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CHINA RELEASES DRAFT ADMENDED MEASURES ON STRATEGIC INVESTMENT BY FOREIGN INVESTORS IN LISTED COMPANIES

On 30 July 2018, the Chinese Ministry of Commerce ("**MOFCOM**") released a draft of the amended *Administrative Measures for Strategic Investment by Foreign Investors in Listed Companies* (the "**Draft**"), set to replace the existing measures (the "**Measures**") in effect since 30 January 2006. The Draft is open for public comments until 29 August 2018.

This Client Alert highlights the key points of the Draft and its potential impact on foreign investors investing in Chinese listed companies.

BACKGROUND

Starting last year, the State Council has issued several notices on measures designed to encourage and promote foreign investment in China. Recently laws and regulations regarding various industries have been revised to further open the Chinese market to foreign investors.

In addition to the above changes, the Measures have become outdated with provisions that do not reflect the current market situation or national economic policies. The Draft proposes looser restrictions on foreign investment in Chinese capital markets that are more in line with those for other sectors.

KEY CHANGES

Compared to the Measures, the key changes proposed in the Draft are:

- **Allowing investment by qualified foreign individuals**

  Under the Measures, only foreign legal persons and other organisations may make strategic investments in Chinese A-share companies. The Draft extends the scope of qualified foreign investors by allowing foreign individuals who are capable of identifying and bearing a certain level of risk to invest in Chinese listed companies.

- **Lowering qualification requirements for foreign investors acquiring non-controlling stakes**

  The Measures set threshold requirements on the total amount of overseas assets that a foreign investor or its parent company must own or manage to be permitted to invest in Chinese listed companies. The Draft lowers these qualification requirements for foreign investors if they will not obtain a controlling interest in the listed company.

Under the Draft, foreign investors acquiring a non-controlling interest (or their actual controller) are required to own assets[1] of at least USD 50 million (reduced from USD 100 million) or to manage assets of at least USD 300 million (reduced from USD 500 million). For foreign investors acquiring a controlling interest in a Chinese listed company (or their actual controller), the thresholds remain the same as under the Measures (i.e. at least USD 100 million in owned assets or at least USD 500 million in managed assets).

- **Simplifying approval and filing procedures and decentralising jurisdiction**

Under the Measures, the central-level MOFCOM has approval authority over any foreign strategic investment in Chinese listed companies. However, since the *Provisional Measures on the Administration of Filings for Establishment and Change of Foreign-Invested Enterprises* ("**FIE Filing Measures**") went into effect in October 2016, all foreign investment that is not subject to special administrative measures need only to be filed with Chinese authorities through the foreign investment integrated management information system.

The Draft is in line with the FIE Filing Measures and requires foreign investors investing in Chinese listed companies to complete filing procedures if such companies are not involved in industries subject to special administrative measures. If an industry subject to special administrative measures is involved and thus administrative approval is required, the existing thresholds used to determine which level of authority has jurisdiction to approve the foreign investment will apply. As such, the Draft allocates some jurisdiction to the provincial-level authority, depending on the investment amount and the industry involved.

- **Removing minimum acquisition requirement and shortening lock-up period**

The purpose of the Measures was to encourage foreign investors to make medium and long-term investments above a certain scale in Chinese listed companies. Accordingly, the Measures require foreign investors to acquire at least 10% of the shares issued by the target company after their initial investment and subject to a lock-up period of three years. The Draft removes this minimum acquisition requirement and shortens the lock-up period to 12 months.

Notwithstanding these changes proposed by the Draft, they do not necessarily result in lower requirements on foreign strategic investment considering breakthroughs in practice on restrictions in the Measures. For example, foreign investors may claim that as the foreign investment does not fulfil the minimum acquisition requirement (i.e. 10%), regardless of whether involving in industries subject to special administrative measures, it does not constitute strategic investment and as a result, such foreign investment does not subject to requirements under the Measures[2]. In comparison, the Draft explicitly requires that foreign investment involving in industries subject to special administrative measures and acquiring listed companies' shares less than 10% shall subject to requirements under the Draft. In this regard, the Draft is stricter to such foreign investment.

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[1] Under the Measures, only overseas assets are calculated.

[2] See the acquisition by Phoenix Prestige Ltd. ("**Phoenix Prestige**") and Spread Grand Ltd. ("**Spread Grand**") of Shanghai Yuyuan Tourist Mart Co., Ltd. (600655.SH, "**Yuyuan**"). According to a notice issued by Yuyuan on 13 July 2018, it was determined based on an interview with the Shanghai MOFCOM that because Phoenix Prestige and Spread Grand would be acquiring less than 10% of Yuyuan's shares, such acquisition did not constitute a strategic investment and thus was not subject to MOFCOM's approval under the Measures.

- **Allowing use of equity of foreign non-listed companies as payment**

  The Draft explicitly permits foreign investors to pay for shares acquired in Chinese listed companies using equity in foreign non-listed companies. Although the *Provisions on Merger and Acquisition of Domestic Enterprises by Foreign Investors* ("**M&A Provisions**") which govern acquisitions of both listed and private companies, allow foreign investors to acquire Chinese companies (including listed companies) by using shares in foreign companies, such foreign companies are limited to foreign listed companies with shares traded on an overseas securities exchange (excluding over-the-counter exchanges).

  Given such restriction, in practice, MOFCOM has not approved any real acquisition utilising a cross-border share swap since 2009[3]. In this regard, the Draft not only reaffirms the feasibility for foreign investors to make an acquisition by paying with foreign company shares, but also extends the scope of such qualified foreign companies from only listed companies to include non-listed companies as well. However, it remains to be seen how MOFCOM will implement such provisions in the Draft as the discrepancy with the M&A Provisions will need to be clarified.

COMMENTS

Since the publication of the Measures in 2005, there have been very few foreign investors whom MOFCOM has approved to conduct strategic investment or acquire controlling interest in Chinese listed companies pursuant to the Measures. There was doubt that China's foreign strategic investment framework would actually allow foreign investors to control industry-leading Chinese companies.

The changes proposed by the Draft seem to signal that this may be more of a possibility in the future. The development strategy of the Chinese government recent years has been to further open the market to foreign investors and reduce restrictions on foreign investment in various industries. In this regard, the Draft seems to be designed to complement such trend. Meanwhile, for Chinese listed companies, the Draft provides more opportunities and convenience to invest abroad.

Still, the final amended Measures and how authorities will implement them remain to be seen. Gide will closely monitor these developments. Please feel free to contact us should you have any questions on the Measures or the Draft.

[3] Some recent cases show that MOFCOM has become a little more flexible in this respect, but all approved cases involved Chinese companies (mainly state-owned) conducting the share swap with their overseas affiliates.

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