Cross-border share swap: a new method for overseas acquisition by A-share companies

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An article examining the regulatory approval of a recent cross-border share swap transaction in China, which included foreign investors receiving Chinese A-shares for offshore equities. It looks at the regulatory regime governing cross-border share swaps by Chinese A-share companies and discusses the current share swap transaction and its implications for other A-share companies. The article also has a table summarising the timeline of regulatory approvals for the current transaction.

Breakthrough cross-border share swap deal

After the **China Securities Regulatory Commission** (CSRC) approved, on 28 July 2016, the A-share listed BTG Hotels (Group) Co., Ltd. (BTG Hotels) (首旅酒店(600258)) of its overseas acquisition of Homeinns Hotel Group (Homeinns) (如家酒店) by a seasoned equity offering of BTG Hotels shares to the principal shareholders of Homeinns, the **Ministry of Commerce** (MOFCOM) approved this cross-border share swap transaction on 28 September 2016. This signals that the transaction completed the key regulatory approval procedures.

Previously, there were many cases of foreign investors obtaining shares in A-share companies by share swaps using the equity of the foreign investors' Chinese subsidiaries as consideration, for example, Focus Media Information Technology Co., Ltd. (分众传媒(002027)) completing its back-door listing on the Shenzhen Stock Exchange through a share swap with HEDY Holding Co., Ltd. (七喜控股). However, the CSRC and MOFCOM had rarely approved foreign investors to obtain shares in A-share companies by cross-border share swap using offshore equities as consideration. The regulatory approval of BTG Hotels' acquisition is good news for A-share companies that intend to acquire offshore assets by way of a seasoned equity offering.

The use of shares or equity as consideration has its advantages. It does not require the purchaser to obtain a large amount of cash, which can be a problem if the transaction value is large or the purchaser has problems obtaining adequate financing. In addition, a share acquisition does not expose the purchaser to balance sheet risk in the same way as depleting the purchaser's cash reserves for the acquisition.

Taken together with the recent trends of Chinese government strictly controlling outbound foreign exchange remittance, a cross-border share swap not only diversifies the available methods for offshore acquisitions, but also avoids (at least delays) the pressure for seeking regulatory approval of outbound foreign exchange remittance. In addition, as the A-share market tends to overestimate asset values compared with offshore capital markets, this may help to export the high valuation bubble in the A-share market and reduce the systemic risks to China's capital markets.

Chinese cross-border share swap regime

The cross-border share swap concept was introduced under the *Provisions on Foreign Investors' Merger with and Acquisition of Domestic Enterprises 2009* (2009 M&A Regulations), which allows direct share swaps between onshore and offshore companies, but only where the foreign shares to be exchanged are:

- Shares publicly listed in a location with a developed stock exchange trading system (see *Foreign shares eligibility*).
- Shares of a **special purpose vehicle** (SPV) established for the purpose of overseas listing of Chinese red chip companies.

The deal must clear Chinese regulatory approvals for both the outbound part of the transaction (that is, the acquisition of the foreign target company by the Chinese buyer) and the inbound part of the transaction (that is, the exchange of the Chinese buyer's equity by using the shares of the foreign target company) (see *A roadmap of Chinese regulatory approvals*).

Since the promulgation of the 2009 M&A Regulations, only a few cross-border share swap cases were approved by MOFCOM and those cases all belonged to **state-owned enterprise** (SOE) intra-group reorganisations. In addition, Chinese regulators have not yet approved any case involving an exchange of the shares of a Chinese red chip SPV.

Foreign shares eligibility

For foreign companies participating in a cross-border share swap, the following criteria must be satisfied:

- The foreign company must be lawfully established and its place of incorporation must have a sophisticated company law system.
- The foreign company must be publicly listed in a location with a sophisticated stock exchange trading system.
- The foreign company and its management must be free of any regulatory authority's penalty in the last three years.

(*Article 28, 2009 M&A Regulations*.)

In addition, to be eligible for the swap, foreign shares must meet the following criteria:

- The shares are legally owned by the shareholders and freely transferable.
- The ownership of the shares is not subject to any dispute, pledge or other encumbrance.
- The shares are publicly traded on a lawfully established public stock exchange.
- The trading price of the shares has been stable over the last one-year period.

(*Article 29, 2009 M&A Regulations*.)

For more information on foreign acquisitions with equity as the consideration, see *Practice note, Payment options (inbound M&A): China: Non-cash consideration*.

A roadmap of Chinese regulatory approvals

A cross-border share swap acquisition by an A-share listed company requires the verification and approval (核准), record-filing (备案) and registration (登记) with various Chinese regulators, including:

- The CSRC.

- The **National Development and Reform Commission** (NDRC) or its local office (local DRC).
- MOFCOM or its local office (local commerce bureau).
- In the case of an SOE, the **State Asset Supervision and Administration Commission** (SASAC) or its local office.

For the distinction between these three levels of scrutiny, see *Practice note, China outbound investments: approvals and process: Levels of scrutiny: regular and enhanced risk projects*.

For further details of what each level of scrutiny entails, see *Practice note, Establishing a China business: Levels of scrutiny*.

CSRC verification and approval for seasoned equity offering

CSRC approval is required for a listed company to issue new shares (*Article 45, Measures for the Administration of Issuance of Securities by Listed Companies 2006*). Generally, it takes three to six months or longer for the CSRC to complete the verification and approval procedure.

Parallel examination mechanism

The CSRC's verification and approval does not depend on the decisions of other regulators (*Article 3, Work Plan for Joint Examination and Approval for Administrative Licensing of the Merger, Acquisition and Reorganization of Listed Companies 2014*), for example:

- The NDRC verification and approval or record-filing for outbound investment.
- MOFCOM approval for foreign strategic investment into A-share companies.
- MOFCOM merger control clearance.

This is called the cross-ministerial parallel examination and approval mechanism.

NDRC verification and approval or record-filing for outbound investment

The following types of outbound investments are categorised as "sensitive projects" and require verification and approval for industrial policy:

- Outbound investment projects involving "sensitive countries and regions" must undergo verification and approval by the NDRC.
- Outbound investment projects involving "sensitive industries" must undergo verification and approval by the NDRC.
- Any of these sensitive projects with Chinese investment of USD2 billion must undergo further verification and approval by the State Council, based on the preliminary opinions of the NDRC.

(*Article 7, Administrative Measures for the Verification and Approval and Record-Filing of Outbound Investment Projects 2014* (2014 NDRC Outbound Investment Measures).)

Projects that do not meet any of these criteria only require record-filing with the NDRC or the local DRCs (*Article 8, 2014 NDRC Outbound Investment Measures*).

The NDRC or the local DRC is required to render its decision:

- On a verification application within a period of 20 to 70 working days.
- On a record-filing application within seven working days.

(*Articles 15, 16 and 21, 2014 NDRC Outbound Investment Measures*.)

For projects with a Chinese investment amount of not less than USD300 million, before the Chinese investor engages any substantive investment work (including signing any investment document with binding effect, providing any binding quotation or conducting any foreign investment approval procedure in the host country), the Chinese investor must obtain a preliminary confirmation from the NDRC. It will take the NDRC seven working days to issue the confirmation (*Article 10, 2014 NDRC Outbound Investment Measures*). Without this preliminary confirmation, the NDRC will not grant its final approval at the formal project verification or record-filing stage.

For more information, see *Practice note, China outbound investments: approvals and process: Industrial policy consent*.

MOFCOM verification and approval or record-filing for outbound investment

Outbound investment by an enterprise that involves sensitive countries and regions or sensitive industries is subject to verification and approval. Outbound investment by a company that falls under any other circumstances requires a record-filing with MOFCOM or the local commerce bureau (*Articles 6, 9 and 10, Administrative Measures for Outbound Investment 2014* (2014 MOFCOM Outbound Investment Measures)).

MOFCOM or the local commerce bureau is required to render its decision on:

- The verification application within a period of 20 to 30 working days.
- The record-filing application within three working days.

(*Articles 9 and 12, 2014 MOFCOM Outbound Investment Measures*.)

For more information, see *Practice note, China outbound investments: approvals and process: Foreign and trade policy consent*.

MOFCOM approval for foreign strategic investment into A-share companies

Foreign investors' strategic investment into A-share companies requires MOFCOM approval (*Article 3, Administrative Measures for Foreign Investors' Strategic Investment in Listed Companies 2005*). Foreign investors obtaining shares of A-share listed companies through a cross-border share swap would fall under the scope of this requirement and therefore would require approval. Although it is difficult to obtain this approval, A-share companies should always make efforts to deal with MOFCOM to seek the approval after first obtaining the relevant approvals from the CSRC (see *CSRC verification and approval for seasoned equity offering*). Generally, SOEs or companies that have smooth communication channels with MOFCOM are more likely to obtain the approval.

MOFCOM merger control clearance

A concentration must be notified to MOFCOM if certain thresholds are triggered (*Anti-Monopoly Law of the People's Republic of China 2007* and *Provisions of the State Council on the Thresholds for Declaring Concentration of Business Operators 2008*).

Failure to notify can result in a fine of up to RMB500,000 and an order to unwind the transaction.

Therefore, for a cross-border share swap transaction, if the relevant thresholds are triggered, the Chinese investor must seek MOFCOM's confirmation on the clearance of any Chinese merger control concerns. This can be done simultaneously with the MOFCOM approval or record-filing for outbound investment.

For more information, see *Practice note, Merger control in China: a practical guide*.

SASAC approval

The transfer of state-owned equity is subject to the decision of the SASAC or its local counterparts (*Article 23, Interim Regulations on the Supervision and Administration of State-Owned Assets in Enterprises 2003*). If the A-share listed company in a cross-border share swap is an SOE, this separate approval will also be required. Whether the approval can be obtained quickly depends on the communications with the relevant regulatory authority and the attitudes of the authority towards the investment. This can be viewed as the internal approval that the Chinese investor needs to clear with its government stake owner no later than the closing of the transaction.

For a general overview of the requirements for the transfer of **state-owned assets** (SOAs), see *Practice Note, Transfer of state-owned assets: China*.

Case study: BTG Hotels' acquisition of Homeinns

After BTG Hotels purchased, through cash, 65.13% of the shares of Homeinns held by foreign public shareholders to privatise Homeinns, BTG Hotels issued shares to Beijing Tourism Group (Beijing Tourism) to purchase all of the shares of Poly Victory Investments Limited (Poly Victory) (that in turn holds 15.27% of the shares of Homeinns), and issued shares to seven other onshore and offshore shareholders of Homeinns to purchase the remaining 19.60% of the Homeinns shares collectively held by them (see *Report of Significant Assets Purchase and Relevant Fund Raising through Cash and Seasoned Equity Offering and related Transactions, at pages 71 and 75* (重大现金购买及发行股份购买资产并募集配套资金暨关联交易报告书) retrieved from *Shanghai Stock Exchange website public disclosure*).

Diagram 1 below shows the equity structure of Homeinns after its privatisation by BTG Hotels but before the completion of the share swap. Diagram 2 shows the equity structure of BTG Hotels after the completion of the share swap.

Diagram 1: Equity structure of Homeinns after first phase privatisation by BTG Hotels

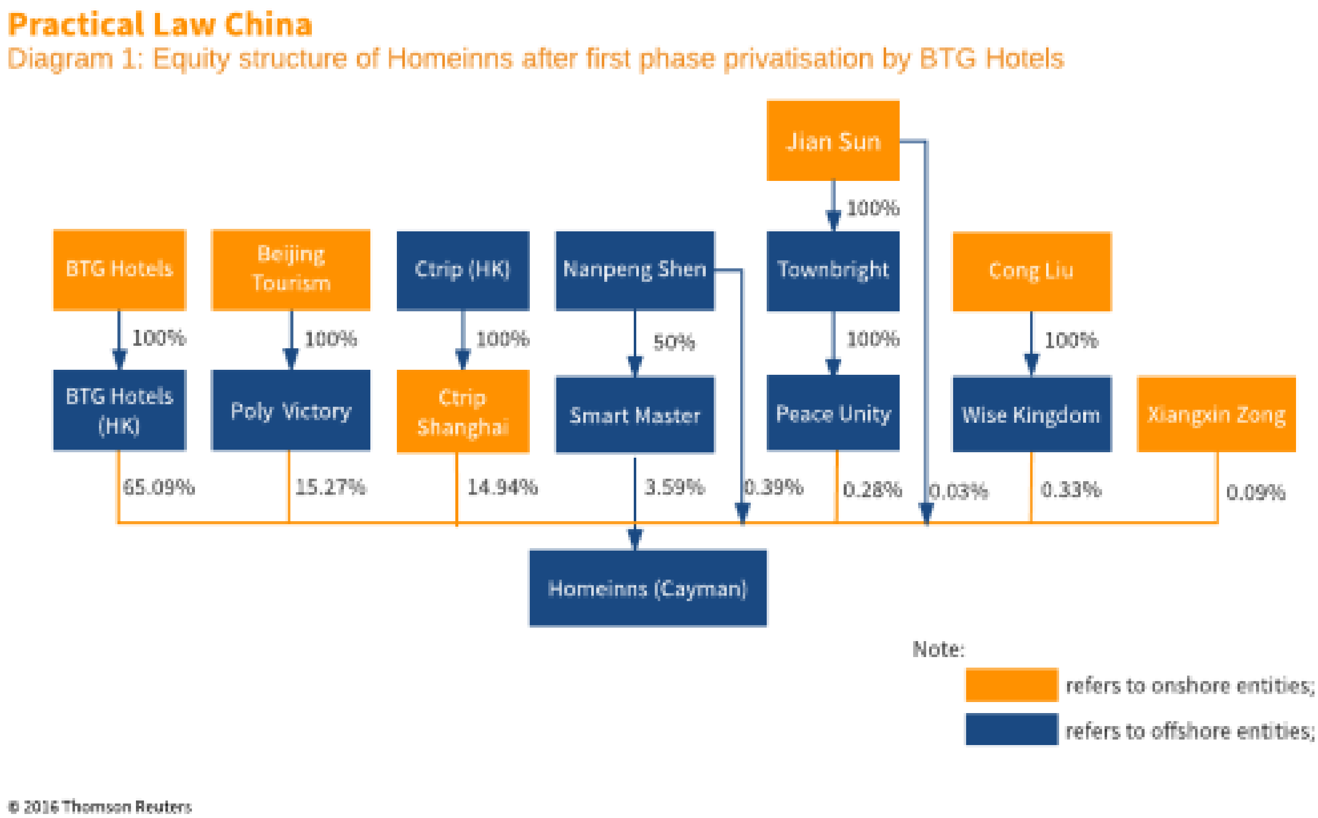
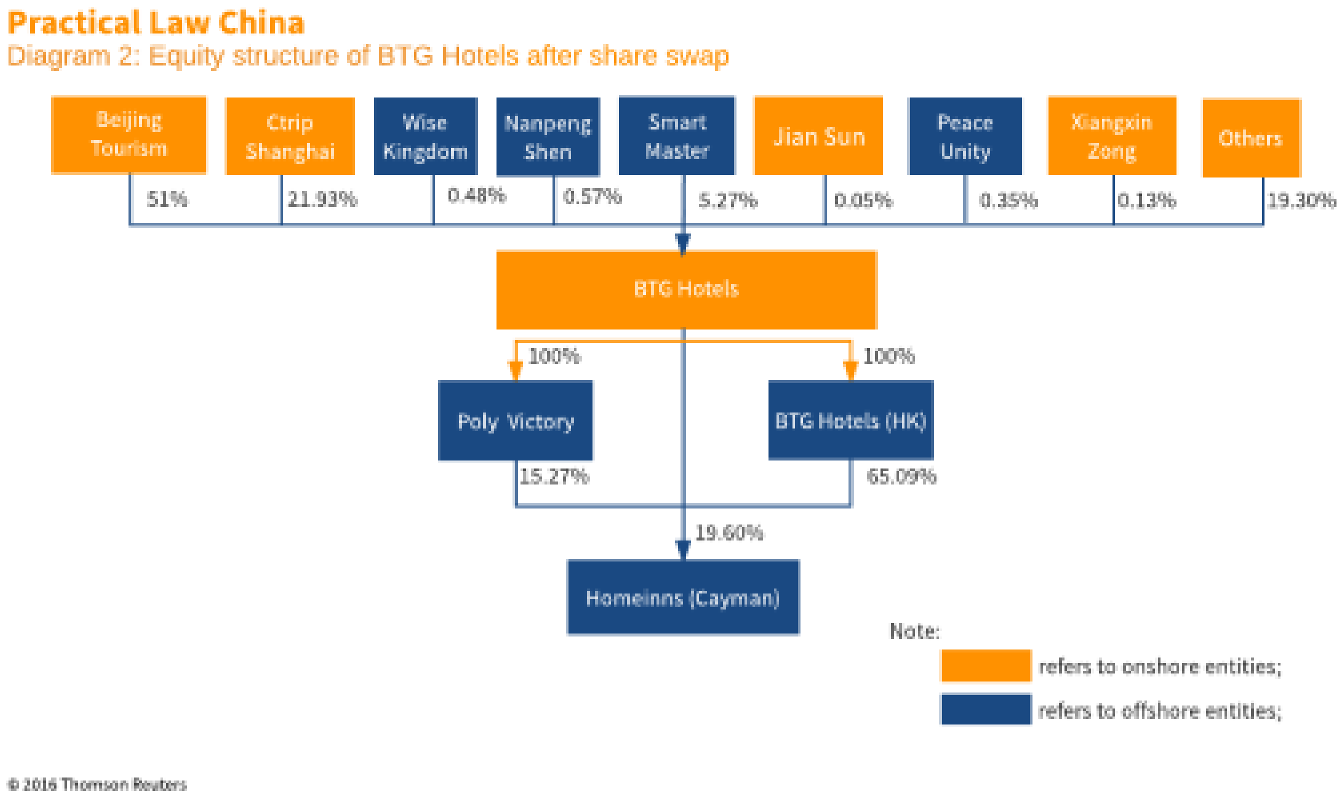


Diagram 2: Equity structure of BTG Hotels after share swap



Regulatory approvals for the BTG Hotels case

BTG Hotels' acquisition of Homeinns through a cross-border share swap obtained the official approval of the CSRC on 28 July 2016, and the foreign investment into BTG Hotels received MOFCOM's approval on 28 September 2016. The timeline of these and other relevant regulatory approvals are set out in the table below.

Approval timeline

Date	Authority	Approval / Record-filing
8 September 2015	NDRC	Letter of confirmation for outbound investment (see *NDRC verification and approval or record-filing for outbound investment*).
25 December 2015	Beijing local office of the SASAC	Approval of BTG Hotels' major asset restructuring plan (see *SASAC approval*).

22 January 2016	NDRC	Project record-filing for outbound investment (see *NDRC verification and approval or record-filing for outbound investment*).
8 March 2016	MOFCOM	Clearance of merger control filing (see *MOFCOM merger control clearance*).
28 July 2016	CSRC	Official approval of BTG Hotels' seasoned equity offering (see *CSRC verification and approval for seasoned equity offering*).
28 September 2016	MOFCOM	Approval for BTG Hotels' seasoned equity offering to strategic foreign investors (see *MOFCOM approval for foreign strategic investment into A-share companies*).
November 2016 (approximate)	Beijing Municipal Commission of Commerce	Record-filing for outbound investment (see *MOFCOM verification and approval or record-filing for outbound investment*).

Implication and influence of BTG Hotels case

One primary reason for MOFCOM's approval of the BTG Hotels case is the parties convinced MOFCOM to distinguish the case from what was intended to be curbed under the *2009 M&A Regulations*.

In 2005 and 2006, due to the sluggish domestic capital markets, a large number of Chinese companies sought to complete initial public offerings in overseas capital markets through the red chip structure (that is, the incorporation of a company outside of mainland China which is listed in Hong Kong), to avoid the supervision of the CSRC and MOFCOM. In response to that trend, six ministries jointly promulgated a 2006 version of the foreign acquisition legislation, which was subsequently amended and re-enacted as the 2009 M&A Regulations. Chapter 4 of the 2009 M&A Regulations regulates cross-border share swaps, including any share swap involving overseas SPVs established for the purpose of the overseas listing of Chinese red chip companies, and requires these swaps to obtain MOFCOM approvals. These regulations were formulated with the intent to restrict Chinese investors from avoiding domestic oversight by transferring domestic assets offshore. In the BTG Hotels case, in contrast, what the foreign investors did is to acquire onshore assets (that is, the A-shares) by injecting offshore assets. Therefore, MOFCOM approved the BTG Hotels share swap as a foreign strategic investment, and did not issue a separate approval for the same transaction under the 2009 M&A Regulations.

Other important reasons for MOFCOM's approval of this case include:

- BTG Hotels is an SOE, which makes its communications with the Chinese regulators more smooth and efficient.
- Homeinns is a private company and was just delisted from its overseas market through privatisation, making it more convenient for the parties to communicate with MOFCOM to justify the fairness of the equity value pricing.
- The recent macro-policy environment of China is to restrict foreign exchange outflow remittance.

Law stated as at 09-Feb-2017

Resource Type

Articles

Jurisdiction

China

