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China Issues Measures for the Security Review of Foreign Investments

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On December 19, 2020, the *Measures for the Security Review of Foreign Investments* (the “**Measures**”) were issued jointly by the National Development and Reform Commission (“**NDRC**”) and the Ministry of Commerce (“**MOFCOM**”). The Measures went into effect on January 18, 2021. The head of the Foreign Investment Security Review Office (the “**Security Review Office**”) stated that the passing of the Measures is aligned with international practices for foreign investment.

The Measures contain 23 articles covering, among others: (i) the foreign investment transactions subject to it; (ii) the scope of review under it; (iii) the reporting procedures; and (iv) penalties. The Measures were enacted based on the *Foreign Investment Law of the People’s Republic of China*¹, and China’s national security review first introduced in 2011 by the *Circular of the General Office of State Council on the Establishment of Security Review for the Merger and Acquisition of Domestic Enterprises by Foreign Investors*. A dedicated office, i.e., the Security Review Office, will be set up and jointly led by NDRC and MOFCOM to implement the Measures.

1. Foreign Investments Subject to the Measures

According to Article 2 of the Measures, foreign investments (the “**Foreign Investment(s)**”) under the Measures include greenfield investments, acquisitions of shares and/or assets in China, and other investments directly or indirectly made by foreign investors. Moreover, Article 22 stipulates that if a foreign investor acquires the shares of any Chinese enterprise through the public markets (i.e., stock exchanges) and such purchases affect or may affect national security, such secondary market transactions will also be subject to review.

2. Scope of Review

Two types of Foreign Investments are subject to the Security Review Office’s review under the Measures. Under the Measures, foreign investors or the relevant domestic parties (collectively, the “**Relevant Party**”) are required to make a declaration to the Security Review Office prior to implementation of the following investments:

- a. Any and all investments in the national defense security industry (i.e., military-related), as well as in areas surrounding military facilities—no *de minimis* foreign ownership threshold exception; or
- b. If the foreign investor will gain “**actual control**” in an investment, then security review of such investment will be triggered if the invested industry is deemed so critical that it concerns China’s national interest:
 - i. The Measures list the following industries that potentially can be deemed critical to national interest: agricultural products, energy and resources, TMTs, IT and web services, financial services, key technologies and other important fields.
 - ii. “**Actual control**” means either the shareholding of the foreign investor is over 50% in the company; the foreign investor has significant impact through its voting power on the board or as a shareholder;

¹ Article 35: The State establishes a security review system for foreign investment, under which the security review shall be conducted for foreign investment affecting or likely affecting the state security. A decision on security review made according to the present Law shall be final.

or the foreign investor has some other significant impact (e.g., via contractual rights) on the company's business decision-making.²

3. Initiating a Declaration

If an investment falls within the ambit of the Measures, the foreign investor or Relevant Party is required to make a declaration to the Security Review Office. A pre-declaration consultation with the Security Review Office is possible, so that the Relevant Party may determine whether a declaration is in fact required. At this time, no detailed rules have been promulgated regarding pre-declaration consultations.

The Security Review Office can also require the Relevant Party to make a declaration on its own initiative. In addition, a review by the Security Review Office may be suggested by the general public if they believe certain Foreign Investments may affect national security. This avenue may potentially be used by competitors or disgruntled employees. If the Relevant Party failed to make the filing, the transaction could be forcibly cancelled before or after it closes.

4. The Review Procedure

As discussed above, the security review process can be initiated either by the Relevant Party or by the Security Review Office, or sometimes by the public. The entire process is expected to typically take 45 to 105 working days, depending on the extent to which the Foreign Investment may affect national security. The review time may be extended if the Foreign Investment is determined to have potential impact on national security. There are no implementation regulations promulgated yet and the system is just being put in place.

The Measures indicate that the Security Review Office can hand down three types of decisions – either: “passed,” “prohibited” or “conditionally passed” with additional commitments by the Relevant Party to eliminate such Foreign Investment’s potential impacts on national security.

Conclusion

The Measures formalize and elaborate on the existing screening procedures for foreign investments across a broad range of sectors falling within China’s expansive definition of national security. For example, China’s foreign investment approval procedures, including anti-monopoly review and technology import and export review, already allowed substantial latitude for imposing conditions on or rejecting proposed foreign investments. The Measures will, however, create an additional layer of uncertainty with respect to foreign investments into China.

Given that the Measures merely set up a framework for national security review for now, have a very wide scope and are still quite vague, it is hard to predict how much impact they will have on the process of foreign investments into China. Thus, foreign investors are advised to keep this additional layer of regulatory approval in mind and carefully assess the transaction certainty of investing in industries that potentially have a national security aspect.

² According to Article 4 of the Measures: “Obtaining the actual controlling stake in the investee enterprise” shall include the following circumstances:

- (i) where the foreign investor holds more than 50% of the equity of an enterprise;
- (ii) where the foreign investor holds less than 50% of the equity of an enterprise, but the voting rights held by it can have significant impact on the resolutions of the board of directors, the board of shareholders or the general meeting of shareholders; and
- (iii) other circumstances where the foreign investor may have significant impact on the enterprise’s business decision-making, human resources, finance, technology, etc.

For more information, please see the following resources:

- [China Updates page](#)
- [China Patent Law Fourth Amendment—Impact on Foreign Companies](#), January 26, 2021
- [China Regulators Remove Restrictions on Insurance Fund Investment](#), December 14, 2020
- [China Adopts Interim Provisions on the Review of Concentrations of Business Operators for the Anti-Monopoly Law](#), November 30, 2020
- [China Releases Draft Personal Data Protection Law for Comments](#), November 12, 2020
- [China Adopts Export Control Law](#), November 5, 2020
- [China Releases New QFII/RQFII Rules](#), October 27, 2020
- [China Releases Provisions on Strengthening the Supervision of Private Equity Investment Funds \(Draft\)](#), October 15, 2020
- [China Releases Provisions on the Unreliable Entity List](#), October 5, 2020
- [China Releases Revised Measures on Handling Complaints of Foreign-Invested Enterprises](#), September 23, 2020
- [China Releases Administrative Measures for Strategic Investment by Foreign Investors in Listed Companies](#), September 10, 2020
- [China Releases Draft Data Security Law](#), September 8, 2020
- [China Releases Circular on Further Stabilizing Foreign Trade and Foreign Investment](#), August 24, 2020
- [China Releases Draft Measures for the Administration of Imported and Exported Food Safety](#), August 18, 2020
- [U.S. Listed Chinese Companies: Regulatory Scrutiny and Strategic Options](#), July 30, 2020
- [China Passes Controversial Hong Kong National Security Law](#), July 9, 2020
- [China's Relaxed Financial Sector May Aid Foreign Investors](#), June 18, 2020
- [Is There a Law in China Similar to the US Defense Production Act?](#), May 8, 2020
- [Coronavirus Brings Force Majeure Claims to LNG Contracts](#), March 4, 2020
- [The Rise of China](#), March 4, 2020
- [Coronavirus Fears Cast Cloud Over Dealmaking](#), February 27, 2020

Additional questions? Please contact Haynes and Boone lawyers [Liza L.S. Mark](#) and [Jasmine Yang](#).