A New Era of Filing Supervision for Overseas Securities Offering and Listing by Domestic Companies is around the Corner

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On 17 February 2023, approved by the State Council, China Securities Regulatory Commission ("**CSRC**") released new regulations for the filing-based administration of overseas securities offering and listing by domestic companies (the "**New Filing Rules**"), which will come into effect on 31 March 2023. The New Filing Rules consist of 6 documents, including *the Trial Administrative Measures of Overseas Securities Offering and Listing by Domestic Companies* (**the "Trial Measures"**) and 5 supporting guidelines[1]. The *Trial Measures* mainly provide for the regulatory system, filing requirements and legal liabilities, while the 5 supporting guidelines further clarify and refine the application of regulatory rules, content and form of filing materials, the content of the report, communication regarding the filing, and filing by overseas securities companies.

Since 31 March 2023, the *Special Provisions of the State Council Concerning the Overseas Offering and Listing of Shares by Companies Limited by Shares* ("**Special Provisions**")(issued by Order No. 160 of the State Council of the People's Republic of China on 4 August 1994) and the *Notice of the State Council on Further Strengthening the Administration of the Offering and Listing Overseas (State Council Announcement [1997] No. 21)*("**Red Chip Guidelines**") shall be repealed simultaneously, which symbols a new era of China's regulations on domestic companies' lawful use of overseas capital markets.

[1] The 6 documents is consisted of:

(1) *Trial Administrative Measures of Overseas Securities Offering and Listing by Domestic Companies;*

(2) *Guideline NO.1 on the Application of Regulatory Rules on Overseas Securities Offerings and Listings ("**Guideline NO.1**");*

(3) *Guideline NO.2 on the Application of Regulatory Rules on Overseas Securities Offerings and Listings: Content and Form of Filing Materials ("**Guideline NO.2**");*

(4) *Guideline NO.3 on the Application of Regulatory Rules on Overseas Securities Offerings and Listings: Content of the Report;*

(5) *Guideline NO.4 on the Application of Regulatory Rules on Overseas Securities Offerings and Listings: Communication regarding the Filing ("**Guideline No. 4**");*

(6) *Guideline NO.5 on the Application of Regulatory Rules on Overseas Securities Offerings and Listings: Filing by Overseas Securities Companies.*

This article briefly summarizes and analyzes the *Trial Measures* and the related issues of indirect overseas securities offering and listing by domestic companies for your reference.

I. Summary of the *Trial Measures*[2]

The *Trial Measures* comprises 6 chapters with 35 articles, summarized as follows:

Main Systems	Summary
1. Refining institutions for overseas offering and listing to implement reforms.	(1) The scope of application is specified. Both direct and indirect overseas offering and listing activities are subject to regulation, and the circumstances are clearly defined, where provisions for direct and indirect overseas offering and listing by domestic companies apply.
	(2) Domestic companies that offer and list securities overseas shall refine their corporate governance, financial and accounting practices, and abide by national secrecy laws and provisions.
	(3) Institutional arrangement such as the negative list system is created. A domestic company is prohibited from offering and listing securities in overseas markets where the intended securities offering and listing falls under specific clauses in national laws, administrative regulations and relevant state rules prohibiting such public financing activities, where the intended overseas offering and listing may endanger national security, where criminal offenses may be involved, where the domestic company is under open investigations for suspicion of criminal offenses or major violations of laws and regulations, or where there are material ownership disputes. If the intended overseas offering and listing necessitates a national security review (NSR), relevant security review procedures shall be fulfilled in accordance with law before submitting offering and listing applications to overseas parties such as securities regulatory agencies and trading venue.
	(4) Filing requirements are specified. Domestic companies offering and listing securities overseas shall undergo filing procedures and submit relevant documents within prescribed period of time. Requirements for filing entities, time points and procedures are specified. It is stipulated that filing documents shall be truthful, accurate and complete, and that securities companies, securities service providers and practitioners providing services to such overseas offering and listing shall guarantee the truthfulness, accuracy and completeness of the documents they produce and issue.

[2] Prepared according to the *Trial Measures* and *Notes on the Trial Administrative Measures of Overseas Securities Offering and Listing by Domestic Companies*.

2. Refining the regulatory system and strengthening regulatory coordination.	(1) Regulatory responsibilities are clearly defined. The CSRC shall exercise regulation according to law over the activities of overseas offering and listing by domestic companies, and the CSRC, together with competent authorities under the State Council, take responsibility for the supervision and regulation over the issuing companies, securities companies and securities service providers. A supervisory and regulatory coordination mechanism is created, with a view to strengthening policy reconciliation, regulatory coordination and cross-agency information sharing.
	(2) Provisions for regulatory measures and legal liabilities are refined. The *Trial Measures* lays out requirements for the reporting of material events. It is stipulated that the CSRC and competent authorities under the State Council may carry out supervisory inspections or investigations, and may impose administrative regulatory measures including order for correction, regulatory talks and warning letters, proportionate to the severity of the violations. The *Trial Measures* defines the legal liabilities for breaches such as offering and listing securities overseas without fulfilling filing procedures, and heightens the cost for offenders by enforcing accountability with administrative penalties and incorporating compliance status of relevant market participants into the Securities Market Integrity Archives.
	(3) Arrangements for cross-border regulatory cooperation are improved. It is required that the CSRC and competent authorities under the State Council shall, under the principle of reciprocity, step up supervisory and regulatory cooperation with overseas securities regulators and competent authorities; the *Trial Measures* also requires the establishment of a filing information sharing mechanism and specified requirements for cross-border investigative evidence-gathering, with a view to promoting joint efforts to crack down on cross-border illegal and in-compliant activities.
3. Strengthening institutional inclusiveness and deepening opening-up.	(1) Restrictions on issuer eligibility is relaxed. Giving consideration to the practice of and market demands for enhancing capital markets opening-up, the *Trial Measures* allows domestic companies to offer securities to specific domestic investors when directly offering and listing securities in overseas markets for certain purposes including employee stock ownership plans (ESOPs) and purchasing assets with offered securities.
	(2) "Full circulation" arrangements are laid out. For the overseas offering and listing by a domestic company, holders of its domestically-based unlisted shares are allowed after filing to convert the shares into overseas listed shares to be circulated on overseas trading venues.

	(3) Currency requirements are relaxed. Domestic companies offering and listing securities overseas are allowed to raise funds and pay dividends in RMB, with a view to meeting the companies' demands to raise RMB funds overseas and promoting RMB internationalization.

II. Key Points regarding Indirect Overseas Listing and Offering by Domestic Companies

1) Indirect overseas Offering and Listing are Explicitly Regulated by the New Filing Rules

According to Article 2 of the *Trial Measures*, indirect overseas offering and listing by domestic companies refer to such overseas offering and listing by a company which is an overseas incorporated entity, whose major business operations are located domestically, and the offering and listing by which are based on the underlying equity, assets, earnings or other similar rights of a domestic company. According to Article 14, where a domestic company seeks to indirectly offer and list securities in overseas markets, the issuer shall designate a major domestic operating entity, which shall, as the domestic responsible entity, be filed with the CSRC. Therefore, both the direct and indirect overseas offering and listing by domestic companies must be filed with the CSRC for unified supervision.

2) Substance over Form: Clear Principles and Criteria for Determination of Indirect Overseas Offering and Listing

The New Filing Rules clarify that the determination as to whether or not an overseas offering and listing by domestic companies are indirect, shall be made on a substance-over-form basis, as well as setting the corresponding determination criteria, thus reducing regulatory blind spots while avoiding regulatory generalization. Specifically, according to Article 15(1) of the *Trial Measures*, any overseas offering and listing made by an issuer that meet <u>both</u> the following conditions will be determined as indirect:

(1) 50% or more of the issuer's operating revenue, total profits, total assets or net assets as documented in its audited consolidated financial statements for the most recent accounting year is accounted for by domestic companies; and

(2) the main parts of the issuer's business activities are conducted in mainland China, or its principle business office is located in mainland China, or the senior managers in charge of its business operation and management are mostly Chinese citizens or domiciled in mainland China.

In addition, *Guideline NO.1* provides in the section of the filing scope that if an issuer does not meet the conditions specified in Article 15(1) of the *Trial Measures* (i.e., it does not meet the criteria for indirect overseas offering and listing), *but submits an application for offering and listing in the overseas market in accordance with the relevant regulations for non-domestic (or regional) issuers thereof, and the risk factors disclosed accordingly are mainly related to mainland China, the securities company and the issuer's domestic legal counsel shall follow the principle of substance over form in accordance with*

Article 15(2) of the Trial Measures to make a comprehensive argumentation and identify whether the issuer falls within the filing scope.

3) Clarifying the Filing Requirements for Indirect Overseas Offering and Listing

The *Trial Measures* provide clearer provisions on indirect overseas offering and listing, and the five supporting guidelines also provide more detailed instructions on the filing requirements. For example, Guideline No. 2 stipulates that when it comes to indirect overseas offering and listing, the filing report and domestic legal opinion should provide detailed explanations. Specifically, for companies conducting indirect overseas offering and listing, the filing report should include information on *the acquisition of domestic enterprises' assets and equity, the relevant procedures, the beneficiaries of the main domestic operating entities* (as determined in accordance with relevant regulations of the People's Bank of China and the State Administration for Market Regulation), etc. Besides, if it involves a contractual control structure, the issuer shall provide detailed explanations in the section of business operation and corporate governance of the issuer, which should include:

(1) the reasons and specific arrangements of the contractual control structure, including the basic information of each legal entity involved, core terms of the main contracts, and transaction arrangements;

(2) the risks relating to control, breaches by related parties, tax and so on that may arise from the contractual control structure; and

(3) arrangements for risk response measures.

Moreover, Guideline No. 2 also requires the domestic legal counsel of the issuer using a contractual control structure to provide explanations on the following aspects:

(1) the participation of foreign investors in the issuer's business operation and management, such as the appointment of directors;

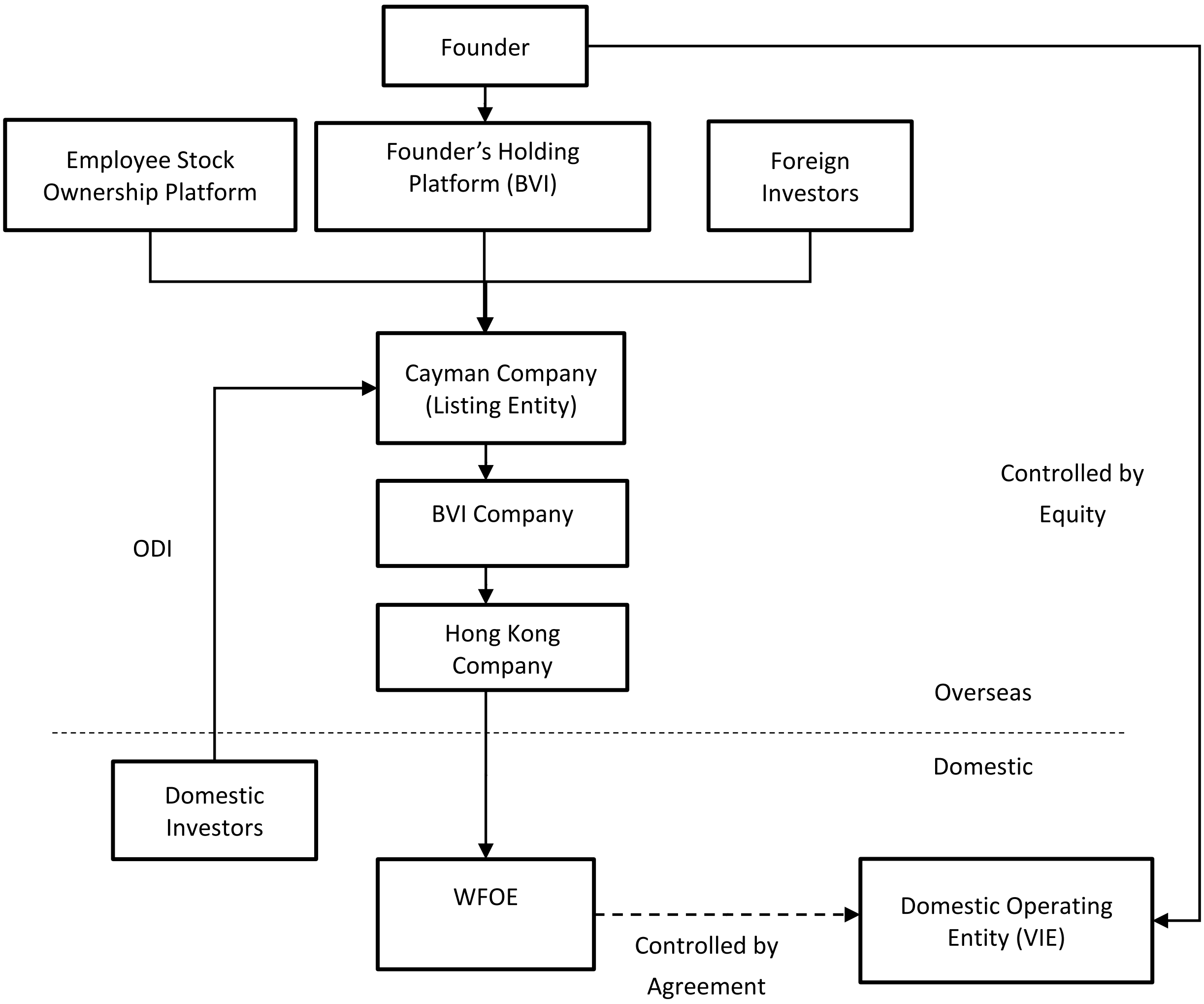
(2) whether there are circumstances where domestic laws, administrative regulations and relevant regulations explicitly prohibit the use of contractual control structure to control business, licenses, qualifications, etc.;

(3) whether the domestic operating entities controlled under the contractual control structure are subject to foreign investment security review, and whether they are involved in industry sectors where foreign investment is restricted or prohibited.

Thus, as a typical approach for indirect overseas offering and listing, the contractual control structure (i.e. "VIE structure") also falls within the scope of filing supervision.

III. Prospects for Domestic Enterprises Using VIE Structure Conducting Indirect Overseas Offering and Listing to File with CSRC

The VIE (i.e. Variable Interest Entities) structure, also known as the contractual control structure, refers to the way in which the actual controller controls the operating entities through various agreements rather



than by holding equity. The VIE structure (a common diagram for VIE structure is shown below) is mainly used by domestic enterprises to issue securities overseas, seek financing, or solicit foreign investors while avoiding China's regulatory restrictions on foreign investment in restricted or prohibited industry sectors. Although the VIE structure has been around for a long time, China's regulatory attitude towards it has been "ambiguous". However, with the promulgation of the *Trial Measures*, the spokesperson of the relevant department of the CSRC made it clear on 17 February 2023, in response to questions from reporters, that "the CSRC will accept filings from legitimate and compliant VIE structured enterprises conducting overseas offering and listing".

1) CSRC has announced that it will accept filings for the overseas offering and listing of VIE-structured companies that meet compliance requirements

In response to a question from reporters on whether VIE-structured companies can be filed for overseas listing, the CSRC spokesperson stated, "For the overseas listing of VIE-structured companies, the filing management will adhere to the principles of marketization and legalization, and strengthen the regulatory coordination. The CSRC will solicit opinions from relevant regulatory authorities and accept filings from VIE-structured companies listed overseas that meet compliance requirements, and support such companies in using both domestic and overseas market resources for sound growth." We note that the prerequisite for VIE-structured companies to be allowed to file for overseas listing is to "meet compliance requirements."

2) Indirect overseas offering and listing through VIE structure shall be regulated in accordance with the *Trial Measures*

As mentioned above, the *Trial Measures* not only require domestic enterprises to file for direct and indirect overseas offering and listing with the CSRC, but also specify the principle of substantive determination to identify indirect overseas offering and listing by domestic enterprises. As a result, by defining "indirect overseas offering and listing", all kinds of indirect overseas offering and listing involving VIE structure shall fall under the supervision. The *Trial Measures* regulates over the fundamental subject of listing – the domestic enterprises, and makes substantive identification on the listing entities, other than distinguishing different situations of indirect overseas listing, so as to carry out unified supervision and management.

3) Companies indirectly listed overseas through VIE structure shall still attend to the restrictions or prohibitions on foreign investment

Regarding the foreign investment access issue of domestic companies listed overseas, according to Article 6 of the *Special Administrative Measures (Negative List) for Foreign Investment Access (Edition 2021)* (the "**Negative List**"), to issue shares abroad and list and trade shares overseas, any domestic enterprise engaging in the industry sectors prohibited by the Negative List shall obtain the consent of the relevant competent government authorities. The overseas investors shall not participate in the operation and management of such enterprises, and overseas investors' shareholding percentages in such enterprises shall be subject to the relevant provisions on administration of domestic securities investment by overseas investors. The *Trial Measures* also stipulate that domestic companies listed overseas should comply with relevant regulations on foreign investment, and such requirement to comply with laws and regulations on foreign investment is reiterated in Articles 3 and 9 of the *Trial Measures*. Therefore, for companies conducting business in industry sectors prohibited by the Negative List, if they seek to directly list abroad, approval by the relevant competent authorities of China is still required.

However, for indirect overseas offering and listing, as to whether domestic companies conducting business in industry sectors prohibited by the Negative List and intending to be listed overseas through VIE structure fall within the scope of this provision, the National Development and Reform Commission ("NDRC") stated in a press conference held in January 2022 that "the scope of Article 6 of the *Special Administrative Measures (Negative List) for Foreign Investment Access (Edition 2021)* is limited to domestic companies conducting business in industry sectors prohibited by the Negative List that are directly listed overseas. *For domestic companies that are indirectly listed overseas, the CSRC is currently soliciting public opinions on relevant regulations, and welcomes constructive suggestions from the public. After the requisite procedures for publication of relevant documents have been completed, the relevant government departments will handle relevant issues according to the regulations.”* After the New Filing Rules are effective, as mentioned above, the New Filing Rules require that such domestic companies conducting indirect overseas offering and listing file with the CSRC, and they must comply with relevant regulations on foreign investment. In addition, domestic legal counsel of the issuer shall explain in the special legal opinion whether the domestic operating entities under the contractual control structure arrangement fall within the scope of foreign investment security review, and whether they are conducting business in industry sectors where foreign investment is restricted or prohibited. Therefore, it is possible that these requirements may place certain restrictions on domestic companies using VIE structure to conduct business in industry sectors where foreign investment is restricted or prohibited when they seek overseas listing. However, at the same time, the Hong Kong Stock Exchange, which is favored by domestic companies when seek overseas listing, requires listing applicants using VIE structure to solve restrictions on foreign investors’ ownership in such applicants only when necessary. Otherwise, listing applicants must directly hold the maximum equity interest of domestic companies (i.e. the Narrowly Tailored Principle). Usually, such "necessary circumstances" refer to a domestic entity as the listing applicant conduct business in industry sectors where foreign investment is restricted or prohibited. Therefore, these domestic companies need to demonstrate that they can meet the "compliance requirements" of the CSRC and undergo indirect overseas listing filing, as well as that they meet the Narrowly Tailored Principle of the Hong Kong Stock Exchange for this structure.

Due to the implementation of New Filing Rules, it is possible that the CSRC will consult with the foreign investment regulatory authorities on foreign investment access issues related to domestic enterprises with VIE structures to list overseas, and the opinions from such foreign investment regulatory authorities will be taken into account for the CSRC to decide whether or not to approve the filing. Therefore, if there are any indirect overseas offering and listing involving VIE structures, the issuer is advised to communicate further with the CSRC based on Guideline No. 4 regarding "industry regulatory policies and control structures".

With the end of the *Special Provisions* and the *Red Chip Guidelines*, the promulgation of the New Filing Rules officially marks the beginning of the transformation of the regulatory systems for domestic enterprises seeking overseas offering and listing. Overall, the New Filing Rules released recently have improved the regulatory system for domestic enterprises seeking overseas offering and listing and further established a more stable and predictable regulatory framework. We believe that with the arrival of the era of comprehensive filing supervision, financing by domestic enterprises through overseas offering and listing will usher in a new spring. Meanwhile, we will keep a pulse on the implementation of the New Filing Rules and conduct further discussions on related issues based on specific practices.

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