Legal Commentary

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Filing-based System for Overseas Listing (V) – Investors

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For a long time, overseas listing of domestic enterprises has been one of the major ways for investment institutions to exit. The filing-based system for overseas offering and listing adopts a unified regulation pattern over direct overseas listing and indirect overseas listing, optimizes the original examination and approval procedures for direct overseas listing and full circulation, and meanwhile increases the filing requirements for indirect overseas listing. For private equity investment funds and other institutional investors, the filing-based system not only brings more options for their investment and future exits, but also brings some new challenges, especially in the aspect of shareholder verification.

As the fifth episode of the series of *New Era of Filing-based System for Overseas Offering and Listing*[1], this article summarizes the information disclosure and verification requirements for investors acting as shareholders of issuers in overseas listing from the perspective of domestic enterprises' investors for your reference.

Penetrating disclosure requirements for investors as major shareholders

From the perspective of investors, under the filing-based system, regardless of whether the issuer is listing directly or indirectly overseas, it is worth noting with respect to the information disclosure of shareholders that a penetrating disclosure of the information of the issuer's major shareholders shall be conducted in the filing report, including the following:

- **Major shareholders:** A major shareholder refers to a shareholder who holds 5% or more of the issuer's shares or voting rights.
- **With the principle of penetration:** Major shareholders shall be penetrated to natural persons, listed companies (including overseas listed companies), public companies such as companies listed on the NEEQ, state-controlled or state-managed entities (including public institutions and industrial funds controlled by state-owned entities), collective organizations, overseas government investment funds (including sovereign wealth funds), university endowment funds, pension funds,

[1] Terms or attributes used in this article but not defined herein shall have the meaning ascribed to them in articles in the series of *New Era of Filing-based System for Overseas Offering and Listing*.

public welfare funds, and publicly offered asset management products.

- **Exception**: where a major shareholder is an overseas private equity fund, if it is not a shareholding entity or platform only for the purpose of holding shares, and the price of purchasing shares is not obviously abnormal, the information penetration mechanism is not required; however, where there is a domestic entity (including legal person, natural person and unincorporated organization with Chinese nationality) among its investors, managing partners or actual controllers, the relevant situation shall be explained through the information penetration mechanism.

- **Under the situation of no controlling shareholder or actual controller:** Where there is no controlling shareholder or actual controller, the information of the major shareholder and other shareholders who may have significant impact on the issuer shall be disclosed by referring to the requirements of the issuer's controlling shareholder and actual controller.

With respect to domestic listing, the CSRC and stock exchanges have proposed relatively strict shareholders penetrating verification standards and requirements. However, with respect to the approval of direct overseas listing, taking H-shares listing as an example, the CSRC has not explicitly required penetrating verification of the shareholders of an issuer. In contrast, there is no penetrating verification requirement for domestic enterprises' indirect overseas listing, as it is not subject to the supervision of the CSRC, while shareholders verification shall be conducted in accordance with relevant rules and requirements of the overseas securities regulatory authority in the listing place. The New Filing Rules clarify that, based on the principle of penetration of major shareholders of the issuer, in consideration of the special conditions of overseas private equity funds, overseas private equity funds satisfying certain conditions are allowed not to be penetrated.

An overseas private equity fund is a mainstream investor in an indirect overseas listing project. The requirement for penetrating verification of an issuer's major shareholders under the New Filing Rules is a reference to that of domestic listing. Although overseas private equity funds are provided as an exception for penetrating disclosure, the New Filing Rules do not specify the identification standard of an overseas private equity fund, and instead overseas private equity funds shall cooperate with the issuer and its lawyer in verifying the reasonableness of the purchase price. In the meantime, if there is a domestic entity among the investors, managing partners or actual controllers of such fund, a penetrating disclosure shall be made, thus such funds still bear certain substantial obligations to conduct verification.

With reference to the practice of domestic listing projects, in the oncoming overseas offering and listing of domestic enterprises, an investor may be required by the issuer to cooperate in verification by providing relevant information and material of the equity structure of itself and all levels of its investors, issuing written confirmation or commitment, and accepting interviews, etc. In order to satisfy the verification requirements of the investee, an investor is advised to consider or conduct due diligence on its investors by collecting necessary information or obtaining relevant confirmations in advance.

Announcements for investors as shareholders by "sudden share subscription"

In the practice of overseas listing, a domestic enterprise usually raises funds or constructs a red-chip structure for restructuring before listing, thus giving rise to the situation called "sudden share subscription"

before an issuer's listing. Under the filing-based system, during an initial offering and listing, an issuer's PRC lawyer shall verify the following information about a new shareholder and issue a clear and conclusive opinion:

- **If the issuer has a new shareholder within 12 months before it submits the application for filing of overseas offering and listing:** the PRC lawyer shall verify and issue a clear and conclusive opinion on the new shareholder's basic information, reason for share subscription, share purchase price and pricing basis, whether the new shareholder is associated with other shareholders, directors, supervisors and senior executives of the issuer, whether the new shareholder is associated with the intermediary for the current offering as well as its person-in-charge, senior executives and handling personnel, and whether there is any direct or indirect participant whose shareholding in the issuer is prohibited by laws and regulations.
- **If there is any change of shareholders after the filing application is submitted:** verification shall be conducted with reference to the requirements above. If the issuer's ownership of control is affected, the filing documents shall be updated.

This verification requirement makes reference to the current listing requirements for domestic listing, but does not impose a post-listing lock-up requirement for shareholder by "sudden share subscription" like domestic listing.

It is worth discussing that, for indirect overseas listing, whether an early investor of a domestic enterprise who is converted into a shareholder of an overseas listed entity due to restructuring of the issuer may be exempt from the abovementioned disclosure requirements for shareholders by "sudden share subscription" if the time of its shareholding at the issuer falls within 12 months prior to the listing application remains to be observed in practice. By referring to the latest requirements for domestic listing, if an issuer applies for listing with a domestic entity whose red-chip structure had been dismantled, and its direct shareholders had been converted from the original shareholders of the red-chip enterprise to the shareholders of the domestic entity within 12 months prior to the listing application, such shareholders are not required to, in principle, be deemed as new shareholders by "sudden share subscription". In view of such changes in the verification and approval requirements of domestic listing, there remains room for discussion if this exception rule is to be adopted in verification of overseas listing, which will also, to some extent, have an impact on investors' decisions on participating in an issuer's financing or restructuring.

Nominee holding

According to the New Filing Rules, an issuer's PRC lawyer shall verify whether there is any nominee holding of shares of the issuer during an initial offering and listing.

- Where there is any nominee holding of shares in the issuer, the issuer's PRC lawyer shall verify the reason, evolution and legal compliance of the nominee holding, whether there are existing or potential disputes, and whether there is any direct or indirect participant whose shareholding in the issuer is prohibited by laws and regulations, and shall issue a clear and conclusive opinion thereon.

Prior to the New Filing Rules, whether any nominee holding of issuer's shares is allowed is mainly based

on the requirements of the overseas securities regulatory authority in the listing place. Certainly, a direct overseas listing was previously subject to the CSRC's approval, and the CSRC generally refers to the verification and approval requirements for domestic listing, which set a higher standard for the clarity and stability of the issuer's shareholding structure and reflect a relatively conservative attitude towards nominee holding. Under the New Filing Rules, especially in the case of a direct domestic listing, it remains to be seen whether the issuer can successfully complete the filing process if it truthfully discloses that the investor has a nominee holding arrangement but has not yet restored or cleared such nominee holding. In the meantime, the retention of nominee holding by the investor shall also be subject to the requirements of the overseas securities regulatory authority in the listing place.

Termination arrangements of special shareholder rights

Special shareholder rights are important guarantees for investors when they are shareholders of the issuer, including the assurance of investment return and exit. Termination arrangements of special shareholder rights are significant adjustments to the rights and obligations of investors. The current disclosure requirements for special shareholder rights provided for in the New Filing Rules include:

- The filing report shall include a table to briefly describe the special shareholder rights arrangements, such as valuation adjustment mechanism; in addition, if the issuer has shares with special voting rights or similar arrangements, it is required to specify: (1) the basic information of the special voting rights arrangements; (2) the scope of matters on which the holders of special voting rights can participate in the shareholders' meeting, and the special matters to which the special voting mechanism does not apply; (3) the relevant risks associated with the change of control possibly caused by the differentiated voting rights arrangements and the impact on the corporate governance.
- The legal opinion shall incorporate special shareholder rights arrangements or special covenants involving shares.

From the foregoing, it can be seen that the New Filing Rules emphasize on information disclosure and interim and ex-post supervision, and do not expressly require the termination of special shareholder rights arrangements. However, such disclosure requirements indicate that the CSRC will pay close attention to the special shareholder rights arrangements. In particular, regarding direct overseas listing, in the past, the CSRC has not explicitly required the disclosure or termination of special shareholder rights in the review of direct overseas listing projects. However, the CSRC has raised requirements in respect of the termination of special shareholder rights for a part of listing projects in the feedback of the overseas listing review, which requires the enterprise to be listed to conduct feedback on whether the special shareholder rights are truly and completely terminated, and requires the issuer's lawyer to issue a verification opinion on the authenticity and completeness of such termination of special shareholder rights. Therefore, whether the special shareholder rights of investors disclosed in direct overseas listing can be retained after the implementation of the New Filing Rules, subject to the compliance with the rules of the listing place, remains to be seen.

In addition to the concerns of the CSRC, the termination of special shareholder rights is also subject to the

relevant laws and regulations of the listing place of the overseas listing. Taking listing in Hong Kong as an example, the listing rules of Hong Kong also stipulate the termination of special shareholder rights, mainly requiring that, if the special rights with respect to enterprises and shareholders are obtained by the investor before the initial offering, those special rights which are not extended to other shareholders generally shall be terminated upon listing so as to comply with the general principle that all shareholders are treated equally. However, where the investor is allowed to withdraw investment, such right to withdraw investment shall be terminated prior to A1 submission, unless such right to withdraw investment is exercisable only in the event that the listing has not taken place and terminated upon listing. In addition, if the special voting right arrangements do not satisfy the conditions stipulated by the listing rules of Hong Kong, such arrangements shall also be terminated.

In addition, it is worth noting that, since the domestic enterprise that directly lists overseas shall be a company limited by shares, a domestic enterprise (except for that directly established as a company limited by shares) is basically required to go through the process of the entire conversion from a limited liability company into a company limited by shares (the "**shareholding reform**") in practice. According to the Company Law, when a limited liability company is converted into a company limited by shares, the total paid-in capital shall not be higher than the net asset value of the company. In consideration that if there are repurchase right, anti-dilution right and other special shareholders' rights under which the company may be required to pay cash compensation, the investment funds may be deemed as financial indebtedness rather than paid-in capital and may affect the audited net asset value of the company on the shareholding reform benchmark date (for example, resulting in negative net asset value or the net asset value lower than the required amount of share capital after the shareholding reform), and therefore the issuer and its intermediaries (especially the auditor) may request the provisions relating to the company's payment obligation under the repurchase right, anti-dilution right and other special rights of the investors to be completely terminated prior to the shareholding reform audit benchmark date, so as not to affect the net asset value of the company on the shareholding reform audit benchmark date.

Based on the above and our previous project experience, the investors should pay attention to the termination arrangements of special shareholder rights as follows:

Timing	Applicable listing circumstances	Requirements
Shareholding reform	Direct overseas listing	**Audit requirements:** The repurchase right, anti-dilution right and other special shareholder rights under circumstances that the company pays cash compensation may be deemed as financial indebtedness and may affect the net asset value in the audited accounts of the company on the shareholding system reform benchmark date (for example, resulting in negative net asset value or the net asset value lower than the required amount of share capital after the shareholding reform) and may be required to be terminated
Filing of listing	Direct or indirect overseas listing	**CSRC's requirements:** Special shareholder rights shall be disclosed at the time of filing but the time of termination is not specified

Timing	Applicable listing circumstances	Requirements
		The requirements of the overseas listing place (taking Hong Kong Stock Exchange as an example): If the investor is permitted to withdraw investment, such right shall be terminated prior to A1 submission, unless such right is exercisable only in the event that the listing has not taken place and is terminated upon listing; special voting rights arrangements that do not meet WVR requirements are required to be terminated prior to A1 submission
Completion of listing	Direct or indirect overseas listing	**CSRC requirements:** Special shareholder rights shall be disclosed at the time of filing but the time of termination is not specified
		The requirements of the overseas listing place (taking Hong Kong Stock Exchange as an example): The special shareholder rights that do not extend to all other shareholders are required to be terminated upon listing

Lock-up of the investors' shares

As introduced above, the lock-up period of an investor's exit through overseas listing of the investee is an important issue to which the investor shall pay attention. It not only concerns the timing of the investor's receipt of investment return but also is closely related to the investment period and duration of the funds. Pursuant to the current laws and regulations, the investors' shares of invested enterprises are subject to different lock-up periods in different listing places. The main lock-up periods are as follows:

Applicable listing circumstances	Main lock-up periods
Direct overseas listing	Shares issued by the company before the public offering shall not be transferred within one year from the date when the company's shares are listed and traded on a stock exchange;
	The shares transferred by the company's directors, supervisors and senior management each year during their term of office shall not exceed 25% of the total shares held in the company. The shares held by the aforesaid persons in the company shall not be transferred within six months after they leave the post.
Indirect overseas listing (Hong Kong Market)	There is no statutory lock-up requirement for ordinary investors, but underwriters usually require a six-month lock-up period by agreement between the investors before listing;
	The controlling shareholder shall not sell the shares held before the listing within six months from the date of listing (twelve months in the case of GEM), and shall not lose its status as the controlling shareholder due to any sale of the shares held in the following six months (twelve months in the case of GEM);

Applicable listing circumstances	Main lock-up periods
	The cornerstone investor shall not sell the cornerstone investment shares held within six months from the date of listing.
Indirect overseas listing (U.S. Market)	Although there is no regulatory requirement, the underwriters usually require that all the shareholders and insiders of a pre-listing company shall not sell the listed shares of the company within 180 days after the listing unless they have obtained the written consent from the underwriters, which can be realized by entering into a lock-up agreement.

The changes in the lock-up period under the New Filing Rules mainly focus on the requirement on the documentation of the application for direct overseas listing. Under the approval-based system, the lock-up commitment made by the shareholders is required to be submitted to the CSRC for the application for direct overseas listing, while no such requirement is stipulated in the New Filing Rules. However, as the lock-up period requirements for direct overseas listing are mainly stipulated by the Company Law, such lock-up period cannot be bypassed or violated.

Verification of other investor-related issues in the New Filing Rules

The New Filing Rules explicitly stipulate the requirements on disclosure and verification for shareholders, as well as disclosure requirements for directors, supervisors and senior management. In addition to the shareholder matters mentioned above, the following information shall also be noted:

- Disclosure of basic information of the investor: In addition to the required disclosure of the time of incorporation, registered capital, registered address, and shareholder composition of general legal persons or partnerships, the following information shall also be disclosed: (a) a statement on the association or concerted action relationship among the existing shareholders shall be provided; and (b) if the investor is a trust, a statement on the time of incorporation, type, operation mode and term of the trust, arrangement of the rights and obligations of the parties to the trust, and the beneficiaries of the trust shall be provided. Therefore, trust investors shall prepare for the information disclosure.

- Disclosure of basic information of directors and supervisors appointed by the investor: If there are directors or supervisors appointed by the investor, the information of such directors or supervisors shall be disclosed, including the gender, age, nationality and overseas residency, major work experience, shareholding of the issuer's shares, and associations with related parties of the issuer.

- Procedural requirements for the investor as a state-owned enterprise: According to the *Notice of the General Office of the SASAC on Further Clarifying the Matters Regarding the Administration of State-owned Equity in Unlisted Companies Limited by Shares*, when an unlisted company limited by shares intends to apply for IPO on the stock exchange, and its shareholders belong to circumstances stipulated in the *Measures for Supervision and Administration of State-owned Equity in Listed Companies*, it shall be identified and administered by the state-owned assets supervision and administration authority. Meanwhile, the New Filing Rules also expressly require that the relevant verification shall be conducted and opinions shall be issued on whether the listing

involves the approval, filing or verification procedures of state-owned assets management, and whether such procedures have been performed according to the law. Therefore, if the investor is a state-owned enterprise, it is necessary for the investor to obtain identification for the state-owned shares during the listing of the invested company; and if the investor participates in the full circulation, it is also necessary to obtain the relevant approvals for converting state-owned shares into overseas-listed shares.

- Notes for investors regarding VIE structures: The New Filing Rules expressly require the PRC lawyers to verify the participation of foreign investors in the operation and management of the issuer, such as the appointment of director. Therefore, if foreign investors invest and participate in the operation and management of the issuer with a VIE structure, such investment and participation shall comply with laws, regulations and agreements.

Important Announcement

This Legal Commentary has been prepared for clients and professional associates of Han Kun Law Offices. Whilst every effort has been made to ensure accuracy, no responsibility can be accepted for errors and omissions, however caused. The information contained in this publication should not be relied on as legal advice and should not be regarded as a substitute for detailed advice in individual cases.

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