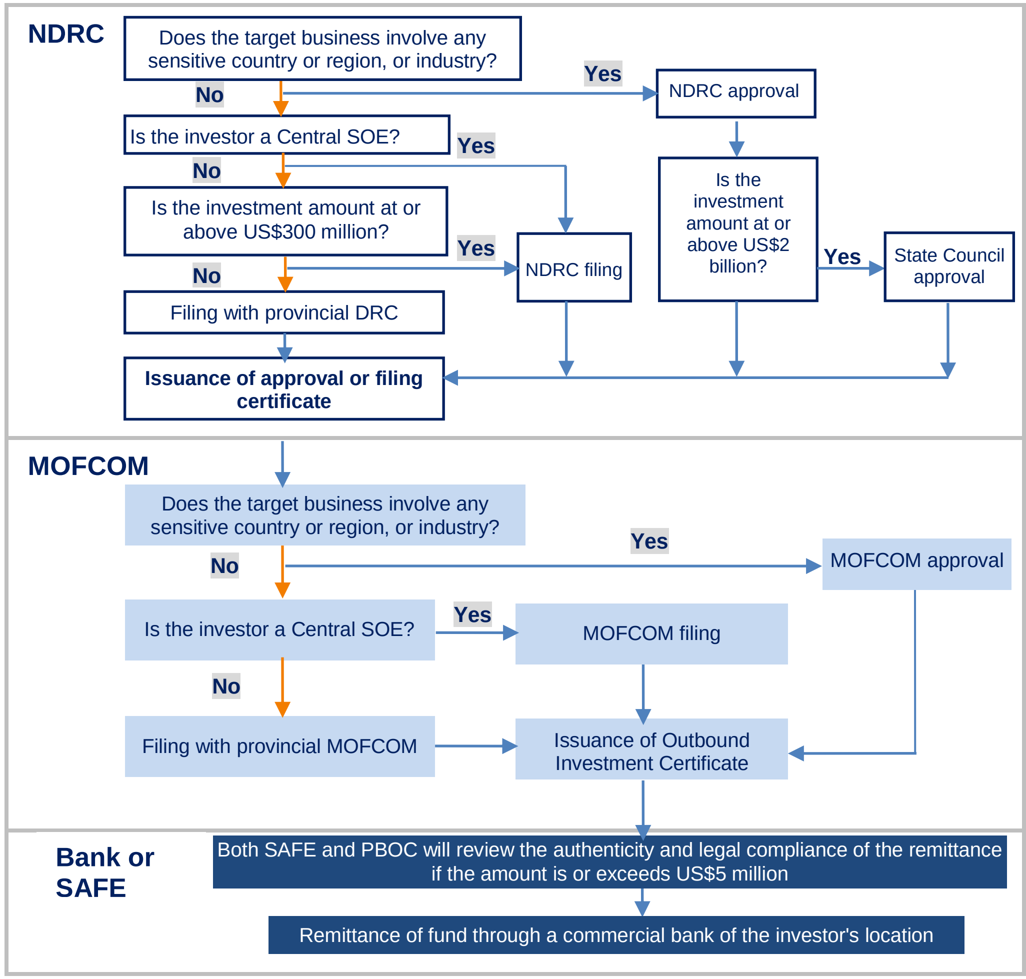
ANNEX 1 – Approval or Filing Procedure for Outbound Investments by PRC Companies



NDRC

- Project Information Report: where the Chinese party's investment in an overseas acquisition or bidding project is at or above **US$300 million**, the investor shall, before **conducting substantive work abroad**, submit a project information report to the NDRC or obtain pre-approval.
- Under NDRC rules, "sensitive countries or regions" are defined as countries or regions "without a formal diplomatic relationship with China or under international sanctions, at war, or in a state of unrest"; and "sensitive industries" include "basic telecommunication operations, cross-border water resources development and utilization, large-scale land development, main electrical grids, news media, etc."
- After the implementation of the Circular of the State Council on Promulgating the Catalogue of Investment Projects Subject to the Approval of the Government (2014 Version) on 31 October 2014, only an NDRC filing is required for all outbound projects, regardless of investment amount, other than those involving a sensitive country or region or industry. (Its 2013 version requires NDRC approval for projects with an investment amount at or above US$1 billion.)

MOFCOM

- Under MOFCOM rules, "sensitive countries or regions" are defined as "countries that have no diplomatic relationship with China or are subject to UN sanctions; (and when necessary, other countries or regions identified by MOFCOM from time to time)"; and "sensitive industries" are defined to include industries relating to export of restricted products and technologies, and industries concerning the interest of more than one country or region.
- After the implementation of the Administrative Measures for Outbound Investment by MOFCOM on 6 October 2014, only a MOFCOM filing is required for all outbound projects, regardless of the investment amount, other than those involving any sensitive country or region or industry, and the investment amount is no longer a decisive factor in determining the approval or filing procedure and the thresholds. (Previously, projects with an investment amount at or above US$100 million must be approved by MOFCOM.) That said, we are aware under the practice of certain local MOFCOMs, they will submit outbound transactions of or above US$300 million to central MOFCOM for filing after they give preliminary approval at the local level.
- On 2 December 2016, MOFCOM issued a notice on its website setting out, among others, additional documents a Chinese investor must submit for a filing with MOFCOM e.g. articles of association, board resolution or resolution on capital contribution etc.

SASAC

- For SOEs, apart from the above, they must follow additional procedures in respect of administration of state-owned assets, including steps relating to outbound investments.

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