



Han Kun Newsletter

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Legal Updates

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1. Judicial Disposal of Crypto Currencies in China: Legislation, Challenges, Risks and Way Out

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Crypto currencies (also known as crypto assets) have seen rapid development since Bitcoin's emergence during the financial crisis in 2008. Due to their anonymity and privacy, crypto currencies are widely used for illegal and criminal activities and serve as a tool to evade judicial accountability. In response to the increasingly frequent criminal cases involving crypto currency, Chinese governments grapple with the complexities of judicial disposal at both policy and practice levels. This article reviews current crypto currencies legislation, analyzes the challenges and legal risks in its judicial disposal, and proposes measures for more effective regulation.

Current crypto currency legislation

I. Legislation on the classification of crypto currency

1. Circular on Preventing the Risks of Bitcoin

On December 3, 2013, the People's Bank of China (PBoC) and other authorities issued the Circular on Preventing the Risks of Bitcoin, which specifically targeted Bitcoin. It was the first document to assert that "*Bitcoin does not possess the attributes of currency*" and "*prohibited financial institutions from engaging in any Bitcoin-related business*".

2. Announcement on Guarding Against the Risks of Financing by Token Offering

On September 4, 2017, due to the emergence of financing activities involving crypto currency issuances, the PBoC and other authorities issued the Announcement on Guarding Against the Risks of Financing by Token Offering, expanding the scope of regulation from Bitcoin to all crypto currencies, out of the consideration for maintaining financial stability. The PBoC reiterated that "*crypto currencies do not have the attributes of currency*" and "*prohibiting financial institutions and non-banking payment institutions from carrying out business related to financing by token offering*". Then, it clarified that "*no organization or individual may illegally engage in activities of financing by token offering*" and expanded the prohibition of crypto currency exchange business from financial institutions and non-banking payment institutions to "*any so-called token financing trading platform*".

3. Circular on Further Preventing and Disposing of Crypto Currency Trading Speculation Risks

On September 15, 2021, to safeguard China's overall economic security and social stability, the PBoC, along with ten other authorities, issued the Circular on Further Preventing and Disposing of Crypto Currency Trading Speculation Risks. This circular maintains a strong stance against crypto currencies and related business activities. The notice not only reiterates that crypto currencies do not have the attributes of currency, but also clearly defines crypto currency-related business activities

as “*illegal financial activities*”. The circular specifies that “*relevant civil legal acts are invalid, and any loss arising therefrom shall be borne by the investor*”, and noted for the first time that “*services provided by overseas exchanges to domestic residents also constitute illegal financial activities*”.

4. Minutes of the National Court Financial Trial Work Conference (Draft for Comments)

The administrative departments of China have shown a trend of increasingly strict supervision of crypto currencies and business activities, as evidenced by the Circular on Preventing the Risks of Bitcoin, issued in 2013, the Announcement on Guarding Against the Risks of Financing by Token Offering, issued in 2017, and the Circular on Further Preventing and Disposing of Crypto currency Trading Speculation Risks, issued in 2021. However, with the increasing number of disputes related to crypto currency transactions, the views of the judiciary in practice are not entirely consistent with those of the regulatory authorities, and the courts also face the issue of unifying judgment standards. Therefore, the Supreme People’s Court specifically drafted rules in January 2023 for adjudication of disputes related to crypto currency in the Minutes of the National Court Financial Trial Work Conference (Draft for Comments) (hereinafter referred to as the “**Minutes of the Financial Conference (Draft for Comments)**”).

II. Rules related to the management and disposal of crypto currency

1. Guidelines for Handling Crypto Currency Cases by the Economic Crime Investigation Department of Public Security Organs (Trial Implementation)

The Guidelines for Handling Crypto Currency Cases by the Economic Crime Investigation Department of Public Security Organs (Trial Implementation) outline procedural requirements for investigating and handling crypto currency cases, including investigation, seizure, custody, and recovery.

2. Minutes of the Financial Conference (Draft for Comments)

The Minutes of the Financial Conference (Draft for Comments) specify that courts must determine the status of crypto currency holdings and the feasibility of their delivery or return. After that, the court should make a specific determination as to whether to specify the delivery or return of crypto currency in the judgment and may take corresponding measures in accordance with the relevant provisions of the civil procedure law on the enforcement procedures.

3. Guidelines on Disposal of Crypto Currency Involved in Criminal Proceedings of Xuhui District, Shanghai, the Administrative Provisions of Fujian Province on the Management of Crypto Currency Involved in Criminal Cases, the Operating Rules of Shandong Province for Disposal of Confiscated Items (Trial Implementation), the Guidelines for Investigation of Crypto Currency Involved Crime of Xiangcheng District, Suzhou City, Jiangsu Province, and other local regulations

In addition to the national regulations, various provinces and cities have also developed effective management strategies for crypto currency based on their case-handling experiences.

On August 29, 2024, in response to common problems and characteristics reflected in case handling, the People’s Procuratorate of Xuhui District, Shanghai, and the Public Security Bureau of Xuhui District

jointly signed the Guidelines on Disposal of Crypto Currency Involved in Criminal Proceedings. The Guidelines provide detailed and explicit regulations for the entire process and various stages involved in handling crypto currency cases, including investigation and evidence preservation, seizure and custody, and transfer and disposal, offering a specific guide for the lawful disposal of crypto currencies involved in cases.

Article 36 of the Operating Rules of Shandong Province for Disposal of Confiscated Items (Trial Implementation), jointly issued by the Shandong Provincial Department of Finance and other departments on August 25, 2023, stipulates that “*Prepaid cards and crypto currencies confiscated by law enforcement agencies according to the law may be negotiated with the issuing parties for repurchase. The repurchase price shall be determined through negotiation between both parties and, in principle, it shall not be lower than 80% of the face value or balance of the crypto currency or prepaid card. Both parties shall sign a repurchase agreement*”.

The Fujian Provincial Public Security Department issued the Administrative Provisions of Fujian Province on the Management of Crypto Currency Involved in Criminal Cases in December 2023, which regulates the seizure, custody, and disposal of crypto currency.

The People's Procuratorate of Xiang Cheng District, Suzhou City, Jiangsu Province, after handling a fraud case involving crypto currency, summarized the experience and, with the office for supervision and cooperation in investigation, issued the Guidelines for Investigation of Crypto currency Involved Crime to the public security authorities in April 2022. The Guidelines incorporate 14 articles to analyze and summarize the issues of seizure of property, collection of evidence, and disposal of property in crypto currency cases, providing a comprehensive guide for the handling of cases involving crypto currencies.

Challenges in the judicial disposal of crypto currency

As mentioned above, business activities related to crypto currency, including the exchange between statutory currency and crypto currency, the exchange between crypto currencies, acting as a central counterparty in the exchange of crypto currency, providing intermediary and pricing services for crypto currency transactions, financing by token issuance, and the transactions of crypto currency derivatives, are all currently considered “illegal financial activities” and are strictly prohibited. Despite this, the emergence of crimes involving crypto currencies continues to rise. Consequently, public security and judicial authorities are inevitably confronted with the management and disposal of crypto currencies in their case handling.

Considering the actual transaction value of crypto currency, it is necessary to liquidate crypto currency for the purpose of asset recovery. However, some judicial and technical challenges are associated with their disposition. Currently, some central and local judicial authorities have established guidelines for the seizure, custody, and disposition of crypto currency to standardize these processes. However, some of these guidelines are still in the trial phase, lack specificity, and are not widely publicized.

Accordingly, the following sections examine the specific judicial and technical challenges involved in the seizure, custody, and disposition of crypto currency.

I. Seizure of crypto currency

Most crypto currencies are decentralized. They are neither tangible nor stored in a central institution which accounts for them. As a result, judicial authorities face difficulties in the process of seizing crypto currencies held by criminal suspects that are different from those encountered in the seizure of traditional assets.

Typically, crypto currencies are stored either in addresses controlled by the suspect or within a crypto currency exchange. These two scenarios are discussed in detail below.

1. Storage in addresses controlled by the criminal suspect

When crypto currencies are stored in addresses controlled by the suspect, their anonymous and confidential nature means that only the suspect is aware of the quantity, location, and private key associated with these currencies.

Firstly, unless the criminal suspect voluntarily confesses or the transaction process of obtaining crypto currencies is tracked through technical means, it is difficult for the judicial authorities to determine whether the suspect holds crypto currencies and, if so, the extent of their holdings.

Secondly, due to the high volatility in the trading value of crypto currencies, even if judicial authorities have control over the sources and the amounts of funds used by criminal suspects to exchange for crypto currencies, it is still difficult to determine the amount of crypto currencies obtained by the suspect unless the judicial authority has access to the specific process and time of the exchange for crypto currencies. The suspect may only confess to a portion of their holdings, thereby complicating the authorities' efforts to secure all related crypto currencies.

Thirdly, even with knowledge of the quantity and address of all the crypto currencies involved in the case, unless the suspect stores the private key in an electronic device, and that device is seized by the investigative authorities and the private key corresponding to the address where the crypto currencies are stored is obtained through a comprehensive examination of the information stored on it; otherwise, if the suspect does not disclose the private key information, and since it is technically impossible to reverse-engineer the private key from the address, the judicial authorities would likely find it very difficult to obtain the private key.

Lastly, for general electronic data, judicial authorities can control it by seizing physical media such as hard drives and USB drives. However, in cases where the seized items are crypto currencies, even if the suspect stores the private key in a physical medium and the judicial authorities have control of the medium and knowledge of the private key information, it is difficult to prevent the suspect or their accomplices from immediately transferring the crypto currencies to other addresses through a backup private key.

2. Storage in a crypto currency exchange

In cases where crypto currencies are stored within an exchange, the cooperation of these exchanges, often based overseas due to domestic trading prohibitions, is crucial. The willingness of these overseas exchanges to cooperate with Chinese judicial authorities to seize and freeze crypto currency

is uncertain.

If the overseas exchange is unwilling to cooperate, the judicial authority may only withdraw and seize the crypto currencies from the overseas exchange after the suspect provides its password and other relevant information.

Therefore, similar to the circumstance of suspect-controlled addresses mentioned above, the seizure of crypto currencies in overseas exchanges also requires the cooperation of the suspect, which introduces considerable difficulty and unpredictability into the judicial process.

II. The custody of crypto currency

If the judicial authorities can successfully complete the seizure of crypto currency, then further issues regarding the custody of crypto currency arise.

Unlike conventional currencies, which are stored in banks and directly frozen with the assistance of banks, crypto currencies pose a transfer risk if left in the possession of the suspect. Therefore, transferring crypto currency into a crypto currency wallet address established by judicial authorities and custody by these authorities is a feasible method currently adopted, but it comes with its own set of considerations.

Article 3 of Several Provisions of Public Security Authorities on Management of Involved Property stipulates that, “*The management of property involved shall follow the principles of separation between case handling and property management, clarity of sources and whereabouts, timely handling according to law, and comprehensive acceptance of supervision*”. In cases involving crypto currency, after judicial authorities obtain the private key from the suspect, since the private key is the fundamental means of controlling crypto currency, this means that the case handlers effectively control the crypto currencies, which may violate the principle of separation between case handling and property management. If the public security authorities do not establish a separate address, and instead, the case handlers transfer the crypto currencies to an address which the handlers establish and hold the private key to, it may also violate the foregoing principles.

A breach of the separation principle may lead to improper disposal of crypto currency by judicial authorities during the case handling process. Moreover, due to the unique nature of crypto currency, it is challenging to trace any covert transfers, and once transferred, it is also difficult to recover.

Furthermore, improper custody and lack of understanding of the relevant technical measures may also lead to the risk that the private key may be obtained by hackers through malicious software or programs, leading to the loss of the custodied crypto currencies.

III. Value determination in the disposal of crypto currency

Determination of the value of crypto currency is an inevitably part of the process of crypto currency disposal.

The trading value of crypto currency often fluctuates significantly, making an accurate assessment difficult. In addition to providing grounds for judicial disposal, the determination of crypto currency

prices also has a significant impact on the conviction and sentencing of the suspect. Meanwhile, if the methods for valuing crypto currency are not clear, it may create opportunities for some individuals to exploit this loophole for improper benefits, such as disposing of the crypto currencies at issue at a lower price for illegal profits.

In practice, the following four methods are generally adopted to determine the value of crypto currencies:

1. Determination through market price

Determination through market price refers to determining the value based on the current market price of the crypto currency.

Since China does not recognize the legality of crypto currency trading, it is impossible to use the so-called domestic market price of crypto currency. One potential approach is to determine the value of crypto currency based on its real-time trading price on overseas trading platforms, and then convert it into RMB through common intermediate currencies such as USDT and the U.S. dollar. However, the problem of this method is that the market price of crypto currency is highly volatile and unstable. Meanwhile, due to the illegality of crypto currency trading platforms in China, the legality of using the market price from overseas trading platforms is questionable.

2. Determination through proceeds of crime

Determination through proceeds of crime refers to assessing the value of crypto currencies based on the proceeds obtained by the criminal suspect from the sale of crypto currencies.

However, this method is not applicable when the criminal suspect has not yet sold the crypto currency. If the judicial authorities seize the crypto currencies and instruct the suspect to liquidate them, there is an inherent risk that the suspect may exploit the opportunity to transfer assets.

3. Determination through acquisition cost

Determination through acquisition cost refers to assessing the value based on the price paid by the criminal suspect or the victim to obtain the crypto currencies involved in the case.

This method is effective for calculating the victim's loss, but for the judicial disposition of the proceeds of crime, due to the volatility of the crypto currency market value, the price at which the criminal suspect or victim obtained the crypto currencies is often significantly different from the price at the time of judicial disposition.

4. Determination through price appraisal

Determination through price appraisal refers to entrusting an appraisal institution to appraise the value of crypto currency.

The method of price appraisal involves the issue of whether crypto currency falls within the scope of judicial appraisal. According to Article 2 of the Decision of the Standing Committee of the National People's Congress on the Management of Judicial Appraisal, "*The state shall implement a registration*

management system for appraisers and appraisal institutions engaged in the following judicial appraisal: (1) Forensic medical appraisal; (2) Physical evidence appraisal; (3) Audio-visual material appraisal; (4) Other appraisal matters that are registered and managed according to the requirement of legal proceedings, as determined by the State Council's judicial administrative department in consultation with the Supreme People's Court and the Supreme People's Procuratorate”.

The court determined the value of crypto currency through price appraisal in the theft case of Zhao tried by Intermediate People's Court of Dalian City, Liaoning Province [Case No.: (2021) Liao 02 Criminal Final No.258]. In that case, the court held that the price appraisal of crypto currency does not fall into the above four categories, and therefore no judicial appraisal is required.

Due to the qualification requirements for judicial appraisal institutions and the legal scope of judicial appraisal businesses, whether the appraisal of crypto currency should be included within the scope of judicial appraisal is a question worth clarification.

Legal risks in the disposal of crypto currency

In judicial practice, there are generally two methods for the judicial disposal of crypto currency: one is to manage and dispose of the crypto currency by judicial authorities, and the other is to entrust third-party institutions to dispose of the crypto currency. The following paragraphs analyze in detail the potential legal risks associated with these two disposal methods.

I. Legitimacy of judicial authorities' custody and disposal of crypto currency

In the process of judicial disposal of crypto currency, judicial authorities inevitably face issues regarding the legality of the storage and disposal of crypto currency, whether in the pre-judgment recovery of illegal gains or in the post-judgment enforcement of confiscated illegal gains.

As the Announcement on Guarding Against the Risks of Financing by Token Offering and the Circular on Further Preventing and Disposing of Crypto Currency Trading Speculation Risks repeatedly clarify that crypto currencies shall not circulate in the market, thus making the trading of crypto currencies strictly prohibited in China. However, there is still a lack of clear prohibitory regulations regarding the holding of crypto currency. As a public authority exercising judicial functions, judicial authorities are entitled to be in the custody of criminal proceeds, but the corresponding operational procedures still need to be specifically described. At the same time, the current regulations prohibit crypto currency trading, which raises questions about the legality of judicial authorities' disposal and liquidation of crypto currency.

II. Entrustment of third-party institutions for the custody and disposal of crypto currency

Since judicial authorities cannot directly conduct public auctions for crypto currency in China, and the disposal of crypto currency requires a certain level of expertise, judicial authorities may choose to entrust its disposal to a professional third-party institution.

The public security organs seized a large amount of crypto currency during the case handling process, including 190,000 BTC, 830,000 ETH, and 27,240,000 EOS in the case of Chen, Ding, et al., who were

charged with organizing and leading pyramid schemes and concealing and hiding the proceeds of crime [Case No.: (2020) Su 09 Criminal Final No.488]. In this case, the public security organs entrusted a technology company in Beijing to liquidate the crypto currencies, and the proceeds were returned as illicit funds.

Compared with the direct disposal by judicial authorities, third-party institutions generally have advantages in technology, resources, and information. They are professional in the technical processing of crypto currency and have more liquidation channels of crypto currency and are familiar with the price and liquidation models of crypto currencies. In judicial practice, third-party agencies are also a popular choice for judicial authorities to facilitate judicial progress. However, the disposal of crypto currency has its own unique features, and the following issues are worth further analysis.

1. Legality of crypto currency disposal by a third-party institution

Firstly, the disposal and liquidation by third-party institutions inevitably raise concerns regarding compliance with existing regulations that prohibit crypto currency transactions.

Secondly, when accepting the entrustment, third-party institutions may encounter issues such as potential rent-seeking behavior, the reasonableness of their fee structures, and the legality of the fund flows involved.

Lastly, since China has banned crypto currency exchanges and characterized the trading of crypto currency as “illegal financial activities”, the liquidation of crypto currencies often necessitates overseas transactions, which may lead to issues including reporting and settlement of foreign exchange for overseas transactions. If third-party institutions declare and exchange foreign currency with false documents or other illegal methods, and finally exchange the crypto currency-related funds into RMB, they may be suspected of violating the foreign exchange administration system.

2. The pricing of fees charged by third-party institutions

The pricing of fees charged by third-party institutions is closely related to the value determination of crypto currency mentioned earlier. Due to the lack of legal provisions and specific standards, as well as the lack of market transparency caused by compliance issues, the standards for the intermediary fees charged by third-party institutions and the basis for the price of crypto currency liquidation are questionable.

In the absence of unified market rules and regulatory provisions, third-party institutions are likely to report excessively high liquidation and disposal costs and charge unreasonable intermediary fees. Due to the compliance issues of crypto currency transactions, there are fewer third-party institutions capable and willing to dispose of crypto currency. Therefore, third-party institutions may take advantage of judicial authorities' unfamiliarity with crypto currency disposal models and prices, as well as their own advantageous position. This can lead to unreasonably high quotes, inflating disposal costs and diminishing the final amount recovered. At the same time, the lack of standardized pricing can easily lead to judicial corruption, where relevant personnel may exploit ambiguous pricing structures to engage in rent-seeking behavior for personal gain.

As mentioned above, similar to intermediary fees, judicial authorities lack a consistent and clear pricing standard for crypto currency, and the market value of crypto currency fluctuates greatly. Third-party institutions may exploit these variations, mixing entrusted crypto currencies with their own and liquidating them in batches, and then reporting the lower prices as the liquidation prices to judicial authorities, obtaining the difference between the actual transaction proceeds of the crypto currencies and the amount remitted to judicial authorities. In addition, third-party institutions may also collude with the downstream buyers, selling at nominally lower prices to obtain illegal benefits.

3. The qualifications of third-party institutions

Since China has not established relevant qualification review standards, industry specifications, or industry qualification standards in the field of crypto currency, judicial authorities lack clear guidelines to assess the compliance and professionalism of third-party institutions. This may lead local judicial authorities to adopt different disposal approaches, leaving room for third-party institutions or other related personnel to unjustly benefit themselves.

Judicial authorities have taken notice of this issue, requiring that the disposal and liquidation of crypto currency involved in cases should be entrusted to “qualified third-party institutions” and requiring the provision of “evidence of compliance with laws and regulations”. However, there are no specific regulations and standards to judge whether they are “qualified third-party institutions”, and what should be included in the “evidence of compliance with laws and regulations” still needs to be detailed.

4. Supervision over third-party institutions

At present, China lacks supervisory standards or measures for third-party institutions dealing with crypto currency, and there is no effective mechanism to monitor their daily operations, methods of crypto currency disposal, the sources of funds obtained from the liquidation of crypto currency, and the ultimate destination of the crypto currency.

Due to the anonymity of crypto currency, there is a significant risk of associated illegal money laundering activities., and third-party institutions may also be involved in crimes such as concealing the proceeds of crime, or money laundering, during the disposal process.

Firstly, the third-party institutions responsible for disposing of crypto currency may themselves be involved in crimes such as concealing the proceeds of crime or participating in money laundering. The decentralized nature of crypto currency means that there is no centralized agency registering the identity information of holders. Therefore, in the case of anonymous holders, anyone who knows the private key can control the crypto currency at the corresponding address. This leads to crypto currency often being used for money laundering through multiple transactions, thereby concealing the final source of the currency and making it difficult for regulators to trace the transaction process. Therefore, without strict scrutiny, third-party institutions may also take advantage of the opportunity to assist others in money laundering or other criminal activities.

Secondly, third-party institutions responsible for disposing of crypto currency may unknowingly receive illegal funds. Even without malicious intent, the prevalence of criminal activities in crypto currency transactions means that if these institutions fail to scrutinize their counterparties, they risk becoming

entangled in their illegal activities. The funds obtained by the third-party institutions from the disposal of crypto currency may originate from criminal proceeds within China; that is, the counterparties may use the illegal funds to purchase the crypto currencies that the third-party institutions are responsible for disposing of, thus involving the crypto currency disposal process in criminal activities. It may even be the case that, after the third-party institutions have completed the disposal, the proceeds are seized and frozen by other public security authorities because of the relationship with criminal activities.

Way out for the disposal of crypto currency

Although there are many difficulties and risks in the judicial disposal of crypto currency as mentioned above, these challenges and risks can be solved with the introduction of relevant legal regulations and standards in the future. The following paragraphs will elaborate on the legal response and prospects to the disposal of crypto currency.

I. Legality of judicial disposal

1. Interpretation on the legality of judicial disposal

While administrative authorities have characterized crypto currency-related business activities as illegal financial activities, we believe that in the context of judicial disposal, it may be possible to resolve this issue of legality through legal interpretation.

Regulations deny crypto currency's classification as currency but do not prohibit it as general virtual property or its holding. This distinction suggests that judicial disposal may be feasible, unlike wholly prohibited items such as drugs or counterfeit currency.

Transactions related to crypto currencies are restricted in order to prevent speculative trading and to protect investors, according to the Notice on Guarding Against the Risks of Financing by Token Offering and the Circular on Further Preventing and Disposing of Crypto Currency Trading Speculation Risks. However, in the judicial disposal process, the disposal actions are under supervision and are essentially a measure to recover victim's property and mitigate losses. They do not involve speculative trading and collective investment risks, and they generally do not undermine the national financial order. Therefore, the judicial disposal of crypto currency should not fall within the scope of the restrictions of the aforementioned documents.

2. Legal disposal based on special policy

China is currently piloting a program allowing qualified third-party institutions to conduct judicial disposal of crypto currency. Since financial activities involving crypto currency are prohibited within China's territory, a viable approach is to cooperate with foreign countries that allow crypto currency transactions. Special policies are implemented within specific cooperation areas, and qualified third-party institutions are granted relevant qualifications.

For example, the People's Republic of China and the Republic of Kazakhstan, in accordance with the Framework Agreement between the Government of the People's Republic of China and the Government of the Republic of Kazakhstan on the Establishment of the "Khorogos International Border

Cooperation Center”, have signed the Agreement between the Government of the People’s Republic of China and the Government of the Republic of Kazakhstan on the Regulation of Activities in the Khorgos International Border Cooperation Center (hereinafter referred to as the “**Agreement**”). Article 7 of the Agreement provides that, “*Business entities operating within the Center may engage in activities that are not prohibited by the laws of both countries. In case of disagreements related to activities carried out within the Center, both parties will consult with each other*”. According to public information, the People’s Republic of China and the Republic of Kazakhstan have established the Khorgos International Border Cooperation Center near the border based on the Agreement and have issued Business Entity Registration Certificates to some enterprises, including those whose business scope contains digital assets, digital currency, virtual assets, and crypto currency disposal. Meanwhile, relevant government agencies will conduct examination and verification of such enterprises, supervise the compliance of their operations and may revoke the Business Entity Registration Certificate of the unqualified enterprise.

Participants in judicial disposal include judicial authorities, crypto currency disposal companies with special qualifications, appraisal institutions with judicial appraisal qualifications, and evaluation institutions with judicial evaluation qualifications. The current process involves judicial authorities signing a crypto currency disposal entrustment agreement with a crypto currency disposal company and entrusting judicial appraisal institutions and evaluation institutions to conduct judicial appraisal and evaluation of crypto currency. Therefore, judicial authorities can consider this approach as a form of judicial disposal if needed.

II. Outlook

1. Clear empowerment

As mentioned earlier, the first concern in the judicial disposal of crypto currency is the legality of such disposal by judicial agencies and third-party institutions. Although there is a certain margin of interpretation for the legality of judicial disposal under existing regulations, the lack of clarity in relevant rules may lead to doubts about its legality. Therefore, it is necessary to introduce relevant regulations to clarify the issue of legality.

In practice, despite the current trend of strict supervision over crypto currency, there are still a considerable number of civil or criminal cases involving crypto currency transactions. Disposal actions taken by judicial authorities in the exercise of public power to maintain the public interest, should be entitled to an exception to the supervision over crypto currency. Without prejudice to the normal legal system, it is clear that judicial authorities are entitled to custody and to dispose of crypto currency in order to perform their duties. In addition, where judicial agencies authorize third-party institutions to dispose of crypto currency, it is crucial to clarify the legality of their actions, and to specify the authorization requirements, scope of authorization, and supervision process. The legality of third-party actions should be confined to authorized limits, with judicial oversight ensuring compliance.

In addition, a white-list system should be established for qualified third-party institutions for the disposal of crypto currency. A special department of the central judicial authority can select qualified institutions with the list being adjusted dynamically according to the actual situation to provide guidance

for judicial authorities across the country in disposing of crypto currency and to mitigate negative impact arising from exceptions to prohibitions on crypto currency transactions.

2. Clear procedures

Apart from the issue of legality, the risks and challenges in the judicial disposal of crypto currency may arise from the lack of procedural rules and inconsistency between regulations. Comprehensive and specific regulations for the entire judicial disposal process should be formulated to standardize measures nationally, ensuring that judicial authorities, third-party institutions, and responsible personnel strictly follow standardized processes for disposal.

Firstly, with regard to the seizure and custody of crypto currency, the central judicial authority or provincial judicial authorities can establish a special seizure address for crypto currency or establish a unified national platform or provincial platform based on the establishment of a special address for judicial authorities.

The private key for the special seizure address for crypto currency should be held by specialized personnel outside the case-handling department, and the electronic devices that store the private key should not be connected to the outside network. It is more appropriate if the specialized personnel responsible for custody have relevant technical backgrounds. After the case-handling personnel obtain the private key of the crypto currency held by the criminal suspect, they should immediately transfer the crypto currency to the special seizure address established by the judicial authorities and record the type and quantity of the crypto currency, and record the entire process of seizure and transfer for review. If a suspect is uncooperative, guidance should be offered to encourage cooperation.

The advantage of adopting a special seizure address lies in its security: only designated personnel of the judicial authorities hold the private key of the address, preventing the criminal suspect or his accomplices from transferring crypto currency, ensuring the security of the seizure. On the other hand, it also complies with Article 21 of the Several Provisions of Public Security Authorities on Management of Involved Property regarding the separation of property management and case handling, preventing relevant personnel from obtaining illegal benefits. In addition, the private key held by specialized technical personnel and stored in hardware isolated from the outside network can prevent the loss of crypto currency from cyber-attacks or other technical means. A standardized national or provincial process for the seizure and custody of crypto currency aids investigations if losses occur. To ensure the safety of the crypto currency, a special address can be established for each individual case.

Secondly, the central judicial authorities or provincial judicial authorities should establish or designate a department and personnel responsible for the liquidation of crypto currency to handle all crypto currencies that needs to be disposed of nationwide or provincewide. This will enhance the professionalism of crypto currency disposal and prevent inconsistencies in disposal methods and standards across different regions.

Clarifying the party responsible for judicial disposal of crypto currency and the supervisory party for the entrustment of third-party disposal institutions facilitates tracking of potential illegal and irregular behaviors involved in the disposal process. In conjunction with this, judicial authorities can establish dedicated transaction accounts at designated banks to handle the flow of currency involved in the disposal. For larger transactions, higher authority or peer review may be required. For example, in cases where public security authorities dispose of crypto currency, prosecutorial authorities could review and approve.

Thirdly, a whitelist database of third-party institutions could be established to limit the scope of institutions authorized to dispose of crypto currency.

The criteria for selecting third-party institutions in the white-list database include that: the institution should have no record of illegal or criminal activities; no history of illegal or criminal activities; absence of administrative penalties related to crypto currency; robust confidentiality mechanisms; a secure system to protect crypto currency from loss; relevant expertise and experience in crypto currency; reasonable pricing for services; efficiency in disposal; and sufficient financial capacity to manage disposal or cover potential losses.

Fourthly, in the process of entrusting third-party institutions to dispose of crypto currency, measures supporting the above procedures should be established.

Prior to entrusting a third-party institution to dispose of crypto currency, it is necessary to sign a standardized power of attorney, specifying the scope, quantity, and possible disposal measures. A unified pricing mechanism is also essential, potentially involving a qualified appraisal institution to assess market value and disposal fees. On this basis, judicial authorities can negotiate with the third-party institution to determine the disposal measures and costs, setting standards for the specific rates and maximum limits of fees charged. Furthermore, the obligations of the third-party institution, as well as the compensation responsibilities for violations of relevant laws or agreements should be determined through written agreements. A reasonable explanation should be provided if the third-party institution's final liquidation price of crypto currency significantly deviates from the assessed price. Serious faults in the disposal process should result in removal from the whitelist and accountability for compensation. Lastly, a supervision mechanism for the disposal of crypto currency by third-party institutions should be established, with dedicated personnel from judicial authorities holding the crypto currency throughout the entire transaction process until the disposal is completed, or requiring the third-party institution to establish a special transaction address for the crypto currency involved in the case, and the aforementioned department responsible for the disposal of crypto currency should monitor the disposal procedures and flow of crypto currency, establish a mechanism for public disclosure of information, require the third-party institution to issue a disposal report, and ensure the legality of the final flow of the crypto currency, the disposal process, and the procedures involving foreign exchange settlement.

As a product of new technology, crypto currencies have special characteristics different from legal tender and general property. Its concealment and anonymity present specific risks and challenges in judicial proceedings. The current regulations on the judicial disposal of crypto currencies require enhancement, and it is hoped that China will introduce comprehensive regulations and procedures for the judicial disposal of crypto currency as soon as possible to provide a solid legal basis for the unified judicial disposal.

2. Key Impacts to Foreign-Funded Banks under the Amended AML Law

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Overview

On 8 November 2024, the Standing Committee of the National People’s Congress, after three readings, adopted the amended *Anti-Money Laundering Law* (the “**Amended AML Law**”), which will take effect on 1 January 2025 and replace the original *Anti-Money Laundering Law* (the “**Original AML Law**”), in effect since 2007.

In general, most of the amendments adopted under the Amended AML Law have not introduced new regulatory requirements but incorporated those regulatory requirements that have already been provided and implemented for years in the administrative regulations and regulatory rules issued by the People’s Bank of China (**PBOC**) and other competent authorities, though the Amended AML Law has also provided several innovative provisions, such as the extra-territorial application of the Amended AML Law and new regulatory regime for the sharing of AML information (including personal information).

To facilitate your understanding of the Amended AML Law and its implications on foreign-funded banks, we have prepared this note outlining the key amendments made under the Amended AML Law that are particularly relevant to foreign-funded banks’ operations.

Key amendments

I. Clarification on the expanded definition of money-laundering activities

Original AML Law	Amended AML Law
Article 2 Anti-money laundering referred to in this Law shall mean the adoption of relevant measures stipulated in this Law to prevent money laundering activities by various means to hide or conceal the source and nature of gains and other proceeds from drug offences, organised crime, terrorist activities, smuggling, corruption and bribery, disruption of financial order, and financial fraud, etc.	Article 2 Anti-money laundering referred to in this Law shall mean the adoption of relevant measures stipulated in this Law to prevent money laundering activities by various means to hide or conceal the source and nature of gains and other proceeds from drug offences, organised crime, terrorist activities, smuggling, corruption and bribery, disruption of financial order, financial fraud, and other crimes.

Article 2 of the Amended AML Law, compared with Article 2 of the Original AML Law, has expressly clarified that the money-laundering activities under the Amended AML Law are not limited to the seven (7) criminal activities specified thereunder. From a regulatory and compliance perspective, such activities to hide or conceal the source and nature of gains and other profits from other crimes, e.g., telecommunications fraud, tax evasion and fraud, shall also be within the scope of money-laundering activities and shall be subject to strict scrutiny by foreign-funded banks.

With the above said, PBOC has, long before the promulgation of the Amended AML Law, expanded

the scope of money-laundering activities and required financial institutions to strengthen their account opening procedures and reporting procedures for suspicious transactions on that basis under the *Notice of People’s Bank of China on Strengthening Administration of Account Opening and Follow-up Control Measures for Suspicious Transaction Reporting* (《中国人民银行关于加强开户管理及可疑交易报告后续控制措施的通知》).

II. Clarification on the expanded scope of AML obligors

Original AML Law	Amended AML Law
<p>Article 35 The scope of specific non-financial institutions that are required to perform anti-money laundering obligations, the specific measures on anti-money laundering obligations to be performed by specific non-financial institutions, and the supervision and administration of such specific non-financial institutions shall be formulated jointly by the State Council anti-money laundering administrative authority and the relevant State Council departments.</p>	<p>Article 64 The following institutions established within the PRC shall perform the anti-money laundering obligations of the specific non-financial institutions prescribed hereunder:</p> <ul style="list-style-type: none"> ■ real estate development companies or real estate agencies providing housing sales, housing purchase and sale brokerage services; ■ accounting firms, law firms, and notary institutions entrusted to handle the purchase and sale of real estates, manage funds, securities, or other assets, manage bank accounts, securities accounts, raise funds for the establishment and operation of enterprises, and act as agents for the buying and selling of business entities for clients; ■ dealers engaged in the spot trading of precious metals and gemstones with value above a prescribed amount; ■ other institutions required to perform the anti-money laundering obligations as jointly determined by the State Council anti-money laundering administrative authority and the relevant State Council departments according to the status of money laundering risks.

Article 35 of the Original AML Law merely provides that the specific non-financial institutions shall perform AML obligations, but does not define the scope of such specific non-financial institutions and leave it to the anti-money laundering administrative authority (i.e., PBOC) and relevant State Council departments for further clarification. Article 64 of the Amended AML Law explicitly clarifies that, real estate development companies, accounting firms, law firms, notary offices, and dealers in precious metals and gemstones that satisfy certain criteria shall perform the AML obligations of specific non-financial institutions under the Amended AML Law.

Notably, prior to the promulgation of the Amended AML Law, PBOC has provided in the *Notice of the General Office of the People’s Bank of China on Strengthening the Anti-Money Laundering Supervision over Specific Non-Financial Institutions* (《中国人民银行办公厅关于加强特定非金融机构反洗钱监管工作的通知》) that real estate development companies, real estate agencies, dealers in precious metals, precious metals exchanges, accounting firms, law firms, notary agencies, and company service providers fall in the scope of specific non-financial institutions and shall perform AML obligations.

III. AML related data protection

1. Confidentiality nature of AML information

Consistent with Article 5 of the Original AML Law and Article 41 of the *Money Laundering and Terrorist Financing Risk Management Guidelines for Corporate Financial Institutions (for Trial Implementation)* (《法人金融机构洗钱和恐怖融资风险管理指引(试行)》), the “**Circular No.19**”, Article 7 of the Amended AML Law reiterates that the identification data and transaction information of the clients and AML investigation information must be kept in strict confidence and must not be provided to any third party unless otherwise provided by laws.

2. Intra-group sharing

Article 37 of the Amended AML Law expressly requires a financial institution that has branches or holdings in other financial institutions at home and abroad, as well as a financial holding company, must coordinate anti-money laundering work at the head office or group level. This constitutes a mandatory legal obligation for financial groups, pursuant to which, foreign-funded banks will be permitted to share AML related information (including personal information) within the group without the need to obtain relevant individuals’ consent under Article 13 of the *Personal Information Protection Law* (《个人信息保护法》), provided that: (i) the banks are required to establish clear mechanisms and procedures for information sharing; (ii) the information must be shared in compliance with relevant data protection laws – the banks will still need to perform other data protection obligations, such as entering into standard contract for cross-border transfer of personal information or opting for other alternative permitted approaches for cross-border transfer of personal information, performing self-assessment, etc.; and (iii) the information shared within the group must be used solely for AML and counter-terrorism financing purposes.

3. Offshore regulators’ request

On the basis of Article 41 of the Circular No.19, paragraph 1 of Article 50 of the Amended AML Law provides that where the onshore financial institutions (including foreign-funded banks in the PRC) are requested by offshore regulators to provide client identification data or transaction information, to seize, freeze, transfer domestic funds or assets, or take other actions, which are not in accordance with the principle of reciprocity or consensus agreement with the PRC, the onshore financial institutions must refrain from acting on the requests of offshore regulators and report to the relevant financial administrative department of the State Council promptly. This echoes the extra-territorial enforcement power of PRC regulators under Article 49 of the AML Amended Law, which is further discussed in paragraph 12 below. Where PRC regulators will be entitled to directly request offshore financial institutions to cooperate to provide AML information or take relevant actions, then the onshore financial institutions should also be permitted to cooperate with the offshore regulators in the jurisdictions where the said offshore financial institutions are located in accordance with the principle of reciprocity or consensus agreement between the PRC and the relevant jurisdictions.

Notwithstanding paragraph 1 of Article 50, paragraph 2 provides that where an offshore regulator, for legitimate regulatory purposes, requests general compliance or operational information, the onshore

financial institutions will be permitted to provide such information after reporting to the financial administrative department of the State Council and competent authorities. It still remains to be clarified what is the scope of the “general compliance or compliance information”, the “financial administrative department of the State Council and competent authorities” and how the reporting should be made. We expect PBOC and the National Financial Regulatory Administration will separately provide guidance in this regard.

Paragraph 3 of Article 50 further provides that the provision of important data and personal information shall comply with relevant provisions under PRC laws. Foreign-funded banks will still need to follow the required formalities and procedures for the cross-border transfer of important data and personal information under other applicable laws when providing such data constituting part of AML related information to offshore regulators.

IV. Identification of Ultimate Beneficial Owners (UBO)

The definition of UBO was not used in the Original AML Law. Article 19 of the Amended AML Law clarifies that the UBO shall refer to the natural person who ultimately owns or actually controls the legal person or unincorporated organization, or enjoys the ultimate benefits of the legal person or unincorporated organization. The standards for the identification of UBOs shall be formulated by the PBOC and relevant departments under the State Council (e.g., the State Administration for Market Regulation (“SAMR”). Foreign-funded banks may refer to the following standards for the identification of UBOs:

1. *Circular on Strengthening Client Identification for Anti-money Laundering (Yin Fa [2017] No.235)* [《关于加强反洗钱客户身份识别有关工作的通知》（银发[2017]235号）];
2. *Circular on Issues concerning Further Improving the Identification of Beneficial Owners* (《关于进一步做好受益所有人身份识别工作有关问题的通知》);
3. *Administrative Measures on Beneficial Owner Information* (《受益所有人信息管理办法》); and
4. *Guidance on Information Filing of Beneficial Owners* (《受益所有人信息备案指南》).

Notably, both market participants (including legal persons and unincorporated organization) and AML obligors are obliged to identify UBOs, specifically:

1. Market participants shall identify and file the information of UBOs when making registrations with local AMRs, and shall update the information of UBOs in a timely manner. Failure to do so may result in measures being taken in accordance with administrative regulations on enterprise registration or be subject to being ordered to rectify or fines imposed by PBOC or its local branches; and
2. AML obligors (including foreign-funded banks) must independently identify and verify the UBOs of their clients, and where any inconsistency or incompleteness is spotted, they shall provide feedback to PBOC in a timely manner.

V. Self-discipline organization

Article 25 provides that AML obligors can establish an AML self-discipline organization which will coordinate with other self-discipline organizations to carry out self-discipline administration on AML matters. It is expected that PBOC will lead and supervise the establishment and operation of the self-discipline organization specifically for AML purposes. AML obligors that have become a member of such organization will need to accept the supervision and abide by the self-disciplinary rules issued by the said organization.

VI. Requirement for AML internal controls

Article 27 of the Amended AML Law requires financial institutions to: (1) establish robust AML internal control systems; (2) assign the responsibility for AML work to a designated internal department or specialized unit that will lead and oversee AML work; (3) regularly assess money laundering risk levels and develop corresponding risk management systems and procedures, as well as establish relevant information systems as needed; and (4) supervise the effective implementation of internal control systems through internal or external audits. In general, these requirements have been provided in several existing PBOC rules (such as the *Measures for the Supervision and Administration of Anti-money Laundering and Counter-terrorism Financing of Financial Institutions (PBOC Order [2021] No.3)* [《金融机构反洗钱和反恐怖融资监督管理办法》(中国人民银行令[2021]第 3 号)], the *Administrative Measures for the Due Diligence of Clients and the Preservation of Clients' Identities and Transaction Records by Financial Institutions* (《金融机构客户尽职调查和客户身份资料及交易记录保存管理办法》) and will not introduce new or additional onerous burdens for foreign-funded banks.

VII. Clients' right to raise objections on AML risk management measures

Articles 4 and 30 of the Amended AML Law require AML obligors (including foreign-funded banks) to take measures in proportion to the money-laundering risks of their clients, and to safeguard the basic and necessary financial services of clients.

Article 39 of the Amended AML Law further entitles clients to raise objections on the risk management measures taken by a financial institution to counter money laundering risks by means of (i) making complaints with the relevant financial institution; (ii) if no response is received from the relevant financial institution within the specified period, or if the client is dissatisfied with the response, making complaints with the PBOC; or (iii) filing a lawsuit against the relevant financial institution. The financial institution receiving the complaint must address the complaint and reply to the client within 15 days, or promptly where the complaint is related to basic and necessary financial services.

VIII. Reiteration of no shifting of liabilities by entrustment of third parties for client due diligence (CDD)

Article 32 of the Amended AML Law has not changed the regulatory position as already provided in Article 17 of the Original AML Law, and reiterated that a financial institution shall not be exempted from its own liabilities where it has entrusted a third party to carry out CDD and such third party does not take required due diligence measures under the Amended AML Law. The entrusted third parties are also required to provide necessary due diligence information to the entrusting financial institutions and

to cooperate with them for constant CDD.

Notably, to facilitate the CDD by financial institutions, PBOC will coordinate with relevant governmental departments (including public security, administration of market regulation, civil administration, tax, immigration administration and telecommunication administration authorities) to provide necessary support for financial institutions to verify clients' identity.

IX. Extended minimum retention period for client identity information and transaction record

Article 34 of the Amended AML Law has significantly extended the minimum retention period for client identification data and transaction information from five (5) years to ten (10) years.

X. AML special precaution measures

Article 40 of the Amended AML Law has introduced a new regulatory regime of AML special precaution measures, which shall be complied with by any entity and individual against the entities and persons on the specified lists (the “**Black Lists**”), i.e., any entity and individual must immediately stop the provision of financial and other services or funds and assets to the entities and persons on the Black Lists and their agents, entities and individuals under their instructions, and entities directly or indirectly controlled by them, and must immediately restrict the transfer of relevant funds and assets. The Black Lists include (i) the list of terrorist entities and individuals identified by the national anti-terrorism leading body and announced by its office; (ii) the list of entities and individuals involved in targeted financial sanctions in the notice of the implementation of the UN Security Council resolution issued by the Ministry of Foreign Affairs; and (iii) the list of entities and individuals identified by the PBOC or in conjunction with relevant state departments as having major money laundering risks and which may cause serious consequences if no measures are taken.

Notably, offshore financial institutions that have opened correspondent bank accounts in the PRC or have other close financial ties with the PRC, if failed to cooperate with PRC regulators for AML investigation, may be enlisted in the Black Lists. Please refer to paragraph 12 below for more detailed information.

XI. AML administrative investigation authority delegated to city level

Article 43 of the Amended AML Law has empowered the city-level branch of PBOC to conduct AML investigations and AML obligors must provide requested documents and information within prescribed timeframe, while under the Original AML Law, the investigation power sits with the provincial level of PBOC or above.

XII. Extra-territorial enforcement

Article 12 of the Amended AML Law has introduced a clause for the extra-territorial application of the Amended AML Law, which provides that money laundering and terrorist financing activities outside the territory of the PRC that endanger the sovereignty and security of the PRC, infringe upon the legitimate rights and interests of citizens, legal persons and other organizations of the PRC, or disrupt the financial order within the PRC shall be dealt with in accordance with the Amended AML Law and relevant laws and regulations, and the legal liabilities shall be pursued accordingly.

Article 49 of the Amended AML Law also imposes an obligation on offshore financial institutions that have opened correspondent bank accounts in the PRC or have other close financial ties with the PRC to cooperate with the investigations initiated by PRC regulators on money laundering and terrorist financing activities in accordance with the principle of reciprocity or the consensus agreement with relevant countries. The violation of such obligation will subject the offshore financial institutions to various administrative actions, including, without limitation, monetary fines, prohibition from engaging in certain business, enlisting in the Black Lists, as a result of which, any entity and individual in the PRC must take AML special precaution measures against such offshore financial institution.

XIII. Enhanced administrative penalties and exemption from liabilities for individuals

1. Article 52 of the Amended AML Law broadens the types of violations and significantly raises the penalty limits. For example, AML internal control-related violations have increased from three (3) to nine (9) categories, and depending on the seriousness of the violations, financial institutions in violation will be subject to order to make corrections, a warning, fines of up to RMB 200,000 or even RMB 2 million in more severe cases, along with possible restrictions or prohibitions on engaging in certain business.
2. Under Article 56 of the Amended AML Law, supervisors are now included as subjects for penalties, with increased fines for responsible directors, supervisors, senior managers, and other directly responsible personnel, reaching up to RMB 1 million per individual.
3. Article 56 of the Amended AML Law has, for the first time, introduced the option of exemption from liabilities for individuals (namely the responsible directors, supervisors, senior managers, and other directly responsible personnel in the AML obligors), whereby the individuals can be exempt from administrative liabilities under the Amended AML Law if they can prove that they have diligently implemented AML measures.

Outlook

The Amended AML Law marks an important step in the development of AML work in China and introduces several innovative regimes which can help foreign-funded banks to better comply with AML related obligations and counter against money laundering risks. However, some issues under the Amended AML Law still remain to be clarified, such as the interactions with offshore regulators and how the Amended AML Law would apply to offshore financial institutions in practice, etc. We will continue to monitor any further updates in these regards and share our insights as appropriate.

3. Insights into the New Strategic Investment Management Measures

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On November 1, 2024, the Ministry of Commerce of the PRC (“**MOFCOM**”) and five other administrative authorities issued revisions to the *Measures for the Administration of Strategic Investment in Listed Companies by Foreign Investors* (the “**Measures**”), which make significant changes to the original version promulgated in 2005. As revised, the Measures lower the thresholds for foreign investment with respect to the scope of investors, asset requirements, investment methods, payment methods for consideration, shareholding ratios, and lock-up periods. The Measures are conducive to further expanding the channels for foreign investment in the securities market, unleashing the potential for attracting investment through strategic investment channels, encouraging foreign investment to conduct long-term and valued investments, and facilitating A-share listed companies to issue shares to foreign investors for mergers and acquisitions. The revisions to the Measures will come into effect on December 2, 2024. In this article, we present our insights into significant aspects of these revisions.

Scope of Strategic Investments subject to the Measures

The Measures apply to foreign investors’ acquisition and medium- to long-term holding of A-shares of listed companies through the new shares issuance to specific investors, shares transfer by agreements, tender offers, and other methods stipulated by national laws and regulations (collectively, “**Strategic Investments**”). Compared with the original Measures, the revisions further expressly allow foreign investors to make Strategic Investments by tender offers.

The Measures do not apply to the following situations:

1. QFII and RQFII investments in listed companies;
2. investments in listed companies by stock connect schemes, such as Shanghai-Hong Kong Stock Connect, Shenzhen-Hong Kong Stock Connect, and Shanghai-London Stock Connect to purchase shares or depositary receipts;
3. acquiring A-shares of listed companies due in the IPO of the invested enterprise;
4. foreign natural persons who meet the relevant requirements buy and sell shares of listed companies in the secondary market or acquire shares of listed companies through equity incentives. For example, foreign natural persons who work in mainland China and whose securities regulatory authorities of the country (region) to which they belong have established a regulatory cooperation mechanism with China Securities Regulatory Commission, acquire shares of listed companies in the secondary market, or foreign employees of domestic listed companies who work overseas may participate in equity incentives of listed companies.

Foreign investors who engage in Strategic Investments in companies listed on the National Equities Exchange and Quotations should refer to the Measures.

Expanding the scope of foreign investors

Consistent with the *Foreign Investment Law of the PRC*, the scope of foreign investors in the revised Measures includes foreign natural persons, allowing foreign natural persons to make Strategic Investments in listed companies. The scope of foreign investors includes foreign natural persons, enterprises, or other organizations. The Strategic Investments in listed companies by the investors from the Hong Kong Special Administrative Region, Macao Special Administrative Region, and Taiwan Province, as well as the Chinese citizens residing abroad, should refer to and comply with the Measures.

Specific requirements of foreign investors

Foreign investors who intend to make Strategic Investments should meet the following three requirements.

	Specific requirements in the revisions	Comparison
Requirement one	<ul style="list-style-type: none"> ■ Foreign enterprises or other organizations shall be established and operated in accordance with the law, with steady and stable financial condition, good credit, mature management experience, completed governance structure, good internal control system, and standardized business behavior. ■ Foreign natural persons shall have the corresponding ability to identify and bear risks. 	The requirements for foreign enterprises or other organizations are consistent with the original Measures. New requirements for foreign natural persons are added.
Requirement two	<ul style="list-style-type: none"> ■ The total actual assets shall be no less than US \$50 million or the total actual assets under management shall be no less than US \$300 million. ■ If the foreign investors become the controlling shareholder of a listed company, the total actual assets shall be no less than US \$100 million or the total actual assets under management shall be no less than US \$500 million. ■ If the total actual assets or the total actual assets under management of foreign enterprises or other organizations do not comply with the above-mentioned assets requirement, but their wholly-owned investor (referring to foreign natural persons, enterprises or other organizations wholly owning the aforementioned entities) applies with the above-mentioned assets requirement, then the foreign investors can conduct Strategic Investment, but at the same time, the wholly-owned investor shall make a commitment or agree with the foreign enterprise or other organization to jointly bear responsibility for the relevant 	<p>This revision reduces the asset requirement for foreign investors which make Strategic Investments as non-controlling shareholders, while the assets requirement for Strategic Investors who become controlling shareholders are consistent with the original Measures.</p> <p>Foreign investors who meet the asset requirement will continue to be allowed to make Strategic Investments through overseas subsidiaries on the premise of jointly bearing responsibility.</p>

	Specific requirements in the revisions	Comparison
	investment activities.	
Requirement three	<ul style="list-style-type: none"> ■ In the past three years, foreign investors have not been subject to any domestic or foreign criminal penalties or serious penalties by regulatory agencies. If the enterprise or other organization has been established for less than three years, it shall be counted from the date of establishment. 	Compared with the original Measures, there is added a new requirement of not being subject to any criminal penalties domestically and internationally.

Cross-border share exchanges – consideration and requirements

The original Measures do not contain relevant provisions on cross-border share exchanges. In principle, mergers and acquisitions of domestic enterprises through cross-border share exchanges were required to be the equity of overseas listed companies, according to the *Provisions on Merger and Acquisition of Domestic Enterprises by Foreign Investors*. As revised, the Measures broaden the consideration eligible for cross-border share exchanges to attract foreign investors to make Strategic Investments in listed companies through cash, equity, and other means and also to facilitate the acquisition of overseas assets by A-share listed companies through cross-border share exchanges. Meanwhile, taking into account the existing regulatory rules for issuance to specific investors and tender offers to ensure the fairness of the transaction, foreign investors are allowed to use the shares of either overseas listed companies or non-listed companies as the payment consideration for Strategic Investments implemented through the issuance to specific investors of new shares and tender offers. However, only the shares of overseas listed companies can be used as payment consideration for Strategic Investments executed through shares transfer by agreements.

Referring to the relevant conditions for cross-border share exchanges according to the *Provisions on Merger and Acquisition of Domestic Enterprises by Foreign Investors*, the revised Measures stipulate that foreign investors who make Strategic Investments in listed companies by means of cross-border share exchanges should further comply with the following requirements:

1. the overseas company shall be legally established, the place of registration has a consummate corporate legal system, and the overseas company and its management have not been seriously punished by domestic or foreign regulatory authorities in the past three years; if the Strategic Investment is conducted through shares transfer by agreements, the overseas company must be a listed company;
2. the foreign investors legally hold the equity of the overseas company and can be transferred according to laws and regulations, or the new shares legally issued by foreign investors;
3. comply with the *Securities Law of the PRC*, the *Company Law of the PRC* and the relevant regulations of the State Council, the securities regulatory authority of the State Council, the stock exchanges and securities registration and clearing institutions;
4. comply with the relevant regulations of the state on overseas investment management and complete

relevant procedures.

Under the above circumstances, when the foreign investors conduct the registration formalities for the acquired shares of the A-share listed company, the foreign investors shall submit the certification materials that the relevant formalities for the domestic investors' overseas investment have been completed, which means, the overseas investment formalities for the domestic investors to acquire the shares of the overseas company in the cross-border share exchanges payment shall be completed before the foreign investors acquire the shares of the A-share listed company.

The use of unlisted overseas company shares as transaction consideration is subject to certain rules to ensure fairness in the transaction. According to relevant provisions of the *Company Law of the PRC*, and the relevant provisions of listed companies refinancing and asset acquisition, the shares of overseas companies used as consideration for the subscription of new shares issued by A-share listed companies shall be appraised, and the listed companies and their intermediaries are required to fully verify and disclose the assets, financial situation, and basis for valuing the overseas companies whose shares are to be used as consideration. As for tender offers, according to the relevant provisions of the *Measures for the Administration of Acquisition of Listed Companies*, foreign investors shall provide audited financial accounting reports for the past three years and share a valuation report of the overseas company to which the consideration shares belong, cooperate with the due diligence work of the independent financial consultant hired by the listed company, and at the same time provide cash options to shareholders of the listed company participating in the tender offers.

Shareholding ratio

The original Measures stipulated the first Strategic Investment involving a foreign investor should involve more than 10% of the listed company's equity.

The revised Measures do not set up additional shareholding ratio requirements for foreign investors that make Strategic Investments, but retain the shareholding ratio consistent with the requirements for such transactions, namely:

1. there is no shareholding ratio requirement for issuance to specific investors, but if foreign investors participate as strategic investors in the issuance of a listed company, the foreign investors should still comply with the requirements of *Opinions No.18 on the Application of Securities and Futures Laws*, which require that strategic investors hold a relatively large proportion shares of the listed companies (the exact amount is unstated);
2. for shares transfer by agreements, the proportion of shares acquired may be no less than 5%;
3. for tender offers, the scheduled acquisition may be no less than 5%.

Lock-up period

The revised Measures reduce the lock-up period from 3 years to 12 months for foreign investors who make Strategic Investments. This shortened lock-up period will not apply to foreign investors whose Strategic Investments were completed before the revisions take effect. The Measures have no special restrictions

on the disposition of A-shares acquired by Strategic Investment, and foreign investors will still need to comply with the relevant regulations on disposing of A-shares.

Foreign investors may make public commitments in accordance with the requirements of intermediaries, listed companies, or related parties. If a Strategic Investment does not comply with the Measures, is made through false statements, or by other unlawful means, the foreign investor is barred for 12 months following rectification of the non-compliance from transferring, donating or pledging the shares of the listed company involved, participating in dividends, exercising voting rights, or influencing the voting of the shares of the listed company.

The 12-month lock-up period notwithstanding, a foreign investor may still be subject to a longer lock-up period in accordance with other laws or regulations. For example:

1. an 18-month lock-up period applies if the foreign investor's Strategic Investment constitutes the acquisition of control of a listed company;
2. an 18-month lock-up period applies if the Strategic Investment of foreign investors, as controlling shareholders, actual controllers or their controlled affiliates of listed companies, or will be controlling shareholders of listed companies by subscribing for the shares issued this time, or as "strategic investors" by "a locked-price issuance";
3. a three-year lock-up period applies for foreign investors who acquire new shares issued by a listed company which result in the shares owned by the foreign investors in the listed company exceeding 30% and the shareholders meeting agrees to exempt the tender offers obligation.

In addition, the wholly-owned investor of an overseas company shall be subject to all the above-mentioned lock-up period where it meets the asset requirements (see Requirement 2 of "Specific Requirements of Foreign Investors" above) but makes a Strategic Investment through an overseas company that does not meet this requirement after the Strategic Investment is completed, and under this circumstance, if the wholly-owned investor transfers the equity of the overseas company, the new transferee should still comply with the foreign investor's requirements stipulated in the Measures, assume the rights and obligations of the wholly-owned investor and the foreign investor in the listed company, and perform information disclosure obligations and other obligations in accordance with the laws and regulations.

Strategic Investments not to require MOFCOM approval or filing

In general, there are no substantive differences between administrative procedures for foreign and non-foreign investors that engage in Strategic Investments with listed companies, whether by issuance to specific investors, shares transfer by agreements, or tender offers.

The revisions to the Measures conform to the *Foreign Investment Law of the PRC*, which entered into effect in 2020 and abolished blanket approval and filing requirements for unique to foreign investors, such as establishing and altering foreign-invested enterprises and Strategic Investments in A-share listed companies. The Measures clarify that foreign investors or listed companies that implement Strategic Investment should submit investment information to the relevant MOFCOM department after the listed company completes the issuance, the shares transfer by agreements, or the tender offers, and when the

shareholding ratio of foreign investors changes by more than 5% or the foreign holding or relative holding position changes after the Strategic Investment is completed, which are consistent with the requirements of the *Foreign Investment Law of the PRC* and the *Measures for Reporting Foreign Investment Information*.

Compliance with other domestic regulatory requirements

In addition to the above-mentioned requirements, shareholding ratio, lock-up periods, and other provisions, foreign investors who make Strategic Investments in A-share listed companies also need to comply with the laws and regulations regarding foreign investment, state-owned assets management, concentrations of undertakings, foreign exchange, taxation, national security review, financial supervision, fulfillment of information disclosure obligations, foreign investment information reporting, and other domestic legal regulatory requirements.

Verification opinions of Third-party Consultants

When making a Strategic Investment, the foreign investors and listed companies should engage financial advisory institutions, sponsors, or law firms ("**Third-party Consultants**"), registered in mainland China comply with provisions of the *Securities Law of the PRC* to conduct a due diligence investigation into the Strategic Investment with respect to the following requirements of the Measures, express clear opinions, and respectively state the number of shares and shareholding ratio of the listed companies acquired and held by the foreign investors and the persons acting in concert with them.

1. compliance with foreign investor requirements;
2. whether the transaction constitutes a cross-border share exchange, and whether it complies with the applicable requirements;
3. whether the investor has made a public commitment to extend the share lock-up period and to restrict share rights with respect to non-compliant Strategic Investments;
4. whether the transaction affects or may affect the national security; and
5. whether the transaction involves the negative list and complies with the relevant requirements for foreign investment.

If a Strategic Investment is conducted through shares transfer by agreements or tender offers, the foreign investor should engage Third-party Consultants to issue a report which verifies these particulars. If the Strategic Investment is conducted through the issuance to specific investors by a listed company, the foreign investor should engage Third-party Consultants to issue a report on 1 to 3, above, and the listed company should engage Third-party Consultants to issue a report on 4 and 5, above.

Conclusion

Foreign investors have made more than 600 Strategic Investments in listed companies since the Measures were first promulgated in 2005, according to a press briefing held by MOFCOM and the five other administrative authorities. In our view, this revision to the Measures will continue to promote China's high-

level opening up and make greater efforts to attract and utilize foreign capital to invest in listed companies, which will contribute to the healthy and stable development of Chinese capital market.

Important Announcement

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