



Capital Markets Law

Analyzing the Measures for Administration of Strategic Investment by Foreign Investors into Listed Companies (Draft for Comment)

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On July 30, 2018, the Ministry of Commerce, State-owned Assets Supervision and Administration Commission, China Securities Regulatory Commission, State Administration of Taxation, State Administration for Market Regulation and the State Administration of Foreign Exchange jointly issued the *Measures for Administration of Strategic Investment by Foreign Investors into Listed Companies (Draft for Comment)* (“**Comment Draft**”). The currently effective *Measures for Administration of Strategic Investment by Foreign Investors into Listed Companies*¹ (“**Effective Measures**”), which became effective on January 31, 2006, have only undergone minor non-principled revisions in 2015 and have been unable to meet practice requirements. The management of foreign-invested enterprises has entered a new age of record-filing, particularly since the promulgation in 2016 of the *Interim Measures for Administration of Record-keeping for Establishment and Alteration of Enterprises with Foreign Investment*² (“**Interim Measures**”), (for details, see [Foreign investment in A-share Listed Companies: New Record-filing changes]), and the Effective Measures has proven to be quite inconsistent with current foreign investment management practices. In addition, the Effective Measures has increased uncertainty and transaction costs for foreign investors participating in mergers and acquisitions involving A-share listed companies due to strict requirements as to the types of foreign investors, asset holdings, investment shareholding ratios, lock-up periods and so on.

¹ [Measures for Administration of Strategic Investment by Foreign Investors into Listed Companies] (Min. of Commerce et al., Decree [2005] No. 28; promulgated Dec. 31, 2005, effective Jan. 31, 2006) 2006 ST. COUNCIL GAZ. 33 (revised by Min. of Commerce, Decree [2015] No. 2; promulgated and effective Oct. 28, 2015).

² [Interim Measures for Administration of Record-keeping for Establishment and Alteration of Enterprises with Foreign Investment (2018 Revision)] (Min. of Commerce, Decree [2018] No. 6; promulgated and effective June 30, 2018).

In light of the current background, the Comment Draft makes significant breakthroughs compared to the Effective Measures with respect to approvals and record-filings for foreign investors that invest in A-share listed companies, simplified investment examinations and approvals, foreign investor qualifications and requirements related to strategic investment. The Comment Draft also makes breakthroughs with respect to the issue of cross-border equity swaps when contrasted with the *Provisions on Merging and Acquiring Domestic Enterprises by Foreign Investors*³ (“**M&A Provisions**”).

I. Distinguishing between approval and filing administration in industries based upon whether they involve special administrative measures for foreign investment access

i. Key Revisions

The standard in the Comment Draft bases the distinction between approval and record-filing administration on whether special administrative measures for foreign investment access (“**Negative List**”) are involved, which is consistent with the Interim Measures.

ii. Han Kun Comment

Before the issuance of the Comment Draft, a foreign investor’s investment in an A-share listed company has been subject to the Effective Measures in cases where the Negative List does not apply to the A-share company’s industry, and also record-filing administration in accordance with the Interim Measures. However, the approval system under the Effective Measures and record-filing provisions of the Interim Measures have different regulatory requirements for foreign investors investing in A-share listed companies which increases complexity in practice.

The Comment Draft is consistent with the Interim Measures on the issue of approvals and record-filing administration for foreign investors investing in A-share listed companies. The Comment Draft stipulates that “the record-filing institution shall be responsible for record-filing and administration under the provisions of the [Interim Measures] where strategic investments do not involve national provisions on special administrative measures for foreign investment access ... the [Ministry of Commerce] shall be empowered by the State Council to examine, approve and administer strategic investments that involve national provisions on special administrative measures for foreign investment access.” As a result, the Comment Draft proposes that Ministry of Commerce approval will only be required where foreign investments are to be made in certain restricted industries under the Negative List.

³ [Provisions on Merging and Acquiring Domestic Enterprises by Foreign Investors] (Min. of Commerce, Decree [2009] No. 6; promulgated and effective June 22, 2009) 2009 ST. COUNCIL GAZ. 25.

The Comment Draft adopts the same standard for dividing between approval and record-filing administration as the Interim Measures – whether the Negative List is involved. The Comment Draft stipulates that “where a foreign investor holds the shares of a public company and continues to invest through means such as a transfer agreement, the public company’s issuance of new shares or a tender offer, when the proportion of the foreign investor’s shareholding changes by more than 5% and control or the relative control position has changed, the foreign investor is required to comply with Article 3 of [the Comment Draft] in performing record-filing or approval procedures.” **That is, record-filing administration will be adopted where a foreign investor makes an initial investment in an A-share listed company or the foreign investor’s shareholding ratio has changed (meeting the stipulated criteria), as long as the Negative List does not apply.**

➤ **Legal Provisions**

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Article 3: “the record-filing institution shall be responsible for record-filing and administration under the provisions of the [Interim Measures] where strategic investments do not involve national provisions on special administrative measures for foreign investment access.

The Ministry of Commerce or the competent Ministry of Commerce authority of the province, autonomous region, municipality directly under the central government, designated municipality and the Xinjiang Production and Construction Corps (hereafter the “**provincial-level MOFCOM authorities**”) shall be empowered by the State Council to examine, approve and administer strategic investments that involve national provisions on special administrative measures for foreign investment access. The provincial-level MOFCOM authorities shall be responsible for the approval and administration of those strategic investments under the threshold amount.

In the case of strategic investments made through transfers by agreement, new listed company share issuances, the above threshold amount shall be calculated according to the purchase amount stipulated in the share issuance or share transfer agreement; for investments through acquisition, the highest amount possible through the offer shall be calculated. Where a strategic investment is made through multiple of the foregoing investment methods concurrently, the amounts shall be aggregated.”

Article 15 “where a foreign investor holds the shares of a public company and continues to invest through means such as a transfer by agreement, the public company’s issuance of new shares or a tender offer, when the proportion of the foreign investor’s shareholding changes by more than 5% and control or the relative control position has changed, the foreign investor is required to comply with Article 3 of these Measures in performing record-filing or approval procedures.”

II. Loosening of cross-border equity swap restrictions

i. Key Revisions

The Comment Draft broadens the scope of offshore enterprises in cross-border equity swaps and embodies the policy of encouraging cross-border equity swaps.

ii. Han Kun Comment

Cross-border equity swaps are currently regulated under the M&A Provisions. According to the M&A Provisions, when a foreign investor acquires a domestic company with equity of a foreign company as consideration (a “**cross-border swap**”), the requirements for the foreign equity to be used as payment consideration are: (1) the equity of the offshore company is listed on a public and legitimate offshore securities exchange market (excluding over-the-counter markets); or (2) the equity is of a “special-purpose company” (which refers to offshore companies directly or indirectly controlled by a domestic company or natural person for the purpose of listing an owned domestic company offshore). The equity of an overseas company that does not meet the above requirements generally cannot be used as a consideration for foreign investors to subscribe for shares of domestic listed companies.

To a certain extent, these restrictions limit the use of offshore equity as payment consideration for A-share listed companies engaging in overseas mergers and acquisitions, thus there have been very few cases in practice where the Ministry of Commerce has approved cross-border swaps.

The Comment Draft loosens the above restrictions on offshore companies by requiring only that the companies be lawfully established, that the companies and their management have not been subject to major penalties imposed by regulatory authorities in the last three years, and that the foreign investors legally hold shares in the foreign companies and that those shares are legally transferrable.

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Article 6 “Where a foreign investor makes a strategic investment in a listed company with the equity of a foreign company he holds or with the issuance of additional shares as a mean of payment, the following conditions shall also be met:

There is a sound legal system in the foreign country where the company is lawfully established and registered, and the foreign company and its management have not been subject to major penalties imposed by regulatory authorities in the last three years;

The foreign investor lawfully holds shares in the offshore company which are transferrable in accordance with law;

Compliance with the relevant provisions of the China Securities Regulatory Commission.

III. Adjusting foreign investor entity qualification requirements

i. Key Revisions

1. The Effective Measures requires foreign investors to have capital of no less than USD 100 million or to manage offshore assets of no less than USD 500 million. For foreign investors that do not acquire control of the listed company, the Comment Draft relaxes the total capital requirement to no less than USD 50 million or to manage total assets of no less than USD 300 million. The Comment Draft does not change the asset requirements for foreign investors that become controlling shareholders of listed companies.
2. The Comment Draft clarifies that foreign natural persons can participate as foreign investors in strategic investments in listed companies.

ii. Han Kun Comment

According to provisions of the Effective Measures, foreign investors are “foreign legal persons and other organizations established and operated in accordance with law,” which precludes strategic investments by foreign natural persons. The Comment Draft clarifies that foreign natural persons may make strategic investments, and provides certain requirements for foreign natural persons. It should be noted that the Comment Draft will not apply to the acquisition of listed company shares by foreign natural persons as equity incentives, which will be regulated by the *Measures for Administration of Equity Incentives of Listed Companies*⁴ that do not require Ministry of Commerce approval or record-filing, although the disclosure obligations should be fulfilled.

In some respects, the Comment Draft relaxes the qualifications for foreign investors, such as by allowing foreign natural persons to be foreign strategic investors, and by reducing the asset requirements of foreign investors in the event that they do not acquire control of a listed company.

However, the Comment Draft may introduce more stringent requirements for foreign investors that invest in A-share listed companies.

According to Article 2 of the Comment Draft, strategic investment means “the act of a foreign investor acquiring and holding shares of an A-share listed company for a certain term through means such as transfer by agreement, the public company’s issuance of new shares (including non-public capital raising share issuances and share issuances for the purchase of assets), tender offer and other means stipulated by national laws and

⁴ [Measures for Administration of Equity Incentives of Listed Companies] (China Sec. Reg. Comm., Decree No. 126; promulgated July 13, 2016, effective Aug. 13, 2016) 2016 ST. COUNCIL GAZ. 33.

regulations.” Foreign investors of the strategic investment should comply with requirements under Article 5 of the Comment Draft, stipulating that the total assets of foreign investors or of the foreign investor’s actual controller shall be no less than USD 50 million or the total assets managed shall not be less than USD 300 million. In the case of foreign investors that become controlling shareholders of a listed company, the total assets of foreign investors or of the foreign investor’s actual controller shall be no less than USD 100 million or the actual assets managed shall be no less than USD 500 million.

Based on the articles of the Comment Draft, foreign investors will need to fulfill the above-mentioned asset requirements if they are to acquire and hold shares of A-share listed companies for a certain period of time by means of transfer by agreement, share issuance or tender offer, even if the foreign investor is managed under the record-filing system.

We expect to see a clear answer to this issue when the new *Measures for Administration of Strategic Investment by Foreign Investors into Listed Companies* is formally promulgated.

➤ Legal Provisions

Measures for Administration of Strategic Investment by Foreign Investors into Listed Companies (Draft for Comment)

Article 2 “These Measures apply to the act of a foreign investor acquiring and holding shares of an A-share listed company for a certain term through means such as transfer by agreement, the public company’s issuance of new shares (including non-public capital raising share issuances and share issuances for the purchase of assets), tender offer and other means stipulated by national laws and regulations (hereafter “strategic investment”).

Article 5 Foreign investors shall fulfill the following requirements:

Foreign companies, enterprises or other economic organizations shall be established and operated in accordance with law, with sound financial stability, good credit standing and mature management experience, sound governance structures, good internal control systems and norms of business conduct; foreign natural persons shall have the appropriate capacity to identify and bear risk;

The total assets of foreign investors shall be no less than USD 50 million or the total assets managed shall not be less than USD 300 million; or the assets of the assets of the foreign investor’s actual controller shall be no less than USD 50 million or assets managed shall be no less than USD 300 million;

In the case of foreign investors that become controlling shareholders of a listed company, the total assets shall be no less than USD 100 million or the actual assets managed shall be no less than USD 500 million; or the assets of the assets of the foreign investor’s actual controller shall be no less than USD 100 million or assets managed shall be no less than USD 500 million;

Foreign investors and their actual controllers have not been severely punished by domestic or offshore regulatory agencies within the past three years; those with fewer than three years since establishment shall be accounted for as of the date of establishment; foreign investors who are foreign natural persons shall also provide records proving no criminal conduct within the past three years.

IV. Modifying requirements related to strategic investment

i. Key Revisions

- 1. Adjusts the sale lock-up period from three years to twelve months;**
- 2. Cancels the requirement that foreign investors' strategic investments in A-share listed companies can be no less than 10%;**
- 3. Allows foreign investors to acquire listed companies through tender offer.**

ii. Han Kun Comment

The Effective Measures stipulates that foreign investors that strategically invest to acquire shares of A-share listed companies shall not transfer those shares for a period of three years; the Comment Draft shortens this sales restriction period to twelve months. In practice, many foreign investors have avoided the three-year sales limit by arguing that their investments did not constitute "strategic investment."

According to the Effective Measures, the shareholding ratio of the foreign investor upon completing an investment may be no less than 10% of the outstanding shares of the issuing company. In practice, many transactions result in the foreign investor acquiring less than 10% of the shares of the A-share listed company, which is not considered to constitute a strategic investment and does not require Ministry of Commerce review and approval. One such example is the issuance of shares by Harbin Gong Da High-Tech Enterprise Development Co., Ltd. (SH 600701) to acquire 100% of the shares of Opzoon Technology and to raise matching funds. The Comment Draft adjusts this provision by making the sole criterion whether approval by the competent department of the Ministry of Commerce is required to be whether the Negative List applies to the transaction. Thus, approval by the competent Ministry of Commerce department will be required for A-share listed companies in industries subject to the Negative List, even if the foreign investor acquires less than 10% of the company's shares following completion of the transaction. From this perspective, the Comment Draft is more explicit and is also stricter with regards to strategic investments that need to be submitted to the competent Ministry of Commerce department for approval.

➤ Legal Provisions

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Article 7 “Shares of A-share listed companies acquired by foreign investors through strategic investment shall not be transferred within twelve months. Where there are other provisions of the Securities Law, the China Securities Regulatory Commission and securities exchanges concerning the period of limitation for the sale of shares, such provisions shall prevail.”

V. Simplifying approval procedures

i. Key Revisions

The Comment Draft simplifies approval procedures.

ii. Han Kun Comment

The Effective Measures requires foreign investors that make strategic investments to report to the Ministry of Commerce for review and approval, **while the Comment Draft delegates part of the approval authority to the provincial-level Ministry of Commerce departments.**

According to the Effective Measures, strategic investments should in principle first be submitted to the Ministry of Commerce for approval, undergo foreign exchange and securities registration, and then obtain a foreign-invested enterprise approval certificate from the Ministry of Commerce after completing the strategic investment, and apply for SAIC registration with the approval certificate. **Based on the Comment Draft, foreign exchange registration, securities registration and SAIC registration are no longer linked with Ministry of Commerce approval, and it is only necessary to comply with foreign exchange, securities, industry and commerce-related laws and regulations, thus making the examination and approval process more flexible and convenient.**

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authorities shall be responsible for the approval and administration of those strategic investments under the threshold amount.

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Article 10, paragraph 2. After a reply in principle has been given by the competent commerce department and completion of the issuance, the listed company shall apply to the competent Ministry of Commerce department for the foreign-invested enterprise approval certificate.

Article 11, paragraph 2. After the competent commerce department gives an approval in principle to the undertaking of the strategic investment by the foreign investor, the foreign investor shall undertake the formalities for transfer by agreement in accordance with the relevant provisions; after the transfer by agreement is completed, the listed company shall apply to the competent commerce department for a foreign-invested enterprise approval certificate.

Article 12, paragraph 2. After the competent commerce department gives an approval in principle to the undertaking of the strategic investment by the foreign investor, the foreign investor shall undertake the formalities for the tender offer purchase in accordance with the relevant provisions; after the completion of the tender offer, the listed company shall apply to the competent commerce department for a foreign-invested enterprise approval certificate.

Article 18. “Where a strategic investment involves national provisions on special administrative measures for foreign investment access, the foreign investor shall, after obtaining approval in principle from the competent commerce department, apply to open a foreign exchange expense account in accordance with the relevant foreign exchange administrative provisions, and handle procedures for the settlement and cancellation of accounts in accordance with the relevant foreign exchange provisions. The foreign investor shall complete the investment within 180 days of the approval in principle.

Where the foreign investor fails to complete the strategic investment in accordance with the investment plan within the prescribed time, the approval in principle of the competent commerce department shall automatically become invalid. Foreign investors shall handle the remittance procedures for foreign exchange purchases in accordance with the relevant foreign exchange provisions.”

Article 19. “Foreign investors that undertake strategic investments that involve foreign exchange administration matters shall handle the formalities such as registration and cancellation, account opening and cancellation, foreign exchange settlement and cross-border receipts and remittances in accordance with the relevant foreign exchange provisions. Strategic investments that involve matters related to securities registration and settlement shall be handled in accordance with the relevant provisions on securities registration and settlement.”

Article 24. “Where the foreign investor’s strategic investment in a listed company involves changes to the registered items of the listed company, the listed company shall apply to the administration for market regulation department for registration in accordance with law.”

The quoted legal provisions cited in this article are unofficial translations and are to be considered for reference purposes only.

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