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Han Kun Newsletter

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Legal Updates

1. Preliminary Analysis of the Measures for Cybersecurity Review

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On January 4, 2022, 13 ministries and commissions, including the Cyberspace Administration of China ("**CAC**") and the China Securities Regulatory Commission ("**CSRC**"), jointly promulgated the Final Measures for Cybersecurity Review (the "**Final Measures**"). The Final Measures are binding and will become effective on February 15, 2022. Overall, the Final Measures follow the basic regulatory framework set out in the Measures for Cybersecurity Review (Revised Draft for Comments) (the "**Draft Measures**") promulgated by such 13 ministries and commissions on July 10, 2021 (for our previous analysis on the Draft Measures, please click *here*). The Final Measures do contain, however, a few key revisions compared to the Draft Measures. This newsletter will briefly analyze these new revisions. We have also attached a comparison between the Final Measures and the Draft Measures for your reference.

The continued use of "listing in a foreign country", which may indicate regulatory intention to exclude operators listing in Hong Kong from the obligation of applying for a mandatory cybersecurity review

The concept of "listing in a foreign country" is retained in the Final Measures, though not further clarified. However, whereas the Regulations on Network Data Security Management (Draft for Comment) issued by CAC on November 14, 2021 (the "**Draft Regulations**") makes a distinction between the standards for a mandatory cybersecurity review for "listing in Hong Kong" and a "listing in a foreign country", the fact that the Final Measures apply the obligation for a mandatory cybersecurity review only to "listing in a foreign country" seems to indicate that the Final Measures intend to exclude Hong Kong listings altogether from mandatory cybersecurity reviews, though this interpretation has yet to be confirmed by regulators in practice. In addition, the Final Measures, prior measures and the Draft Measures all grant regulators the right to initiate cybersecurity reviews ex officio. Therefore, in practice, companies intending to list in Hong Kong may want to voluntarily apply for a cybersecurity review as a precautionary measure if they engage in a substantial amount of sensitive data processing activities. As with the Draft Measures, the Final Measures require CAC to respond within ten business days following the receipt of an application for cybersecurity review on whether there is a need for such review.

Like the Draft Measures, the Final Measures do not specify their scope based on the method of listing. The Final Measures only state that they apply to "application materials for listing such as an IPO". However, we are still inclined to believe that aside from traditional IPOs, Chinese companies proposing to list in the U.S. via SPACs (Special Purpose Acquisition Companies), RTO (Reverse Takeovers), direct listings and other methods should proactively apply for a cybersecurity review.

Entities subject to cybersecurity reviews when listing in a foreign country changed to "online platform operators"

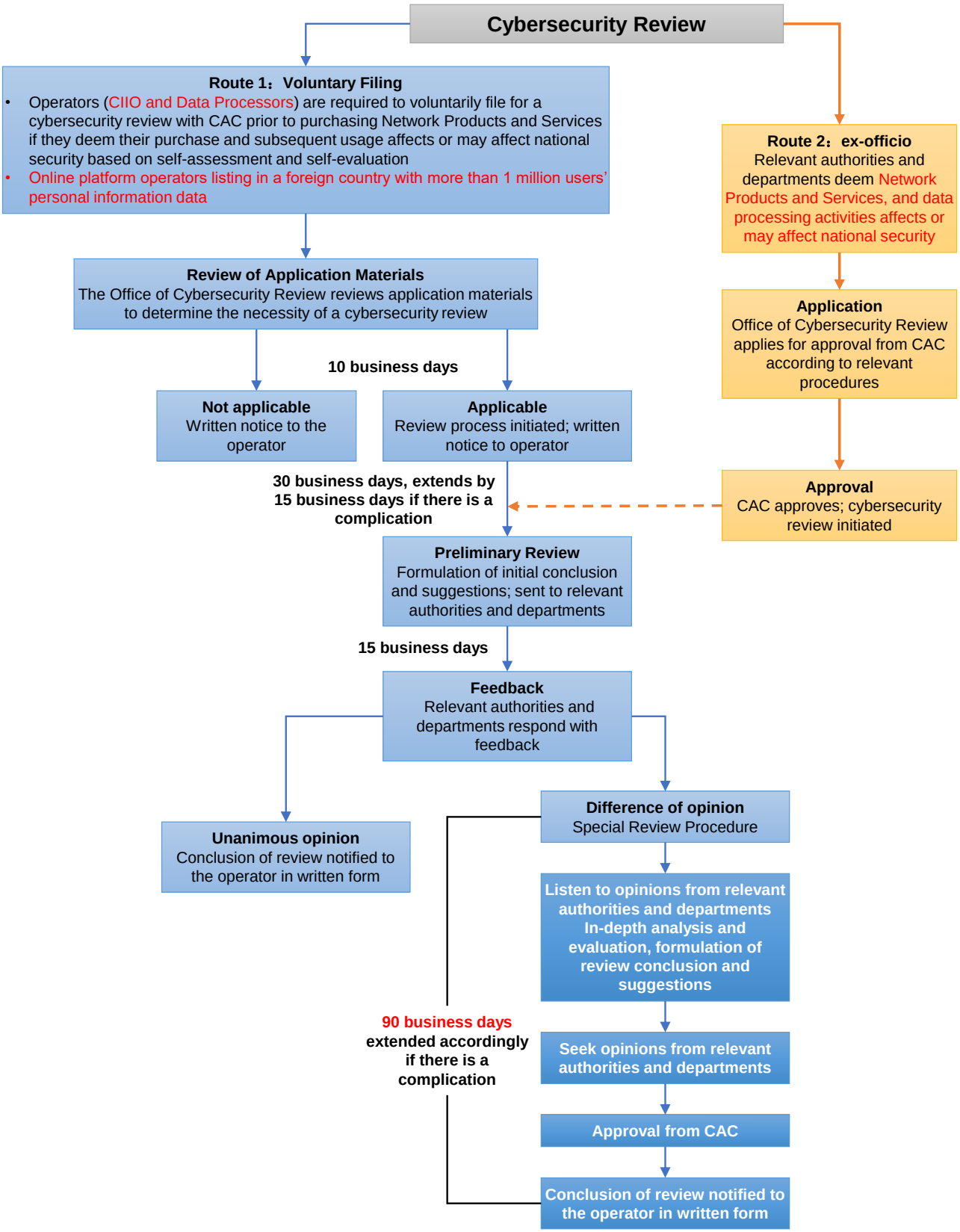
The Final Measures stipulate that "online platform operators listing in a foreign country with more than one million users' personal information data must apply for a cybersecurity review with the Cybersecurity Review Office." This provision continues to follow the jurisdictional (i.e. "listing in a foreign country") and quantitative (i.e. one million users) cybersecurity review thresholds set out by the Draft Measures. However, entities subject to cybersecurity reviews have changed from "data processors" to "online platform operators". The Final Measures do not define "online platform operator", but the Draft Regulations defined it as "data processors who provide Internet platform services such as information publishing, social networking, transaction, payment, or audio-visual services". Common sense suggests that the scope of "online platform operators" seems narrower than "data processors" previously used and seems to exclude self-operated e-commerce services of fast-moving consumer goods companies that do not provide online platform services. However, the vagueness of "online platform operators" leaves room for interpretation by regulators in practice, who may require all types of operators with "more than one million users' personal information" to proactively apply for cybersecurity reviews.

Timing and potential outcomes of a cybersecurity review

According to a Q&A on the Final Measures, online platform operators possessing personal information of no less than 1 million users are required to apply for a cybersecurity review prior to the submission of their listing application with non-PRC securities regulators. The outcome of the application may include: (i) review not required; (ii) where a review is initiated, the review concludes that the listing does not affect national security and grants clearance for the listing in a foreign country; and (iii) where a review is initiated, the review concludes that the listing does affect national security and the listing in a foreign country is prohibited. Operators with the former two outcomes may continue their listing application with non-PRC securities regulators. However, note that according to the Measures for the Overseas Issuance of Securities and Listing Record-Filings by Domestic Enterprises (Draft for Comments) issued by the CSRC on December 24, 2021, these companies must complete a separate filing procedure (of which clearance from CAC is a part) within 3 business days after the submission of their filing application.

Further extension of the time limit for special review procedures

Taken as a whole, the review process set forth in the Final Measures follows that of the existing measures and the Draft Measures with one exception: where there is disagreement between the members of the cybersecurity review group and the relevant departments, there will be a special review process seeking the opinions of the relevant authorities and the case will be reported to CAC. The time limit for this special review procedure is extended to 90 business days from the 3 months stipulated in the Draft Measures, and this time limit may be extended accordingly to the extent there are complications. The overall review process according to the Final Measures is shown in the figure below.


Cybersecurity Review
Route 1：Voluntary Filing
• Operators (CIIO and Data Processors) are required to voluntarily file for a cybersecurity review with CAC prior to purchasing Network Products and Services if they deem their purchase and subsequent usage affects or may affect national security based on self-assessment and self-evaluation
• Online platform operators listing in a foreign country with more than 1 million users' personal information data
Route 2：ex-officio
Relevant authorities and departments deem Network Products and Services, and data processing activities affects or may affect national security
Review of Application Materials
The Office of Cybersecurity Review reviews application materials to determine the necessity of a cybersecurity review
Application
Office of Cybersecurity Review applies for approval from CAC according to relevant procedures
10 business days
Not applicable
Written notice to the operator
Applicable
Review process initiated; written notice to operator
30 business days, extends by 15 business days if there is a complication
Approval
CAC approves; cybersecurity review initiated
Preliminary Review
Formulation of initial conclusion and suggestions; sent to relevant authorities and departments
15 business days
Feedback
Relevant authorities and departments respond with feedback
Unanimous opinion
Conclusion of review notified to the operator in written form
Difference of opinion
Special Review Procedure
Listen to opinions from relevant authorities and departments
In-depth analysis and evaluation, formulation of review conclusion and suggestions
90 business days extended accordingly if there is a complication
Seek opinions from relevant authorities and departments
Approval from CAC
Conclusion of review notified to the operator in written form

Risk prevention and mitigation measures should be taken accordingly during the review period

Article 16 of the Final Measures states that "to prevent risks, the party should take risk prevention and mitigation measures during the review period in accordance with cybersecurity review requirements". Past practice suggests that "risk prevention and mitigation measures" may include suspending new-user registrations, suspending app downloads, etc., and may include actions like divesting relevant data assets or even suspending relevant online product services.

Formal launch of review hotlines concurrent with the publication of review application procedures

The Q&A accompanying the release of the Final Measures published the channels through which applications are reviewed and accepted. Namely, "the Cybersecurity Review Office is located within CAC. Specific work will be carried out by the China Cybersecurity Review Technology and Certification Center ("**CCRC**"). Under the guidance and leadership of CAC, CCRC will be responsible for tasks such as accepting and formally reviewing application materials. CCRC has also set up cybersecurity review consultation hotlines." We hope that CAC and the CCRC will publish as soon as possible clearer application guidelines for companies fulfilling their application obligations as soon as possible.

2. Overseas IPOs (Part I): Rules Based Filing System

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On December 24, 2021, the China Securities Regulatory Commission ("**CSRC**") released the *Administrative Provisions of the State Council Regarding the Overseas Issuance and Listing of Securities by Domestic Enterprises* (the "**Administrative Provisions**") and the *Measures for the Overseas Issuance of Securities and Listing Record-Filings by Domestic Enterprises* (Draft for Comments) (the "**Filing Measures**"), both of which have a comment period that expires on January 23, 2022. The Administrative Provisions and Filing Measures regulate the system, filing management, and other related rules in respect of the direct or indirect overseas issuance of listed and traded securities by "domestic enterprises". As analyzed below, the Administrative Provisions and Filing Measures apply to PRC enterprises with Cayman parent entities and /or variable interest entity structures.

For a period of time, especially in the past six months, market participants such as listing applicants, listed companies, professional advisers, and PRC and non-PRC investors alike have paid close attention to the reform and improvement of the regulatory system in respect of the overseas issuance of listed and traded securities by domestic enterprises. The market and these participants expected the PRC to issue rules and regulations quickly to further clarify requirements and procedures. The Administrative Provisions and Filing Measures provide directional guidance to the PRC's reform plan for the supervision of overseas listings. They play a positive role in setting the rules of the road to allow PRC enterprises to make their own choices on listing location and particulars, to achieve stable and healthy development.

This newsletter summarizes the Administrative Provisions and Filing Measures' regulatory requirements and filing procedures in respect of the overseas issuance of listed and traded securities by domestic enterprises, and is for reference only.

Background of the methods of overseas listing and the supervisory reform system

The current regulatory regime for the overseas issuance of listed securities by domestic enterprises is primarily set forth in the Special Provisions of the State Council on the Overseas Offering and Listing of Securities by Companies with Limited Liability (Order No. 160 of the State Council) issued in 1994, which was formulated when the PRC's capital markets was in its infancy. These rules have fallen behind market practice. In December 2019, the newly revised Securities Law of the PRC clarified that **direct and indirect** overseas issuances and listings should comply with the relevant regulations of the State Council.

For PRC enterprises, there have always been two methods of accessing capital markets outside of Mainland China, one of which was direct and one of which was indirect, but the existing regulatory framework prior to the issuance of the Administrative was very different for both.

1. A "direct" issuance and listing of securities by a domestic enterprise refers to the issuance of overseas securities that are listed and trading by a company limited by shares incorporated in the PRC. This includes "H" shares (i.e. PRC entities issuing public shares on the Stock Exchange of Hong Kong), "N"

shares (i.e. PRC entities issuing public shares on U.S. exchanges) and "S" shares (i.e. PRC entities issuing public shares on the Stoch Exchange of Singapore). This type of "direct" listing has always required the dual review of both PRC regulators and the regulators of the place of listing.

For example, in a typical "H" shares listing, the applicant is a company limited by shares, the applicant first submits an applicant to the CSRC in accordance with its requirements. The CSRC first issues an acknowledgement of receipt commonly known as the "**Initial Pass**". The applicant then applies to list with the Stock Exchange of Hong Kong, and then receives an approval from the CSRC commonly known as the "**Final Pass**", after which it can list on the Stock Exchange of Hong Kong.

2. An "indirect" issuance and listing of securities by a domestic enterprise refers to the overseas listing of an enterprise whose primary business activities are in the PRC, using a non-PRC parent as the issuer, where the listing is based on the equity, assets, income, or other similar rights and interests of PRC entities (the "**Red-Chip Model**"). The Red-Chip Model is divided as follows:

(1) **Large Red-Chips**: A "large" red-chip exists where the issuer (i.e. a non-PRC entity issuing listed securities) is established and/or controlled by a PRC entity. The *Notice of the State Council on Further Strengthening the Administration of Offering and Listing of Shares Overseas* (the "**97 Red Chip Guidelines**") applies where a PRC enterprise's assets are transferred to a non-PRC non-listed entity established or controlled by a PRC enterprise that then intends to list, or a PRC enterprise's assets are first transferred to a non-PRC non-listed entity established by a PRC enterprise and then transferred to another non-PRC non-listed entity established or controlled by a PRC enterprise that intends to list. Pursuant to the 97 Red Chip Guidelines, the required governmental approvals and registrations include, but are not limited to, approval by the provincial People's government or the relevant competent department of the State council, the approval of the CSRC (if necessary) and the approval or filing with other regulatory authorities such as the National Development and Reform Commission and the local Ministry of Commerce. Due to the complexity of the supervisory requirements, few applicants in the market have achieved an overseas listing through the Large Red-Chip structure.

(2) **Small Red-Chips**: A "small" red-chip exists where the issuer (i.e. a non-PRC entity issuing listed securities) is established and controlled by a PRC natural persons. Such PRC natural persons transfer the PRC and non-PRC assets, income, or other similar rights and interests (including by way of direct shareholding or a control model via a variable interest entity structure) to a non-PRC entity that intends to list outside of Mainland China. Under the current regulatory framework prior to the Administrative Provisions and Filing Measures, there was less PRC supervision of this structure. Namely, the PRC issues mainly involved the establishment of overseas special purpose vehicles by PRC natural persons and return investment registration pursuant to Circular 37 of the State Administration of Foreign Exchange and any overseas direct investment approvals required by domestic investors to take shares in the non-PRC parent. Accordingly, the procedures for overseas listings of Small Red-Chips were comparatively more flexible and convenient as compared to Large Red-Chips.

Key points for the regulation of overseas offerings and listings: centered on "filing"

The overseas listings regulatory reform is based on the concept of a "filing" based system.

The Administrative Provisions specify that the CSRC has regulatory authority over the "overseas securities offering and listing by domestic enterprises", and requires "domestic" companies to complete filing procedures with the CSRC if they wish to list overseas. The Administrative Provisions also contain regulatory red lines for overseas offerings and listings by "domestic" companies.

The Filing Measures provide supporting rules for the Administrative Provisions by specifying the primary filing procedures for overseas offerings and listing by "domestic" companies.

I Uniform regulation for the "overseas offerings and listings by domestic enterprises"

The Administrative Provisions specify that its jurisdiction extends to the "overseas offering and listing by domestic enterprises", whether directly or indirectly. The Administrative Provisions specify that the CSRC has regulatory authority over the "overseas securities offering and listing by domestic enterprises", and requires "domestic" companies to complete filing procedures with the CSRC if they wish to list overseas. The Administrative Provisions also contain regulatory red lines for overseas offerings and listings by "domestic" companies (set forth below).

With respect to the meaning of the phrases "direct" and "indirect", as stated above, the term "direct" means an overseas offering and listing made by an issuer that is a company limited by shares incorporated in Mainland China, while the term "indirect" means an overseas offering and listing made by an issuer not incorporated in Mainland China, but where the offering is based on the underlying equity, assets, earnings, or other similar rights of a Mainland China company whose primary operations are in Mainland China.

With respect to the meaning of the phrase "overseas", as the Administrative Provisions fall under the umbrella of the Securities Law of the PRC, the definition of "overseas" should be consistent with the definitions for the phrases "in/outside China", "exit/enter China" and other related phrases in the Securities Law and its implementation rules and other existing laws and regulations[1]. In other words, the term "overseas" typically includes Hong Kong.

In addition, the Administrative Provisions specify that its jurisdiction extends to entities controlled by domestic listed companies that intend to list outside of Mainland China. Furthermore, the Administrative Provisions clearly specify that its jurisdiction extends not only to listed shares, but also depository receipts, convertible corporate bonds, or other equity instruments.

Put another way, the different offering and listing models, such as IPOs, DPOs, RTOs, and SPACs, all will be subject to the CSRC's jurisdiction under the Administrative Provisions.

[1] For example, under Article 89 of the *Exit and Entry Administration Law of the People's Republic of China*, exit refers to leaving Mainland China for other countries or regions, the Hong Kong Special Administrative Region or the Macao Special Administrative Region, or Taiwan. Entry refers to entering Mainland China from other countries or regions, the Hong Kong Special Administrative Region or the Macao Special Administrative Region, or Taiwan.

II Regulatory red lines for overseas offerings and listings by domestic enterprises

According to Article 7 of the Administrative Provisions, an overseas offering and listing is prohibited under any of the following circumstances: (1) if the intended securities offering and listing is specifically prohibited by national laws and regulations and relevant provisions (*For example, the Opinions of the General Office of the CPC Central Committee and the State Council on Further Reducing Burdens of Homework and Off-campus Training on Students at the Compulsory Education Level clearly provides that, all curriculum-based tutoring institutions are prohibited from pursuing financing by a public listing, and are strictly prohibited from receiving investment*); (2) if the intended securities offering and listing may constitute a threat to or endangers national security as reviewed and determined by competent authorities under the State Council in accordance with law (*For example, if the competent authorities under the State Council determines the existence of such national security impact after a review pursuant to the National Security Law, Cybersecurity Law, Data Security Law, Measures for Cybersecurity Reviews, or other provisions*); (3) if there are material ownership disputes over the equity, major assets, and core technology, etc. of the issuer; (4) if, in the past three years, the domestic enterprise or its controlling shareholders or actual controllers have committed corruption, bribery, embezzlement, misappropriation of property, or other criminal offenses disruptive to the order of the socialist market economy, or are currently under judicial investigation for suspicion of criminal offenses, or are under investigation for suspicion of major violations; (5) if, in past three years, directors, supervisors, or senior executives have been subject to administrative punishments for severe violations, or are currently under judicial investigation for suspicion of criminal offenses, or are under investigation for suspicion of major violations; (6) other circumstances as prescribed by the State Council.

III Summary of the key points of the "filing" system

The Administrative Provisions established the "filing" based system, while the Filing Measures further specify the procedural requirements for a filing, as follows:

1. A filing for an initial public offering and listing

Where a domestic enterprise intends to directly offer and list securities in an overseas market, it is required to complete the filing obligations itself. Where the domestic enterprise intends to indirectly offer and list securities in an overseas market, the filing obligation is with a major operating entity incorporated in Mainland China.

The Filing Measures adopt an "ex-post filing mechanism" where the filer completes its filing obligation within 3 working days after it submits its listing application to the regulator in the place of intended listing.

Where the issuer intends to list securities in multiple overseas jurisdictions or by way of reverse merger or SPAC, the filer is also required to complete filing obligations in compliance with the requirements for an initial public offering and listing.

2. The particulars and process for a "filing" for an initial public offering and listing

The Filing Measures set forth the requirements for the filing to be submitted to the CSRC in different scenarios. The required filing materials for an initial public offering and listing should include at least the following: record-filing report and related undertakings; compliance certificate from the primary regulator of the applicant's business; filing or approval documents (if applicable); security assessment opinion issued by related departments (if applicable); PRC legal opinion; prospectus.

- With respect to the "compliance certificate from the primary regulator of the applicant's business and filing or approval documents (if applicable)", we understand they are different from the compliance requirements of the listing rules of the Stock Exchange of Hong Kong. We tend to believe that these requirements are for specially regulated industries where a no-objection certificate from the regulator is required prior to submitting a listing application. However, the specific requirements still need to be clarified in subsequent implementation rules;
- With respect to the "security assessment opinion issued by related departments (if applicable)", we believe they mainly cover regulatory red line requirements that overseas issuances and listings must not endanger national security, and is consistent with a series of policies recently issued and proposed by the Cyberspace Administration of China and other regulators responsible for data security;
- With respect to the "PRC legal opinion and prospectus", the style and content must meet the requirements of the regulators of the place of proposed listing. As to the CSRC, how to demonstrate an overseas issuance and listing does not cross any of the regulatory red lines stipulated in Article 7 of the Administrative Provisions, as well as the requirements for any writing methods, language, style, disclosure requirements and the like, are all matters where more detailed guidance from the CSRC is required.

If the filing materials are complete and fulfil requirements, the CSRC will issue a filing notice within 20 business days and publish it on its website. If the CSRC believes that the information in the application materials is incomplete or insufficient, it will require the applicant to provide supplemental explanations. Furthermore, based on the materials submitted by the applicant, the CSRC may consult other regulators on an as needed basis, and such consultations are not counted towards the time limit for feedback. The status of those consultations will be reported back to the applicant in a timely way. If the applicant intends to submit a confidential or non-public filing overseas, the filing procedures under the Filing Measures are made to a system created by the CSRC, and the applicant can apply to the CSRC to postpone any release of the status of the filing application.

3. Securities service providers subject to regulation

The Administrative Provisions requires all securities companies and service institutions engaged in the overseas issuance and listing of securities of domestic enterprises to be subject to regulation and management in accordance with the law. The Filing Measures provide that overseas securities companies engaged in the sponsoring business for overseas issuances and listings of domestic enterprises, or who act as the lead underwriter, to complete a filing with the CSRC within 10 business

days from the date they first engage in the relevant business. Furthermore, by January 31 of each year, they are also required to submit to the CSRC a status report on their business in the past year in respect of the overseas issuance and listing of securities of domestic enterprises.

IV Filing and reporting requirements after an overseas listing

After completing the filing procedures for an overseas initial public offering and listing, for the purposes of implementing and strengthening the CSRC's supervision, issuer will now need to comply with continuous filing and reporting requirements after such offering and listing, including the following:

- A reporting obligation in respect of a material event completed after the completion of an overseas offering and listing, which arose prior to such offering and listing;
- Filing for follow-on offerings after the initial offering and listing;
- Filing for share exchanges where by the issuer issues securities to acquire assets;
- A reporting obligation for material events after the initial offering and listing.

We note that the issuance of public bonds by overseas listed entities is currently regulated by the National Development and Reform Commission through a filing and registration management system. Accordingly, listed companies with red-chip structures have to complete the filing procedures with the National Development and Reform Commission. However, the Filing Measures also include in their regulatory scope the issuance of overseas "debt securities". How these two systems are reconciled requires urgent action from regulators through the introduction of measures.

V Legal liabilities specifically prescribed, which increase the consequences of non-compliance

The Administrative Provisions clarify that the first actor responsible for compliance for and overseas issuance and listing of a domestic enterprise is the domestic enterprise itself. With respect to the domestic enterprises, non-compliance with the Administrative Provisions or an overseas listing completed in breach of them may result in a warning or a fine of 1-10 million RMB. If the circumstances are serious, they may be ordered to suspend their business or suspend their business pending rectification, or their permits or businesses license may be revoked. Furthermore, the controlling shareholder, actual controllers, directors, supervisors, and other legally appointed persons of the domestic enterprises may be warned, or fined between 500,000 - 5 million RMB either individually or collectively.

If, during the filing process, the domestic enterprises conceal important factors or the content is materially false, and securities are not issued, they are subject to a fine of 1-10 million. If the securities have been issued, the domestic enterprise is subject to a fine of 10-100% of the listing proceeds. With respect to the controlling shareholder, actual controllers, directors, supervisors, and other legally appointed persons, they are subject to a warning and fines between 500,000 RMB and 5 million RMB, individually or collectively.

Securities companies and securities service providers that provide services for the overseas issuance and listing of domestic enterprises may also be subject to liability for non-compliance under the

Administrative Provisions and Filing Measures. Namely, under the Administrative Provisions securities companies and law firms that do not comply are subject to a warning and fines between 500,000 RMB to 5 million RMB. The responsible person of these institutions are subject to a warning and fines between 200,000 RMB and 2 million RMB. If these service providers provide false records, misleading statements, or material omissions in application documents, they are subject to a potential suspension of practice before the CSRC of 3 months to 1 year.

Impact of indirect overseas listings and issuances by domestic enterprises

With respect to indirect overseas listings and issuances by domestic enterprises, substance will be more important than form. There should be a comprehensive analysis of the proportion of PRC sourced income and profit, the composition of senior management, and the location of business operations. In particular, the Filing Measures state that the following would be considered "indirect": (i) the operating income, gross profit, total assets, or net assets of the domestic enterprise in the most recent fiscal year was more than 50% of the relevant line item in the issuer's audited consolidated financial statement for that year and (ii) senior management personnel responsible for business operations and management are mostly PRC citizens or are ordinarily resident in Mainland China, and the main place of business is in Mainland China or carried out in Mainland China. We believe that the above standards should be further clarified by regulators. For example, the accounting standard by which the financial thresholds are judged (IFRS, US GAAP, PRC GAAP, the standard in the proposed place of listing) is not specified. Furthermore, the standards for senior management do not state whether they apply to the main legal entity, or the domestic legal entity.

Compared with the status quo for overseas listings and issuances by indirect domestic enterprises, if the Administrative Provisions take effect in their current form, the filing process with the CSRC will be enhanced. While the filing technically is to be submitted after the submission of the overseas listing application, to prepare for the listing, the filing documents need to be prepared concurrently. In terms of filing, the process seems different from prior H-share listings, and we note that the new regulatory red lines and potentially serious consequences of non-compliance will mean that practically speaking, the regulators at the place of listing will likely view the successful attainment of the filing from the CSRC as a condition for the approval of the overseas listing, which may affect timing.

Exhibit A sets forth a comparison between the standards for overseas issuances and listings currently in place and those contemplated by the Administrative Provisions and Filing Measures.

Changes in the regulatory model for direct overseas listings and Full Circulation of domestic enterprises

As discussed above, currently, the overseas public listing and issuance of shares of direct domestic enterprises requires an approval opinion from the CSRC. Under the current regulatory framework, available methods for shareholders applying to convert their domestic unlisted shares into overseas listed shares for circulation on overseas trading markets ("**Full Circulation**") include either obtaining CRSC approval at the same time as the direct overseas offering and listing, or separately thereafter. In essence, both the existing direct overseas listing procedure and Full Circulation of domestic enterprises require

CRSC review and approval. If both the Administrative Provisions and the Filing Measures are officially implemented in accordance with their drafts for comment, a filing-based regulatory model will be established for direct domestic enterprises listing overseas and their Full Circulation, which will differ from the existing approval-based regulatory model and regulatory environment. Below is a summary of the current model as compared to the proposed model.

Item	Existing regulatory model (approval)		Draft regulatory model (filing)	
	Direct overseas listing of domestic enterprises	**Full circulation**	**Direct overseas listing of domestic enterprises**	**Full circulation**
Procedure	Issuers are required to (i) obtain the Initial Pass from CRSC prior to submitting their IPO application; (ii) obtain the Final Pass before the review hearing and; (iii) report to CRSC within 15 days of their IPO.	(1) Issuers applying for Full Circulation at the same time as their overseas IPO are required (i) obtain the Initial Pass from CRSC prior to submitting their IPO application; (ii) obtain the Final Pass before the review hearing and; (iii) report to CRSC within 15 days of their IPO. (2) Issuers applying for Full Circulation after listing will need to obtain CRSC approval separately.	As set out above, issuers are required to submit filing materials with CRSC within 3 business days after the submission of their overseas IPO application and after the initial offering.	Issuers are required to comply with relevant CSRC regulations and submit filing materials through their domestic entities. However, there is no current regulation relating to filing for Full Circulation.
Required materials	Issuers must submit the following application materials to obtain Xiao Lu Tiao from CSRC: (1) Application form and supporting documents; (2) Regulatory opinion	Issuers must submit the following application materials when applying for Full Circulation: (1) Application form and supporting documents; (2) Regulatory opinion issued by industry regulators (if	(1) Please see above for the filing materials required to be submitted to CSRC after the issuer has submitted their IPO application. (2) Filing materials to be submitted by PRC issuer to CSRC after overseas' listing:	The domestic entity must submit filing materials to CSRC with respect to Full Circulation, such materials include but are not limited to: ■ Filing form and relevant undertakings; ■ PRC legal

Item	Existing regulatory model (approval)		Draft regulatory model (filing)	
	Direct overseas listing of domestic enterprises	Full circulation	Direct overseas listing of domestic enterprises	Full circulation
	issued by industry regulators (if applicable); (3) Documents related to the review, approval or filing of fund-raising investment projects (if applicable); (4) Proof of taxation issued by the tax authorities either for the past three years (Main Board) or two years (GEM); (5) PRC legal opinion; (6) Prospectus (draft).	applicable); (3) Approval documents relating to the management of the establishment of state-owned shares and the conversion of state-owned shares to overseas listed shares if applicable); (4) Shareholder's authorization for the application of Full Circulation for domestic unlisted shares and a compliance statement on the shares. (5) PRC legal opinion.	■ Filing form and relevant undertakings; ■ PRC legal opinion.	opinion.
Key concerns	Issuers and their PRC lawyers are required to issue specific opinions in accordance with Guidelines for the for Overseas Public Offering of Shares and Listing (Including Additional Issuance) by A Company Limited by Shares.	Issuers and their PRC lawyers are required to issue specific opinions in accordance with the Guidelines for the Application for the "Full Circulation" of the Domestic Unlisted Shares of H-Share Companies.	No specific regulation; detailed guidelines to be drafted by CSRC	No specific regulation; detailed guidelines yet to be drafted by CSRC
Material changes	No specific regulation. However, if an overseas listed	No specific regulation. Full Circulation shares are predominantly	Please see above.	No specific regulation, detailed guidelines for Full Circulation filings

Item	Existing regulatory model (approval)		Draft regulatory model (filing)	
	Direct overseas listing of domestic enterprises	Full circulation	Direct overseas listing of domestic enterprises	Full circulation
	enterprise wishes to terminate its public status, relevant procedure must be met in accordance with the regulations.	managed by designated brokers and regulators.		yet to be drafted.

Based on the comparisons summarized above, if the direct listing and Full Circulation of a PRC enterprise takes the filing-based model, then the requirements with respect to procedures, timings, and documents to be submitted are more relaxed, giving greater flexibility to direct domestic enterprises listing overseas. Additionally, there is a greater emphasis on regulatory oversight during and after an IPO, which benefits the standardization of regulation.

Furthermore, since the adoption and implementation of Full Circulation, there has been an increase in the number of direct overseas listings of PRC companies, including those operating in the technology and innovation sectors. Current reforms may also give rise to a more relaxed regulatory environment for (i) flexible arrangements of weighted voting rights (WVR) and employee stock option plans (ESOPs) that are commonly expected of technology and innovative companies, as well as (ii) the establishment of VIE structures as a part of the listing process.

1. With respect to WVR, due to the provisions regarding the "same share same rights" principle in the existing Company Law and Essential Clauses in Articles of Association of Companies Listed Overseas, PRC companies intending to directly list overseas cannot set up WVRs. The existing Company Law is currently being revised and it is clear that companies will be able to issue different classes of shares with rights different to those attached to ordinary shares in accordance with their articles of associations. At the same time, the implementation of the Filing Measures will mean the Essential Clauses in Articles of Association of Companies Listed Overseas will be abolished. Instead, PRC companies directly listing overseas will use Guidelines for Articles of Association of Listed Companies as a reference when drafting their articles of association. As such, it is our understanding that after the implementation of the legislative changes discussed, legal restrictions on the establishment of WVR for PRC companies listing overseas will cease to exist.

2. With respect to flexible arrangements for ESOPs, as existing direct domestic enterprises listing overseas are subject to approval from the International Department of CSRC, who uses A-share review and approval requirements as a reference when raising clear and consistent requirements during their own review and approval process, most ESOPs of H-share listed companies are exercised prior to their listing, and only very few cases have ESOPs or reserved options. If the regulatory mechanism were to become filing-based, there is a possibility that the flexibility of ESOPs of direct domestic enterprises listing overseas will increase.

3. For the establishment of VIE structures for direct domestic enterprises listing overseas, considering the flexibility provided under the filing-based system and the fact that CSRC has confirmed the possibility of filing for the listing of VIE structured applicants in accordance with laws and regulations, there is a reasonable possibility that VIE structured domestic enterprises may directly list overseas, provided PRC laws, regulations and compliance requirements are met.

In sum, the implementation of a filing-based regulatory model for direct domestic enterprises listing overseas and Full Circulation will offer more flexibility and is expected to reduce the time taken for listing. However, the Administrative Provisions and the Filing Measures only provide a legislative framework and underlying principles for the filing-based mechanism and its requirements. Specific issues for direct domestic enterprises listing overseas and Full Circulation have yet to be addressed by the relevant regulators with supplementary guidelines and measures.

Active regulatory guidance generated by regulatory reform

I Emphasis of regulatory reform lies in perfecting the system and guiding the market

According to the Administrative Provisions, the Filing Measures and the Q&A with the Relevant CSRC Officials, the CSRC will establish a collaborative regulatory system with the competent authorities of relevant industries and fields within the PRC, including, (1) where the competent authorities of a particular industry/field explicitly requires pursuant to rules and regulations that an enterprise must perform its obligation to go through regulatory procedures prior to an overseas IPO, the enterprise must obtain a regulatory opinion, and obtain filing or approval documents issued by the competent authorities before the submission of their filing application; (2) CSRC will proactively communicate with or seek opinions from the relevant authorities upon the receipt of filing application materials; and (3) for overseas listings of enterprises that are subject to laws and regulations such as security reviews for foreign investment and cybersecurity reviews, the enterprise must apply for relevant security reviews in accordance with the law before submitting their filing application.

The Administrative Provisions and the Filing Measures currently under consultation do not extend the scope of regulation relating to market concerns such as industry-specific regulatory opinions and security reviews. Where industry-specific regulatory opinions, filings or approvals from industry-specific authorities are required, companies are subject to blackletter rules explicitly requiring them to fulfil regulatory procedures prior to their overseas listing, but this is not applicable to all industries. Security reviews and cybersecurity reviews, the latter currently under consultation, reflect the increasing emphasis placed on the issue both at the legislative and executive level.

In addition, under the current rules of the Administrative Provisions and the Filing Measures, the CSRC will lead the establishment of an inter-departmental and collaborative regulatory mechanism for the overseas listing of PRC enterprises and cooperate with the relevant authorities to clarify rules of specific industries under the regulatory system. This is particularly appealing with regards to creating certainty in the filing procedure for listing overseas. Certain industries face issues such as being regulated by multiple regulators, unclear regulatory attitudes, or ununified detailed rules in different regions.

II VIE structures can list Overseas, but must pay attention to regulatory principles

The Q&A with the Relevant CSRC Officials points out that, provided all PRC laws and regulations are complied with, enterprises with compliant VIE structures may list overseas after filing. For VIE structured enterprises that intend to list overseas, we suggest focusing on staying compliant with laws, regulations and regulatory filing requirements on foreign investment, industry access, cybersecurity, data security and others.

The Filing Provisions emphasizes that the CSRC filing of a domestic enterprise listing overseas by no means indicates that the CSRC guarantees the truthfulness, accuracy, and completeness of the filing materials. Also taking into account the provisions of the Administrative Provisions regarding how the CSRC will strengthen collaborative regulation with industry authorities in areas like risk response, issuers should be aware that during the filing application of VIE structured enterprises, the CSRC may consult with other competent authorities, impacting the filing process for overseas listings.

III Far-reaching impact on private equity investment

Overseas offerings and listings of domestic enterprises have long been one of the main exit strategies for private equity funds. As mentioned above, under the current regulatory system, compared with overseas listings of indirect domestic enterprises, direct domestic enterprises choosing to list overseas face a degree of uncertainty due to factors such as domestic regulatory procedures, difficulties in obtaining domestic approval, the difficulties in accurately predicting the timeline of listing, and in particular, regulatory attitude towards VIE structures. Altogether, these factors cause PRC companies to elect to be indirect domestic enterprises that list overseas. For companies in the emerging and innovative markets, private equity investments are limited by future listing choices, and the closing process is often delayed by the need to set up an overseas listing structure for the target company. The introduction of the Administrative Provisions and the Filing Measures, particularly their impact on direct domestic enterprises listing overseas (e.g. H-shares), previously an uncommon choice for private equity exits, has undoubtedly given more room and convenience for private equity investments and their potential future exits by creating a system that is legally agnostic as to structure with no one structure being preferred by law to another. This dynamic may afford private equity investors more freedom to invest alongside other market participants on an equal playing field, by not pigeonholing them into one structure that must exist or be established as a condition to investment.

IV Steady progress, smooth transition

The CSRC has publicly declared that it will follow the basic legal principles of not applying the Administrative Provisions and Filing Measures retroactively and respecting business customs and market practices. In other words, the CSRC will distinguish companies already listed overseas from those current seeking to list overseas to roll out the reforms in a steady and orderly manner.

The new system is designed in such a way that new companies and existing companies seeking to carry out activities like follow-on financing will follow the filing procedures as required. The other filing procedures other existing companies will be provided separately with a sufficient transition period. A distinction is also drawn between initial public offerings and follow-on financings. The new system

takes the convenience and efficiency of overseas follow-on financings into full account and provides differentiated arrangement for follow-on financings with respect to the timing of filing and required filing materials. This will enable smooth transition with respect to overseas market practices and reduce any impact on the financing activities of overseas listed companies.

The Administrative Provisions and the Filing Measures will establish a collaborative inter-departmental regulatory system based on filing as led by the CSRC for overseas listings of domestic enterprises. This will create a more transparent and predictable regulatory environment for going public overseas. We will continue to carry out detailed interpretations and analyses on the Administrative Provisions and Filing Measures, and proactively work with market participants to provide constructive feedback on this regulatory reform.

Exhibit A

Listing Standards Before and After the Administrative Provisions and Filing Measures

	Prior to the administrative provisions and filing measures			After the administrative provisions and filing measures (if adopted in their current form)		
	Hong Kong					
Structure	**CAC approval**	**CSRC approval**	**Special Hong Kong requirements**	**CAC approval**	**CSRC approval**	**Special Hong Kong requirements**
Onshore Parent	N/A	Yes, compliance certificate required from the primary regulator of the applicant's business	CSRC approval	Yes, to the extent the data processor's Hong Kong listing will or may potentially impact "national security" (an undefined term)	Yes, subject to the new measures issued by the CSRC, consisting of the following: -Record-filing report and related undertakings -Compliance certificate from the primary regulator of the applicant's business (consistent with the current practice for onshore parent applicants) -Security assessment opinion issued by related departments (i.e. the CAC rules) -PRC legal opinion -Prospectus	CSRC "record-filing", which must fulfill all requirements under the measures Most likely a CAC approval (as part of the CSRC "record-filing") to ensure that the listing does not impact "national security" as defined and interpreted by CAC
Offshore parent (No VIE)	N/A	N/A	None		Yes, subject to the new measures issued by the CSRC, consisting of the following: -Record-filing report and related undertakings -Compliance certificate from the primary regulator of the applicant's business (pursuant to the newly updated Negative List effective Jan. 1, 2022, foreign investment in prohibited sectors will now need an extra permission from the regulator in charge of its business in order to list	CSRC "record-filing", which must fulfill all requirements under the measures Most likely a CAC approval (as part of the CSRC "record-filing") to ensure that the listing does not impact "national security" as defined and interpreted by CAC

	Prior to the administrative provisions and filing measures			After the administrative provisions and filing measures (if adopted in their current form)		
					outside of the PRC) -Security assessment opinion issued by related departments (i.e. the CAC rules) -PRC legal opinion -Prospectus	
Offshore parent (VIE)	N/A	N/A	VIE must be narrowly tailored and the structure must be endorsed by the primary regulator of the applicant's business		Yes, subject to the new measures issued by the CSRC, consisting of the following: -Record-filing report and related undertakings -Compliance certificate from the primary regulator of the applicant's business (pursuant to the newly updated Negative List effective Jan. 1, 2022, foreign investment in prohibited sectors will now need an extra permission from the regulator in charge of its business in order to list outside of the PRC) -Security assessment opinion issued by related departments (i.e. the CAC rules) -PRC legal opinion -Prospectus	CSRC "record-filing", which must fulfill all requirements under the measures Most likely a CAC approval (as part of the CSRC "record-filing") to ensure that the listing does not impact "national security" as defined and interpreted by CAC VIE must be narrowly tailored and the structure must be endorsed by the primary regulator of the applicant's business
	US					
Structure	**CAC approval**	**CSRC approval**	**Special US requirements**	**CAC approval**	**CSRC approval**	**Special US requirements**
Offshore parent (No VIE)	N/A	N/A	De-listing in three years if audit papers cannot be inspected by the U.S. PCAOB (may be reduced to two based on	Yes, to the extent the listing applicant is a data processor that processes the personal information of more than one million	Yes, subject to the new measures issued by the CSRC, consisting of the following: -Record-filing report and related undertakings -Compliance certificate from the primary	CSRC "record-filing", which must fulfill all requirements under the measures CAC approval (as part of the

	Prior to the administrative provisions and filing measures			After the administrative provisions and filing measures (if adopted in their current form)		
			proposed legislation that has already passed the Senate unanimously)	individuals; the term "data processor" means "individuals and entities that have the ability to decide on the purpose and method of data processing activities"	regulator of the applicant's business (pursuant to the newly updated Negative List effective Jan. 1, 2022, foreign investment in prohibited sectors will now need an extra permission from the regulator in charge of its business in order to list outside of the PRC) -Security assessment opinion issued by related departments (i.e. the CAC rules) -PRC legal opinion -Prospectus	CSRC "record-filing") CAC/CSRC approval (as part of disclosure on attainment of PRC approvals); De-listing in three years if audit papers cannot be inspected by the U.S. PCAOB (may be reduced to two based on proposed legislation that has already passed the Senate unanimously)
Offshore Parent (VIE)	N/A	N/A	Prominent disclosure of VIE; De-listing in three years if audit papers cannot be inspected by the U.S. PCAOB (may be reduced to two based on proposed legislation that has already passed the Senate unanimously)		Yes, subject to the new measures issued by the CSRC, consisting of the following: -Record-filing report and related undertakings -Compliance certificate from the primary regulator of the applicant's business (pursuant to the newly updated Negative List effective Jan. 1, 2022, foreign investment in prohibited sectors will now need an extra permission from the regulator in charge of its business in order to list outside of the PRC) -Security assessment opinion issued by related departments (i.e. the CAC rules) -PRC legal opinion -Prospectus	

3. The 2021 Revised Negative List for Foreign Investment

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On December 27, 2021, the National Development and Reform Commission ("**NDRC**") and the Ministry of Commerce ("**MOFCOM**") issued two revised versions of negative lists (collectively the "**2021 Foreign Investment Negative Lists**"), which came into effect on January 1, 2022:

- Special Administrative Measures (Negative List) for Foreign Investment Access (2021 Edition) (the "**2021 National Negative List**").
- Special Administrative Measures (Negative List) for Foreign Investment Access in Pilot Free Trade Zones (2021 Edition) (the "**2021 FTZ Negative List**").

The Foreign Investment Law of the PRC, which came into effect on January 1, 2020, legally prescribed the PRC's use of a "pre-establishment national treatment plus negative list" management mechanism with respect to foreign investment in the PRC. The current revisions of the negative lists for foreign investment access ("**Negative Lists**") prominently highlight how emphasis is being placed on the **precision of these Negative Lists**. This echoes the recent filing-based regulatory reform in respect of the overseas listings of domestic enterprises proposed by the China Securities Regulatory Commission ("**CSRC**").

We have summarized key themes of the 2021 Foreign Investment Negative Lists, focusing on the new precision-focused regulatory model.

Reduction-focused revisions based on the existing principle of high-level opening up

The latest revised 2021 Foreign Investment Negative Lists contain **no additional entries with respect to all industries and sectors** compared with their 2020 counterparts. Instead, the number of entries in the Negative Lists have reduced, specifically from 33 to 31 with respect to the 2021 National Negative List, and from 30 to 27 with respect to the 2021 FTZ Negative List. As the two Negative Lists have been reduced, their main revisions are as follows:

- **Removal of restrictions on automotive manufacturing**. Both new Negative Lists have removed the requirement that "PRC capital must be no less than 50% for manufacturers of passenger vehicles" and the requirement that "a single foreign investor may establish up to two joint ventures ("**JVs**") in the PRC to manufacture the same type of vehicles". For the first time, the automotive manufacturing industry is made fully accessible to foreign investment.
- **Removal of restrictions on television and broadcasting equipment manufacturing**. Both new Negative Lists have removed the entry "investment in the manufacturing of ground receiving facilities and key parts for satellite television broadcasting", opening up the manufacture of ground receiving facilities and key components for satellite television broadcasting to foreign investment.

- **Zero manufacturing entries for pilot free trade zones ("FTZs")**. This revision results in zero manufacturing entries for FTZs, demonstrating that the PRC is willing to give further access to and promote its manufacturing industry.
- **Relaxed foreign investment restrictions with respect "market surveys" and "social surveys" for FTZs**. In addition to the 2021 National Negative List, the 2021 FTZ Negative List has eased foreign investment restrictions on "market surveys", no longer requiring "market surveys to be limited to JVs". Similarly, the restriction on foreign investment for "social surveys" has also eased. The previously prohibited provision banning foreign investment in the sector has changed to a restrictive one, requiring that "PRC capital must be no less than 67% and the legal representative must have Chinese nationality."

Once the 2021 Foreign Investment Negative Lists comes into effect, **the pre-establishment national treatment plus negative list** regulatory system will universally apply to all foreign investors looking to invest in the PRC. In addition to these Negative Lists, foreign investors must also comply with the Negative List for Market Access:

#	Name of negative list	Effective date	Applicable scope
1.	The Negative List for Market Access (2020 Version)	December 10, 2020	Universally applicable to all (**domestic and foreign**) investors in the PRC.
2.	The 2021 National Negative List	January 1, 2022	Applicable to foreign investors in the PRC.
3.	The 2021 FTZ Negative List	January 1, 2022	Applicable to foreign investors in FTZs and takes precedence over the 2021 National Negative List within FTZs.

Analysis of the precision-focused regulatory model

Section VI of the Notes attached to the 2021 Foreign Investment Negative Lists contains a new provision that improves the precision and inclusiveness of the Negative List-based regulatory system:

Any domestic enterprise engaging in businesses prohibited by the Negative Lists that lists, issues securities and trades shares overseas must ***obtain pre-approval consent from relevant competent regulator; overseas investors must not engage in the operation and management of the enterprise, and the percentage of foreign shareholding is subject to the relevant provisions in the administrative measures for domestic securities investments by foreign investors.***

The new provision discussed above, together with the *Administrative Provisions of the State Council Regarding the Overseas Issuance and Listing of Securities by Domestic Enterprise (Draft for Comments)* (the "**Administrative Provisions**") and the *Measures for the Overseas Issuance of Securities and Listing Record-Filings by Domestic Enterprises (Draft for Comments)* (the "**Filing Measures**"), both recently promulgated on December 24, 2021, will have a far-reaching effect on the regulatory system and market with respect to cross-border investments and overseas listings by PRC companies.

I Regulatory difficulties in choosing a listing structure for the overseas listing of PRC companies

Since the inception of Negative Lists used to regulate foreign investment, there remain numerous PRC companies operating in businesses restricted or prohibited from foreign investment that engage in various forms of "foreign" private investments or cross-border capital market activities. The "foreign" element of these activities causes these PRC companies to inevitably face risks associated with regulation and compliance, resulting in uncertain exit strategies for institutional investors. Against this backdrop, the market has created various cross-border investment and financing structures, including the VIE structure, to satisfy the financing and exit needs of investors.

Bound by policies relating to foreign investment access, if PRC companies operating in businesses that are on the Negative Lists intend to list and raise capital to the public, there are two main ways of doing so under the current regulatory framework:

- Use the domestic entity to list on domestic exchanges (A-Shares); or
- Establish a cross-border red-chip structure (due to the restrictions on foreign investment, either through control agreements or a VIE structure) to indirectly list overseas using an offshore entity, or to list on an A-shares market by issuing CDRs using the red-chip entity.

The 2021 revision of the Negative Lists provide more avenues for the listing of PRC companies engaging in businesses that are prohibited by the Negative Lists.

II Three basic requirements for the overseas listing of PRC companies

The 2021 Foreign Investment Negative Lists reserve room for flexibility for the overseas listing of domestic enterprises engaging in businesses that are prohibited by the Negative Lists. Specifically, the lists confirm that there are three basic requirements that this type of PRC company must satisfy prior to listing overseas:

Requirement 1: Pre-approval consent from the competent regulator

The NDRC and MOFCOM clarified in a public Q&A that the requirement of "pre-approval consent from relevant regulator" refers to the pre-approval consent as to the non-application of the prohibitions set out in the Negative Lists for the overseas listing of PRC enterprises, not the consent and approval of the overseas listing (of a PRC enterprise) itself.

We understanding that "***relevant regulator***" primarily refers to the competent authorities regulating the industry/sector in which the PRC enterprise operates. PRC companies should also consider communicating with the CSRC while obtaining pre-approval consent from the relevant regulator.

Requirement 2: Passive investment – foreign investors prohibited from participating in the management of the company

This requirement lays out the "passive" nature of foreign investments in prohibited industries set forth in the Negative Lists.

The 2021 Foreign Investment Negative Lists do not specify the criteria for determining "participation in

the management of the company", meaning the specific criteria for this requirement remain to be clarified, such as: (i) whether foreign investors have the right to nominate/appoint directors, supervisors, and senior management; (ii) whether foreign investors have the right to participate or vote in matters relating to the management of the enterprise.

This requirement will have a substantial impact on the governance of companies with VIE structures. How this requirement may be satisfied remains to be demonstrated through market practice once the Negative Lists have taken effect.

Requirement 3: Limitation on shareholding percentage – subject to the relevant provisions in the administrative measures for domestic securities investments by foreign investors

According to existing provisions in the administrative measures for domestic securities investments by foreign investors and a Q&A by the NDRC and the MOFCOM, the restrictions on foreign shareholding is as follows:

- The percentage of shares held by a single foreign investor and any related party must not exceed 10% of the company's total shares.
- The percentage of shares held by all foreign investors and any related party must not, in the aggregate, exceed 30% of the company's total shares.
- For enterprises listed in and outside of the PRC, the percentage of foreign shareholding must be calculated on a consolidated basis.

The shareholding restrictions discussed above provide a more open financing mechanism for PRC companies intending to list on either the domestic A-shares market or the overseas H-shares market. The market expects that overseas H-shares issuances and listings will be given more space for market development with the implementation of these parameters.

Although the 2021 Foreign Investment Negative Lists do not directly mention specific regulatory arrangements for domestic enterprises listing overseas using a red chip structure, it is reasonable to assume that the underlying principles of the "shareholding limitation" mechanism discussed above serve as a **potential reference** PRC companies listing overseas using a red-chip structure, that is, if (i) the PRC shareholding of the offshore parent entity in a red-chip structure is no less than 70%; (ii) the foreign shareholding is no more than 30%; (iii) the passive investment requirement is satisfied with respect to foreign investment; and (iv) the pre-approval consent from relevant regulator is obtained, PRC companies operating in industries prohibited by the Negative Lists may have the opportunity to satisfy the CRSC filing procedure to complete an indirect overseas listing after the foregoing conditions are met.

If the foregoing assumptions are officially acknowledged by the regulatory authorities, then the necessity of adopting VIE structures for PRC companies operating in businesses prohibited by the Negative Lists may be significantly reduced. The market demand for and design of transaction structures may also fundamentally change.

III No retroactive application of the law

The NDRC and MOFCOM confirmed in a public Q&A that in principle, the regulatory framework for new and existing companies will differ from one another. With respect to the few existing overseas listed PRC companies that have exceeded the foreign shareholding percentage limitation, they will not be required to reduce the number of shares already issued overseas or the number of A-shares already held by foreign investors.

IV Smooth transition of the overseas listing process

The CRSC will take the lead in regulating PRC companies listing overseas. After a PRC company engaging in businesses prohibited from foreign investment applies to the CSRC for an overseas listing, the CSRC will consult with the competent authorities of that industry/field when implementing relevant regulatory procedures.

Once the Administrative Provisions and the Filing Measures are officially effective, the precision-focused regulatory model established by the 2021 Foreign Investment Negative Lists will act as a more positive policy guidance for the overseas listing of PRC companies.

4. The Holding Foreign Companies Accountable Act-2021 Developments

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On December 2, 2020, the U.S. House of Representatives passed the *Holding Foreign Companies Accountable Act* (the "**China De-Listing Law**") by unanimous voice vote. The U.S. Senate also passed the China De-Listing Law on May 20, 2020 by unanimous voice vote. On December 18, 2020, President Trump signed the China De-Listing Law, making it effective on that day. On March 24, 2021, the Securities and Exchange Commission ("**SEC**") issued an interim final rule (the "**First Implementation Rule**") implementing portions of the China De-Listing Law and requesting public comment on the implementation of other portions of the China De-Listing Law, including the procedures for de-listing. On May 13, 2021, the Public Company Accounting Oversight Board ("**PCAOB**") issued a proposed rule setting forth a framework for determining the audit firms that it is unable to inspect as required by the Sarbanes-Oxley Act of 2002 (the "**Act**"), which came into effect on November 4, 2021 (the "**PCAOB Rule**"). On December 2, 2021, the SEC issued a final rule (the "**Final Amendments**"), wherein it amended disclosure forms, announced the creation of a public website that will list Subject Issuers (defined below), and provided a clarification about the disclosure requirements under the China De-Listing Law also applying to group companies within a VIE structure. The Final Amendments will be effective on January 10, 2022.

Main points of the China De-Listing Law

The China De-Listing Law purports to address the inability of the PCAOB to inspect the Hong Kong and PRC based auditors of Chinese companies listed in the U.S. The issue is not new, and has been raised by the SEC during three Presidential administrations (Trump, Obama, Bush). The main points of the China De-Listing Law are as follows:

1. The SEC is required to identify issuers whose audits cannot be inspected as determined by the PCAOB ("**Subject Issuer**"). Each Subject Issuer will be required to submit to the SEC documentation proving that it is not owned or controlled by a governmental entity in a jurisdiction that does not permit the PCAOB audits.

2. If an issuer is a Subject Issuer for three (3) consecutive years, it will be required to be de-listed, including from national exchanges (such as NYSE and Nasdaq), as well as over-the-counter.

3. The Subject Issuer is required to disclose in its SEC filings (i) the percentage of shares of the issuer owned by governmental entities in the issuer's place of incorporation, (ii) whether government entities in the auditor's place of incorporation have a "controlling financial interest" in the issuer, (iii) each "official of the Chinese Communist Party" who is a board member of the issuer and operating entity of the issuer, and (iv) whether the articles of association of the issuer contains any "charter of the Chinese Communist Party, including the text of any such charter."

Main points of the first implementation rule and final amendments

The First Implementation Rule amends annual report forms by incorporating the provisions of #1 and #3 above and lays the foundation for determining Subject Issuers. Namely, the PCAOB, which is regulated by the SEC, is required under the First Implementation Rule to "act quickly" to determine the Subject Issuers. The SEC will confirm the Subject Issuers and then publish a list, currently set at May 15 of each year. A "non-inspection" year is the year in which the SEC identifies a Subject Issuer based on the annual report filed by such Subject Issuer for the prior year. The earliest a Subject Issuer may be identified as such is 2022, for the annual report filed for 2021. Accordingly, under the First Implementation Rule, the earliest a Subject Issuer may be forcibly de-listed is 2024, though practically such Subject Issuer will need to prepare for the de-listing well in advance (e.g. re-listing public shares in Hong Kong, a take private and re-listing in Hong Kong or the PRC, or a take private). The date may also be moved forward to 2023 pursuant to the Accelerating Holding Foreign Companies Accountable Act (see below).

I Final amendments

The Final Amendments amended the form annual reports that are required to be completed and filed by Subject Issuers by incorporating the required disclosures under the China De-Listing Law. With respect to the disclosure of shares owned by governmental entities in the issuer's place of incorporation, the Final Amendments expanded the requirements to all group companies in a VIE structure, such that disclosure of government ownership in a VIE company in the VIE structure will now be required in addition to disclosure of government ownership in the parent entity. The Final Amendments also stated that Subject Issuers will be identified on a public website at: www.sec.gov/HFCAA.

Importantly, the Final Amendments do contain rules on de-listing procedures, namely that the SEC will de-list a non-compliant Subject Issuer after three consecutive years of being identified as such (may be reduced to two soon, see below). The de-listing will be effective on the fourth business day after an order is delivered by the SEC.

II Items of clarification

The sponsor of the China De-Listing Law in the House Brad Sherman (Democrat-California), who has long supported similar legislation, previously indicated that he wished to improve on the Senate version of the bill. However, this ultimately did not come to pass, leading to a bill that has the following uncertainties:

1. The term "governmental entities" is not defined, leading to uncertainty over what constitutes government ownership (e.g. the role of state owned entities, state owned limited partners).
2. The term "official of the Chinese Communist Party" is not defined, leading to uncertainty over what constitutes an "official" (e.g. a member of the Communist Party, or something else).
3. The term "controlling financial interest" is not defined, leading to uncertainty over how the matter is to be disclosed.

4. There are no provisions that state the consequences of what happens if a Subject Issuer is in fact owned or controlled by a governmental entity, in which case it will be unable to certify otherwise as required by the China De-Listing Law.

5. There are no provisions on the treatment of local audits of the Chinese subsidiaries and operations of multinational issuers[2].

The First Implementation Rule addresses #3 above by stating that the terms "owned or controlled", "owned," and "controlling financial interest" should reference the definition of "control" under the 1934 Exchange Act. The First Implementation Rule addresses #4 above by stating that Subject Issuers that are controlled by a governmental entity will not be required to provide a certification that they are not controlled by a governmental entity, but are still subject to the disclosure obligations that apply to all Subject Issuers.

The First Implementation Rule seeks public comment on defining the terms "governmental entities" (item #1 above) and "official of the Chinese Communist Party" (item #2 above). The Final Amendments stated that the SEC declines to further define the term "official of the Chinese Communist Party", as that term was "clear". The Final Amendments did not address the definition of "governmental entities".

Neither the First Implementation Rule nor the Final Amendments addresses #5 above, though the First Implementation Rule does state that based on the SEC's own internal analysis, up to 273 companies that are currently listed in the U.S. will be impacted by the China De-Listing Law.

Main points of the PCAOB Rule

The PCAOB Rule sets forth the framework for determining the audit firms that it is unable to inspect as required by the Act of 2002 ("**Subject Audit Firms**"). Pursuant to the China De-Listing Law, once the PCAOB determines Subject Audit Firms, the SEC will use the list as a basis to identify Subject Issuers (i.e. Chinese issuers whose auditors are Subject Audit Firms).

Under the PCAOB Rule, a Subject Audit Firm can be an audit firm headquartered in a jurisdiction that does not permit PCAOB access to audit working papers. In other words, China based auditors would be covered by this provision. In addition, a Subject Audit Firm may be an office of an audit firm located in a jurisdiction that does not permit PCAOB access to audit working papers. In other words, the PRC and Hong Kong offices of international audit firms such as the Big Four would be covered by this provision.

The factors considered by the PCAOB when determining the list of Subject Audit Firms are as follows

[2] In the legislative discussion on December 2, 2020, Brad Sherman read a statement by him and John N. Kennedy (Republican Senator who co-sponsored the China De-Listing Law in the Senate) on the record that the China De-Listing Law does not apply to any issuer where no more than one-third of its "total audit" is outside the scope of inspection by the PCAOB. The term "total audit" is to be defined by the SEC through implementation regulation, and can include total revenue, assets, or other metrics. In other words, the China De-Listing Law will not apply to U.S. multinationals whose China operations are also audited by auditors who cannot be inspected by the PCAOB, as long as the China portion of its "total audit" is not more than one-thirds. This discussion is not legally binding and only serves as a reference point for the SEC in any future implementation of the China De-Listing Law.

("**Audit Determination Factors**"):

1. *the PCAOB's ability to select engagements, audit areas, and potential violations to be reviewed or investigated;*

2. *the PCAOB's access to, and the ability to retain and use,* ***any document or information (including through conducting interviews and testimony) in the possession, custody, or control of the firm(s) or any associated persons thereof that the PCAOB considers relevant to an inspection or investigation;***

3. *the PCAOB's ability to conduct inspections and investigations in a manner consistent with the provisions of the China De-Listing Law and the Rules of the PCAOB, as interpreted and applied by the PCAOB.*

The second Audit Determination Factor above re-iterates the long-standing position of the PCAOB that it has broad, sweeping powers to inspect and investigated audit firms, whether they are located in the U.S. or outside of the U.S.

The list of Subject Audit Firms will be determined annually, and may be amended by the PCAOB in its discretion.

In addition to setting forth the particulars of the PCAOB Rule, the discussion by the PCAOB preceding the text of the rule contains important clues about the position taken by the PCAOB in respect to China's proposal for a joint audit mechanism.

First, the PCAOB noted that "at this time, as reflected on the PCAOB's website, the PCAOB can conduct inspections in all but two of those jurisdictions (China and Hong Kong)." Previously, Belgium also denied the PCAOB full access to audit firms located in Belgium, but the two countries resolved their differences in April, 2021 through a joint agreement. This means that practically speaking, the China De-Listing Law is effectively targeted only at China based audit firms who perform audits of Chinese companies listed in the U.S.

Second, China proposed in August 2020 a mechanism by which the CSRC and the PCAOB would conduct joint reviews of China based audit firms. FANG Xinghai, the vice-chairman of the CSRC, recently expressed frustration over the lack of response to this proposal by U.S. authorities, stating.

We had sent over the latest version on Aug. 4 last year about a joint review with the PCAOB, but unfortunately, the atmosphere in the U.S. since the U.S. presidential election has not been favourable for China-U.S. cooperation. And we haven't received a reply from the PCAOB over whether our proposal is suitable or not. We have been sending an email every month since last August, but they just didn't reply to us.

However, the discussion in the PCAOB Rule suggests that the Chinese proposal may be inadequate in the eyes of U.S. authorities. The discussion acknowledges that "some of the position taken by foreign authorities have been based upon 'gatekeeper' laws, which provide that a registered firm can transfer its audit work papers to the PCAOB only via a local non-U.S. regulator…the PCAOB's ability to conduct inspections or investigations could become impaired in any of these jurisdictions, however, if such an

arrangement were terminated." In other words, the PCAOB appears to reject the notion of joint oversight, based on a fear that access may be curtailed or limited at the discretion of a non-U.S. regulator such as the CSRC.

The discussion then notes that non-U.S. regulators can use other substantive laws to impair the PCAOB's ability to access "firm personnel, audit work papers, or other documents or information relevant to an inspection or investigation". One set of laws mentioned was "personal data protection laws".

On December 16, 2021, the PCAOB issued a determination report (the "**2021 PCAOB Determination**") concluding that all firms registered with the PCAOB in the PRC and Hong Kong, including each of the Big Four firms, are Subject Audit Firms. The 2021 PCAOB Determination concluded that each of the Audit Determination Factors were not fulfilled as to both inspections and investigations. The effect of the conclusions in the 2021 PCAOB Determination is that all Chinese issuers using the Subject Audit Firms listed in the 2021 PCAOB Determination (including the PRC and Hong Kong offices of the Big Four) will now be designated by the SEC as Subject Issuers whose U.S. public securities will be subject to delisting pursuant to the China De-Listing Law.

The 2021 PCAOB Determination was accompanied by a detailed analysis of its positions and justifications. The material differences between the two sides are as follows:

The right of prc regulators to withhold or redact information: A common theme throughout the 2021 PCAOB Determination is the PCAOB's disagreement with the right of PRC regulators to review audit papers in advance and have the right to withhold or redact information contained in them. In addition to disagreeing with this right on principle (given that a fundamental tenant of the Audit Determination Factors is the PCAOB's unfettered access to information it deems relevant in its inspection), the 2021 PCAOB Determination cited a pilot inspection exercise in December 2014 that led to the PCAOB not, in its view, receiving the information it needed to perform the inspection due to PRC regulators withholding or redacting information in the relevant audit papers. While the 2021 PCAOB Determination acknowledged proposal tabled by the CSRC from 2019-2021, it noted that "the CSRC proposals continue to permit withholding or redacting information and fail to create a mechanism whereby withheld documents and redacted information can be provided to the PCAOB in recognition of the PCAOB's need to review them to complete its inspection".

The PCAOB's right to determination who to inspect and the scope of inspection: The 2021 PCAOB Determination did not accept purported proposals by PRC regulators to limit inspections of issuers deemed sensitive by PRC regulators. Two industries cited were state-owned enterprises and "large technology-related companies". The 2021 PCAOB Determination also expressed frustration at the PCAOB's inability to complete "a regular program of inspections" of the Subject Audit Firms.

The PCAOB's purported inability to complete audit investigations: The 2021 PCAOB Determination concluded that the PCAOB was unable to conduct audit investigations as it would not receive requested information or interview witnesses, both of which are fundamental tenants of the Audit Determination Factors. Specifically, the PCAOB alleged that PRC regulators did not comply with a 2013 Enforcement MOU signed by the parties to facilitate the exchange of information for investigations. The PCAOB claims that the CSRC has not produced requested documents for investigations pursuant to the 2013

Enforcement MOU since 2013, and has not produced any documents for investigations of Subject Audit Firms in Hong Kong. Furthermore, it has not been granted the authority to take testimony from witnesses due to the absence of an arrangement between them in this regard. The 2021 PCAOB Determination cited a 2017 meeting between the PCAOB and the CSRC and Ministry of Finance in Beijing, which did not result in additional information being provided pursuant to the 2013 Enforcement MOU, or an arrangement on interviewing witnesses.

Recent developments related to the China De-Listing Law

I Accelerating holding foreign companies accountable act

On June 22, 2021, the U.S. Senate passed by unanimous consent a bill[3] that would amend the de-listing deadline for Subject Issuers from three years to two years (the "**Accelerating Holding Foreign Companies Accountable Act**"). On October 26, 2021, the U.S. House Committee on Financial Services' Subcommittee on Investor Protection, Entrepreneurship, and Capital Markets held a hearing discussing the Accelerating Holding Foreign Companies Accountable Act and other potential actions impacting Subject Issuers (the "**House Hearing**").

The fact that the Accelerating Holding Foreign Companies Accountable Act passed the U.S. Senate by unanimous consent and has been given a hearing in the U.S. House, indicates that its chances of passing the U.S. House and being signed by the President in the near term are high. If passed, the earliest date of de-listing for Subject Issuers will be 2023.

II Proposed listing and U.S. investment prohibitions

On May 27, 2021, Senator Marco Rubio (Republican – Florida), a frequent and long-time China critic, introduced a bill *No IPOs for Unaccountable Actors Act* (the "**Proposed Listing Prohibitions Act**"). The Proposed Listing Prohibitions Act would prohibit, commencing one year after the date of enactment, any U.S. listing of a company whose audit working papers may not be inspected by the PCAOB, including a company that proposes to list through a business combination with a special purpose acquisition company (SPAC). The Proposed Listing Prohibitions Act may have been introduced to address the significant increase in the volume of Chinese listings in the U.S. in 2021 notwithstanding the enactment of the China De-Listing Law[4].

The congressional record also reveals that on May 26, 2021, Senator Rubio tried to insert the text of the Proposed Listing Prohibitions Act as an amendment to another bill that is further along in the legislative process, the *Endless Frontier Act*[5],a bill proposed by Senator Schumer and co-sponsored by 13 other Senators, among which 7 are Republicans[6]. This is a common legislative tactic used to

[3] The full name of the bill is *S.2184 - A bill to amend the Sarbanes-Oxley Act of 2002 to institute a trading prohibition for certain issuers that retain public accounting firms that have not been subject to inspection by the Public Company Accounting Oversight Board, and for other purposes.*

[4] See Financial Times article of April 26, 2021, citing a 440% annualized increase in funds raised by Chinese companies through U.S. equity offerings, at https://www.ftchinese.com/story/001092291/ce?archive.

[5] See the Congressional Record of the Senate of May 26, 2021, pages 5-6, at https://www.congress.gov/117/crec/2021/05/26/167/92/CREC-2021-05-26-pt1-PgS3512.pdf.

[6] The *Endless Frontier Act* has the stated goal of "strengthening of U.S. leadership in critical technologies through basic

bypass the need to vote on a bill separately, instead inserting its terms as an amendment to another bill that has more pressing urgency[7]. Given that the *Endless Frontier Act* is also purportedly aimed at China, there is at least a basis that Senator Rubio can use to convince Senate leadership to include the text of the Proposed Listing Prohibitions Act as an amendment to the *Endless Frontier Act*, thereby potentially accelerating passage of the Proposed Listing Prohibitions Act.

At the House Hearing, Congressman Sherman also raised the prospect of new proposed laws that would (i) require the SEC to investigate whether Chinese companies should continue to avail themselves of the right to list in U.S. public markets as "foreign private issuers" as designed by U.S. securities laws and (ii) prohibit index funds from investing in Subject Issuers with VIE structures. If the SEC concludes that Chinese companies cannot list as foreign private issuers in U.S. public markets, which Mr. Sherman noted was originally designed for companies in jurisdictions such as the United Kingdom with similar sets of investor protections, then Chinese companies will in effect be prevented from listing in the U.S. As a large proportion of Subject Issuers have VIE structures, including virtually all TMT companies that are not health care and life sciences companies, if index funds cannot invest in Subject Issuers with VIE structures, the market impact may be significant. The impacted index funds may have to engage in a costly restructuring of their offerings through a segregation of index funds with U.S. investors and those without U.S. investors.

The Proposed Listing Prohibitions Act was co-sponsored by Senator Bob Casey (Democrat – Pennsylvania) and Congressman Sherman is a liberal Democrat, indicating bipartisan support for further actions that would decouple Chinese companies from U.S. public markets and U.S. investors generally.

III SEC public statement

On July 30, 2021, the SEC Chairman Gary Gensler issued a public statement, which stated that he had instructed SEC staff to seek additional disclosures from prospective Chinese issuers. The specified new disclosures in the public statement on the VIE structure and the China De-Listing Law are already in prospectuses of Chinese issuers in one form or another, but will need to be enhanced to comply with the public statement. What was new in the public statement was the requirement to disclose whether PRC regulatory approval is required for the U.S. IPO, and if so, whether it could be denied or rescinded. The intent appears aimed preventing another Didi listing, which was subject to a continuous PRC regulatory investigation on its data practices immediately after its U.S. IPO.

On August 17, 2021, in a video presentation posted on Gary Gensler's Twitter account, Mr. Gensler stated that the SEC will pause processing the listing applications of Chinese issuers with VIE structures until the SEC receives "full and fair disclosure" of the risks enumerated in the public statement. On or after August 13, 2021, the SEC began issuing detailed follow-up requirements to prospective

research in key technology focus areas, such as artificial intelligence, high performance computing, and advanced manufacturing, and the commercialization of those technologies to businesses in the United States". The legislative record of the bill reveals that both Democrats and Republicans agree the bill should be designed to counter competition from China, with Republicans stating the bill does not go far enough in this regard.

[7] In fact, the revised CFIU.S. (*The Foreign Investment Risk Review Modernization Act of 2018*) and export control laws (*Export Control Reform Act of 2018)* were actually amendments to a "must pass" annual defense bill.

Chinese issuers, which had the effect of enhancing present disclosures (such as PRC regulatory developments having the possibility to "cause the value of such [listed] securities to significantly decline or be worthless"). In addition, prospective Chinese issuers are required to disclose whether PRC regulatory approval is required for the U.S. IPO, and if so, whether it could be denied or rescinded. In particular, there are specific references in the requirements to compliance with the data security requirements of the Cyberspace Administration of China generally and as it relates to the U.S. IPO.

The public statement also reiterated the requirements under the China De-Listing Law and the need for prominent disclosure of potential de-listing risks. In an interview with *Bloomberg*, Mr. Gensler reiterated the need for the PCAOB to inspect the audit work papers of Subject Issuers, stating "the path is clear, the clock is ticking… I have not been informed about anything yet that is a clear path forward[8]".

On September 20, 2021, the SEC released an Investor Bulletin that reiterated the public statement's principles, including the risks associated with investing in VIE structures that may be banned in the future by the PRC government[9].

IV SEC sample letter to China-Based Companies

On December 20, 2021, the SEC's Division of Corporation Finance released the *Sample Letter to China-Based Companies* (the "**Sample Letter**") on its website, which sets forth the SEC's expectations for enhanced disclosures to be made by Subject Issuers, in particular those with VIE structures and PRC companies that propose to list by way of merger with a special purpose acquisition vehicle. In addition to requiring additional disclosure of the Accelerating Holding Foreign Companies Accountable Act and the implementation of the China De-Listing Law and amendments to prospectuses that separate VIEs from the rest of the group structure, the Sample Letter reveals the SEC's general understanding of PRC regulatory developments that may impact U.S. IPOs of PRC issuers, as follows:

Statements by PRC Regulators Covered In Addition to PRC Laws and Regulations: The Sample Letter requires PRC issuers to "address how recent statements and regulatory actions by China's government, such as those related to the use of variable interest entities and data security or anti-monopoly concerns, have or may impact the company's ability to conduct its business, accept foreign investments, or list on a U.S. or other foreign exchange… given recent statements by the Chinese government indicating an intent to exert more oversight and control over offerings that are conducted overseas and/or foreign investment in China-based issuers, acknowledge the risk that any such action could significantly limit or completely hinder your ability to offer or continue to offer securities to investors and cause the value of such securities to significantly decline or be worthless." These requirements reveal the SEC's belief that market sentiment and pronouncements of intent are material for any proposed U.S. listing of PRC issuers.

Specific References to CAC and the CSRC: The Sample Letter requires additional disclosure on

[8] Bloomberg, *SEC Chief Warns 'Clock Is Ticking' on Delisting Chinese Stocks*, August 25, 2021, available at: https://www.bloomberg.com/news/articles/2021-08-25/sec-chief-warns-clock-is-ticking-on-delisting-chinese-stocks.

[9] Investor Bulletin: U.S.-Listed Companies Operating Chinese Businesses Through a VIE Structure, available at: https://www.investor.gov/introduction-investing/general-resources/news-alerts/alerts-bulletins/investor-bulletins-95.

potential approvals required for U.S. listings and the consequences if they are not obtained or if the issuer misjudges whether an approval applies to them. Namely, the Sample Letter requires as follows, "State whether you, your subsidiaries, or VIEs are covered by permissions requirements from the China Securities Regulatory Commission (CSRC), Cyberspace Administration of China (CAC) or any other governmental agency that is required to approve the VIE's operations, and state affirmatively whether you have received all requisite permissions or approvals and whether any permissions or approvals have been denied. Please also describe the consequences to you and your investors if you, your subsidiaries, or the VIEs: (i) do not receive or maintain such permissions or approvals, (ii) inadvertently conclude that such permissions or approvals are not required, or (iii) applicable laws, regulations, or interpretations change and you are required to obtain such permissions or approvals in the future…In light of recent events indicating greater oversight by the Cyberspace Administration of China (CAC) over data security, particularly for companies seeking to list on a foreign exchange, please revise your disclosure to explain how this oversight impacts your business and your offering and to what extent you believe that you are compliant with the regulations or policies that have been issued by the CAC to date." These requirements reveal that the SEC is well aware of PRC regulatory developments that may substantially impact PRC issuers during the period from their proposal to the issuance of final rules. The requirements can be interpreted as written in a way so as to strongly discourage a U.S. IPO in the absence of PRC regulatory approval, as specific disclosure would render the listing meaningless due to heightened regulatory risk.

Important Announcement

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