

## Client Alert

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Baker McKenzie FenXun  
A Leading Chinese and  
International Law Joint Platform

For further information, please contact:

Yingzhe Wang  
Partner, Beijing  
+86 10 6505 4641  
[wangyingzhe@fenxunlaw.com](mailto:wangyingzhe@fenxunlaw.com)

Zhi Bao  
Partner, Beijing  
+86 10 6505 4627  
[baozhi@fenxunlaw.com](mailto:baozhi@fenxunlaw.com)

Yingfei Yang  
Partner, Beijing  
+86 10 5649 6002  
[yangyingfei@fenxunlaw.com](mailto:yangyingfei@fenxunlaw.com)

Lawrence Lee, J.P.  
Partner, Hong Kong  
Chairman of the Hong Kong and  
PRC offices  
+852 2846 1980  
[lawrence.lee@bakermckenzie.com](mailto:lawrence.lee@bakermckenzie.com)

Jackie Lo  
Partner, Beijing  
+86 10 6535 3838  
[jackie.lo@bakermckenzie.com](mailto:jackie.lo@bakermckenzie.com)

Christina Lee  
Partner, Hong Kong  
+852 2846 1692  
[christina.lee@bakermckenzie.com](mailto:christina.lee@bakermckenzie.com)

Hang Wang  
Partner, Beijing  
+86 10 6535 3866  
[hang.wang@bakermckenzie.com](mailto:hang.wang@bakermckenzie.com)

Ivy Wong  
Partner, Hong Kong  
+852 2846 2357  
[ivy.wong@bakermckenzie.com](mailto:ivy.wong@bakermckenzie.com)

The A-share market in China is opened to foreign investors to a limited extent. This Q&A discusses three methods for foreign investors to participate in the A-share market: (i) private placement of the shares of listed companies (the "**Private Placement**"), (ii) foreign investors accepting the transfer of shares from existing shareholders of listed companies by agreement (the "**Acquiring by Agreement**"), and (iii) the listed companies issue shares as consideration to purchase the equities of a target company held by foreign investors which results in foreign investors becoming shareholders of listed companies (the "**Equity Restructuring**").

### Questions and Answers on Foreign Investors' Strategic Investment in A-share Listed Companies

According to current PRC laws, the main methods for foreign investors to directly invest in A-share listed companies include:

1. Private Placement;
2. Acquiring by Agreement;
3. Equity Restructuring;
4. Investing through Qualified Foreign Institutional Investor (QFII) / RMB Qualified Foreign Institutional Investor (RQFII);
5. Investing through Shanghai-Hong Kong Stock Connect / Shenzhen-Hong Kong Stock Connect; and
6. Holding shares of listed companies through equity incentive schemes which allocate shares to foreign natural persons.

The Administrative Measures for Strategic Investment by Foreign Investors in Listed Companies (the "**Strategic Investment Measures**") shall be applicable to foreign investors' investment through Private Placement or Acquiring by Agreement. Since Equity Restructuring involves Private Placement, in theory, the Strategic Investment Measures shall also apply to Equity Restructuring. However, in practice, regulatory authorities will generally lower the requirements on foreign investors who participate in the Equity Restructuring, such as investors' qualifications, shareholding percentage, etc. Thus, foreign investors need to communicate with the regulatory authorities on the basis of specific case conditions.

It is also necessary to note that in July 2018, the PRC Ministry of Commerce has issued the Administrative Measures for Strategic Investment by Foreign Investors in Listed Companies (Draft for Comment) (the "**Draft for Comment**"). The Draft for Comment has made important amendments to the Strategic Investment Measures with regard to the foreign investors' qualifications,

shareholding percentages, lock-up period and other matters. Although the Draft for Comment has not been officially implemented yet, in practice, the regulatory authorities have referred to certain provisions of the Draft for Comment. Therefore, it is recommended to communicate the relevant matters with the regulatory authorities in advance in the implementation of specific projects.

## 1. Private Placement

### (1) Are there any requirements on foreign investors' qualifications to participate in Private Placement?

Yes, there are certain requirements. The requirements on foreign investors' qualifications are as follows:

Relevant Provisions in the Strategic Investment Measures	Relevant Changes in the Draft for Comment	Market Practice
a. It is a foreign legal person or other organization which is lawfully established and operates with sound finance, good credit standing and mature management experiences.  b. The total amount of its actual overseas assets shall not be less than USD100 million or the total amount of its actual overseas assets under management shall not be less than USD500 million; or the total amount of actual overseas assets of its parent company shall not be less than USD100 million or the total amount of actual overseas assets managed by its parent company shall not be less than USD500 million.  c. It has a sound governance structure, a well-developed internal control system, and	The Draft for Comment retains several requirements on foreign investors such as sound finance, good credit standing, and conducting business in compliance with laws and regulations. The major changes are as follows:  a. Foreign natural persons who are able to identify and bear risks are allowed to act as strategic investors;  b. The qualification requirements for a foreign investor not to be the controlling shareholder of a listed company are lowered: the total amount of its actual assets is not less than USD50 million or the total amount of its actual assets under management is not less than USD300 million; or the total amount of its de facto controller's actual assets is not	The current Strategic Investment Measures remain effective.

<p>standardized business conduct.</p> <p>d. Domestic or overseas regulatory authorities have not imposed any significant penalty on the investor or its/his/her parent company in the last three years.</p>	<p>less than USD50 million or the total amount of its de facto controller's actual assets under management is not less than USD300 million.</p> <p>However, the qualification requirements for an investor to become a controlling shareholder of a listed company remain unchanged.</p>	
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## (2) How to determine the benchmark date of pricing?

The Rules for the Implementation of Non-public Stock Offerings by Listed Companies (the “**Rules for Non-public Stock Offerings**”) regulates the benchmark date of pricing for Private Placement.

<b>Rules for Non-public Stock Offerings (applicable to listed companies except those on the Growth Enterprise Market (“GEM”))</b>	<b>Interim Administrative Measures for the Issuance of Securities of Listed Companies on the GEM</b>	<b>Market Practice</b>
<p>Benchmark date of pricing is the first day of Private Placement.</p>	<p>The benchmark date of pricing may be either:</p> <ul style="list-style-type: none"> <li>a. The announcement date of the board resolutions regarding the Private Placement; or</li> <li>b. The first day of the issuance period of the Private Placement.</li> </ul>	<p>The Rules for Non-public Stock Offerings does not require GEM companies to comply with it. In practice, however, since the implementation of the Rules for Non-public Stock Offerings from February 2017, even GEM companies are selecting the announcement date of the board resolutions on Private Placement as the benchmark date of pricing.</p>

### (3) How to determine the issue price?

#### Floor Price of Issuance:

The issue price shall not be lower than 90% of the average price of the underlying stocks in 20 trading days preceding the benchmark date of pricing. Companies listed on the GEM may also choose a price which is not lower than 90% of the average price of the underlying stocks on the day before the benchmark date of pricing (but no GEM company choose to use this standard recently).

#### Lock-up Price Issuance:

- Applicable circumstances: the lock-up price issuance should only apply when the targets of issuance are domestic or foreign strategic investors, controlling shareholders or de facto controller of the listed company, or investors who will obtain actual control of the listed company through the issuance (hereinafter collectively referred to as the "**Lock-up Targets**").
- Lock-up price: the issuing price may be determined prior to the issuance (for example, being 95% of the average price of the underlying stocks in 20 trading days preceding the benchmark date of pricing) but shall not be lower than the floor price.

#### Issuance by Inquiry:

- Applicable circumstances: If there are other uncertain targets in addition to the Lock-up Targets, the listed company shall determine the offering price by inquiry.
- The price inquiry shall be led by the underwriter; qualified investors shall make bids on the first day of the issuance and the bids shall not be lower than the floor price. Based on the principle of price priority, the underwriter and issuer shall reasonably determine the final issue price, targets and quantity of shares after book-building.
- Where shares are issued by price inquiry, the foreign investor shall not participate in the price inquiry process but shall accept the price determined by inquiry, which means the price determined by inquiry shall be the foreign investors' subscription price.

### (4) Is there any minimum investment ratio requirement?

Relevant Provisions in the Strategic Investment Measures	Relevant Changes in the Draft for Comment	Market Practice
The initial investment by foreign investors shall be no less than 10% of the issued shares of the listed company.	No minimum investment ratio requirement.	Most recent cases are still following the existing Strategic Investment Measures. Recently, some listed companies have

		obtained oral regulatory opinions agreeing that the proportion of foreign investment could be lower than 10%, but foreign investors still need to confirm with the regulatory authorities on a case by case basis.
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#### **(5) What approvals shall be obtained for Private Placement? How long will it take?**

To participate in Private Placement, a foreign investor shall at least obtain the following approvals:

- a. The board resolutions and the shareholders resolutions of the listed company regarding the introduction of foreign strategic investors through the Private Placement;
- b. Approval issued by the China Securities Regulatory Commission (the “**CSRC**”) regarding the Private Placement.

The current Strategic Investment Measures requires foreign investors to obtain a prior approval from the Ministry of Commerce before making strategic investment in listed companies. However, based on our consultation with the Ministry of Commerce and with reference to the recent cases, the Ministry of Commerce has referred to the Draft for Comment in its approval. In other words, if the listed company is involved in the industries implementing special administrative measures for foreign investment, the approval of competent commerce department shall be obtained. If the listed company is not involved in such regulated industries, it shall complete the foreign investment record-filing procedures after the issuance.

Subject to the CSRC's speed of examination and approval on the Private Placement of listed companies, it usually takes 6-12 months to complete the Private Placement. In case of any change on securities regulatory policies, the time required is highly unpredictable.

## **2. Acquiring by Agreement**

#### **(1) Are there any qualification restrictions on foreign investors' Acquiring by Agreement?**

Yes, there are certain qualification restrictions. Where a foreign investor acquires shares of a listed company through Acquiring by Agreement, it shall also satisfy the foreign strategic investor qualification requirements. Please refer to the above section “**1. Private Placement -- (1) Are there any requirements on foreign investors' qualification to participate in the Private Placement?**” for more details.

#### **(2) What approvals shall be obtained for Acquiring by Agreement? How long will it take?**

Where a foreign investor acquires not more than 30% of the shares of a listed company by agreement and the mandatory general offer is not triggered, the approval procedures for strategic investment by the foreign investor are as follows:

- a. The board resolutions and the shareholders resolutions of the listed company regarding the introduction of foreign strategic investors; and
- b. The confirmation opinion issued by the stock exchange in respect of the share transfer.

In this case, foreign investors do not need to obtain an administrative permit for their investment. The time required is controllable and may take 1 to 2 months approximately.

Where a foreign investor acquires more than 30% shares of a listed company, it will trigger a mandatory general offer according to the *Administrative Measures on Acquisition of Listed Companies*. Given the complexity of a mandatory general offer, for the purpose of this Q&A, Acquiring by Agreement does not include acquiring by general offer.

### **(3) How to determine the purchase price?**

Where a foreign investor acquires the shares of a listed company by agreement, the purchase price shall not be lower than 90% of the closing price of the underlying stocks on the last trading day before the execution date of the agreement.

### **(4) What are the advantages and disadvantages of Private Placement and Acquiring by Agreement?**

#### **a. Use of Investment Funds**

Funds invested by foreign investors into a listed company through Private Placement shall be used for the pre-determined purpose and approved by the CSRC based on the needs of the listed company.

The funds for acquiring existing stocks shall be paid by the foreign investor to the original shareholders of the listed company. Such funds will not be used for business operation of the listed company, and thus will not contribute to the development of the listed company.

#### **b. Time Required**

The Private Placement is subject to the approval of the CSRC, which will take roughly 6-12 months from the date of board resolutions approving the Private Placement.

No examination or approval of the CSRC is required for Acquiring by Agreement. It will take approximately 1-2 months from the date of board resolutions approving the Acquiring by Agreement.

### c. The Time when the Price is Determined

The issue price of the Private Placement will be determined on the first date of the issuance period rather than the execution date of the subscription agreement. The issue price shall not be lower than 90% of the average price of the underlying stocks in 20 trading days preceding the first date of the issuance period.

The price of shares to be acquired through Acquiring by Agreement may be determined on the execution date of the agreement, provided that such price shall not be lower than 90% of the closing price of the underlying stocks on the last trading day before the execution date of the agreement.

## 3. Equity Restructuring

### (1) Whether the Strategic Investment Measures shall apply to the Equity Restructuring?

Equity Restructuring is a private placement in nature and shall be subject to the provisions of the Strategic Investment Measures in theory. However, with reference to market practice, the CSRC has not required the foreign investors involving in Equity Restructuring to meet the requirements of the Strategic Investment Measures, such as investor qualification, shareholding percentages and lock-up period.

### (2) Could a foreign investor invest in the target company to be acquired by the listed company and finally become a shareholder of the listed company?

Theoretically, such operation is feasible. But in practice the following barriers may be encountered:

- a. There is uncertainty on whether the listed company will successfully issue shares for purchase of assets. The listed company may cancel the issuance decision at any time due to market environment, its own conditions and the conditions of the target company, which will result in the failure of the foreign investor's investment.
- b. The issuance of shares for purchase of assets by a listed company is subject to approval by the CSRC. If the foreign investor has invested in the target company for a relatively short period of time, the CSRC may suspect the investment purpose of the foreign investor and the legitimacy of the acquisition of the target company by the listed company.

## 4. Other Considerations

### (1) Where the foreign investor holds more than 5% shares of the listed company, the transactions between the foreign investor and the listed company shall constitute a related party transaction.

According to the Stock Listing Rules of the Shanghai Stock Exchange and the Shenzhen Stock Exchange, legal persons holding more than 5% of the shares of listed companies are related parties of the listed companies. According to the currently effective Measures for Strategic Investment, foreign investors that make strategic investment in listed companies shall hold at least 10% of the

shares of the listed companies. Therefore, after making a strategic investment in a listed company, a foreign investor will become a related party of the listed company, and the transactions between the listed company and the foreign investor will constitute related-party transactions. Main requirements for the approval and disclosure of related-party transactions of listed companies include:

- a. Related-party transactions between a listed company and its related legal person with an aggregate amount of more than CNY3 million and account for more than 0.5% of the absolute value of the audited net assets of the listed company in the latest audit period shall be submitted to the board of directors of the listed company for approval and disclosure;
- b. In addition to prompt disclosure, related-party transactions with an aggregate amount of more than CNY30 million and account for more than 5% of the absolute value of the audited net assets of a listed company in the latest audit period shall also be audited or assessed by an appointed intermediary and the audited or assessed results shall be submitted to the general meeting of the listed company for approval;
- c. Transactions conducted with the same related party or transactions conducted with different related parties on similar related subject matters in the last 12 consecutive months shall be aggregated, approved and disclosed in accordance with the standards in the preceding Item a and Item b.

**(2) Where a foreign investor becomes the controlling shareholder of a listed company, it shall avoid horizontal competition with the listed company.**

The CSRC urges controlling shareholders and de facto controller of listed companies not to operate business identical with or similar to the major business of listed companies (the "**Competing Business**"). In general, in case of any horizontal competition, the controlling shareholder or de facto controller of a listed company shall take the following measures to obtain the approval of the CSRC:

- a. The controlling shareholder sells the Competing Business to the listed company or an independent third party;
- b. The controlling shareholder appoints the listed company to operate the Competing Business and pay management fees to the listed company;
- c. The controlling shareholder fully explains that the Competing Business will not result in competition with the listed company, and shall communicate with regulatory authorities in advance based on the actual situation.

**(3) Are there any restrictions on the withdrawal of foreign investors from the listed companies after their investment?**

Strategic foreign investors' lock-up period for A-shares shall be three years. According to the Draft for Comment, the lock-up period is expected to be changed to 12 months, but such change is subject to the implementation of the final provisions.

After the expiration of the lock-up period, the transfer of shares of listed companies is still restricted. In accordance with the current Strategic Investment Measures, foreign investors that make strategic investment in listed companies shall hold at least 10% of the shares of the listed companies, and the foreign investors will then be deemed as substantial shareholders (a shareholder holding more than 5% shares) of the listed companies. Pursuant to current rules on the transfer of A-shares, substantial shareholders of listed companies shall bear the following obligations:

- a. Where the foreign investors plan to reduce their shares held in the listed company through auction on the stock exchange, they shall report to the stock exchange and pre-disclose their share reduction plans 15 trading days before placing the first sell order. The total number of shares sold by a foreign investor of a listed company through auction on a stock exchange for a period of 90 consecutive days shall not exceed 1% of the company's total shares. At the same time, if foreign investors acquire stocks through Private Placement, the number of the stocks reduced via centralized bidding must not exceed 50% of the stocks acquired through Private Placement in the 12 months after the expiry of the lock-up period.
- b. Where the foreign investors reduce their shares in the listed company by block trading, the total number of shares sold by a substantial shareholder of a listed company through block trading on a stock exchange for a period of 90 consecutive days shall not exceed 2% of the listed company's total shares.
- c. Where foreign investors reduce their shares in the listed company by agreement, the number of shares transferred to a single transferee shall not be less than 5% of the company's total shares.

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[www.bakermckenzie.com](http://www.bakermckenzie.com)  
[www.fenxunlaw.com](http://www.fenxunlaw.com)

Baker McKenzie FenXun (FTZ)  
Joint Operation Office  
Unit 1601, Jin Mao Tower  
88 Century Avenue, Pudong  
Shanghai 200121, PRC

Tel: +86 21 6105 8558  
Fax: +86 21 5047 0020