Latest Trends of China Overseas Direct Investment Regulations

INTRODUCTION

It is well known that Chinese enterprises need to go through certain formalities before making an investment outside mainland China. The main authorities involving in each outbound transaction are (1) the National Development and Reform Commission (NDRC), (2) the Ministry of Commerce (MOFCOM), (3) the State Administration of Foreign Exchange (SAFE), and (4) the State-owned Assets Supervision and Administration Commission (SASAC) if the investment is to be made by a State-owned enterprise ("SOE").

Over the years, a huge number of regulations have been issued to define the powers of these four stakeholders in administering Chinese outbound investment. An intimate knowledge of these regulations as well as the related administrative practice is necessary to determine if an outbound investment will generally be regarded as permissible, whether it falls under the administration of the central or the provincial authorities, and which exact administrative procedures (e.g. approval or filing) apply to it.

From the 1990-ties onwards, the regulatory requirements on outbound investments had been gradually relaxed. This, amongst many other factors had led to an unprecedented boom of Chinese outbound investment. In the last two years, however, we have seen a tightening of the review practice aimed at controlling capital flows from mainland China. In this newsletter we explain the most significant changes against the background of other regulatory measures of the recent past that aim to tighten the regulatory regime for China outbound direct investment ("ODI").

HIGHLIGHTS OF NEW REGULATIONS

On 4 August 2017, the General Office of the State Council issued the *Circular on Forwarding the Guidance Opinion of the National Development and Reform Commission, the Ministry of Commerce, the People's Bank of China and the Ministry of Foreign Affairs on Further Guiding and Regulating Overseas Investment Direction*. This circular codifies a set of principles for the Chinese government authorities to follow in regulating overseas investments. It also classifies overseas investments into three categories, namely "encouraged", "restricted" and "prohibited". Additionally, NDRC, MOFCOM, People's Bank of China and SAFE stated in December 2016 that they are closely monitoring the following four phenomena: mega-investments in non-core business; outbound investments by limited partnerships; "quick setting up and quick investment" (i.e. outbound investments by enterprises that have established for only a few months with no substantial business operation); and "small parent company with big subsidiary" (i.e. the scale of an outbound investment far outweighs the registered capital or financial strength of the parent company).

On 26 December 2017, NDRC released the *Administrative Measures for Overseas Investments by Enterprises* ("New NDRC Measures"), which will come into force on 1 March 2018. Highlights of the New NDRC Measures include:

- The New NDRC Measures have a broader scope than the old ones. They now apply to overseas investments made by Chinese enterprises (including non-financial enterprises and financial enterprises in various forms), public institutions, social groups and other non-enterprise organizations directly or through offshore enterprises controlled by them. The same also applies to overseas investments made by Chinese individuals through offshore enterprises under their control. "Control" is defined as direct or indirect ownership of over 50% of the voting rights, or the ability to influence business operation, financial affairs, human resources management affairs, technology and other significant matters. The definition of what constitute "overseas investments" is broadened as well. However, the New NDRC Measures are not applicable to ODI by Chinese individuals.

- The pervious requirement for Chinese investors to submit a project information report to and obtain a confirmation letter from NDRC for any overseas acquisition or bidding project of USD 300 million or above is now abolished.

- NDRC approval is required for overseas investments made by Chinese investors directly or through offshore enterprises under their control in sensitive countries/regions or sensitive sectors. Non-sensitive projects carried out directly by Chinese entities are subject to filing with NDRC or its provincial branch. NDRC and its provincial branch retain the discretion not to approve or file a project. A common set of criteria applies to both approving and filing. In addition, where a Chinese investor intends to carry out a non-sensitive project through an offshore enterprise under its control where the Chinese investor(s)' investment amount is USD 300 million or above, the investor shall report to NDRC prior to implementation of the project.

- Local Chinese entities may make an application for approval/filing directly with NDRC (rather than through the provincial NDRC branch).

- The New NDRC Measures require Chinese investors to obtain approval/filing prior to implementation of a project.

- The valid period of an approval or filing document is extended to 2 years.

- The New NDRC Measures specify circumstances requiring a "change application" to an already approved or filed project. They also clarify that in the case of failure of such approval/filing, the approval/filing authority (i.e. NDRC or its provincial branch) can order the investor to suspend or unwind the implementation of the transaction and/or rectify the situation within a specified period.

MOFCOM requires that when going through outbound investment filing or approval procedures, a domestic investor shall also provide the following materials: (i) Articles of Association (or contract/agreement) related to overseas establishment of enterprise or acquisition; (ii) relevant board resolution or resolution on capital contribution; (iii) latest audited financial statements (full set); (iv) description of preliminary work (including due diligence, feasibility study report, source of investment funds, investment environment analysis and evaluation, etc.); (v) Overseas Investment Authenticity Undertaking Letter; and (vi) Overseas M&A Preliminary Report.

SAFE strengthens authenticity and compliance review for ODIs, requiring that when handling foreign exchange registration for ODIs and outbound remittance of funds, domestic investors shall explain the source and use of investment funds and provide board resolution (or resolution of partners), contracts or other materials proving authenticity of the transaction to the bank.

SASAC at the central level as well as its counterparts in a number of provinces and cities have carried out a classified administration of outbound investment projects made by central and local SOEs, and formulated a negative list to define prohibited outbound investment projects ("Prohibited Projects") and those subject to special regulation ("Projects Subject to Special Regulation"). SOEs are prohibited to invest in any Prohibited Projects. In terms of Projects Subject to Special Regulation, SOEs shall report to SASAC for review. For projects outside the negative list, SOEs may make decisions by themselves according to their own development strategies and planning.

CONCLUSION

In general, China promotes what it considers as healthy and sustainable development of outbound investments. Genuine and lawful ODI deals continue to be supported, but Chinese authorities on various levels scrutinize their authenticity and compliance. While those transactions

continue to be generally viable, delays in the outward remittance of funds are likely to take place. However, the regulators are closely monitoring certain types of "restricted" ODI deals as set out above and have reminded enterprises to make "prudent" decisions.

Under both ODI approval and filing procedures, investors are required to provide a substantial amount of documents and information to various authorities, and in both types of procedures the authorities have a certain degree of discretion in deciding whether to grant an approval or accept a filing or not.

Chinese investors and their business partners should also keep in mind that changes in an existing outbound investment must be reported and may trigger another round of review by Chinese authorities. The outcome of such review may affect the Chinese investor's future actions.

The Chinese ODI regulatory environment is complex and in a state of flux. And thus, parties to Chinese ODI transactions should seek advice regarding regulatory risks, deal structure, due diligence, appropriate safeguards in transaction documents and legal compliance in order to ensure a smooth Chinese ODI transaction.

We will keep you informed of the developments of Chinese ODI rules and practice.

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