China Securities Regulatory Commission, Ministry of Finance and State Economic and Trade Commission Notice Regarding Transfer to Foreign Investors of State-owned Shares and Legal Person Shares of Listed Companies

In order to attract advanced foreign management experience, technology and funds, accelerate the steps for the adjustment of the economic structure, improve corporate governance in listed companies, heighten international competitiveness, protect the lawful rights and interests of investors, and promote the healthy development of the securities market, with the approval of the State Council, notification regarding the transfer of state-owned shares and legal person shares to foreign investors is hereby made as follows:

Article 1 The transfer to foreign investors of state-owned shares and legal person shares of listed companies should be in accordance with the following principles:

(a) Comply with national rules and regulations, protect national economic security and the public interest of society, prevent the loss of state-owned assets, and maintain social stability;

(b) Meet the requirements of the strategic adjustment of the arrangment of the state-owned economy, and promote the optimal allocation of state-owned assets and fair competition;

(c) Uphold the principles of openness, justice and fairness, and protect the legal rights and interests of shareholders, particularly medium and small shareholders;

(d) Attract medium and long term investment, defend against short term speculation, and maintain the order of the securities market.

Article 2 The transfer of state-owned shares and legal person shares of listed companies to foreign investors should comply with the requirements of the " Guidance Catalogue for Foreign Investment in Industry". In any [sector] in which foreign investment is prohibited, state-owned shares or legal person shares may not be transferred to foreign investors; where the Chinese party must have a controlling interest or relative control, then after the transfer the controlling interest or relative control position of the Chinese party should be maintained.

Article 3 Foreign investors who are transferees of state-owned shares or legal person shares of listed companies must have relatively strong operations and management capabilities and financial resources, a relatively good financial situation and reputation, and the ability to improve the listed company's corporate governance structure and promote the continued development of the listed company.

In principle, transfers of state-owned shares and legal person shares of listed companies to foreign investors shall use the public competitive price method.

Article 4 Where the transfer of state-owned shares and legal person shares of listed companies to foreign investors relates to industrial policy and the restructuring of an enterprise, the State Economic and Trade Commission shall be responsible for examination and confirmation; when related to the management of state-owned equity, the Ministry of Finance shall be responsible for examination and confirmation; important matters shall be reported to the State Council for approval. The transfer of state-owned shares and legal person shares to foreign investors must comply with the regulations concerning the acquisition of listed companies, information disclosure, etc. of the China Securities Regulatory Commission.

No local or departmental [authority] may on its own approve the transfer of state-owned shares and legal person shares to foreign investors.

Article 5 Using the examination and approval documents regarding the transfer issued by the State Economic and Trade Commission and the Ministry of Finance, and evidence showing payment by the foreign investor, etc., the parties to a transfer should in accordance with the law undertake procedures for transfer registration with the securities registration and clearance authority and for change of shareholders registration at the State Administration of Industry and Commerce. Prior to the payment in full of the transfer price, the securities registration and clearance authority and the State Administration of Industry and Commerce may not undertake the procedures for registration of transfer and change of shareholders.

Article 6 The parties to the transfer of state-owned shares and legal person shares of listed companies to foreign investors should, prior to the actual transfer of shares, undertake foreign investment foreign exchange control registration at the foreign exchange control department; with respect to the re-transfer of equity interests by foreign investors, amendment of the foreign investment foreign exchange registration must be handled at the foreign exchange control department.

Article 7 Foreign investors must make payment of the transfer price in freely convertible foreign exchange. Foreign investors that have already invested domestically may, upon examination and confirmation by the foreign exchange control department, use the Renminbi yuan profits they have received from investment as payment. [Only] twelve (12) months after the payment in full of the transfer price [may] the foreign investor transfer the purchased shares.

Article 8 The transferor should, within the stipulated time period and on the basis of the transfer approval documents, settle the foreign exchange proceeds arising from the transfer of state-owned shares and legal person shares after reporting to the foreign exchange control department for approval.

After a foreign investor takes title to state-owned shares or legal person shares of a listed company, with respect to net profit distributions by the listed company, the proceeds from the re-transfer of the equity interest, and proceeds from the liquidation of the listed company, the foreign investor may, with the examination and approval of the foreign exchange control department, purchase foreign exchange and remit it abroad.

Article 9 After the state-owned shares or legal person shares of a listed company have been transferred to foreign investors, the listed company shall continue to be subject to the original relevant policies, and shall not benefit from treatment applicable to foreign-invested enterprises.

The proceeds arising from the transfer of state-owned shares shall be disposed of and used in accordance with relevant national rules.

Article 10 This stipulations of this Notice shall be applicable to the transfer of state-owned shares and legal person shares of listed companies to investors in the Hong Kong SAR, the Macao SAR and the Taiwan region.

[from "Securities Daily", November 4, 2002]

Transfer of State-owned Shares and Legal Person Shares to Foreign Interests -- 1995 State Council Ban is Reversed

On November 4, 2002, China's "Securities Daily" carried the text of a highly significant Notice ("Notice") promulgated by the China Securities Regulatory Commission ("CSRC"), the Ministry of Finance ("MOF"), and the State Economic and Trade Commission ("SETC") – and approved by the State Council of the People's Republic of China ("PRC" or "China") – on the question of transfers of state-owned share capital and legal person shares[1] in listed companies[2] to foreign interests. We attach the Paul, Weiss translation of this very important Notice, as the text was carried in the "Securities Daily" on November 4, 2002.

The Notice effectively reverses the prohibition in a 1995 State Council-promulgated ban on the sale of state-owned or legal person shares of listed companies to foreign interests, and opens the way for invigorated M&A activity with respect to Chinese corporates, for foreign investors and Chinese owners alike. It is difficult to speculate how and why a Notice of such great import has been released only a few days prior to the convening of the 16th National Congress of the China Communist Party, and whether the fact of this new rule implies the serious reform intent of the incoming leadership, or a gift from the departing leadership.

The following aspects are especially noteworthy:

- Since September 23, 1995, and the promulgation of the Notice of the Office of the State Council Transmitting the Request for Instructions of the State Council Securities Commission Regarding Temporarily Halting the Transfer to Foreign Investors of State Shares and Legal Person Shares in Listed Companies ("State Council Ban"), the transfer of "state-owned shares" and "legal person shares" (regardless of whether any entity

[1] Although the terminology is confusing in both Chinese law and idiomatic usage, the following seems true: "state shares" represent the equity interest of a government department attributable to state equity investment or a lawful transfer of stock, and may be owned only by government departments. "Legal person shares" represent equity attributable to investment of discretionary funds by, or a lawful transfer to, entities that are formal "legal persons", such as companies and certain institutions and social groups. Such legal persons may or may not be in turn state-owned or state-controlled. When they are, the share capital they hold (i.e., indirectly state-owned share capital) is known as "state-owned legal person shares". In formal terms, "state shares" and "state-owned legal person shares" are together known as "state-owned shares". Unfortunately, beginning with the 1995 Notice, reference in regulation has been made to both "state-owned shares" and "legal person shares", which in the latter case may cover more than the state-owned assets authorities really have a right to.

[2] In the Chinese context, "listed companies" are PRC-domiciled issuers which have any part of their issued share capital listed on a stock exchange in the PRC or abroad. All Chinese issuers which are "listed" have a substantial amount of their share capital which is unlisted and relatively illiquid.

affiliated with the state owned or controlled the legal person) issued by PRC companies with any listed stock to foreign interests has been strictly forbidden. (This has been the case even with the promulgation on March 24, 1997 of the intervening Normative Opinion on the Exercise by Holders of State-owned Shares of Share Rights in Companies Limited by Shares ("1997 Opinion") by the now defunct Commission on Restructuring of the Economic System ("CRES") which seemed to allow an affirmative basis for transfer of such share capital -- in fact, the Ministry of Finance has simply not approved any such proposed transfers, citing the State Council Ban as higher authority than the 1997 Opinion.) The Notice, and the reversal of the State Council Ban, confirms in regulation and policy the *ad hoc* approval behind the recently-announced Newbridge purchase of state-owned shares or legal person shares in the A-share listed Shenzhen Development Bank.

- The MOF, in its role as custodian of state-owned assets, has long been a key player in the approval of transfers of state-owned and legal person shares. Its role continues, but new is the involvement of the SETC, which is now empowered to review deals where a transaction relates to "industrial policy and the restructuring of an enterprise". Additionally, the newly-promulgated rules of the CSRC with respect to acquisitions of listed companies must be complied with. The PRC Ministry of Foreign Trade and Economic Cooperation ("MOFTEC") is not referred to in the Notice, even though MOFTEC has direct approval jurisdiction over foreign purchases of equity in Chinese companies limited by shares. This lapse may be a result of the focus in the Notice on state and legal person sellers of equity in listed companies, and probably is not meant to further strip MOFTEC of jurisdiction over such transactions. It seems certain that notwithstanding the provisions of the Notice, MOFTEC will have approval jurisdiction over the subsequent sale by a foreign purchaser of "unlisted foreign capital shares" gained by purchase of state-owned or legal person shares.

- The Notice makes provision for the purchase of state-owned and legal person shares not only by foreign-domiciled investors, but also by China-domiciled foreign-invested enterprises, using Renminbi yuan as consideration. Thus, conceivably foreign investors will be able to establish PRC-domiciled foreign invested enterprise holding companies which can purchase state-owned and legal person shares in listed PRC companies (if they qualify as holding companies under either MOFTEC regulation or the PRC Company Law).

- Foreign investors who purchase state-owned and legal person shares are forbidden from transferring such shares for a twelve (12) month lock-up period after the first purchase and payment in full of the purchase price (thus, for example, any holdback would delay the start of the lock-up period).

- The Notice states that the foreign exchange control authority should allow foreign investors to convert Renminbi yuan proceeds into hard currency and remit the same upon the subsequent sale of an equity interest in a Chinese issuer -- a key allowance as this is a "capital account" transaction. This statement applies to transactions involving true private equity what is already applicable to sales of registered capital interests in foreign-invested enterprises to PRC-domiciled purchasers.

- The issuers of such equity interests will *not* be treated as "foreign invested enterprises" (with respect to certain tax, foreign exchange control, etc. preferences) upon the completion of a transfer transaction, when a foreign investor becomes a shareholder of such company.

- Only upon payment in full by a foreign purchaser will such foreign entity be registered as a shareholder of the issuer (a departure from many other regulations in China, where the foreign investor gains title upon government approval, even prior to any payment of consideration).

- The Notice makes clear that, in principle, transactions implicating the sale of state-owned or legal person shares should be "public" and "competitive". While it seems unlikely that the Notice desires all transactions to be effected via public auction, the language of the Notice would serve to disfavor entirely private, bilaterally negotiated, transactions.

- The Notice contains an overly broad prohibition regarding approvals by "local or departmental authorities" approving the transfer of state-owned shares or legal persons to foreign investors; this is overbroad because the law currently allows for local approvals in certain situations, especially where the issuer has no listed share capital, and the government holdings are deemed to be precisely "local" or "departmental" (i.e., held by an administrative department or Ministry).

- The Notice articulates a concern for the disposition of sale proceeds by sellers of "state-owned shares", but does not speak to similar proceeds arising from the disposition of "legal person shares". This may indicate tacit acknowledgment that certain legal person shareholders, already participants in the private industrial economy, are entitled to keep such proceeds without handing them over to the "state" or any ministry.

- As in all Chinese regulations impacting upon foreign investment, investors domiciled in Hong Kong, Taiwan and Macao are considered "foreign" for the purposes of such transactions.