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CHINA RELEASES DRAFT AMENDMENT MEASURES ON FOREIGN STRATEGIC INVESTMENTS IN LISTED COMPANIES

CHANGES THAT INDICATE FURTHER OPENING UP OF THE CHINESE CAPITAL MARKET

On 18 June 2020, the Chinese Ministry of Commerce ("**MOFCOM**") released a revised draft amendment of the *Administrative Measures for Strategic Investment by Foreign Investors in Listed Companies* ("**2020 Draft**"), set to replace the current measures in effect since 30 January 2006 ("**Measures**"). The 2020 Draft is open for public comments until 19 July 2020, and if promulgated, it will be a major change leading to the further opening of the Chinese capital market.

MOFCOM released a previous draft amendment in 2018, which was never adopted ("**2018 Draft**"; please refer to our previous Client Alert on this topic **here**). However, major revisions to the Measures in the 2018 Draft are included in the 2020 Draft. Furthermore, compared to the 2018 Draft, the 2020 Draft further revises the Measures in line with other legislative reforms regarding foreign investment enacted this year.

This client alert highlights the key points of the 2020 Draft and their potential impact on foreign investment in Chinese listed companies.

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BACKGROUND

In recent years, Chinese authorities have revised laws and regulations to open the Chinese market more to foreign investors in various industries, and begun implementing new measures designed to encourage and promote foreign investment in China. In particular, the issuance of the *Foreign Investment Law*, its implementation measures, and *Measures on the Reporting of Foreign Investment Information* (collectively, the "**Foreign Investment Law**") overhauled the regulation of foreign investment in China (for more details, please see our Client Alert on this topic **here**).

As a result, the Measures have become outdated with provisions that do not reflect the current market situation and are not consistent with the reformed legal system. Based on the 2018 Draft, the 2020 Draft further revises the Measures to be in line with regulations for other sectors.

KEY CHANGES

The 2020 Draft proposes the following key changes to the Measures:

- **Expand scope of permitted foreign investors and Chinese listed companies**

  Under the Measures, only foreign legal persons and other organisations may make strategic investments in Chinese A-share companies. The 2020 Draft keeps the revision made in the 2018 Draft that extends the scope of qualified foreign investors to foreign individuals who are capable of identifying and bearing a certain level of risk. However, the 2020 Draft further stipulates that such foreign individuals are subject to the same qualification requirements as foreign legal persons and organisations for foreign strategic investment.

  Compared to other channels for foreign individuals investing in Chinese listed companies (such as qualified foreign institutional investors schemes and connect programmes subject to shareholding caps), foreign individual investors may find it more onerous to invest in a Chinese listed company through a foreign strategic investment due to the mandatory lock-up period, minimum investment amount, and administrative procedures etc.. However, for the acquisition of a controlling interest or shares above a certain threshold in certain Chinese listed companies, a foreign strategic investment is the only option for foreign investors.

  The 2020 Draft also explicitly states that foreign investors are allowed to invest in companies traded on the National Equities Exchange and Quotations ("**NEEQ**"), in addition to Chinese A-share companies. While the State Council issued a notice in 2018 stating that foreign investors may invest in NEEQ-traded companies in accordance with laws and regulations regarding listed companies, which permitted the practice for foreign strategic investment in NEEQ-traded companies, the 2020 Draft finally provides a legal basis and detailed requirements for it.

- **Lower 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 2020 Draft lowers these requirements for foreign investors if they will not obtain a controlling interest in the listed company.

  Under the 2020 Draft, foreign investors acquiring a non-controlling interest in a Chinese listed company must own assets [1] of at least USD 50 million (reduced from USD 100 million) or manage assets of at least USD 300 million (reduced from USD 500 million). The thresholds remain the same for foreign investors acquiring a controlling interest (i.e. at least USD 100 million in owned assets or at least USD 500 million in managed assets). If the foreign investor itself does not satisfy these requirements but its sole shareholder does, such foreign investor will be permitted to make the acquisition provided its sole shareholder undertakes irrevocable joint liability for the investment.

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

- **Removal of MOFCOM approval and more oversight by intermediaries**

Under the Measures, any foreign strategic investment in a Chinese listed company is subject to approval by the central-level MOFCOM. In practice, it may take months to obtain such approval, prolonging the timeline and creating regulatory uncertainty for an investment. Since the *Provisional Measures on the Administration of Filings for Establishment and Change of Foreign-Invested Enterprises* ("**FIE Filing Measures**") went into effect in 2016, all foreign investment that is not subject to special administrative measures need only to be filed with MOFCOM through online system. Accordingly the 2018 Draft proposes to revise the Measures by changing MOFCOM approval into filing for foreign investment not involved in industries subject to special administrative measures as well as allocating some jurisdiction to the provincial-level authority, depending on the investment amount and the industry involved.

However, the FIE Filing Measures has been replaced by the Foreign Investment Law since January 2020, under which MOFCOM's approval or filing for foreign investment is replaced by post-reporting through online system. Although the Measures are still in effect, in practice MOFCOM does not accept application for the approval for foreign strategic investment due to the above legislative reform. Therefore, by removing MOFCOM's approval for foreign strategic investment, the 2020 Draft is in line with the Foreign Investment Law, resulting in acceleration of the administrative process and elimination of regulatory uncertainty for the transaction.

In correspondence to the removal of MOFCOM approval for foreign strategic investment, the 2020 Draft imposes greater operational and post-operational oversight on foreign strategic investment compared to the current Measures. For instance, intermediaries are tasked with more responsibility as the scope of their professional opinions on a foreign strategic investment is widened. Under current practices, intermediaries must conclude whether a foreign investor fulfils the qualification requirements. However, the 2020 Draft further requires professional opinions on whether a foreign strategic investment falls under the *Special Administrative Measures on Access to Foreign Investment* ("**Negative List**") and whether the criteria stipulated in the Negative List are satisfied. Furthermore, if an intermediary fails to conduct due diligence or its report contain any false records, misleading statements, or major omissions, it may face legal punishment.

- **Lower minimum acquisition requirement and shorter 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, they require foreign investors to acquire at least 10% of the shares issued by the target company after their initial investment, subject to a lock-up period of three years. In practice, foreign investors have found various workarounds to restrictions under the Measures. For example, if their foreign investment does not meet the 10% minimum acquisition requirement, they may claim that it does not constitute a strategic investment and therefore is not subject to the Measures.

The 2020 Draft lowers the minimum acquisition requirement and shortens the lock-up period to 12 months. Specifically, for a transfer by agreement or tender offer, foreign investors need to acquire at least 5% of the target company's shares, while there is no minimum requirement at all for an acquisition through private placement. Although the 2020 Draft does not clarify whether acquisitions below these thresholds will constitute foreign strategic investment (in case of transfer by agreement or tender offer) and thus be subject to relevant requirements, considering the current workarounds, we tend to believe that under the 2020 Draft, foreign investment in Chinese listed companies below the required minimums may still be permitted without application of the requirements for foreign strategic investment. Nevertheless, this issue is subject to further assessment on how the 2020 Draft is implemented in practice.

If any strategic investment is made under false statements without meeting the requirements imposed by 2020 Draft, the 12-month lock-up period will not start until appropriate measures have been taken to satisfy such requirements. It should be noted that the 12-month lock-up period is also inconsistent with the 18-month lock-up period imposed by the *Securities Law* (amended on 28 December 2019) and the *Administrative Measures on Acquisitions of Listed Companies* (amended on 20 March 2020). As such, whether the lock-up period requirement under the 2020 Draft will be further revised should be closely followed.

- **Payment with equity of foreign non-listed companies permitted**

  Under the *Provisions on Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* ("**M&A Provisions**"), which govern acquisitions of both listed and private companies, foreign investors may acquire Chinese companies (including listed companies) using shares in foreign companies. However, 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[2].

  The 2020 Draft explicitly permits foreign investors to pay for shares acquired in Chinese listed companies using equity in foreign non-listed companies, except in transfers by agreement. In this regard, the 2020 Draft not only reaffirms the feasibility for foreign investors to pay for an acquisition with foreign company shares, but also expands the scope of such qualified foreign companies to include non-listed companies. It remains to be seen how such provisions in the 2020 Draft will be implemented as the discrepancy with the M&A Provisions will need to be clarified.

  For transfers by agreement, however, only the shares of foreign listed companies is allowed in a cross-border share swap. It is notable that this restriction was added back into the 2020 Draft, as the 2018 Draft permits it. We understand that Chinese authorities may have concerns regarding the value of foreign non-listed companies' equity in transfers by agreement, whereas acquisitions through private placements and tender offers already have regulated mechanisms supervising the transaction share values.

COMMENTS

Since the publication of the Measures in 2005, very few foreign investors have received MOFCOM approval to conduct strategic investment or acquire a controlling interest in a Chinese listed company 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.

[2] 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.

This second revision of the Measures, which contains fewer restrictions and lower requirements, shows the government's desire to further open up the Chinese capital market to foreign investment.

The changes proposed by the 2020 Draft not only conform to recent legislative reforms, but are also consistent with broader legislative developments in China to reduce restrictions on foreign investment in various industries. Meanwhile, the 2020 Draft also provides more opportunities and convenience for Chinese listed companies 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 2020 Draft.

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