# China's Foreign Investment Security Review In A Nutshell

## By Llinks Corporate & Compliance Practice Group

On December 19, 2020, China's National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) released the *Foreign Investment Security Review Measures* (hereinafter referred to as the "***Measures***"), which will take effect on January 18, 2021. According to the *Measures*, "foreign investments that affect or may affect national security" shall only be implemented after passing national security review. The *Measures*, as a supplement to the *Foreign Investment Law,* regulate market access and will have substantial impact on foreign investors' investment in specific sectors in China. In this article, Llinks Corporate & Compliance Practice Group analyzes the *Measures* in the form of Q&A.

### Q1: Is national security review a new scheme?

The *Measures* are not the first regulation that prescribes the foreign investment security review. China formally established the foreign investment security review system back in 2011. In February 2011, the General Office of the State Council issued the *Notice on Launching the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (Guobanfa [2011] No. 6)* (hereinafter referred to as the "***Notice***"), marking the establishment of the foreign investment security review system in China. In September 2011, the MOFCOM formulated the *Interim Provisions on the Implementation of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (MOFCOM Announcement No. 53 of 2011)* (hereinafter referred to as the "***Interim Provisions***").

In April 2015, the General Office of the State Council further promulgated the *Trial Measures for the National Security Review of Foreign Investment in Pilot Free Trade Zones (Guobanfa [2015] No. 24)* (hereinafter referred to as the "***Trial Measures***"), which, in

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conformity with the negative list regulatory scheme, stipulate implementation measures for foreign investment national security review in China (Shanghai) Pilot Free Trade Zone, China (Guangdong) Pilot Free Trade Zone, China (Tianjin) Pilot Free Trade Zone, China (Fujian) Pilot Free Trade Zone and other pilot free trade zones.

The *Measures* absorb security review practices in the past 10 years since the security review system was established in 2011, especially those time-tested practices in free trade zones, and make appropriate adjustments to the review authority and scope. **For reference, we compare provisions in relation to the scope, subject matters, and working mechanism prescribed respectively in the *Notice*, the *Interim Provisions*, the *Trial Measures* and the *Measures* at the end of this article.**

As mentioned by a representative from the Foreign Investment Security Review Working Mechanism Office in a press conference, the security review is not a unique practice in China. Other jurisdictions such as the U.S., the E.U., Australia, Germany, Japan, and the U.K. have formulated or updated their respective foreign investment security review schemes.

### Q2: What is the legal basis of the *Measures*?

In accordance with the *Foreign Investment Law* and the *National Security Law*, with a view to achieving the overall national security and development, the *Measures* coordinate development and security, and place equal emphasis on openness and security.

On the one hand, the *Foreign Investment Law* and its implementing regulations formally establish a “pre-entry national treatment plus negative list” regulatory scheme, and put forward the principle that foreign investments that affect or may affect the national security shall be subject to security review. On the other hand, the *National Security Law* also raises that China establishes a national security review and supervision system and mechanism, and carries out national security review of foreign investments, specific items and critical technologies, network information technology products and services that affect or may affect national security, construction projects involving national security issues, and other material matters and activities in order to effectively prevent and resolve national security risks.

### Q3: Which government authority is in charge of foreign investment security review?

A foreign investment security review working mechanism will be established to take the responsibility of organizing, coordinating, and directing foreign investment security review. The Working Mechanism Office is based in the NDRC, jointly led by the NDRC and the MOFCOM, and is in charge of foreign investment security review.

### Q4: What constitutes “foreign investment”?

The *Measures* regulate “foreign investments that affect or may affect national security”.

According to Article 2 of the *Measures*, foreign investments refer to investment activities conducted by foreign investors directly or indirectly within the territory of China, including the following circumstances:
(1) Foreign investors, alone or jointly with other investors, invest in new projects or establish enterprises in China;
(2) Foreign investors acquire equity or assets of domestic enterprises through mergers and acquisitions;
(3) Foreign investors invest in China through other means.

The above definition derives from Article 2 of the *Foreign Investment Law*, which provides that foreign investments refer to investment activities conducted by foreign natural persons, enterprises or other organizations ("foreign investors") directly or indirectly in China, including the following circumstances:
(1) Foreign investors, alone or jointly with other investors, establish a foreign-invested enterprise in China;
(2) Foreign investors obtain shares, equity, property shares or other similar rights and interests of China's domestic enterprises;
(3) Foreign investors, alone or jointly with other investors, invest in new projects in China;
(4) Investment through other methods prescribed by laws, administrative regulations or regulations by the State Council.

Additionally, it is noteworthy that the *Trial Measures* issued in 2015 for free trade zones not only enlarge the scope of regulated transactions from using "M&A" to the broader term of "investment", but also include other forms of investment like investment through VIE, entrusted holding, trust, reinvestment, overseas transaction, lease, and convertible bond subscription.

## Q5: What types of investment are caught by foreign investment security review?

Article 4 of the *Measures* defines the scope of foreign investment security review, which includes two types set out in the chart below.

Type 1: security review is required for all Type 1 investments.
Type 2: security review is required if a foreign investor acquires control of the target company in a Type 2 investment.

The *Measures* do not provide a clear definition of "control". We suggest that foreign investors refer to factors in determining control under the merger control regime of the *Anti-Monopoly Law*.

| | Type 1 | Type 2 |
|---|---|---|
| **Scope** | **Sector:** military industry, military industry accessory and other national defense and security fields<br>**Location:** area surrounding military facilities and military industrial facilities | **Related to national security:**<br>Important agricultural products<br>Important energy and resources<br>Important equipment manufacturing<br>Important infrastructure<br>Important transportation services |

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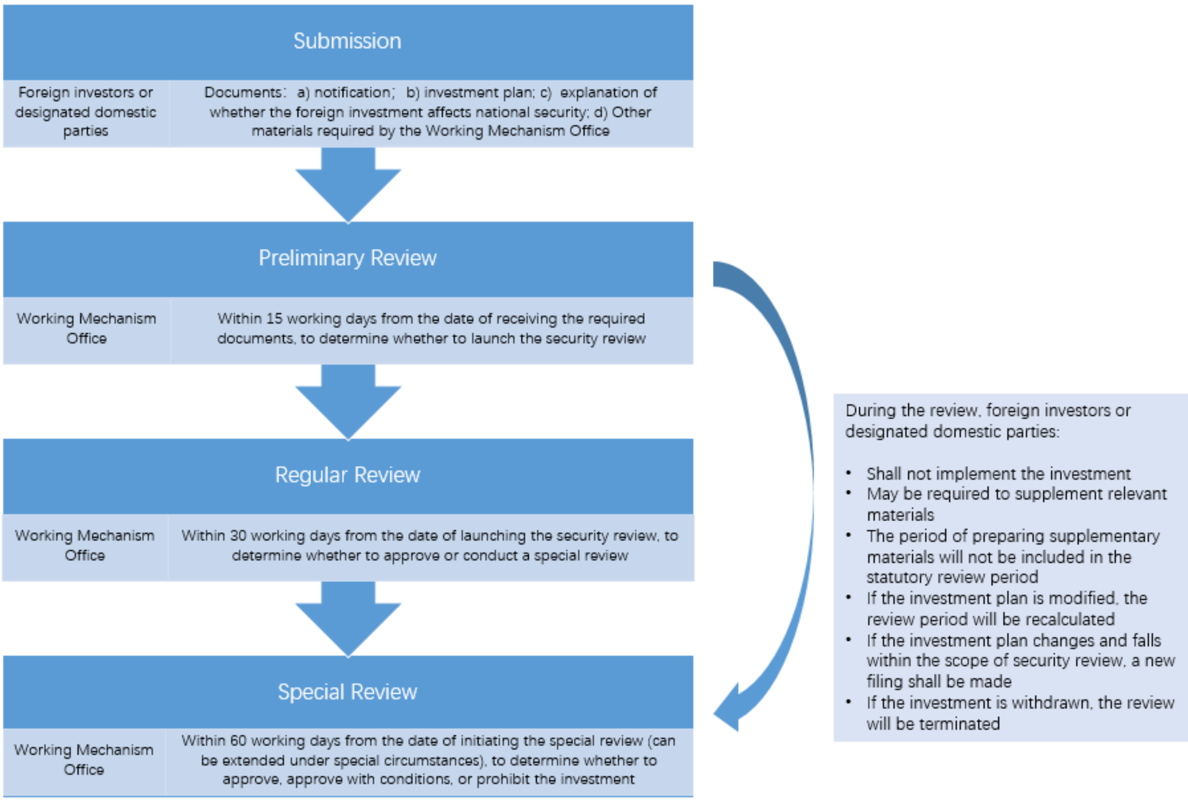
| | | Important cultural products and services<br>Important information technology and Internet products and services<br>Important financial services<br>Critical technologies<br>Other important sectors |
| **Condition** | Foreign investment | Foreign investment + control<br><br>**Control:**<br>a) Where the foreign investor's shareholding in the target company exceeds 50%;<br>b) Where the foreign investor's shareholding in the target company is below 50%, but its voting rights enable the foreign investor to **exert significant influence on resolutions of the board of directors, the board of shareholders or the general meeting of shareholders**; or<br>c) Other circumstances where the foreign investor can **exert significant influence on the target company's operating decision, personnel, finance, technology, etc.** |
| **Prior Consultation** | Foreign investors may consult the Working Mechanism Office[1] on the specific conditions of the project when they cannot determine whether their investment falls within the scope of security review. | |

## Q6: What are the application documents and review procedures for foreign investment security review?

For foreign investments that fall within the scope of security review, foreign investors or designated domestic parties (collectively referred to as "parties") should file with the Working Mechanism Office prior to implementing the investment, and the Working Mechanism Office has the power to mandate filings if the

[1] According to the NDRC's No.4 Announcement in 2019, the government affairs hall of the NDRC is responsible for receiving security review filings. Address: 1st Floor, West Annex Building of National Development and Reform Commission, 5 SanLiHe South, Xicheng District, Beijing. Tel: 010-68501622, 68502979.

parties fail to do so. Relevant agencies, enterprises, social organizations, and the general public may also submit review suggestions (for foreign investments that should have been reviewed but not yet reviewed) to the Working Mechanism Office. The decisions of the Working Mechanism Office include three categories: approval, conditional approval, or prohibition. Please see the chart below for more details on the notification procedures:




## Q7: What is the supervision and punishment mechanism for foreign investment security review?

First, Article 15 of the *Measures* provides a means for public supervision. If relevant agencies, enterprises, social organizations, and the general public consider that a foreign investment affects or may affect national security, they may submit an opinion to the Working Mechanism Office to suggest the office to initiate security review. Second, Articles 16 to 19 of the *Measures* stipulate the punishments for violations such as refusal to notify, falsification, and not implementing additional conditions. The Working Mechanism Office may order the parties to dispose of equity or assets within a time limit, or downgrade the parties' credit ratings in the national corporate social credit system, and consequently impose joint sanctions.

## Q8: Whether foreign investments in securities sector fall into the scope of the Measures?

Article 22 of the *Measures* stipulates that with regard to foreign investors' purchase of stocks of domestic enterprises in the stock market which affect or may affect national security, applicable security review measures will be formulated by securities regulatory authority of the State Council together with the Working Mechanism Office. Such legislation work is in progress.

## "Concluding" Remarks

Notably, in its lame-duck period, the Trump administration has stepped up the suppression of Chinese enterprises during Trump's remaining term of office. On December 18, 2020, 77 entities were added to the "Entity List" by the Bureau of Industry and Security of the U.S. Department of Commerce, most of which are Chinese enterprises, universities and individuals. On December 19, 2020, the *Measures* were officially promulgated. It may not necessarily be a tit-for-tat countermeasure, but the international political environment will undoubtedly influence the future implementation of the *Measures*. Foreign investors are advised to keep a close eye on further development.

**Appendix: Comparison Table of the *Notice*, the *Interim Provisions*, the *Trial Measures* and the *Measures***

| | The *Notice* (2011.3.3) | The *Interim Provisions* (2011.9.1) | The *Trial Measures* (2015.5.8) | The *Measures* (2021.1.18) |
|---|---|---|---|---|
| **Scope** | 1) 外国投资者并购境内军工及军工配套企业，重点、敏感军事设施周边企业，以及关系国防安全的其他单位；<br>2) 外国投资者并购境内关系国家安全的重要农产品、重要能源和资源、重要基础设施、重要运输服务、关键技术、重大装备制造等企业，且实际控制权可能被外国投资者取得。<br><br>"外国投资者并购境内企业"情形：<br>1) 外国投资者购买境内非外商投资企业的股权或认购境内非外商投资企业增资，使该境内企业变更设立为外商投资企业；<br>2) 外国投资者购买境内外商投资企业中方股 | 对于外国投资者并购境内企业，应从交易的实质内容和实际影响来判断并购交易是否属于并购安全审查的范围；外国投资者不得以任何方式实质规避并购安全审查，包括但不限于代持、信托、多层次再投资、租赁、贷款、协议控制、境外交易等方式。 | 总原则：对影响或可能影响国家安全、国家安全保障能力，涉及敏感投资主体、敏感并购对象、敏感行业、敏感技术、敏感地域的外商投资进行安全审查：<br>1) 外国投资者在自贸试验区内投资军工、军工配套和其他关系国防安全的领域，以及重点、敏感军事设施周边地域；<br>2) 外国投资者在自贸试验区内投资关系国家安全的重要农产品、重要能源和资源、重要基础设施、重要运输服务、重要文化、重要信息技术产品和服务、关键技术、重大装备制造等领域，并取得所投资企业的实际控制权。<br><br>"外国投资者在自贸试验区内投资"情形： | 1) 投资军工、军工配套等关系国防安全的领域，以及在军事设施和军工设施周边地域投资；<br>2) 投资关系国家安全的重要农产品、重要能源和资源、重大装备制造、重要基础设施、重要运输服务、重要文化产品与服务、重要信息技术和互联网产品与服务、重要金融服务、关键技术以及其他重要领域，并取得所投资企业的实际控制权。<br><br>"外商投资"情形：<br>1) 外国投资者单独或者与其他投资者共同在境内投资新建项目或者设立企业；<br>2) 外国投资者通过并购方式取得境内企业的股权或者资产；<br>3) 外国投资者通过其他方式在境内 |

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| | 东的股权，或认购境内外商投资企业增资;<br>3) 外国投资者设立外商投资企业，并通过该外商投资企业协议购买境内企业资产并且运营该资产，或通过该外商投资企业购买境内企业股权;<br>4) 外国投资者直接购买境内企业资产，并以该资产投资设立外商投资企业运营该资产。 | | 1) 外国投资者单独或与其他投资者共同投资新建项目或设立企业;<br>2) 外国投资者通过并购方式取得已设立企业的股权或资产;<br>3) 外国投资者通过协议控制、代持、信托、再投资、境外交易、租赁、认购可转换债券等方式投资。 | 投资。 |
| **Subject matters** | 1) 对国防安全，包括对国防需要的国内产品生产能力、国内服务提供能力和有关设备设施的影响;<br>2) 对国家经济稳定运行的影响;<br>3) 对社会基本生活秩序的影响;<br>4) 对涉及国家安全关键技术研发能力的影响。 | / | 1) 对国防安全，包括对国防需要的国内产品生产能力、国内服务提供能力和有关设施的影响;<br>2) 对国家经济稳定运行的影响;<br>3) 对社会基本生活秩序的影响;<br>4) 对国家文化安全、公共道德的影响;<br>5) 对国家网络安全的影响;<br>6) 对涉及国家安全关键技术研发能力的影响。 | / |

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| **Working mechanism** | 外国投资者并购境内企业安全审查部际联席会议，在国务院领导下，由国家发展改革委、商务部牵头，根据外资并购所涉及的行业和领域，会同相关部门开展并购安全审查。 | / | 外国投资者并购境内企业安全审查部际联席会议，国家发展改革委、商务部根据外商投资涉及的领域，会同相关部门开展安全审查。 | 外商投资安全审查工作机制，工作机制办公室设在国家发展改革委，由国家发展改革委、商务部牵头。 |

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