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## China Puts VIE-Structured Overseas Listings under Regulatory Spotlight

Chinese regulators have recently provided responses to the market's concern that China will crack down on overseas listings of Chinese businesses on a variable interest entities ("VIE") structure. On December 24, 2021, the China Securities Regulatory Commission ("CSRC") released for public comments *Provisions of the State Council on the Administration of Overseas Securities Offering and Listing by Domestic Companies (Draft for Comments)* and *Administrative Measures for the Filing of Overseas Securities Offering and Listing by Domestic Companies (Draft for Comments)*<sup>1</sup> (the "Draft Rules"). The Draft Rules, if declared into effect, will implement a new regulatory framework requiring Chinese businesses to file with CSRC when pursuing overseas listings. Three days later, China's National Development and Reform Commission ("NDRC") and the Ministry of Commerce promulgated *Special Administrative Measures (Negative List) for the Access of Foreign Investment (2021 Version)*,<sup>2</sup> effective as of January 1, 2022 (the "Negative List"). The Negative List for the first time declares China's jurisdiction over (and detailed regulatory requirements on) overseas listings made by Chinese businesses in the so-called "Prohibited Industries", in which China prohibits foreign investment. The intended scope of such jurisdiction was further clarified by NDRC officials on a press conference held on January 18, 2022.<sup>3</sup> The Draft Rules and the Negative List (with NDRC's subsequent clarification), taken as a whole, indicate the latest attitude of Chinese regulators towards VIE-structured overseas listings of Chinese businesses in the Negative-Listed industries, consisting of the Prohibited Industries and the so-called "Restricted Industries" (where foreign ownership is permitted at certain percentages).

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Such businesses (including many in the tech sector such as e-commerce platforms and online publishing/streaming platforms) mostly adopt a VIE structure to achieve a contract-based beneficiary shareholding offshore because China restricts or prohibits foreign ownership in their industries. Over the past two decades, VIE structure has developed into an established strategy for Chinese companies in the Negative-Listed industries to invite foreign investment and eventually go public on international capital markets. Hundreds of VIE-structured companies have been successfully listed in the US or Hong Kong, and some of them have grown into giants like Alibaba and Tencent. However, Chinese regulators have never officially addressed the question of China's regulatory jurisdiction on such listings. Nor have the regulators addressed the more in-depth question of whether VIEs are legitimate at all, given that they circumvent the country's industry-specific restrictions of foreign investment.<sup>4</sup> Market stakeholders therefore have relied on the resulting regulatory grey area in the past; but now, the release of the Draft Rules and Negative List has herded VIE-structured listings into the regulatory spotlight.

The Draft Rules propose a new filing system for all Chinese companies (not only the VIE-structured) that are pursuing listings outside mainland China. The rules also include a definition of "indirect overseas listings" that captures overseas listings of VIE-structured companies.<sup>5</sup> Like other overseas listings, a VIE-structured listing is required to be filed with CSRC within three working days (i) following the submission of IPO application in the case of an IPO (or similar application in the case of a dual listing on another market), or (ii) following the submission of offering/registration applications (or following the first announcement of the transaction, as applicable) in the case of a SPAC listing or "back-door" listing. For pre-existing VIE-structured listings, the Draft Rules suggest that they will be grandfathered, while additional offerings to be made by such companies (such as follow-on offerings, secondary offerings or other shelf offerings) are still required to be filed with CSRC within three working days following the completion of such offerings.

Once in effect, the Draft Rules will affirm that VIE-structured overseas listings are legally permissible and allay investors' fears that China will crack down on such listings arbitrarily. That said, the rules have not given practicable guidance on how the Negative-Listed businesses can satisfy CSRC's filing requirements for overseas listings when they bear a VIE structure. For example, one of the requisite filing documents is "opinion, filing or approval issued by competent industry-specific regulators (where applicable)." It is unclear whether this requirement is applicable to VIE-

structured companies in the Negative-Listed industries, and if it is, what opinion, filing or approval it refers to. Further, if applicable to VIE-structured companies, this requirement appears to call for industry-specific regulators to opine on VIE-related topics, which they have generally avoided in the past. Also unclear is CSRC officials' statement in the press briefing that "to the extent in compliance with regulatory requirements, the VIE-structured overseas listings are permissible", while leaving undefined the exact meaning of "compliance with regulatory requirements". Therefore, how the filing requirements will work in practice remains to be seen.

Notably, the Negative List also picks up the topic of overseas listings for the first time. Section 6 in the notes of the Negative List provides that any Chinese company in the Prohibited Industries pursuing overseas listing should secure pre-approval by relevant governmental authorities. In response to the doubt if Section 6 would have jurisdiction over VIE-structured listings by companies in the Prohibited Industries, NDRC officials explained to the press on January 18, 2022 that the Section 6 requirements apply to *direct* overseas listings only (e.g., Chinese companies offering H-shares on the Hong Kong Stock Exchange), with the rules on *indirect* overseas listings still in development led by CSRC.<sup>6</sup> That way, NDRC gives deference to CSRC on regulating VIE-structured listings, as they are deemed indirect overseas listings. As for direct overseas listings such as H-share listings, Section 6 appears to be regulatorily more permissive than in the past, when companies in the Prohibited Industries were categorically not allowed to pursue direct listings in an offshore market (including Hong Kong). Optimists believe the regulatory relaxation would drive the growth of H-share listings by Chinese companies in the Prohibited Industries. If that comes true, many companies' appetite for VIE-structured listings may change.

Overall, the market has welcomed the Draft Rules and the Negative List insofar as they signal regulators acknowledging VIE-structured overseas listings. Yet the market remains cautious on questions left unanswered, particularly on how the filing system will work. With the Draft Rules and the Negative List, China has gone from turning a blind eye to VIE-structured overseas listings to tightening its regulation in this area. Given its profound impact on sectors that have contributed significantly to China's remarkable economic success over the decades, the change will not be easy, either legislatively or economically. Balanced and careful policymaking in this area is essential for the numerous unlisted businesses in the Negative-Listed industries that have absorbed foreign investments relying on VIE structure, to help them successfully get listed on overseas capital markets.

1. Full version of the Draft Rules can be found at: [http://www.csrc.gov.cn/csrc/c101981/c1662244/1662244/files/附件1：国务院关于境内企业境外发行证券和上市的管理规定%20\(草案征求意见稿\).pdf](http://www.csrc.gov.cn/csrc/c101981/c1662244/1662244/files/附件1：国务院关于境内企业境外发行证券和上市的管理规定%20(草案征求意见稿).pdf)  
[http://www.csrc.gov.cn/csrc/c101981/c1662251/1662251/files/附件1：境内企业境外发行上市备案管理办法%20\(征求意见稿\).pdf](http://www.csrc.gov.cn/csrc/c101981/c1662251/1662251/files/附件1：境内企业境外发行上市备案管理办法%20(征求意见稿).pdf)
2. Full version of the Negative List can be found at: <https://www.ndrc.gov.cn/xxgk/zcfb/fzggwl/202112/P020211227540591870254.pdf>
3. Full transcript of the press conference can be found at: <https://www.ndrc.gov.cn/xwdt/wszb/20221yue/wzsl/?code=&state=123>
4. When China was enacting its Foreign Investment Law in 2015, VIE was once mentioned in a draft for public comments but was taken out of the final version when the law was officially promulgated in 2019.
5. The Draft Rules define "indirect overseas listings" as listings in the name of an offshore entity but based on the underlying equity, assets, earnings or similar rights of a business primarily operating in China. In particular, it will be considered as "indirect overseas listings" if (1) the total assets, net assets, revenues or profits of the Chinese company account for more than 50% of those on the issuer's audited consolidated financial statements; (2) the senior management are mostly Chinese citizens (or have domicile in mainland China) and the primary premise of business operation is in mainland China or main business operations are conducted in mainland China. In addition, CSRC officials stated in the press briefings that "to the extent in compliance with regulatory requirements, the VIE-structured overseas listings are permissible after completing the required filing." CSRC, Relevant Responsible Person of the CSRC Answers to Journalists' Questions (Dec. 24, 2021), <http://www.csrc.gov.cn/csrc/c100028/c1662240/content.shtml>.
6. NDRC January 18, 2022, Press Conference (see note 3).