

National Development and Reform Commission and Ministry of Commerce Issue Rules on the National Security Review of Foreign Investment

China Business Solution Office
RMB Internationalization Business Promotion Office

On December 19, 2020, the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) issued “Rules on the National Security Review of Foreign Investment” (2020 Order No. 37, hereinafter the “NSR Rules”). The NSR Rules that detail the foreign investment security review system in China will take effect on January 18, 2021 as regulations relevant to the Foreign Investment Law.

[Key Takeaways]

- Foreign investors are required to check whether they are subject to a national security review (NSR) when establishing a new foreign-invested enterprise (FIE) or purchasing equity in a non-foreign enterprise.
- The NSR will target foreign investment in defense, military and other key sectors that pertain to national security.
- Foreign investors are required to complete the relevant consultations, applications and reviews for NSR before executing their investment.

1. Background of the Policy

The Foreign Investment Law and its regulations for implementation, which came into effect on January 1, 2020, set forth three main measures to manage foreign investment: 1) the management system for pre-entry domestic treatment and negative lists, 2) the foreign investment data reporting system, and 3) **the foreign investment security review system**. In particular, the foreign investment security review system is an international management system for foreign investment, mainly focusing on **balancing economic benefits and national security** while also attracting foreign investment.

At beginning, China’s foreign investment security reviews mainly targeted M&As by foreign investors. In free trade zones (FTZs), however, the country has expanded the scope of foreign investment security reviews to new projects, the establishment of new FIEs, and other types of investment (VIEs, shareholding by proxy, etc.). Please refer to Fig. 1 for more details on the history of the relevant regulations.

[Fig. 1] History of Regulations Pertaining to Foreign Investment Security Reviews

Year issued	Order No.	Name of law/regulation	Outline
2007	Presidential order No. 68	Anti-monopoly Law	First explicit stipulation that the Chinese government would conduct NSRs on M&As by foreign investors
2011	Guobanfa [2011] No. 6	Notice on creation of an NSR system relating to M&As of a non-foreign enterprise by foreign investors	Formal establishment of the NSR system for M&As by foreign investors

2015	Guobanfa [2015] No. 24	Rules on NSR for foreign investment in FTZs	Expansion of the scope of foreign investment security reviews in FTZs to new projects, the establishment of new FIEs, and other types of investment*
2020	NDRC-MOFCOM Order No. 37 in 2020	Rules on the National Security Review of Foreign Investment	Formal establishment of the national-level NSR system for foreign investment

* Other types of investment include the variable interest entity (VIE) model, shareholding by proxy, trust, reinvestment, offshore transactions, leasing, and the purchase of EBs (exchangeable bonds).

2. Main Details of the NSR Rules

1) A Foreign Investment Security Review Working Mechanism

The government will establish a foreign investment security review working mechanism, led by **NDRC and MOFCOM** and being responsible for organizing, coordinating, and guiding foreign investment security review work. The Working Mechanism Office is established at the NDRC and can be contacted via the following methods*.

Address: 1st fl., NDRC West Bldg. Sanlihe South 5-Xiang, Xicheng District, Beijing

Phone: 010-68501622, 68502979

*Source: NDRC Notice No. 4, 2019

2) Types of Foreign Investment Transactions Subject to NSR

[Fig. 2-1] Types of Foreign Investment Transactions Subject to NSR

- ✓ Foreign investors establish a new domestic project or enterprise independently or jointly with other investors.
- ✓ Foreign investors purchase equity or assets from a non-foreign enterprise via an M&A.
- ✓ Foreign investors invest domestically through other types of methods.

*Investments from Hong Kong, Macau, and Taiwan are to be executed based on the NSR Rules.

*The method of applying foreign investment security reviews to securities is being formulated.

3) Sectors of Foreign Investment Subject to NSR

[Fig. 2-2] Sectors of Foreign Investment Subject to NSR

Defense and military industries	<ul style="list-style-type: none"> ✓ Investment in the military industry, military-related industries and other areas relating to China's national defense and security ✓ Investment in the locations surrounding military installations and military facilities
Investing in key sectors relating to national security and obtaining actual control of investment targets	<p>Scope of key sectors</p> <p>1) Important agricultural products, 2) important energy and resources, 3) important equipment manufacturing, 4) important infrastructure, 5) important transportation services, 6) important cultural products and services, 7) important information technology and internet products and services, 8) important financial services, 9) core technologies, and 10) other important sectors</p>
	<p>Situations in which foreign investors obtain actual control</p> <ul style="list-style-type: none"> ✓ Foreign investors own more than 50% of the shares ✓ Foreign investors own less than 50% of the shares but have sufficient voting rights to exert a material influence over the shareholder vote and resolutions of the board

	of directors and shareholders' meetings/general meetings ✓ Foreign investors gain actual control of business decision-making, human resources, financial matters, technologies, etc.
*If the foreign investors are not sure if their investment sectors are subject to NSR, the investors may consult with the Working Mechanism Office about the specific projects.	

4) Application for NSR

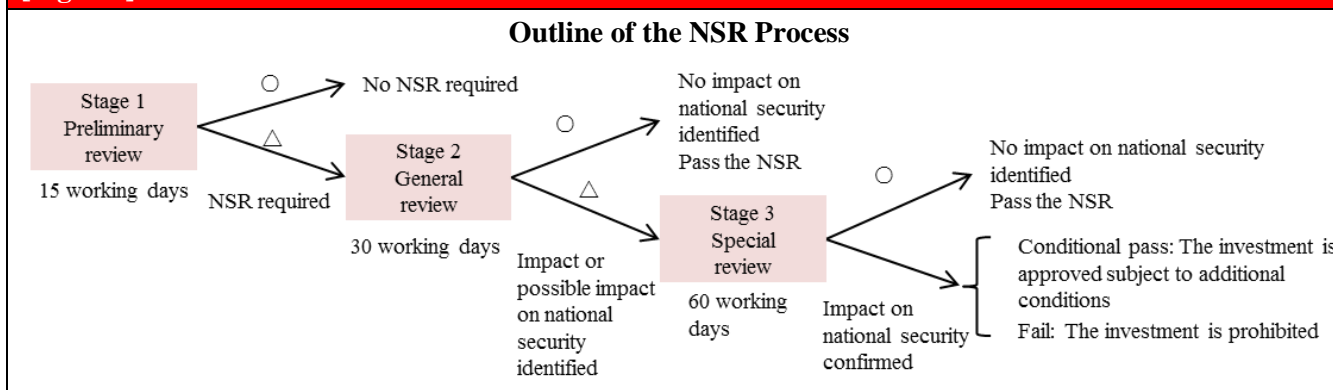
[Fig. 2-3] Application for NSR

Foreign investors or the relevant non-foreign parties are required to **voluntarily submit applications of the investments that fall within the scope of the review to the Working Mechanism Office before executing investments.**

Application materials	1) Application form*, 2) investment plan, 3) explanation of an impact on national security which the foreign investment may have, and 4) other materials set forth by the Working Mechanism Office. *The application form is required to include the names, addresses, and the scope of business responsibilities of the foreign investors, as well as the basic information of the investment and other matters set forth by the Working Mechanism Office.
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5) NSR Process

[Fig. 2-4] NSR Process



Stage	Review Period	Result/decision of the review		Remarks	
Stage 1: Preliminary review	15 working days	○	No NSR required	➤ The applicant is not allowed to execute any foreign investment during the review period.	
		△	NSR required → Referred to Stage 2		
Stage 2: General review	30 working days	○	Pass the NSR	➤ The office shall notify the applicant of the decision of the review in writing.	
		△	Impact or possible impact on national security identified → Referred to Stage 3		
Stage 3: Special review	60 working days May extend under special circumstances	○	Pass the NSR	➤ If the impact on national security can be eliminated by imposing additional conditions, the applicant may accept such conditions in writing.	
		△	Impact on national security		The investment is approved subject to additional conditions
		×	confirmed		The investment is prohibited

6) Revisions to or Withdrawal of the Foreign Investors' Investment Plan

[Fig. 2-5] Revisions to or Withdrawal of the Foreign Investors' Investment Plan		
During review period	Investment plan revisions	The Working Mechanism Office shall recalculate the review period from the date of receiving the revised investment plan.
	Withdrawal of investment	The Working Mechanism Office terminates the NSR.
After passing review	Investment plan revisions	If the applicant revises the investment plan after it has passed the NSR, it must resubmit the plan to the Working Mechanism Office if the proposed investment has or potentially has an impact on national security.

7) Execution upon Receiving the NSR Result

[Fig. 2-6] Execution upon Receiving the NSR Result	
NSR decision	Investment execution
Investment approved	Foreign investors are permitted to execute the investment.
Investment approved conditionally	Foreign investors are permitted to execute the investment subject to additional conditions.
Investment prohibited	<ul style="list-style-type: none"> ➤ Foreign investors are not allowed to execute the investment. ➤ If foreign investors have already executed the investment, they are required to dispose of the equity or assets and/or take other necessary measures by the deadline to return to the state before execution and eliminate any impact on national security.

8) Disciplinary Actions for Regulatory Violation

[Fig. 2-7] Disciplinary Actions for Regulatory Violation		
Types of regulatory violation	Disciplinary actions to be taken	
Investment executed with no application made in compliance with the regulations	<ul style="list-style-type: none"> ➤ The regulators shall order foreign investors to make an application by the deadline. ➤ If foreign investors refuse to make an application, the regulators shall order them to dispose of the equity or assets and/or take other necessary measures by the deadline to return to the state before execution of the investment and eliminate any impact on national security. 	The regulators shall record the foreign investors as having poor credit on the state-run financial credit database and take disciplinary actions based on the relevant regulations.
False materials provided or relevant information concealed	<ul style="list-style-type: none"> ➤ The regulators shall retract the relevant decision. ➤ If foreign investors have already executed the investment, the regulators shall order them to dispose of the equity or assets and/or take other necessary measures by the deadline to return to the state before execution of the investment and eliminate any impact on national security. 	
Investment not executed in compliance with the additional conditions	<ul style="list-style-type: none"> ➤ The regulators shall issue an improvement order. ➤ If foreign investors refuse to follow the improvement order, the regulators shall order them to dispose of the equity or assets and/or take other necessary measures by the deadline to return to the state before execution of the 	

	investment and eliminate any impact on national security.	
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3. Impact on Enterprises

The foreign investment security review system is an international management system for foreign investment and one of the major Chinese measures to manage global foreign investment. In the days to come, foreign investors will be required to check in advance whether their investment activity or investment sector is subject to an NSR when executing an investment in China (e.g. establishing a new FIE or purchasing equity in a non-foreign enterprise in the region). If you are not sure whether you are subject to an NSR, you can consult with the Working Mechanism Office. If you have determined that you are subject to an NSR, you must pass the NSR as required by the NSR Rules prior to starting activities for investment in China based on the regulations.

We will continue to follow up on related information and provide further updates as they come.

End

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