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Highlights and practical reflections on the Administrative Measures of Strategic Investment by Foreign Investors in Listed Companies

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NEWSLETTER

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On 1 November 2024, the Ministry of Commerce (MOFCOM), the China Securities Regulatory Commission (CSRC), the State-owned Assets Supervision and Administration Commission of the State Council (SASAC), the State Administration of Taxation (SAT), the State Administration for Market Regulation (SAMR), and the State Administration of Foreign Exchange (SAFE) jointly issued the Administrative Measures of Strategic Investment by Foreign Investors in Listed Companies (No. 3 of 2024, the "**New Strategic Investment Measures**"), which will come into force on 2 December 2024. On the same day, representatives from those six departments answered questions from reporters about the New Strategic Investment Measures (the "**Answers to Reporters**").

The Administrative Measures of Strategic Investment by Foreign Investors in Listed Companies were originally jointly promulgated in 2005 by MOFCOM, CSRC, SAT, SAMR and SAFE, and were revised in 2015 which generally requires approvals be obtained for foreign investors' strategic investments in listed companies (the "**Old Strategic Investment Measures**").

Since September 2016, the regulatory system for foreign investment has gradually shifted from an approval-based system to a filing-based system. The subsequent implementation of the Foreign Investment Law and its implementing regulations in 2020 marks a new stage for the negative list system and the foreign investment information reporting system for foreign investment access. At the same time, securities regulations and rules for listed companies have also been updated and adjusted. To cope with these changes, MOFCOM issued the Decision on Amending the Administrative Measures for Strategic Investment by Foreign Investors in Listed Companies (Consultation Draft) on 30 July 2018 and then revised and reissued it again on 18 June 2020 (the "**2020 Draft**")". Further, MOFCOM has included in the legislative plan on several occasions the revision of the Administrative Measures for Strategic Investment by Foreign Investors in Listed Companies. On 1 November 2024, the New Strategic Investment Measures, which have been eagerly awaited by the market, was officially promulgated. The New Strategic Investment Measures are of great significance for the institutional regulation of foreign investment and further encouraging foreign investment.

The New Strategic Investment Measures promulgated on 1 November 2024 basically fully reflect the amendments in the 2020 Draft. Those amendments include expanding the scope of investors, adding investable markets, increasing the methods and flexibility for strategic investment, lowering the investment threshold and shortening the lock-up period, simplifying and clarifying approval requirements and processes for strategic investment, and highlighting other regulatory compliance requirements such as national security review. Based on the 2020 Draft, the New Strategic Investment Measures further introduce the method for bidding for new shares, refine the due diligence requirements for intermediary institutions, and introduce a commitment mechanism for foreign investors and a system for forfeiture of rights. In this article, we analyze the key revisions of the New Strategic Investment Measures and their practical impact.

1. Application scope: Expands application scope of foreign investors and clarifying the reference application to the NEEQ

(1) Lowers investment qualification threshold

The New Strategic Investment Measures lower the asset requirements for foreign investors, stipulating that the total actual assets of foreign investors shall not be less than US$50 million or the total actual assets under management shall not be less than US$300 million. Only when a foreign investor becomes the controlling shareholder of a listed company, it is required to meet the same asset criteria as under the Old Strategic Investment Measures, i.e., the total actual assets are not less than US$100 million or the total actual assets under management are not less than US$500 million. Further practice will be needed to clarify how the New Strategic Investment Measures will address the situation where, in the course of the investment, a foreign investor passively becomes a controlling shareholder due to the reduction of shareholdings by other shareholders or other reasons, and such foreign investor does not meet the asset requirements of the controlling shareholder.

The New Strategic Investment Measures also clarify that an unqualified direct investor can still invest through a commitment from or an agreement with its qualified parent company to jointly bear responsibility. The Old Strategic Investment Measures had a similar provision, under which the overseas parent company could submit to MOFCOM a letter of commitment to assume joint and several liability with the direct investor. The New Strategic Investment Measures clarifies the ways in which the overseas parent company assumes responsibility following changes in the functions of the MOFCOM, providing a more actionable guide for practical operations.. Further observation will be needed to see the exact practice requirements on the format and content for commitments and agreements and on the practice requirements for disclosures.

(2) Includes foreign natural persons as foreign investors

The New Strategic Investment Measures include foreign natural persons as foreign investors, which is consistent with the existing legal system for foreign investment. Other than requiring a foreign natural person to have corresponding risk identification and risk bearing capacity, the New Strategic Investment

Measures impose no additional requirements on foreign natural persons to strategically invest in domestic listed companies. Therefore, the other requirements for foreign natural persons should be consistent with the requirements for foreign enterprises and other organizations to strategically invest in domestic limited companies.

Further observation will be needed to see how foreign natural persons are certified and verified as qualified in practice. During the investment, the specific procedures of foreign natural persons participating in transactions, registration and settlement still needs to be clarified in the existing registration and settlement rules.

(3) Clarifies that Chinese citizens residing abroad must comply with the New Strategic Investment Measures

For the first time, the New Strategic Investment Measures clearly stipulate that Chinese citizens who reside abroad must comply with the New Strategic Investment Measures in terms of qualification and procedural requirements when they acquire shares in a listed company in Mainland China through a private placement of new shares, an agreement or a tender offer. Considering that the existing securities trading, registration and settlement rules do not substantially differentiate between Chinese citizens based on whether they have settled abroad or not, it remains to be observed how the New Strategic Investment Measures regulates the increasing and trading of shares of listed companies by overseas resident Chinese citizens who have already participated in securities trading in the domestic securities market.

(4) Clarifies that the NEEQ Market is applicable by reference

In the Notice on Several Measures to Actively and Effectively Use Foreign Investment to Promote High-quality Economic Development issued by the State Council in 2018 and the Detailed Rules for the Agreement on the Transfer of Shares of Companies Listed on the NEEQ System issued by the NEEQ and the China Securities Depository and Clearing Co., Ltd (CSDC) in 2019, foreign investors strategically investing in the NEEQ Market should follow the general provisions applicable to foreign strategic investors in listed companies. However, the New Strategic Investment Measures explicitly stipulate for the first time that foreign investors strategically investing in NEEQ-quoted companies should refer to the New Strategic Investment Measures, formally establishing the regulations under the New Strategic Investment Measures as applicable to foreign strategic investments.

Since the implementation of the Old Strategic Investment Measures, foreign investors have made strategic investments in more than 600 listed companies. However, foreign strategic investment in NEEQ-quoted companies remains relatively rare. The New Strategic Investment Measures with improved policy support should encourage qualified investors to target NEEQ-quoted companies and thus revitalize the NEEQ Market.

2. Investment methods: diversifies investment methods and reduces the shareholding ratio and the lock-up period

(1) Lowers the shareholding ratio

The Old Strategic Investment Measures required foreign investors to acquire more than 10% of the listed company's shares in their initial strategic investment. The New Strategic Investment Measures lower that requirement. For a strategic investment under a transfer agreement or through a tender offer, the foreign investor must acquire more than 5% of the listed company's shares in their initial strategic investment. For a strategic investment through a private placement of new shares, there is no minimum share acquisition required.

This lowered threshold for market entry by foreign investors will enhance market liquidity as part of the government's aim to encourage long-term investment by foreign investors and to respond to investors' demand for greater liquidity. Moreover, when the investment range is between 5% and 10%, foreign investors can consider strategic investments as a feasible investment method together with the QFII and the stock-connects mechanism to improve the flexibility of foreign investment (for detailed discussion, see Part 5 of this article).

(2) Shortens the lock-up period but restricts the transfer of obtained shares by unqualified investors

Although the New Strategic Investment Measures generally shorten the lock-up period for strategic investment by foreign investors from 3 years to 12 months, longer lock-up periods will still need to be observed if another regulation requires a longer lock-up period, such as Article 75 of the Securities Law of the PRC, Article 74 of the Administrative Measures for the Acquisition of Listed Companies, and Article 59 of the Administrative Measures for the Registration of Securities Offering of Listed Companies. Nonetheless, the generally shorter lock-up period will create more efficient capital turnover and greater investment and exit flexibility for foreign investors. These improvements will allow foreign investors to respond more swiftly to market changes and adjust their investment strategies in a timely manner. This is undoubtedly a positive legislative signal and policy benefit for foreign investors.

It is worth noting that the New Strategic Investment Measures prohibit unqualified foreign investors from transferring any shares obtained until 12 months after they have become qualified. This rule binds the fulfillment of foreign investors' qualifications to the extension of the lock-up period, not only extends of the lock-up period for unqualified foreign investors, but also strengthens the information disclosures related to investment qualifications and newly requires foreign investors to make voluntary commitments. If a foreign investor makes a false statement in connection with its investment qualifications, the lock-up period will be extended until the investor fulfills qualifications. It remains to be further observed whether there are other ways to deal with the investor who cannot meet the qualifications due to objective reasons besides the share transfer restriction or limits on the exercise of shareholder rights.

(3) Refines the private placement of new shares in strategic investments and allows participation in the private placement by bidding

The New Strategic Investment Measures stipulate that if a strategic investment is implemented through a private placement of new shares, the foreign investor can subscribe for new shares as an issuance object determined in advance by the board of directors of a listed company, or as an issuance object determined by bidding. According to the previous rules, foreign investors were not allowed to directly participate in the private placement of new shares by A-share listed companies, except for special entities such as QFIIs. After the implementation of the New Strategic Investment Measures, we expect that the CSRC, the Stock Exchanges and the CSDC will amend corresponding rules to incorporate changes under the New Strategic Investment Measures to the private placement of new shares by listed companies, including the criteria for qualified investors and the requirements for opening stock accounts. Since foreign investors are no longer required to acquire a minimum proportion of listed company’s shares in strategic investment through private placement of new shares, and foreign investors can strategically invest through either price-locking or bidding. This flexibility will generally help to increase foreign investors enthusiasm for strategically investing through these methods, but foreign investors will still need to comply with the CSRC's higher qualification requirements for strategic investors under the price-locking method.

(4) Adds tender offer as new investment method to bring more flexibility to foreign strategic investment

The strategic investment methods stipulated in the Old Strategic Investment Measures only included the private placement of new shares and transfer by agreement; whereas, the New Strategic Investment Measures add the tender offer as new strategic investment method. The New Strategic Investment Measures require that no less than 5% of a listed company's shares are acquired in a tender offer. This requirement is consistent with the current provisions of the Administrative Measures for the Acquisition of Listed Companies on tender offers.

In principle, the acquisition of more than 30% of the shares of a listed company will trigger the compulsory tender offer obligation. Although the Old Strategic Investment Measures do not clearly stipulate the tender offer method, cases exist where foreign investors invested through tender offers due to the compulsory tender offer being triggered. For these compulsory tender offer transactions, the New Strategic Investment Measures may have limited impact.

However, for voluntary tender offers, a foreign investor can meet the minimum acquisition requirement by acquiring 5% of a listed company's shares. This will allow foreign investors to retain more flexibility in making strategic investments in listed companies and basically aligns with the methods available to domestic investors.

(5) Allows cross-border share swaps as an investment and payment method

The New Strategic Investment Measures have introduced cross-border share swaps as a new method for foreign strategic investment and payment, which partially reflects the principles outlined in the 2009 Order No. 10 on cross-border share swaps. Meanwhile, the New Strategic Investment Measures clarify that cross-border share swaps are permitted through non-listed foreign companies for strategic investments through tender offers or private placements of new shares.

However, the requirements for a foreign-listed company remain the same for a strategic investment through transfer by agreement. Additionally, the New Strategic Investment Measures stipulate basic requirements for foreign companies.

The purpose behind introducing cross-border share swaps is to encourage foreign investors to strategically invest in listed companies through various methods, including cash and equity. Moreover, the purpose is also to facilitate domestic listed companies in acquiring foreign assets through cross-border share swaps.

When foreign investors use newly issued shares as a payment method for strategic investments in listed companies, they are still subject to the PRC Corporation Law (2023 Revision). It specifies that "a listed company’s holding companies are not allowed to acquire any shares of the listed company." Similar restrictions exist in every stock market's listing rules. Therefore, in a cross-border share swap, a foreign investor must pay attention to the investment scale of the cross-border share swap to avoid the situation where a PRC-listed company becomes a controlling shareholder of the foreign investor.

In the context where a listed company issues new shares to purchase assets, if such assets involved equity in domestic enterprises held by foreign investors, it is still unclear whether such circumstances will be subject to the "New Strategic Investment Regulations. In many previous cases, intermediary institutions have issued opinions that the Strategic Investment Measures are inapplicable; however, the Administrative Departments of Commerce have held the opposite view. The New Strategic Investment Measures have not clarified which view should prevail.

Furthermore, some practitioners might interpret the permission under the New Strategic Investment Measures for foreign investors to use an equity interest in a foreign company as a payment method to mean that similar payments using an equity interests in a domestic company should also be subject to the New Strategic Investment Measures. If these payments with domestic company shares are subject to the New Strategic Investment Measures, foreign investors will need to meet all the requirements and thresholds under the New Strategic Investment Measures. This added regulatory burden could affect whether an intermediary institution issues an opinion for these transactions.

3. Investment Process: Simplifies the procedures and processes for foreign strategic investment

(1) Eliminates the MOFCOM approval requirement and aligns with other legal and regulatory requirements

The New Strategic Investment Measures eliminate the MOFCOM approval requirement stipulated in the Old Strategic Investment Measures. Instead, the New Strategic Investment Measures require foreign investors or listed companies to report investment information to the administrative departments of commerce upon completing the strategic investment. In connection with this change, the New Strategic Investment Measures have also eliminated all provisions linking the transaction completion timeline to the MOFCOM approval and the opening of foreign exchange accounts with MOFCOM. Finally, any related procedural requirements for filing and registration have been eliminated.

As for information reporting, the New Strategic Investment Measures require foreign investors or listed companies making strategic investments to report investment information to the administrative departments of commerce if: the investment changes either the foreign investor's shareholding ratio by more than 5% or the foreign party's controlling or relative controlling position.

These revisions align with the existing foreign investment system and resolve inconsistencies in how authorities functioned under the Old Strategic Investment Measures.

For specific investment procedures, the process for foreign investors to make strategic investments through transfer by agreement, private placements of new shares, or tender offers is mostly the same to the domestic investors.

At the same time, the New Strategic Investment Measures clarify that foreign investors engaging in strategic investments must comply with various domestic regulatory requirements. Those requirements include ones addressing foreign investment access, state-owned asset management, concentration between undertakings, foreign exchange, taxation, security examination, financial regulation, information disclosure, and foreign investment information reporting. This clarification aligns the New Strategic Investment Measures with the existing regulatory framework, reflecting equal treatment between domestic and foreign investors.

(2) Removes the requirement for company resolutions

The New Strategic Investment Measures no longer require listed companies to have board and shareholder resolutions approving a strategic investment if the investment is made through a tender offer or a transfer by agreement because the listed company itself is not a party to the transaction. However, the resolutions are still required if the strategic investment is made through a private placements of new shares because it involves increasing the listed company's share capital.

For a strategic investment made through a tender offer or a transfer by agreement, no longer needing board or shareholder resolutions to approve the investment is helpful in simplifying the transaction procedure therefore shortening the transaction timeline. However, if foreign investor signs a contract, such as strategic cooperation agreement, with the listed company during the strategic investment process, the deal may be considered as a related-party transaction. In this case, the board must consider whether board and shareholder approvals are required to fulfill information disclosure requirements under the listing rules and the company’s Article of Association.

4. Specifies responsibilities: refines the due diligence responsibilities of domestic intermediary institutions and introduces investor commitments and systems for forfeiture of rights

(1) Requires intermediary institutions to provide professional opinions on foreign strategic investments and conduct a comprehensive compliance evaluation for each foreign strategic investment on an article-by-article basis

The New Strategic Investment Measures formally abolish the prior approval and filing requirements with the administrative departments of commerce for foreign investors making strategic investments. As a result, in practice without these requirements, no competent authority, such as MOFCOM, will examine foreign investor qualifications before the investment. Instead, to mitigate risks, the New Strategic Investment Measures emphasize the due diligence responsibilities of intermediary institutions.

The New Strategic Investment Measures clarify that foreign investors must employ qualified intermediary institutions such as financial advisory institutions, sponsor institutions, or law firms registered in China to conduct due diligence to ascertain whether foreign investors are qualified, whether the investment falls within the negative list, and whether the investment will impose any risks for national security. In addition to providing a professional opinion on each of these aspects, they must fulfill information disclosure requirements. Further, the intermediary institutions must also indicate the total shareholding of the listed company held by foreign investors and their concerted parties through various ways including QFII, RQFII, and the Shanghai-Shenzhen-Hong Kong Stock Connect mechanisms. In sum, The New Strategic Investment Measures require intermediary institutions to conduct a thorough assessment to ensure the foreign strategic investment activities are compliant before the activity is undertaken.

Even though the new regulations allow foreign investors to employ financial advisory institutions, sponsor institutions, or law firms as intermediary institutions, whether each one of these institutions independently issuing professional opinions is enough remains to be further observed in practice.

When issuing an opinion, the intermediary institutions may need to cooperate with foreign regulatory authorities and obtain relevant documents, as well as professional opinions from overseas intermediary institutions, to verify whether foreign investors are qualified under the New Strategic Investment Measures. In practice, the transaction progress and timeline can be affected if the overseas documents or professional opinions fail to fully demonstrate the foreign investor's qualifications or fail to meet any other requirement set by the PRC regulatory authorities.

(2) Introduces voluntary investor commitments and system for forfeiture of rights

The New Strategic Investment Measures introduce a voluntary commitment mechanism regarding foreign investor qualification. Foreign investors may make compliance commitments for their strategic investments based on the requirements set by intermediary institutions, listed companies, or other relevant parties. If a foreign investors completes a foreign strategic investment because of a false representation or other noncompliant act under the New Strategic Investment Measures, the foreign investor can also voluntarily commit to rectify within a specified timeframe and to refrain from transferring shares until it meets all qualification requirements. The foreign investor may also voluntarily relinquish substantive shareholder rights, such as dividend and voting rights. In practice, foreign investors might have concerns about undertaking these voluntary commitments until the specific enforcement being clarified.

(3) Establishes more limited role for Ministry of Commerce

The New Strategic Investment Measures do not establish a clear examination and approval authority for qualifying foreign investors. Instead, the New Measures shift compliance verification to intermediary institutions to conduct due diligence on foreign investor qualifications and to provide supporting opinions. Nonetheless, the administrative departments of commerce may impose after-the-fact restrictions and penalties on foreign investors who have made false representations in connection with their investment qualifications. The administrative departments of commerce have not specified the processes and the frequency for examining foreign investor qualifications.

5. Facilitates foreign investors' multi-channel investments and clarifies the maximum limitation of shareholdings should be calculated according to the consolidated standard

According to the New Strategic Investment Measures, any method for a foreign investor to acquire equity in a listed company as established under other laws and regulations will not be subject to the New Strategic Investment Measures. Instead, those methods are governed under the laws and regulation under which they are established. Those methods exempt from the New Strategic Investment Measures include methods established under the QFII, the stock-connect mechanisms, the IPO of the invested non-listing company, and the trades by qualified foreign natural persons.

However, the Answers to Reporters clarified that the aggregate shareholding restriction on a foreign investor and persons acting in concert with the foreign investor should be calculated on a consolidated basis to avoid violating the negative list. This requirement applies not only to investments subject to the New Strategic Investment Measures, but also to investments subject to rules for QFII/RQFII, Shanghai-Shenzhen-Hong Kong Stock Connect, etc. Moreover, foreign investors subject to foreign investment rules other than the New Strategic Investment Measures, such as the QFII and the Mainland-Hong Kong Stock Connect, must abide by those rules, including the cap on a foreign investor holding a maximum of 10% of the shares in a single listed company.

Additionally, it is worth noting that before the implementation of the New Strategic Investment Measures, due to the threshold limit of 10% of the proportion of strategic investment, a foreign investor who acquired less than 10% of the shares of listed companies could not make the acquisition through a strategic investment; instead, it could only be done through the QFII, a stock-connect or other means. However, after the New Strategic Investment Measures, the investment ratio has been reduced to 5%. By having an investment ratio range between 5% and 10% opened to them, foreign investors will have a more diverse investment path and more strategic choices. Foreign investors will have more flexibility in exit mechanisms, capital entry and exit, corporate governance rights, and investment structures enabling them to adapt to market changes and investment needs.

Conclusion

The New Strategic Investment Measures positively signal the opening up of the securities market to foreign investment, expand access to investors and markets, lower investment thresholds, diversify investment forms, and simplify investment processes. All of which will make domestic capital markets more attractive to high-quality foreign investment. At the same time, the New Strategic Investment Measures also reflect a clear trend away from pre-investment approval toward post-investment supervision, while increasing the role of domestic intermediary institutions to conduct due diligence and ensure compliance. Foreign investors should still adhere to the principle of "medium- to long-term investment," to fully fulfill information disclosure obligations, and to conduct investment activities in accordance with the law. Fangda will continue to monitor how the New Strategic Investment Measures are implemented in practice and will provide our readers with updates.

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