# Understanding the Regulations and Application Procedures for Chinese Outbound Direct Investment

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After China's membership of the WTO in 2001, China's "Go-Out" policy was officially announced and listed as one of China's economic development goals in the 10th Five-Year Plan (2001-05). As a result, China's Outbound Direct Investment (ODI) continued to steadily grow and later accelerate over the following 15 years with some prominent takeovers and equity stakes in European and US companies.

However, with the huge surge in capital outflows from China in 2016 where China's ODI reached USD 196 billion at an annual growth of 35%, the Chinese authorities introduced new guidelines and administrative measures in 2017 to regulate and control "undesirable" overseas investments.

For foreign enterprises invested by or owned by Chinese companies, the current regulations have created some uncertainty and doubt about the requirements for the transfer of Chinese investment capital not least because ODI projects face more scrutiny and stricter conditions. But once approved or recorded, the involved Chinese authorities do not limit or prevent the flow of ODI.

## China's ODI Figures

Since China's economic reform and opening-up policy in late 1978, China has developed into one of the world's largest recipients of Foreign Direct Investment (FDI). In 2020, China became the world's top destination of FDI at **USD 149 billion**.

At the same time, China has gradually become a major contributor of outward FDI with a Top 5 ranking since 2009. China's outward FDI more than doubled from USD 69 billion in 2010 to USD 146 billion in 2015 and reached a peak of **USD 196 billion** in 2016.

Some prominent Chinese ODIs include Legend Holding's acquisition of IBM's PC business in 2005 for USD 1.75 billion, Geely Holding's acquisition of VOLVO Cars in 2010 for USD 1.8 billion and its 9.7% equity stake in Daimler AG in 2018 for USD 9 billion, Haier's purchase of the GE Appliance business in 2016 for USD 5.6 billion, and HNA's 25% equity stake in Hilton Worldwide in 2016 for USD 6.5 billion.

Despite the negative effects of Covid-19, China became the world's largest contributor of outward FDI in 2020 reaching **USD 154 billion** or equal to **20.8%** of the total global FDI outflows in 2020. In the first half of 2021, China's outward FDI reached USD 71.4 billion which is up 12.3% year-on-year.

The **main destinations** of China's outward FDI in 2020 were: 1. Asia (73.1%) with Hong Kong alone (58%), Latin America (10.8%), Europe (8.3%), North America (4.1%) with the US alone (3.9%), Africa (2.8%) and Oceania (0.9%).

**Europe's largest recipients** of China's outward FDI in 2020 were: The Netherlands, Sweden, Germany, Switzerland, and the UK. By the end of 2020, Chinese investors had established 2,800 enterprises in the EU while employing 250,000 foreign personnel.

The **main industries** of China's outward FDI in 2020 were: 1. Leasing and business services (25.2%), 2. Manufacturing (16.8%), 3. Wholesale & retail trade (15%), 4. Financial industry (12.8%), 5. IT (6%), 6. Construction (5.3%), 7. Logistics (4%), 8. Mining (4%), 8. Utilities (3.7%), 9. Real estate (3.4%), and 10. Scientific research and technology services (2.3%).

## Guidelines – Code of Conduct

In direct response to the record high capital outflows in 2016, the National Development & Reform Commission (NDRC), Ministry of Commerce (MOFCOM), People's Bank of China (PBC) and Ministry of Foreign Affairs (MFA) issued a joint Notice on **4 August 2017** on "Further Guiding and Regulating Outbound Investment Orientation" to promote more sustainable and healthier ODI.

The Guidelines introduce the concept of "Encouraging Development + Negative List" for outward FDI whereby ODI is classified as either Encouraged, Restricted and Prohibited which is similar to the regulations used for inward FDI.

**Encouraged**

1. Investment in infrastructure projects that facilitate the "One Belt, One Road" initiative and the interconnection to surrounding infrastructure.
2. Investment that drive the output of advantageous production capacity, high-quality equipment, and technical standards.
3. Investment that strengthen the cooperation with overseas high-tech and advanced manufacturing companies and encourage the establishment of R&D centres abroad.
4. Investment in the exploration and development of offshore oil and gas, mineral and other energy resources.
5. Investment that expand overseas cooperation in agriculture, forestry, animal husbandry, fishery and similar.
6. Investment that promote business, trade, logistics and culture, and supports qualified financial institutions to establish overseas branches and service networks.

**Restricted**

1. Investment in sensitive countries and regions with no diplomatic relations with China, experiencing war or restricted by bilateral or multilateral agreements signed by China.
2. Investment in real estate, hotels, cinemas, entertainment, sports clubs and similar.
3. Investment in equity investment funds or platforms without any specific projects.
4. Investment in outdated production equipment that fails to meet the technical requirements of the destination country.
5. Investment that fails to meet the environmental protection, energy consumption or safety standards of the destination country.

**Prohibited**

1. Investment involving the export of core technologies and products of the military industry without the approval of the host country.
2. Investment that use technologies, techniques, or products that are banned from being exported by China.
3. Investment in gambling, sex industry and similar.
4. Investment prohibited by international treaties concluded or signed by China.
5. Investment that endangers or may endanger national interests or state security of China.

## Administrative Measures

Under the current regulatory system, Chinese investors need to apply separately to both NDRC and MOFCOM prior to project implementation, which can usually be done in parallel, and later apply to SAFE for the overseas remittance in foreign currency via an authorized bank. Whether an ODI project is subject to **Approval or Record-filing** with NDRC and MOFCOM depends on the country/region, industry type, and investment amount.

### NDRC Measures

The current regulations refer to the "Administrative Measures for the Outbound Investments by Enterprises" (Order No. 11) issued by NDRC that took effect **on 1 March 2018**.

Regardless of any ODI project, it shall <u>not</u> (1) Violate any Chinese laws and regulations, (2) go against China's national economic policies, (3) Violate any international treaties signed by the PRC, and (4) Threaten or damage China's national interest and security.

#### <u>NDRC Approval</u>

ODI projects subject to NDRC Approval refer to:

- **Sensitive Countries or Regions:** (1) No diplomatic relations with the PRC, (2) Experience war and civil conflict, (3) Restricted by international treaties and agreements signed by the PRC, and (4) Other.
- **Sensitive Industries:** (1) Research, production, maintenance, and repair of weaponry, (2) Development and utilisation of cross-border water resources, (3) News media, and (4) Restricted according to Chinese laws, regulations, and policies.

To obtain the Approval, the investor shall file an **Application Report** with supporting documents to NDRC online such as: 1. Basic information about the investor, 2. Investment destination, 3. Project background, 4. Main content and size of project, 5. Investment and financing plan, 6. Major risks and precautions, and 7. Impact on national interests and security of China.

The Application Report can be prepared by the investor or an agency with the required know-how and experience.

After receiving the Application Report, NDRC shall notify the investor online whether it has been accepted and after the review inform of its decision by issuing a written **Approval Letter** or **Notice of Disapproval**.

NDRC shall make its decision within **20 working days** after the receipt of the Application Report but for complicated projects, it can be extended by up to 10 working days.

NDRC can prior at its own cost entrust an external advisory agency to conduct the ODI project evaluation which shall not exceed 30 days but may be extended by up to 60 working days. The approval time excludes the evaluation time of the advisory agency.

Once the approval is granted, NDRC shall issue an **Approval Letter** which is valid for **two years**.

**NDRC Record-filing**

ODI projects subject to NDRC Record-filing refer to direct investment by an investor in **Non-sensitive** projects where the investment amount is **USD 300 million or above**.

The investor shall submit a **Filing Form** with supporting documents to NDRC online which is similar but less detailed than for the Application Report. After the receipt, NDRC shall notify the investor online whether it has been accepted and after the review inform of its decision by issuing a written Notice of Approval or Disapproval within 7 working days.

Once the Record-filing is completed, NDRC shall issue a **Filing Notice** which is valid for **two years**.

If the total investment of the Chinese investor is **below USD 300 million**, no approval, record-filing or reporting is required.

When the ODI project has been completed, the investor shall file a **completion report** to NDRC within 20 working days.

**MOFCOM Measures**

The current regulations refer to the “Administrative Measures on Overseas Investments” (Order No. 3) issued by MOFCOM that took effect on **6 October 2014**.

Regardless of any overseas investment, it shall not (1) Compromise the sovereignty, security and public interests of the PRC or violate its laws and regulations, (2) Harm the relationship between the PRC and the relevant countries (regions), (3) violate any international treaties and agreements signed by the PRC, and (4) Export products and technologies prohibited by the PRC.

**MOFCOM Approval**

ODI projects subject to MOFCOM Approval refer to:

- **Sensitive Countries:** (1) No diplomatic relations with the PRC, (2) Sanctioned by the United Nations, and (3) Any countries or regions listed by MOFCOM.
- **Sensitive Industries:** (1) Products and technologies with export restrictions, and (2) Affect the interests of more than one country (region).

To get the Approval, the investor shall file an **Application** with supporting documents to MOFCOM online such as: 1. Application form, 2. Application form for Overseas Investments, 3. Relevant contract or agreement on overseas investment, 4. Any export approvals of restricted products or technologies, and 5. Business license.

The relevant Chinese embassy or consulate shall be consulted for the review and approval of the overseas investment which shall respond within 7 working days from the consultation request.

After receiving the Application, MOFCOM shall make its decision of approval or rejection within 20 working days from the acceptance of the Application including the time taken to consult with the Chinese embassy or consulate.

If approved, MOFCOM shall issue a written approval decision and issue an **"Outbound Investment Certificate for Enterprises"** which is valid for **two years**.

**MOFCOM Record-filing**

Any other overseas investments are subject to MOFCOM Record-filing. If the investor is a central enterprise (i.e., state-owned enterprise), it shall apply directly with MOFCOM while local companies shall apply with the local provincial Committee of Commerce (COFCOM).

The **Filing Form** shall be filled-in and printed out from the online system, attached with the Company Seal, and submitted with a copy of the Business License. If the Filing Form meets the requirements, it shall be processed within 3 working days from the receipt and MOFCOM shall issue the "**Outbound Investment Certificate for Enterprises**" which is valid for **two years**.

### Different Purpose and Focus

With the continued rise in capital outflows and high ODI in 2016, the Chinese authorities introduced new guidelines and measures in late 2017 to direct and control overseas investments to better align with national (economic) interests and priorities.

Despite an initial decline, China's ODI has since begun to climb again but with a different purpose and focus. Asia and especially Hong Kong remain the main investment destination or hub where investments in the "One Belt, One Road" initiative, high-tech and advanced manufacturing, agriculture and food, and the development of energy resources are encouraged while investments in e.g., real estate, hotels, cinemas, entertainment, sports clubs and similar are restricted.

Although the regulations are more streamlined, Chinese investors still need to get prior approval or consent from both NDRC and MOFCOM according to the investment country/region, industry type, and amount before PBC will approve the money transfer. This still places a big burden on the time, cost, and resources of Chinese investors for ODI projects in sensitive areas but less so elsewhere.

However, given the growing negative sentiment in recent years against Chinese ODI by the US, Australia, and many EU countries with the introduction of new investment laws and regulations to prevent or limit foreign takeover and control of key technologies and companies, China has been redirecting its overseas investments to countries and regions that still welcome Chinese investments.

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