

Legal Commentary

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The 2021 Revised Negative List for Foreign Investment

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On December 27, 2021, the National Development and Reform Commission (“**NDRC**”) and the Ministry of Commerce (“**MOFCOM**”) issued two revised versions of negative lists (collectively the “**2021 Foreign Investment Negative Lists**”), which came into effect on January 1, 2022:

- Special Administrative Measures (Negative List) for Foreign Investment Access (2021 Edition) (the “**2021 National Negative List**”).
- Special Administrative Measures (Negative List) for Foreign Investment Access in Pilot Free Trade Zones (2021 Edition) (the “**2021 FTZ Negative List**”).

The Foreign Investment Law of the PRC, which came into effect on January 1, 2020, legally prescribed the PRC’s use of a “pre-establishment national treatment plus negative list” management mechanism with respect to foreign investment in the PRC. The current revisions of the negative lists for foreign investment access (“**Negative Lists**”) prominently highlight how emphasis is being placed on the **precision of these Negative Lists**. This echoes the recent filing-based regulatory reform in respect of the overseas listings of domestic enterprises proposed by the China Securities Regulatory Commission (“**CSRC**”).

We have summarized key themes of the 2021 Foreign Investment Negative Lists, focusing on the new precision-focused regulatory model.

Reduction-focused revisions based on the existing principle of high-level opening up

The latest revised 2021 Foreign Investment Negative Lists contain **no additional entries with respect to all industries and sectors** compared with their 2020 counterparts. Instead, the number of entries in the Negative Lists have reduced, specifically from 33 to 31 with respect to the 2021 National Negative List, and from 30 to 27 with respect to the 2021 FTZ Negative List. As the two Negative Lists have been reduced, their main revisions are as follows:

- **Removal of restrictions on automotive manufacturing.** Both new Negative Lists have removed the requirement that “PRC capital must be no less than 50% for manufacturers of passenger vehicles” and the requirement that “a single foreign investor may establish up to two joint ventures (“JVs”) in the PRC to manufacture the same type of vehicles”. For the first time, the automotive manufacturing industry is made fully accessible to foreign investment.
- **Removal of restrictions on television and broadcasting equipment manufacturing.** Both new Negative Lists have removed the entry “investment in the manufacturing of ground receiving facilities and key parts for satellite television broadcasting”, opening up the manufacture of ground receiving facilities and key components for satellite television broadcasting to foreign investment.
- **Zero manufacturing entries for pilot free trade zones (“FTZs”).** This revision results in zero manufacturing entries for FTZs, demonstrating that the PRC is willing to give further access to and promote its manufacturing industry.
- **Relaxed foreign investment restrictions with respect “market surveys” and “social surveys” for FTZs.** In addition to the 2021 National Negative List, the 2021 FTZ Negative List has eased foreign investment restrictions on “market surveys”, no longer requiring “market surveys to be limited to JVs”. Similarly, the restriction on foreign investment for “social surveys” has also eased. The previously prohibited provision banning foreign investment in the sector has changed to a restrictive one, requiring that “PRC capital must be no less than 67% and the legal representative must have Chinese nationality.”

Once the 2021 Foreign Investment Negative Lists comes into effect, **the pre-establishment national treatment plus negative list** regulatory system will universally apply to all foreign investors looking to invest in the PRC. In addition to these Negative Lists, foreign investors must also comply with the Negative List for Market Access:

#	Name of negative list	Effective date	Applicable scope
1.	The Negative List for Market Access (2020 Version)	December 10, 2020	Universally applicable to all (domestic and foreign) investors in the PRC.
2.	The 2021 National Negative List	January 1, 2022	Applicable to foreign investors in the PRC.
3.	The 2021 FTZ Negative List	January 1, 2022	Applicable to foreign investors in FTZs and takes precedence over the 2021 National Negative List within FTZs.

Analysis of the precision-focused regulatory model

Section VI of the Notes attached to the 2021 Foreign Investment Negative Lists contains a new provision that improves the precision and inclusiveness of the Negative List-based regulatory system:

Any domestic enterprise engaging in businesses prohibited by the Negative Lists that lists, issues

securities and trades shares overseas must obtain pre-approval consent from relevant competent regulator; overseas investors must not engage in the operation and management of the enterprise, and the percentage of foreign shareholding is subject to the relevant provisions in the administrative measures for domestic securities investments by foreign investors.

The new provision discussed above, together with the *Administrative Provisions of the State Council Regarding the Overseas Issuance and Listing of Securities by Domestic Enterprise (Draft for Comments)* (the “**Administrative Provisions**”) and the *Measures for the Overseas Issuance of Securities and Listing Record-Filings by Domestic Enterprises (Draft for Comments)* (the “**Filing Measures**”), both recently promulgated on December 24, 2021, will have a far-reaching effect on the regulatory system and market with respect to cross-border investments and overseas listings by PRC companies.

I Regulatory difficulties in choosing a listing structure for the overseas listing of PRC companies

Since the inception of Negative Lists used to regulate foreign investment, there remain numerous PRC companies operating in businesses restricted or prohibited from foreign investment that engage in various forms of “foreign” private investments or cross-border capital market activities. The “foreign” element of these activities causes these PRC companies to inevitably face risks associated with regulation and compliance, resulting in uncertain exit strategies for institutional investors. Against this backdrop, the market has created various cross-border investment and financing structures, including the VIE structure, to satisfy the financing and exit needs of investors.

Bound by policies relating to foreign investment access, if PRC companies operating in businesses that are on the Negative Lists intend to list and raise capital to the public, there are two main ways of doing so under the current regulatory framework:

- Use the domestic entity to list on domestic exchanges (A-Shares); or
- Establish a cross-border red-chip structure (due to the restrictions on foreign investment, either through control agreements or a VIE structure) to indirectly list overseas using an offshore entity, or to list on an A-shares market by issuing CDRs using the red-chip entity.

The 2021 revision of the Negative Lists provide more avenues for the listing of PRC companies engaging in businesses that are prohibited by the Negative Lists.

II Three basic requirements for the overseas listing of PRC companies

The 2021 Foreign Investment Negative Lists reserve room for flexibility for the overseas listing of domestic enterprises engaging in businesses that are prohibited by the Negative Lists. Specifically, the lists confirm that there are three basic requirements that this type of PRC company must satisfy prior to listing overseas:

Requirement 1: Pre-approval consent from the competent regulator

The NDRC and MOFCOM clarified in a public Q&A that the requirement of “pre-approval consent from relevant regulator” refers to the pre-approval consent as to the non-application of the prohibitions set out in the Negative Lists for the overseas listing of PRC enterprises, not the consent and approval of

the overseas listing (of a PRC enterprise) itself.

We understand that “**relevant regulator**” primarily refers to the competent authorities regulating the industry/sector in which the PRC enterprise operates. PRC companies should also consider communicating with the CSRC while obtaining pre-approval consent from the relevant regulator.

Requirement 2: Passive investment – foreign investors prohibited from participating in the management of the company

This requirement lays out the “passive” nature of foreign investments in prohibited industries set forth in the Negative Lists.

The 2021 Foreign Investment Negative Lists do not specify the criteria for determining “participation in the management of the company”, meaning the specific criteria for this requirement remain to be clarified, such as: (i) whether foreign investors have the right to nominate/appoint directors, supervisors, and senior management; (ii) whether foreign investors have the right to participate or vote in matters relating to the management of the enterprise.

This requirement will have a substantial impact on the governance of companies with VIE structures. How this requirement may be satisfied remains to be demonstrated through market practice once the Negative Lists have taken effect.

Requirement 3: Limitation on shareholding percentage – subject to the relevant provisions in the administrative measures for domestic securities investments by foreign investors

According to existing provisions in the administrative measures for domestic securities investments by foreign investors and a Q&A by the NDRC and the MOFCOM, the restrictions on foreign shareholding is as follows:

- The percentage of shares held by a single foreign investor and any related party must not exceed 10% of the company’s total shares.
- The percentage of shares held by all foreign investors and any related party must not, in the aggregate, exceed 30% of the company’s total shares.
- For enterprises listed in and outside of the PRC, the percentage of foreign shareholding must be calculated on a consolidated basis.

The shareholding restrictions discussed above provide a more open financing mechanism for PRC companies intending to list on either the domestic A-shares market or the overseas H-shares market. The market expects that overseas H-shares issuances and listings will be given more space for market development with the implementation of these parameters.

Although the 2021 Foreign Investment Negative Lists do not directly mention specific regulatory arrangements for domestic enterprises listing overseas using a red chip structure, it is reasonable to assume that the underlying principles of the “shareholding limitation” mechanism discussed above serve as a **potential reference** PRC companies listing overseas using a red-chip structure, that is, if (i) the PRC shareholding of the offshore parent entity in a red-chip structure is no less than 70%; (ii)

the foreign shareholding is no more than 30%; (iii) the passive investment requirement is satisfied with respect to foreign investment; and (iv) the pre-approval consent from relevant regulator is obtained, PRC companies operating in industries prohibited by the Negative Lists may have the opportunity to satisfy the CRSC filing procedure to complete an indirect overseas listing after the foregoing conditions are met.

If the foregoing assumptions are officially acknowledged by the regulatory authorities, then the necessity of adopting VIE structures for PRC companies operating in businesses prohibited by the Negative Lists may be significantly reduced. The market demand for and design of transaction structures may also fundamentally change.

III No retroactive application of the law

The NDRC and MOFCOM confirmed in a public Q&A that in principle, the regulatory framework for new and existing companies will differ from one another. With respect to the few existing overseas listed PRC companies that have exceeded the foreign shareholding percentage limitation, they will not be required to reduce the number of shares already issued overseas or the number of A-shares already held by foreign investors.

IV Smooth transition of the overseas listing process

The CRSC will take the lead in regulating PRC companies listing overseas. After a PRC company engaging in businesses prohibited from foreign investment applies to the CSRC for an overseas listing, the CSRC will consult with the competent authorities of that industry/field when implementing relevant regulatory procedures.

Once the Administrative Provisions and the Filing Measures are officially effective, the precision-focused regulatory model established by the 2021 Foreign Investment Negative Lists will act as a more positive policy guidance for the overseas listing of PRC companies.

Important Announcement

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