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New Chinese guidelines on overseas investment confirm restrictive trend

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On 18 August 2017, China's State Council issued a new set of guidelines on overseas investment. The guidelines formalise previously fragmented policies and provide a set of opinions for the relevant government authorities to follow when regulating Chinese overseas investments and outbound capital flow. The guidelines are an important formal position of the Chinese government on its outbound investment policy, which has become more restricted since the end of 2016 following a period of increased liberalisation. Any party to a Chinese overseas investment would be wise to carefully consider the guidelines.

Background

The new guidelines were jointly formulated by the National Development and Reform Commission (NDRC), the Ministry of Commerce (MOFCOM), the People's Bank of China and the Ministry of Foreign Affairs. The NDRC has indicated that it will update and amend currently existing rules to include the guidelines' policies. Other branches of government are expected to follow.

As we reported in previous editions of In Context (see February 2017 and June 2017), the restrictions on outbound investments are driven by the increasing flow of capital out of China, which has further depleted foreign exchange reserves already under pressure by the government's measures to stabilise a depreciating renminbi. The renewed government scrutiny on outbound investment has generally been effective in significantly decreasing Chinese capital outflow; the State Administration for Foreign Exchange (SAFE) reported last week that China's foreign reserves have steadily risen since the beginning of this year, its longest run since 2014. However, the prioritisation of currency stability has come at the price of suppressing genuine Chinese outbound investments. As a result of the stricter controls, the path to regulatory approval has become longer and more uncertain.

The guidelines

The guidelines clarify that the Chinese government will continue to support outbound investments, albeit *"in a rational and orderly manner".* This means within the limits of the regulatory regime currently in place and in accordance with the commercial rationale and political purpose further set out in the guidelines.

In addition, and most importantly, the guidelines now categorise outbound investments, by target industry or sector, into three distinct groups – "*encouraged*", "*restricted*" and "*prohibited*" – resembling the way in which the Chinese government also classifies inbound foreign investment. The guidelines further provide specific policy considerations with regard to each category. The guidelines do not indicate if outbound investments which do not fall into one of the three categories will be permitted.

The categories and their policy treatment can be summarised as follows:

Category	Characteristics	Policy treatment
Encouraged	• infrastructure projects conducive to the One Belt, One Road strategy • investments facilitating China's industrial production capacity and the export of high-quality equipment and technology • high-tech and advanced manufacturing businesses, especially with regard to cooperation with overseas counterparts and the establishment of overseas R&D centres • the exploration, mining and development of oil and gas, minerals and other natural resources • industries pertaining to agriculture, forestry, animal husbandry, fisheries • investments in service sectors such as commerce, trade, culture and logistics, and investments establishing offshore branches and service networks of Chinese financial institutions.	"Encouraged investments" are to be facilitated through preferential taxation, foreign exchange, insurance, customs and information sharing.
Restricted	• projects in countries and regions with which China has no diplomatic relations, or countries currently at war or in turmoil • real estate, hotels, cinemas and movie studios, the entertainment industry and sports clubs • equity investment funds with no operating business • obsolete or outdated manufacturing equipment • investments breaching environmental, energy efficiency or safety norms of the target jurisdiction.	"Restricted investments" from categories (i) – (iii) require approval by the relevant authorities, which might have to meet higher standards and levels of scrutiny than ordinary government clearance. Investors in "restricted investments" must be given necessary guidance and warnings.
Prohibited	• export of military technology and products without Chinese government approval • technologies, techniques or products banned for export • gambling and pornography • investments prohibited by Chinese treaties • investments that endanger national interest or public security.	"Prohibited investments" must be subject to strict management and control.

Assessment and outlook

First and foremost, the policy as now codified in the guidelines reaffirms the existing tightened regulatory regime. This means that qualifying Chinese outbound investments will continue to require the approval of the Chinese authorities. As such, parties to those transactions should still expect the relevant filing and approval processes with agencies, including the local or national branches of the NDRC and MOFCOM, SAFE, and, in the case of a state-owned enterprise, the State-owned Assets Supervision and Administration Commission (SASAC). For this reason, any party to a Chinese overseas investment would be wise to carefully consider these guidelines and assess how a planned transaction fits in the provided categories. Deal uncertainty and time challenges remain. However, on a more positive note, the guidelines do offer some degree of clarity and, as such, transactions befitting the current agenda, i.e. those falling into the "encouraged" category, might meet a more favourable regulatory climate.