CHINA WIDENS MARKET ACCESS FOR FOREIGN INVESTMENT

On 27 December 2021, the National Development and Reform Commission ("**NDRC**") and Ministry of Commerce ("**MOFCOM**") jointly issued two updated negative lists for foreign investment: the *Special Administrative Measures (Negative List) for Foreign Investment Access (2021 Edition)* ("**2021 National Negative List**") and the *Special Administrative Measures (Negative List) for Foreign Investment Access in Pilot Free Trade Zones (2021 Edition)* ("**2021 FTZ Negative List**"; together with the 2021 National Negative List, the "**2021 Negative Lists**"), both went into effect on 1 January 2022. The 2021 Negative Lists further ease market access for foreign investment in more sectors, as well as optimize and improve China's foreign investment management regime.

This Client Alert highlights the key points of the 2021 Negative Lists and their potential impact on foreign investment in China.

Editorial

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BACKGROUND

China's negative lists for foreign investment provide guidance to foreign investors by enumerating the industry sectors in which foreign investment is prohibited or restricted. Since the issuance of the first *Negative List for Foreign Investment Access - Shanghai Pilot Free Trade Zone* in 2013, the negative list has been amended six times, and the number of sectors subject to special measures has been greatly reduced from 190 to 31 in the 2021 National Negative List and 27 in the 2021 FTZ Negative List.

With the *Foreign Investment Law* and its implementing regulations that came into effect in 2020, China opened a new chapter for foreign investment. The release of the 2021 Negative Lists is part of its ongoing efforts to optimize its economy and further its reforms.

HIGHLIGHTS

Manufacturing Sector

Most noteworthy, the 2021 FTZ Negative List finally enables full market access for foreign investors to the manufacturing sector in China's free trade zones ("**FTZs**"), clearing all restrictions on foreign investment in the manufacturing sector in such regions.

Meanwhile, the biggest highlight of the 2021 National Negative List is the further opening of the manufacturing sector, especially automobile manufacturing. Restrictions on foreign investment in auto manufacturing can be traced back to 1994's *Formal Policy on the Development of the Automotive Industry*[1], which required that the Chinese investor of an auto manufacturer hold at least 50% of the shares. Foreign investors also could not establish more than two joint ventures in China to manufacture the same type of vehicle.

[1] Abolished and replaced by the *Policies for the Development of the Automotive Industry* in 2004.

Such restrictions remained unchanged until the *Special Administrative Measures (Negative List) for Foreign Investment Access (2018 Edition)* ("**2018 National Negative List**"), which lifted the restriction on foreign shareholding for both special purpose vehicles and new energy vehicles manufacturers. The 2018 National Negative List also provided a "schedule" for further liberalization of the foreign shareholding restriction for commercial vehicles and passenger vehicles in 2020 and 2022, respectively.

Indeed, the restriction for commercial vehicles was removed in 2020, and now with the 2021 National Negative List, the last remaining restriction on passenger vehicle manufacturing has been lifted. As such, foreign investors are now free to invest in the auto manufacturing industry without shareholding restrictions, and they may establish more than two joint ventures to manufacture the same type of vehicles in China.

The 2021 National Negative List also levels the playing field for foreign investors in radio and television equipment manufacturing by eliminating the restriction on the production of ground receiving facilities and key components for satellite television broadcasting therefrom.

Business Service Sectors in FTZs

Before the release of the 2021 Negative Lists, foreign investors could engage in market surveys only through equity joint ventures; in particular, for radio and television ratings surveys, the joint venture had to be controlled by the Chinese party. Foreign investment in social surveys was completely prohibited.

The 2021 FTZ Negative List lifts the foreign shareholding restriction for the market survey sector. It also opens the social survey sector in FTZs to foreign investors, who now can establish joint ventures with Chinese parties. However, the Chinese parties must hold at least 67% of the shares, and the legal representative of the joint venture must have Chinese nationality.

More Detailed Implementing Instructions

(1) Market Access Negative List

To optimize the management of foreign investment, the 2021 Negative Lists provide specific explanations and clarifications in their instruction sections. Most importantly, they mention that the *Market Access Negative List*[2] applies equally to both domestic and foreign investors, as before there was some misunderstanding whether it applied to foreign investors. Furthermore, a new provision in the instructions clarifies that the 2021 Negative Lists apply also to investments by foreign-invested entities in China. This provision is in line with the *Foreign Investment Law*, which states that foreign-invested entities must comply with the laws and regulations on foreign investment admission when making re-investments in China.

(2) Overseas Listings of Domestic Entities

Another new provision specifies that domestic companies in sectors prohibited to foreign investors under the 2021 Negative Lists are subject to review and approval before they may be listed overseas. Such companies must also meet two conditions: (i) foreign investors cannot

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[2] The *Market Access Negative List (2020 Edition)* contains two categories: prohibited sectors and sectors subject to approval by authority. For industries, sectors and businesses, etc., that are not on the negative list, all market entities may enter equally in accordance with the law.

participate in their operation or management, and (ii) the foreign shareholding ratio must comply with regulations on the management of foreign investment in the domestic securities market.

According to the interpretation of officials from NDRC and MOFCOM, this new provision provides the possibility for domestic entities engaging in prohibited industries under the 2021 Negative Lists to seek overseas listings, provided that authorities approve and confirm that their overseas listing will not trigger the application of the 2021 Negative Lists and the two aforementioned conditions are met. Officials further explained that such companies are subject to the same foreign shareholding restrictions as for qualified foreign institutional investors (QFII) and RMB qualified foreign institutional investors (RQFII), as well as the stock market interconnection mechanism etc., That is, a single foreign investor and its related parties may not hold more than 10% of the total shares of an overseas listed company, and the total shareholding ratio of all foreign investors and their related parties together may not exceed 30% of the total number of shares of the company.

For domestic companies engaging in prohibited industries under the 2021 Negative Lists that are listed both onshore and offshore, the foreign investors should be counted both onshore and offshore together. However, these requirements do not apply to existing domestic companies that have been listed overseas; if their foreign shareholding exceeds these restrictions, they will not be required to be reduced or regularized.

Under the current legal regime, domestic companies may seek overseas listing by way of direct overseas listing or indirect listing (red-chip model). In particular, for companies engaging in sectors that are prohibited or restricted to foreign investment under the negative lists, a variable interest equity ("**VIE**") structure [3] is often used to circumvent such foreign investment restrictions. The new provision in the 2021 Negative Lists does not clearly indicate the scope of application for overseas listings, and it remains uncertain whether it applies to red-chip listings/VIE structures. Thus, it remains to be seen how such provision will work with recently released draft regulations on the management of overseas listings of domestic entities ("**Overseas Listing Regulations**") [4], which may have a profound impact on cross-border financing and overseas listings of domestic companies.

OUTLOOK

The 2021 Negative Lists will bring positive changes to the foreign investment environment in China and provide more opportunities and convenience for foreign investors.

In anticipation of this liberalization, since the release of the 2018 National Negative List, many foreign auto companies began restructuring their industry plans in China. Most noteworthy, in October 2018, BMW entered into an agreement with its Chinese partner, Brilliance, under which BMW would acquire a 25% stake in their joint venture in 2022. As a result, BMW will become the controlling shareholder holding 75% of the equity. With the complete opening of the auto manufacturing sector to foreign investment by the 2021 Negative Lists, there are no longer any policy obstacles for BMW's investment, and it is likely that more foreign investors will consider restructuring and adjusting their investments in the auto manufacturing industries in China.

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[3] Basically a form of contractual control.

[4] China Securities Regulatory Commission issued the Administrative Provisions of the State Council on Overseas Issuance of Securities and Listing by Domestic Enterprises (Draft for Public Comment) and the Administrative Measures for the Filing of Overseas Issuance of Securities and Listing by Domestic Enterprises (Draft for Comment) on 24 December 2021.

In addition to the manufacturing sector, the wider opening of the business service sector and others by the 2021 Negative Lists will also undoubtedly attract more foreign investment to China.

Meanwhile, for foreign investors who invest in China's prohibited industries through a VIE structure or overseas securities markets, upcoming clarifications and the implementation of the new provision on overseas listings in the 2021 Negative Lists and Overseas Listing Regulations will have a profound impact. Gide will continue to monitor the implementation of the 2021 Negative Lists and future related legislation. In the meantime, please do not hesitate to get in touch with any questions you may have on how these changes may impact your business in China.

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