Cross-border M&A in mainland China amidst dual circulation and a new regulatory environment

Executive summary

Foreign direct investment (**FDI**) has been, and continues to be, a subject of fundamental importance to the development of economies worldwide, including mainland China. This paper focuses on the inbound investment opportunity into mainland China, specifically through mergers and acquisitions (**M&A**), amidst a backdrop of continuing economic growth and regulatory change in China's domestic economy and polity.

The paper is divided into three sections, summarised below:

Section 1 includes a review of the new Foreign Investment Law (**FIL**) and associated laws and regulations that support, regulate and encourage foreign investment into mainland China, such as:

- the Implementing Rules for the FIL
- the Ministry of Commerce of the People's Republic of China's (**MOFCOM**'s) overhaul of the foreign investment filing system
- the ongoing reduction of the Negative List
- the ongoing extension of the Encouraged Industries Catalogue
- reform measures by the State Administration of Foreign Exchange (**SAFE**)
- changes to securities laws and new measures from the State Administration for Market Regulation (**SAMR**)

These measures have significantly accelerated and encouraged foreign investment into mainland China through M&A by reducing and simplifying legal and regulatory processes, offering reassurances in relation to equal treatment, widening the range of business activities available for foreign investment, and improving capital market access for foreign investors.

Section 1 also reviews the new Measures for the Security Review of Foreign Investment (**Measures**), which update mainland China's pre-existing foreign investment screening regime against a backdrop of other major economies' own activities in updating their foreign investment screening regimes, and discusses how they may impact inbound M&A into mainland China.

Section 2 is a review of how dealmaking by foreign investors has changed in the light not only of the FIL coming into force on 1 January 2020, but also the backdrop of the Covid-19 pandemic of 2020. Some of the major trends we identify include a strong recovery in mainland Chinese inbound M&A in 2020 despite a fall in the first quarter of 2020, and significant activity in sectors such as new energy, consumer and retail, healthcare, industrials, automotive and high technology. This reflects the development of both the consumer side and the production side of mainland China's economy, which will continue in light of the renewed focus on "dual circulation"; and increasing international diversification among acquirors of, and investors in, mainland Chinese businesses.

We suggest that China's rapid and robust handling of the Covid-19 pandemic has helped deal flow to recover to pre-Covid-19 levels and highlighted the strength and attractive prospects of mainland China's economy, including as an increasingly attractive destination for M&A and other forms of foreign investment. Nevertheless, the pandemic has led to a lengthening in deal duration, new areas for negotiation and due diligence between acquirors and sellers, and reappraisals of business models

across industries – and it is likely that the new Measures will also impact deal timetables for transactions in relevant sectors.

Section 3 of this report suggests areas of consideration for policymakers and dealmakers in light of these findings. These areas include a recognition of the importance of on-the-ground expertise (particularly operational expertise) in order to successfully source and close deals; a recognition of the increasing importance of transparency in obtaining regulatory clearance; the increasing roles of the capital markets in connecting mainland Chinese businesses and international investors; and the increasing influence of mainland China's growing and maturing domestic M&A market on the trends in inbound M&A.

Dealmakers and policymakers therefore have a significant opportunity to accelerate investment into mainland China by engaging in dialogue, education and networking. Such dialogue is particularly important given ongoing global tensions in relation to trade and foreign investment scrutiny and the continued effect of the Covid-19 pandemic, which may significantly hinder the growth of inbound M&A, despite the robust handling of the pandemic in mainland China.

We also suggest that there is an exciting opportunity for mainland Chinese businesses and policymakers to continue to share their experience and insights of managing the Covid-19 pandemic, with corresponding benefits not only to China but also the world.

Section 1: Legal context

The liberalisation of inbound investment into mainland China has accelerated over the last few years, even before the FIL came into force on 1 January 2020 (it was enacted on 15 March 2019). In October 2016, mainland China fundamentally reformed its decades-old foreign investment approval system. Newly-established foreign invested enterprises and foreign-related M&A of companies incorporated in mainland China would no longer require the approval of MOFCOM. MOFCOM's approval jurisdiction was retained for those investment sectors that continued to operate restrictions and prohibitions on foreign investment – a group of sectors known as the "Negative List".

The continuing liberalisation of inbound investment into mainland China can be seen in two major recent legal developments: firstly, the ongoing shortening of the Negative List (and the parallel expansion of the Encouraged Industries Catalogue); and secondly the FIL which takes measures to offer equal treatment and intellectual property (**IP**) protection for foreign-invested businesses, while also reserving the right to take action against economies that discriminate against mainland Chinese investment.

Against this backdrop of liberalising foreign investment, it should also be noted that China also published, in December 2020, new measures which updated the 2011 regime for foreign investment screening on the basis of national security. While the impact of these measures is yet to be felt, they are a vital component of China's policy response to foreign investment and bring China into line with other major economies in enhancing the scrutiny of foreign investment.

The Foreign Investment Law 2019

The FIL came into force on 1 January 2020. It is a landmark piece of legislation meant to serve two aims: improving the business environment for foreign investors in mainland China and ensuring that foreign invested enterprises (**FIEs**) participate in the market on an equal basis as domestic enterprises.

The FIL is relatively high level in nature, and many of the measures suggested therein can be grouped under the aims of:

(1) offering equal treatment to foreign investors

(2) offering reassurances over IP protection

(3) offering reassurances over the ease of doing business in mainland China

(4) ensuring that China retains the ability to take protective and reciprocal action where appropriate

A selection of some of the measures in the FIL is given below.[1]

- Equal treatment
    - Foreign investors enjoy equal treatment with domestic counterparts, excluding sectors specified on the Negative List (Article 4)
    - FIEs have equal rights when participating in government procurement and standards setting processes (Articles 15 and 16)
    - FIEs have the ability to raise funds through public share offerings, corporate bonds, and other means in mainland China (Article 17)
    - A consistent standard for foreign-invested businesses and mainland Chinese businesses for reviewing business permits and licenses (Article 30)
- IP protection

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1 Source: http://www.fdi.gov.cn/1800000121_39_4872_0_7.html

    - Administrative departments and their staff members are prohibited from using administrative means to require technology transfers from foreign businesses (Article 22)
    - Technology co-operation is encouraged based on “free will and business rules” (Article 22)
- Ease of doing business in mainland China
    - The establishment of a “service system for foreign investment, and [the provision to] foreign investors and foreign-funded enterprises [of] consultation and services in respect of laws and regulations, policies and measures, investment project information and other aspects” (Article 11)
    - Government “at all levels” must “streamline procedures for handling affairs, raise their efficiency and optimise government services, so as to further improve the services offered for foreign investment” (Article 19)
    - Establishing a “complaint mechanism for foreign-funded enterprises” to be used where “any administrative act of an administrative department or its staff member infringes [an FIE’s] legitimate rights and interests” (Article 26)
- Reciprocity
    - Provision for China to take “corresponding” measures against countries that discriminate against Chinese investment (Article 40)
    - A foreign investment security review system that would cover foreign investments “affecting or having the possibility to affect” national security, any decisions under this system being “final” (Article 35)

Although the FIL has set out a clearer framework for foreign investment into mainland China, further detailed rules and regulations are expected to flesh out the high-level provisions of the FIL over the course of 2021 and beyond. For example, although the treatment of variable interest entities (**VIEs**) was mentioned in the consultation draft of the FIL, the final form of the FIL is silent on VIE structures, so these continue to carry uncertainty as vehicles for foreign investment.

Some of the ancillary laws and regulations that have impacted foreign investment transactions in mainland China are given below.

Implementing Rules for the Foreign Investment Law 2019

The implementing rules (**Rules**) make important clarifications to the concepts given in the FIL. In particular, the Rules help enforce the FIL principle that foreign investments will not be expropriated without reasonable compensation: no discrimination, market value must be compensated, and rights of administrative appeal for the expropriated party.

The Rules provide a defined basis for investors to hold government authorities to their FIL obligations to comply with commitments and contracts, by (i) specifying that “commitments” include all forms of written policy support or preferential/accommodative treatment for local investments, and (ii) expressly disallowing changes to governmental divisions, officers or functions as basis for reneging on their contractual obligations.

On the FIL’s commitment to protect foreign investors’ IP, the Rules promise to step up sanctions and law enforcement against infringers.

To underpin the FIL’s commitments to a fair and competitive government procurement process including equal treatment of FIEs, the Rules provide that supplier selection may not be restricted on the basis of ownership, corporate form, nationality or brand.

Overhaul of foreign investment filing system

Around the same time as the Rules were released, MOFCOM updated its foreign investment filing system.

In accordance with the provision for a foreign investment information reporting system in the FIL, MOFCOM has introduced new reporting requirements for all FIEs, replacing the previous filing-based system for establishment of, and changes to, FIEs which had been in place since 2016. The new reports, which comprise an information report, an amendment report, a deregistration report and an annual report, are to be submitted through the enterprise creditworthiness publicity system which is also used to register the establishment of new FIEs and domestic enterprises. It is also clarified that the new reports must be completed for all direct and indirect investments by FIEs in mainland China.

The new system has resulted in time and efficiency savings for foreign investors, enabling them to submit all FIE-related information on a single platform without needing to make multiple filings with MOFCOM and SAMR. Procedures for the filing of the new MOFCOM reports and the application to SAMR for the establishment of FIEs are not sequential and can largely be completed in a single submission.

All investment filings made by foreign investors, including FIEs, in sectors not on the Negative List (see below) are to be treated the same as domestic investor filings. Importantly, the new judicial interpretation of the Supreme People's Court on the FIL expressly prohibits mainland Chinese courts from declaring that an investment agreement in any of these sectors is void (or has not come into effect) on the basis that relevant industry regulatory approvals have not been obtained, thus drawing a clear line between the effectiveness of an investment agreement and compliance with industry regulatory approval, consent and filing requirements in these sectors.

For FIEs in sectors restricted to foreign investment under the Negative List, the previous requirement of MOFCOM approval, involving the issuance of a MOFCOM approval certificate, has been abolished. SAMR is required to register the establishment of these FIEs provided they comply with the restrictions as to foreign ownership percentage, legal representative and key persons in charge (if applicable) under the Negative List, and to the extent that necessary industry-specific regulatory approvals have been obtained.

Finally, a key change of note is that compliance with these procedures is not, as a matter of law, a condition precedent to deal closing. The reformed regime is thus expected to further speed up the process of foreign investment by inbound M&A into mainland China.

The ongoing shortening of the Negative List

China released its updated Foreign Investment Negative List (a list of industries where foreign investment is either restricted or prohibited) in June 2020, which continued to reduce the number of such industries and sectors. Areas on the national Negative List fell from 40 to 33 (and from 37 to 30 in free trade zones (**FTZs**)). Notably, there was significant liberalisation of the financial services and automotive sectors: foreign ownership caps on securities, fund management, futures, life insurance companies, as well as commercial vehicle enterprises, were removed. Other changes include allowing foreign investors to take majority shares in water supply and drainage joint ventures in cities with a population of more than 500,000, and wholly foreign-owned institutions to set up vocational education institutions.

In December 2020, China released its updated Negative List for Market Access[2], which again continued to reduce the number of prohibited and restricted areas of business. The new list stood at

[2] The Negative List for Market Access is distinct from the Foreign Investment Negative List described in the previous paragraph. The former applies to all types of investment into mainland China, whether for domestic or foreign investors; the latter is for foreign investment only.

123 items (5 prohibited, 118 restricted): a reduction from 131 in 2019[3]. Activities deleted from the list included oil and gas exploration and production and the appointment of new executives in securities companies – while items added to the list included restrictions on the establishment of financial holding companies[4], showing China's determination to place responsibility for financial regulation firmly with the existing individual financial sub-sector regulatory authorities.

The ongoing extension of the Encouraged Industries Catalogue

In December 2020, the National Development and Reform Commission (**NDRC**) and MOFCOM published the 2020 Catalogue of Encouraged Industries for Foreign Investment (**Catalogue**), which lists industries where FDI will be encouraged at a national level and for central, western and north eastern regions, and which became effective in January 2021. The 2020 Catalogue contains 1,235 items (a rise of c. 11% versus 2019, where there were 1,108 items)[5].

The main trends of the Catalogue at the national level include a continuing encouragement for foreign investors and FIEs to invest in high-tech manufacturing (e.g. automotive engines using new energy sources; components of new energy vehicles and intelligent vehicles; automotive charging piles and charging piles for energy storage; new energy power generation equipment; quantum computers, brain-like computers and other next-generation computers; 4G and 5G mobile telecom equipment; etc.) and services such as venture capital and scientific R&D. This focus on advanced manufacturing sectors will ultimately increase the range and sophistication of products and services available to China's domestic consumers. At the regional level, it should be noted that Henan, Shaanxi and Guangxi provinces have added "medical equipment, epidemic prevention and protection articles, and active pharmaceutical ingredient (API) production" to their encouraged list.[6]

Simplifying funds remittances for inbound investments in mainland China

SAFE introduced 12 reform measures to boost foreign investment in October 2019. These include in particular (i) allowing foreign-invested businesses in mainland China whose main purpose is not investment to make equity investments with their registered capital (before this change, such FIEs were required to have "investment" in their business scopes in order to make equity investments – a change that was difficult to make in practice); and (ii) making it easier for sellers of PRC assets to deal with buyers paying in foreign currency. This was followed, in December 2020, by a joint notice by SAFE, the People's Bank of China, NDRC and the State-owned Assets Supervision and Administration Commission, which aims to accelerate the use of cross-border renminbi (**RMB**) capital flows in the Chinese domestic economy. A key part of the new notice simplifies the account opening structures in the use of cross-border RMB by foreign investors as well as the use of profits generated in RMB by FIEs in China to pay for new acquisitions. This makes it easier for sellers of PRC assets to accept cross-border RMB and reinvested RMB profits as payment for acquisitions and further increases incentives for investors to consider reinvesting profits from their investments in mainland China instead of repatriating them abroad.

Changes to securities law

The FIL states that "foreign-funded enterprises may conduct financing through public offering of shares, corporate bonds and other securities or by other means".[7] In 2020, the mainland Chinese securities law was amended so as to transition towards a registration-based IPO system, increase disclosure requirements, and impose larger penalties for violations. These measures will not only

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[3] Source: "China reduces items on the negative list for market access", 16 Dec 2020, Reuters

[4] Source: "China releases 2020 Negative List for market access", 23 Dec 2020, China Briefing

[5] Source: "China Expands Encouraged Catalogue, Improves Foreign Investor Access'', 5 Jan 2021, China Briefing

[6] Source: ibid.

[7] Source: http://www.fdi.gov.cn/1800000121_39_4872_0_7.html

liberalise mainland China's capital markets but also improve their attractiveness to domestic and foreign investors: in turn, increasing the propensity of inbound investors and acquirors to use them in order to fund M&A.

New measures from SAMR

In April 2020, SAMR, through its arm that supervises and regulates market competition and monopolies, published antitrust measures to manage the Covid-19 pandemic and the resumption of work and industrial production. SAMR has established a "green channel" for expediting its review of merger filings in some industrial sectors, including the pharmaceutical manufacture, medical equipment and apparatus manufacture, food production, transportation, wholesale and retail, and other sectors closely related to daily life and the prevention and control of the pandemic.

Notwithstanding Covid-19, the review of no-issue cases has been increasingly expedited. SAMR reportedly took an average of 12.8 days to approve deals placed under its simplified merger review procedure in the first quarter of 2020 compared to 13.4 days in the preceding quarter. This slight shortening of duration was evidence of SAMR's commitment to support resumption of work and industrial production.

SAMR confirmed in a press release in mid-March 2020 that it has received 37 merger filings since 3 February 2020, formally initiated 45 cases and closed 45 cases, at average closing two cases per business day, which "greatly supported company M&A activity."

Not only is the simplified merger review procedure expedited by taking advantage of the "green channel", some no-issue cases filed under the normal procedure have also been observed as having been cleared speedily: for example, in April 2020, SAMR cleared the merger filing for a joint venture between Coca-Cola and China Mengniu Dairy within Phase 1, such a swift approval being rarely seen in previous cases reviewed under the normal procedure.

In contrast, complex cases continue to face lengthy review processes. Based on SAMR's conditional approval decisions published in 2020, it took filing parties an average of 291 days to obtain the approvals from the date of submission, and two out of the four remedy cases were pulled and refiled. This indicates that for high-profile deals with substantive issues, SAMR still typically takes time for a thorough review.

Measures for the security review of foreign investment

Whilst the FIL reserves the right for deals to be scrutinised and/or blocked for national security reasons, this has historically been little used in practice. This is expected to change given the publication of the Measures by NDRC and MOFCOM in December 2020, which took effect in January 2021. The new regime updates the previous rules, which were seen as mainly focused on large deals in the military, energy and infrastructure spaces and hence needed updating to reflect China's commercial and technological development and aspirations. The Measures are an important and necessary component of mainland China's policy response to foreign investment and come against a backdrop of many other major economies updating their foreign investment screening regimes (see section 3 of this report for the US, Europe and UK experience).

The revised Measures cover all types of foreign direct and indirect investments in mainland China, and also introduce a new office (**Office**) responsible for foreign investment screening for national security reasons. The Office will be set up by NDRC and jointly managed by NDRC and MOFCOM. As before, investments by investors from Taiwan, Hong Kong SAR and Macau SAR are all covered by the Measures.

Transactions covered by the Measures include (1) investments in sectors relating to national defence and security, as well as (2) investments where control or major influence is acquired in businesses in

sectors such as agriculture, energy, resources, infrastructure, manufacturing of heavy equipment, transport, cultural activities, IT and internet, key technologies, financial services, and other important sectors to the extent that they have a bearing on national security. Further rules are to be published on how the Measures will apply when the foreign investor conducts the transaction by acquisition of listed shares.

Security review under the Measures will be a three-stage process once a transaction is notified to the Office:

- Stage 1: The Office will decide whether there is a need for a security review of the transaction within 15 working days of notification.
- Stage 2: If the Office decides a review is required, it will conduct an “ordinary review”, which will take up to 30 working days.
- Stage 3: If the Office decides following its ordinary review that the transaction will or could affect national security, it will conduct a “special review”, which will take up to 60 working days (or more, if the Office decides that this duration needs to be extended).

The special review can result in the transaction being prohibited, or conditions being set in order to eliminate the national security risk of the transaction.

In line with many other major economies’ screening regimes, “national security” is not defined in the Measures. But it is clear from the wide set of activities listed in the Measures that foreign investors seeking to pursue transactions in the light of the FIL must also be ready to work with the Office in order to clear foreign investment screening security review, and to incorporate the associated timelines, disclosures and risks in their deal planning.

Section 2: How is inbound dealmaking changing, following the new FIL and the onset of Covid-19?

Of course, the FIL coming into force was not the only macro-level change for inbound M&A into mainland China. We have also seen the Covid-19 pandemic having a significant impact on international dealmaking at every stage of the process. Acquisition screening and portfolio review processes have been upended by the need to factor in changes in business models necessitated by the pandemic. The gap between buyers' and sellers' valuation expectations has often widened due to differing views about the potential size and duration of the pandemic's effect. Auction and due diligence processes have also lengthened as international travel and site visits have become more problematic.

The relative resurgence of growth in the Chinese economy

Mainland China's robust handling of the pandemic has led to a rapid recovery in its economy. Not only did "China's economy return to growth in the second quarter [of 2020]"[8], but "China's gross domestic product expanded 6.5% in the fourth quarter of 2020, beating forecasts… China will be the only one of the world's big economies that did not shrink [in 2020]".[9]

Signs of the strength of mainland China's economy include:

- The rapid growth of industrial production in mainland China: 7.1% growth in the fourth quarter of 2020[10].
- The forecast recovery and growth in mainland China's consumption economy in 2021: Goldman Sachs predict that consumption will "take over the baton and become the main growth driver in 2021", estimating that household consumption would increase 13% in 2021 (versus a 4% fall in 2020).[11]
- Mainland China's trade surplus hitting US$78bn in December 2020: its highest monthly level, driven by global demand for medical equipment and lockdown-related goods.[12]
- The renminbi/US dollar exchange rate breaching 6.5 for the first time since 2018, "roughly back to the level it was before President Donald Trump kicked off a trade war between Beijing and Washington in mid-2018", reflecting China's successful control of Covid-19.[13]
- Mainland China's stock market reaching its highest level since the global financial crisis in February 2021, and at the time of writing[14] the CSI 300 is close to its all-time high.
- The outperformance of Mainland China's CSI 300 stock market index versus the S&P 500: "China's benchmark CSI 300 index is up about 27% this year [2020], in dollar terms, beating the S&P 500 by more than 13 percentage points".[15]

The extremely competent handling of the pandemic in mainland China is seen as a potentially highly significant accelerator for its economy in the short term and longer term versus Western economies. In the short term, "China's control over the pandemic is widening its divergence with other nations,

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8 Source: "China's industrial production rises at fastest rate this year", 15 Dec 2020, Financial Times

9 Source: "China's economy expands at faster rate than before coronavirus", 18 Jan 2021, Financial Times

10 Source: Financial Times, ibid

11 Source: "Chinese consumers move towards forefront of economic recovery", 29 Nov 2020, Financial Times

12 Source: "China trade surplus breaks record monthly level", 14 Jan 2021, Financial Times

13 Source: "Renminbi rallies past 6.5 per dollar for first time since 2018", 4 Jan 2021, Financial Times

14 1 March 2021

15 Source: "Global investors place RMB 1 trn bet on China breakthrough", 14 Dec 2020, Financial Times

many of which are now reimposing virus restrictions amid new waves of cases."[16] In the longer term, "as a result [of the comparative handling of the pandemic], the Chinese economy is now forecast to overtake the US economy in 2028, five years earlier than in 2033 as we previously forecast [in 2019]."[17]

So how has inbound M&A into mainland China changed in 2020 following the FIL and the onset of the pandemic? We note the following trends from our experience and wider data on international M&A:

Inbound M&A into mainland China increased in 2020

Announced inbound M&A into mainland China was US$46.5bn in 2020. This was c. 5% higher than the figure for 2019 ($44.4bn), despite the Covid-19 pandemic.

In Q1 2020, inbound M&A into mainland China was US$6.7bn (46% below Q1 2019). By contrast, inbound M&A in the last nine months of 2020 came to US$39.9bn (24% above the corresponding level for 2019).[18] The rebound and maintenance of deal activity is testament not only to mainland China's management of the pandemic, but also the attractiveness of its economy in terms of its continuing opening-up, as well as its robustness and growth prospects of its economy, as described above.

Significant activity in the automotive, consumer and retail, energy, financials, healthcare, technology and industrials sector…

70% of inbound M&A into mainland China in 2020 was in the automotive, consumer and retail, energy, financial services, healthcare, technology, and industrial sectors.[19]

Large inbound M&A deals announced in these sectors in 2020 include:

- The US$2.1bn acquisition of a further 12.5% stake in BeiGene, a manufacturer of biological products, by an investor group comprising Amgen Inc, Baker Bros Advisors LP and Hillhouse Capital Group (healthcare).
- The US$1.7bn acquisition of an undisclosed minority stake in Jiangsu Manyun Software Technology Co Ltd, a Nanjing-based internet service provider, by a consortium of investors including Sequoia, Fidelity, Permira and Softbank Vision Fund (technology).
- The US$1.4bn acquisition of Meeca Technology and Topo Technology, manufacturers of sheet metal works, by LENS Technology of Hong Kong SAR (industrials).
- The US$1.0bn acquisition of 23% of Gotion High-Tech Co Ltd, a manufacturer of storage batteries and electronic equipment, by Volkswagen (automotive/new energy/high technology).
- The US$0.9bn acquisition of the remaining 79% of Car Inc, a Beijing-based provider of passenger car rental services, by Indigo Glamour Co Ltd, a unit of South Korea-based private equity fund (consumer).
- The US$0.9bn acquisition of an undisclosed minority stake in Guangzhou Xiaopeng Motors Technology Co Ltd, an automobile manufacturer, by an international investor group including Hillhouse Capital, Coatue Management LLC, Mubadala Investment Co PJSC, Qatar Investment Authority, Aspex Management (HK) Ltd and Sequoia Capital (automotive/industrials).
- The US$0.7bn acquisition of Hangzhou Haomusi Food Co Ltd, an online retailer, by PepsiCo (retail).

16 Source: Bloomberg, 14 Dec 2020
17 Source: CEBR World Economic League Table 2021
18 Source: Refinitiv database
19 Source: Refinitiv database

- The US$0.7bn acquisition of 37.5% of BoCommLife Insurance Company Ltd, a Shanghai-based direct life insurance carrier, by Japan-based MS&AD Insurance Group Holdings (financial services).
- The US$0.7bn acquisition of Shanghai Gas, a natural gas distributor, by Hong Kong SAR-based Panva Gas Holdings Ltd (energy).
- The US$0.7bn acquisition of 25% of JAC Volkswagen Automotive Co Ltd, a manufacturer of automobiles, by Volkswagen from its joint venture partner, taking Volkswagen's stake from 50% to 75% (automotive/industrials).
- The US$0.7bn acquisition of a 12.33% stake in TCL China Star Optoelectronics Technology Co, a manufacturer of semiconductors and related devices, by Samsung (high technology).

It should also be noted that these sectors also accounted for nearly 80% of "domestic" M&A (ie where the target and the acquiror were both based in mainland China) by value, reflecting their importance. Analysts have noted that "domestic M&A value hit a record high in both consumer and industrials sectors, positively influenced by the "Dual Circulation" and "Industrial Upgrade" government initiatives to expand investment in advanced industrials and infrastructure."[20]

…reflecting the transition and development of the consumer and production sides of the mainland Chinese economy

The importance of the sectors listed above for inbound M&A reflects the ongoing development of both the consumption and the production sides of mainland China's economy. Both the consumption and the production sides of the economy are core to the government's new five-year plan (its fourteenth, set to run between 2021 and 2025), in which the principle of "dual circulation" – that is, the strengthening of mainland China's own consumer market in conjunction with the technological upgrading of its production economy – features very strongly.

There are several potential drivers behind the growth and development of the consumption side of mainland China's economy:

- The partial unwinding of the very high savings ratio seen during 2020. In the first three quarters of 2020, the savings ratio in mainland China was 37% versus a normal level of c. 30%.[21] As consumer confidence returns in 2021, this high savings level may be released as consumption.
- Mainland China's job market is expected to perform strongly in 2021 as the world's emergence from the Covid crisis drives global demand. Even now employment is relatively strong: unemployment was 5.2% in November 2020, the same level it was in December 2019.[22]
- The continuing rise of mainland China's middle class: over 20% of the global middle class resides in mainland China. By 2027, it is estimated that 1.2 billion people in mainland China will be in the middle class, making up on quarter of the world total.[23] The rise of the middle class in China led to increasing demand for higher quality consumer products, technology, healthcare, financial services and automotive products – similar to the behaviour of the middle class in Western economies. But the middle class in China is also demanding new products and services delivered in new ways: for example, in relation to e-commerce and fintech – and it is likely that the trend-setting arising from this behaviour will change the way the middle class around the world engage in consumption in future.
- The projected growth over the next 10 years of the number of people aged 60 and above: a cohort projected to grow from 241 million in 2019 to 351 million in 2029 (a rise of more than

20 Source: PwC, 27 Jan 2021
21 Source: Morgan Stanley, 1 Dec 2020
22 Source: Financial Times, 15 Dec 2020
23 Source: Brookings, October 2020

100 million people).[24] The rise of this cohort will result in increasing demand for healthcare, as well as financial services such as retirement and insurance.

On the production side, the importance of these sectors for inbound M&A also reflects the potential of mainland China's industrial capabilities, especially the movement of mainland China's economy up the value chain, for example:

- The 14th five-year plan mentioning the importance of key industries including "artificial intelligence, quantum computers, semiconductors, health and life sciences, neuroscience, biological engineering, aerospace technologies, and deep-sea exploration".[25]
- Mainland China's continuing desire to transition into a manufacturer of highly value-added products has been widely seen in measures such as the "Made In China 2025" strategy as well as the activities that have come off the Negative List or put onto the Catalogue of Encouraged Industries for Foreign Investment.
- Mainland China has the fastest growth in industrial R&D in the world (21% in 2019, versus 11% for the US, 6% for the EU, and 2% for Japan)[26].
- Increasing international recognition of mainland China's potential in achieving world-leading status in important emerging technologies. For example: "by 2025, China's technology ecosystem will have matured and be on par with Silicon Valley in terms of dynamism, innovation, and competitiveness. That dynamism will increasingly take the form of industrial applications of information technology, as the locus of Chinese innovation shifts from the consumer internet to the industrial internet. China will largely succeed in deploying highly capable "new infrastructure"—cloud computing, 5G networks, smart cities, and surveillance networks, among others—to facilitate this transition to the industrial internet."[27]

Over the last few years, one route through which mainland Chinese businesses have sought to move up the value chain has been outbound investment, in order to acquire suitable assets, technologies, expertise and partners. However, increasing regulatory and political barriers in Western economies to foreign investment into sensitive sectors have more recently made this a less viable route for going up the value chain (see section 3 below).

The liberalisation of inbound foreign investment into the mainland Chinese economy is a way of supporting the development of an increasing high-value-add industrial base in mainland China and will be increasingly important if outbound investment activity continues to be hindered or blocked. Supporting the continuing path of the mainland Chinese economy into higher-value products and services will also be particularly important to service the domestic demands of mainland China's growing middle class as well as to promote mainland China's economy more generally.

Acquirors are becoming more international

Hong Kong SAR-based acquirors accounted for nearly half of inbound deal flow in 2020 (US$21.2bn, 45% of total). This was followed by the United States (US$6.1bn, 13% of total), Singapore (US$5.0bn, 11% of total), South Korea (US$2.3bn, 5% of total), Germany (US$2.3bn, 5% of total) and the UK (US2.0bn, 4% of total).[28]

The concentration of Hong Kong SAR-based acquirors is unsurprising given political, legal, cultural and commercial linkages between this region and mainland China. However, the proportion of non-Hong Kong SAR-based acquirors for inbound M&A has been on a long-term upswing. In 2015, this figure was 37% of the total (US$19.9bn of inbound M&A versus a total of US$54.4bn). In 2020, this

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24 Source: Populationpyramid.net
25 Source: China-Britain Business Focus, 3 Dec 2020
26 Source: 2020 EU Industrial R&D Investment Scoreboard
27 Source: Forecast 2025, Marco Polo, 26 Oct 2020
28 Source: Refinitiv database

figure was 55% of the total (US$25.3bn versus a total of US$46.5bn).[29] Again, this reflects not only the ongoing liberalisation of the mainland Chinese economy but also its increasing attractiveness as a robust region with strong growth prospects.

Deal times are lengthening as negotiations and due diligence become more protracted post-Covid-19

Everything else being equal, the FIL and associated changes in law and policy would have shortened the duration of deals (albeit that the Measures may have a countervailing effect in future – see section 1). MOFCOM's approval system has been replaced by the SAMR online information reporting system and, accordingly, a foreign investment information report should be first filed with the SAMR online system in relation to the acquisition by a foreign investor of a mainland Chinese company or assets. The repeal of the MOFCOM approval system is a potential accelerator for deals.[30]

However, our recent experience of advising on international M&A suggests to us that deal times have lengthened. This is due to the Covid-19 pandemic changing the key focus areas for deal negotiation, as well as the impact of the pandemic on deal processes and timelines.

From a deal negotiation perspective, buyers are seeking additional protections and conditionality in order to cover themselves against Covid-19 related risks. We have seen especial focus on material adverse change (MAC) clauses, allowing potential buyers to walk away from deals if there is a significant worsening in the target's business, as well as break fees and reverse break fees (where targets and buyers pay a fee to the other side in the event of a transaction not completing for specified reasons).

These negotiation points come on top of widening valuation expectations between buyers and sellers, as the two sides take different perspectives on the duration and impact of the Covid-19 crisis. This difference in perspective can be particularly pronounced between the seller of a domestically-focused mainland Chinese business versus an international purchaser, given the speed with which the pandemic has been contained in mainland China versus the rest of the world.

From a deal process perspective, the durations of due diligence and between deal signing and closing are lengthening. This is largely due to travel restrictions arising from the pandemic (for example, 14-day quarantine requirements, and stringent visa requirements for travel into mainland China). While a lot of due diligence can take place remotely, crucial items often need to be checked in person. In addition, handing over key business matters will also frequently still need to take place in person.

Finally, the new Measures are also expected to impact deal timelines, particularly for deals in areas deemed to be important to national security. The Measures have only recently been published, but given the wide range of transaction types and sectors that they cover, we expect a significant portion of dealmaking will have to include provision for notification to and review by the Office.

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[29] Source: Refinitiv database

[30] Advance filing with the central MOFCOM may still be required if an acquisition which results in control passing to a foreign entity involves a key industry, has an impact on the economic security of mainland China or results in a transfer of the controlling interest of an enterprise that owns any famous or traditional brands.

Section 3: Recommendations for dealmakers and policymakers

We list below a set of recommendations for dealmakers seeking to participate in, and policymakers seeking to manage, inbound M&A into mainland China following the observations and trends listed in sections 1 and 2 above.

The increasing importance of on-the-ground operational expertise

While the pandemic runs its course, international buyers will continue to have a greater need to conduct due diligence remotely. Large international firms of lawyers and accountants will have offices or "best friend arrangements" in mainland China to support legal and accounting due diligence, as well as commenting on legal process issues.

However, it is often harder to outsource operational due diligence, given that a large part of it is often conducted in-house by acquiring companies in order to ascertain how a business might be integrated with its new owner. There is a greater need for local expertise to assist with such due diligence, particularly given:

(1) the increasing range of business activities that are newly open to inbound investment following the launch of the FIL and changes to the Negative List
(2) the number of business models that are undergoing significant evolution as a result of the pandemic
(3) the need to understand stakeholders that are influential or vital to commercial success (for example, particular customer, supplier or regulatory relationships), and to understand the extent to which these relationships will continue or how they might evolve, especially after a change in ownership.

Local operational experts are also potentially of great use in sourcing new investment or acquisition candidates. The most attractive candidates for investment or acquisition might be relatively new start-ups or otherwise unknown businesses, especially in emerging subsectors or where developing technologies are concerned.

Dealmakers would therefore be well served to develop relationships with local experts to assist such diligence. Policymakers are well placed to catalyse such relationships through (for example) networking platforms, online seminars and conferences.

The increasing importance of experienced and innovative advisers

As described in section 2, the pandemic is changing every aspect of how deals are sourced, valued, negotiated, diligenced and closed. New solutions and norms are evolving in dealmaking in response to these challenges, whether it is in relation to structuring, conducting due diligence, or the project management of an M&A process.

It is therefore increasingly important for acquirors, investors and sellers to work with experienced and innovative advisers who are plugged into "live" dealmaking in the Covid-19 era, and who can bring contemporaneous insights from the wider dealmaking universe to any particular situation. In particular, being able to bridge the gap of understanding between a buyer and seller with very different expectations of the impact of Covid-19 will be very important to negotiating deals successfully.

The increasing importance of transparency

Significant regulatory reporting requirements remain in relation to dealmaking, despite the streamlining arising from the FIL and Rules. In our experience, there is still a relative lack of uniformity of practice amongst authorities tasked with administering the revamped foreign investment filing regime at local level: for example, differences in whether filings should be physical or electronic, what accompanying documentation needs to be submitted as part of transaction filings and so on. In addition, authorities require increasing amounts of information in order to process deals. The new

Measures will also require transparent disclosures to the Office for a wider set of potential deal types and business activities.

Dealmakers therefore need to be prepared to offer increasing levels of transparency about their businesses and bids. Policymakers can assist the speed and certainty of deals by continuing efforts to make reporting requirements more consistent and increasingly streamlined.

The opportunity to share expertise in pandemic management

China's handling of the Covid-19 pandemic, and resulting economic performance, has been instructive to the rest of the world. There is a significant continuing opportunity for mainland Chinese businesses and policymakers to share their expertise in handling the pandemic with the rest of the world. Such expertise sharing would continue to showcase the strength of the mainland Chinese economy, with corresponding benefits for inbound M&A (both in terms of volume and value). It would speed up the recovery of the rest of the world, again putting potential overseas buyers and investors in a better position to engage in targeted M&A in mainland China to offset problems in their home markets caused by the pandemic. Finally, it would increase global levels of business and societal resilience in the long run (for example in the face of potential future pandemics): such a global de-risking would not only encourage further growth in business internationally, but would also reduce the negative impact of future global shocks, not limited to pandemics.

Ongoing questions about variable interest entities

VIE structures allow a foreign investor to take effective control over (and to receive economic benefits from) a mainland Chinese company through contractual arrangements. They have been adopted as a structure to enable foreign partnership with mainland Chinese businesses in sectors that are subject to restrictions on foreign investment. They have historically been perceived as having an ambiguous status due their perceived use as a manner of skirting foreign investment restrictions. The FIL covers investment activities being conducted "directly or indirectly" and covers not only investors acquiring equity "or other similar rights" but also "where a foreign investor invests in any other way stipulated under laws, administrative regulations or provisions of the State Council". Similar expansive provisions are seen in the Measures.

In a previous report for the CDF[31] we described ongoing questions among market practitioners as to if and how VIEs might be regulated under the FIL, and the possible ramifications thereof. This is especially important given that "investors outside China have about US$1tn invested in firms that use them [VIEs]"[32].

The FIL does not expressly touch on VIE structures. Furthermore, the provision in the consultation draft of the Rules which would have exempted from foreign ownership restrictions all reverse investments into mainland China by wholly Chinese-owned entities subject to approval by the State Council (which was considered a step to lay down the foundation for future regulation of VIE structures) was withdrawn from the final text.

In what was a major breakthrough, the recently published *Antitrust Guidelines for Platform Economy* confirms that transactions involving a VIE structure require merger control filings if the turnover thresholds are met (just as with other transactions), ending the long-time uncertainty surrounding this issue. Thus, SAMR penalised three large private Chinese companies (Alibaba, Tencent and SF Express) for failure to notify their transactions involving a VIE structure, and have recently reviewed and cleared a merger filing[33] explicitly involving the VIE structure.

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[31] See "Reversing the flow; the inbound investment opportunity in China", Linklaters, 2019.

[32] Source: Economist, 16 September 2017

[33] The filing relates to a greenfield 60/40 JV jointly controlled by Mingcha Zhegang and a subsidiary of the Yum group to provide technology solutions for the catering sector.

The role of international capital markets

International investment into mainland China's capital markets continues apace. This has been encouraged by:

- the continuing rise of Bond Connect through 2020
- the successful launch of Shanghai-London Stock Connect in 2019 (and the approval by the China Securities Regulatory Commission for China Pacific Insurance to issue securities through this scheme in June 2020)
- the quadrupling of the weighing of China A-shares in Morgan Stanley Capital International's global benchmarks
- September 2020's announcement that two major inbound investment programmes (QFII and RQFII) which provide foreign institutional investors with access to China's A-share markets will be combined into a single 'qualified foreign investor' regime to provide broader and deeper opportunities in these markets.

In parallel, the FIL allows for investments into be funded by the issuance of public securities. All of this means a greater level of investor interest in foreign businesses with direct investments in mainland China, alongside foreign direct investment in mainland Chinese businesses. This can be seen by the enormous foreign investor appetite for participating in China's capital markets in 2020: it is estimated that in 2020, "foreign investors snapped up more than RMB1tn [US$150bn] worth of stocks and bonds…. which came through Hong Kong [SAR] programmes that connect [foreign] investors with the mainland".[34]

Policymakers, regulators and exchanges in the capital markets therefore have an opportunity to harmonise, or at least to clearly explain, disclosure and investment norms in order to further encourage international investment. Bankers and fund managers also have the opportunity to increase their use of technology in order to conduct roadshows and due diligence into new public market investment opportunities.

The increasing importance of domestic M&A in setting expectations for inbound M&A

2020 was a strong year for M&A activity in mainland China, with US$734bn of deals taking place – "the highest since 2016, driven by strong state and government investment support" with "domestic M&A [rebounding] to levels last seen in 2017 driven by strong state involvement and support for various banks and securities companies and accelerated reform of [state-owned enterprises] in response to the turbulent economic conditions".[35]

The strong level of domestic M&A activity does not just demonstrate the continuing maturing of mainland China's activity. It also represents a highly influential factor that will impact the way inbound M&A will be considered and negotiated. As domestic bidders become more prevalent and better versed in M&A, international bidders will need to improve the attractiveness of their deal proposals to keep pace: whether this relates to value, conditionality, the strength of the business case of the proposed combination, or other intangible factors. The widespread use of state-mandated auction processes in M&A transactions involving state-owned assets in mainland China which imposes certain mandatory deal terms on all buyers also limits the extent to which bidders can structure their deal proposals for these assets.

This increasingly competitive environment poses a challenge to international bidders to evaluate acquisitions not just on a per deal basis, but to factor in the contribution that each acquisition can make to their overall plans for long-term investment and growth in mainland China on a group basis.

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[34] Source: Financial Times, 14 Dec 2020

[35] Source: PwC, 27 Jan 2021

Recent developments on the simplification of funds remittances discussed in section I, as well as the range of local incentives available in different investment and development zones that are aimed at attracting long-term investment commitments[36], are expected to become increasingly important factors in sealing the attractiveness of acquisitions in mainland China for foreign investors.

The increasing scrutiny of foreign investment

Our previous reports to the CDF on outbound and inbound investment to and from mainland China described the increasing political and regulatory barriers to foreign investment (often, but not always, mainland Chinese investment) in the US and Europe and other economies such as Australia into sectors deemed to have national importance (particularly from a national security perspective). This accelerating trend is important, given the FIL's statement that China may take measures against countries that discriminate against Chinese investment (and there are anecdotal examples of investors seeking to manage such risks in negotiating their inbound investments in mainland China). Inbound investors will need to continue to monitor the situation, and work with advisers with deep knowledge of the regulatory outlook in mainland China as well as the wider global picture, in order to ascertain the risks of their deals being affected by such measures.

United States

In the US, the Foreign Investment Risk Review Modernization Act (**FIRRMA**), which broadened the jurisdiction of the Committee on Foreign Investment in the United States (**CFIUS**), completed its implementation in February 2020. CFIUS's 2019 annual report[37] confirms that companies filed 231 notices of transactions that CFIUS determined to be subject to CFIUS jurisdiction – in line with the levels of 2017 and 2018. 89% of these notices related to transactions in the manufacturing sector (especially computer and electronic product manufacturing, electrical equipment manufacturing, and transportation equipment manufacturing), finance, information and services (especially professional, scientific and technical services), or the utilities sector.

Over the period 2017-2019, mainland China-based acquirors accounted for 20% of covered transactions: the highest share of any country (the next largest being Japan with 14%). Nevertheless, it should be noted that mainland China was not at the top of the CFIUS league tables in 2019 alone. For example, in 2019, mainland China-based acquirors only accounted for 25 out of 231 notified transactions: second place behind Japan (with 46), and nearly on par with Canada (23). Mainland China was also very low down the list of acquirors of US "critical technology" in 2019, with only 3 instances versus 20 for Japan, 11 for Germany, 7 for France and Canada, 6 for the UK and 4 for South Korea.

2020 was an active year for the various authorities responsible for US foreign investment review, even without considering the widely publicised presidential order by then-President Trump requiring the divestment of Musical.ly, the US predecessor of the popular video-sharing application TikTok, or the activity in December 2020 where the US Department of Commerce Bureau of Industry and Security added 59 mainland Chinese entities and individuals to its "Entity List" for activities deemed to be contrary to the US's national security and/or foreign policy interests.

In September 2020, CFIUS issued a new rule revising one of the thresholds for non-US investments in "critical technology" businesses for which pre-closing filings will be required. For those investors that CFIUS would view as benign, certain transactions will no longer be subject to mandatory pre-closing filings just because the target was involved in a sensitive industry. On the other hand,

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[36] Depending on the policies in the particular region, these could cover various benefits including tax rebates, rental subsidies, allowances for purchase of equipment and incentives for hiring experts.

[37] Source: https://home.treasury.gov/system/files/206/CFIUS-Public-Annual-Report-CY-2019.pdf

investors from countries subject to heavier export licensing requirements will be subject to more required filings. The new threshold also increases the level of diligence required by parties to assess whether a pre-closing CFIUS filing is required. Not only do the parties have to know whether the US business develops or produces critical technologies, they also need to know whether export licenses would be required for the non-US investor or its owners. This analysis can be particularly challenging for early-stage US businesses with immature export compliance programs. It may also present issues for non-US investors that are less accustomed to dealing with export controls or their application to the investors' owners.

Finally in relation to CFIUS, it should be noted that January 2021 saw the presidency transfer to Joe Biden. Early signs of how CFIUS might pertain in the Biden era include the shelving of the forced sale of TikTok's American operations to a group including Oracle and Walmart as the Biden administration began a review to "help it determine whether the national security threat cited by the Trump administration continues to warrant the ban"[38], as well as reports that CFIUS is now increasingly scrutinising venture capital investments into technology businesses, "even small-dollar deals, where the money can be traced back to China".[39]

Europe

In Europe, the new EU framework for screening FDI became operational in October 2020. This follows the EU framework for screening foreign direct investment approved in 2019. This framework:

- Created a cooperation mechanism for Member States and the European Commission (**EC**) to exchange information and, if necessary, raise concerns related to specific investments.
- Allows the EC to issue opinions when an investment poses a threat to the security or public order of more than one Member State, or when an investment could undermine a project or programme of interest to the whole EU.
- Sets deadlines for cooperation between the EC and Member States, and among Member States, observing non-discrimination and strong confidentiality requirements.
- Establishes certain core requirements for Member States who maintain or adopt a screening mechanism at national level on the grounds of security or public order.
- Encourages international cooperation on investment screening, including sharing of experience, best practices and information on issues of common concern.[40]

It should be noted that the new regulation complements (rather than replaces) screening mechanisms of EU Member States, which are also being strengthened in several countries. It is designed to help Member States and the EC to collectively assess potential cross-border threats to security and public order arising from a foreign direct investment. Member States retain the final decision as to whether an investment is authorised in their territory and under which conditions.[41]

It is likely that this new framework will increase deal durations (as each Member State will await the views of the European Commission and other Member States as part of its own screening procedure).

Additionally, in June 2020, the EC published a set of proposals intended to prevent foreign investors from using government subsidies to enable them to price out other bidders for European assets.[42] The proposals describe "a specific concern about foreign subsidies in the contexts of the acquisition of EU targets".[43] While mainland China is not mentioned by name, commentators have suggested that such

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[38] Source: Wall Street Journal, 10 Feb 2021
[39] Source: Wall Street Journal, 31 Jan 2021
[40] Source: https://ec.europa.eu/commission/presscorner/detail/en/IP_20_1867
[41] Source: https://trade.ec.europa.eu/doclib/docs/2019/june/tradoc_157945.pdf
[42] Source: https://ec.europa.eu/commission/presscorner/detail/en/ip_20_1070
[43] Source:
https://ec.europa.eu/competition/international/overview/foreign_subsidies_white_paper.pdf

measures may be directed towards mainland Chinese acquirors.[44] The EC is expected to release its proposal on addressing foreign subsidies in 2021.

These policies have contributed to a significant fall in mainland Chinese outbound investment into Europe and the US: for example, "Chinese investors' mergers and acquisitions in Germany last year [2019] amounted to just €1.3bn, according to the German Economic Institute, a fraction of the €12bn of deals seen in 2017."[45]

The increasing scrutiny of foreign investment, particularly in the US, runs parallel to ongoing trade and investment negotiations between the world's major economies. In December 2020, Europe and China concluded a deal in principle for a Comprehensive Agreement on Investment (**CAI**), following 7 years of negotiation. The EU says that the deal will "significantly improve the level playing field for EU investors". The deal offers "enhanced access rights" to areas including the automotive, telecom, cloud computing and healthcare sectors, and "puts the EU on the same footing as the US when it comes to operating in the Chinese financial services market." For China, the deal "locks in existing rights for Chinese companies in the EU market when the EU is looking to expand its legal arsenal" as against what it perceives as market distorting competition, as described above. It "also offers China new openings in manufacturing and the growing market for renewable energy".[46]

UK

In November 2020, the UK government published, in its National Security and Investment Bill, its proposed reforms to its powers to scrutinise foreign investment. The Bill proposes the introduction of a standalone CFIUS-style foreign investment regime for the first time in the UK. The Bill provides for a mandatory notification obligation for sectors perceived to be of highest national security risk, with a voluntary regime for others. Coupled with a very broad jurisdictional scope and no safe harbours, this will capture a very wide range of transactions. The Government's Impact Assessment estimates that the new regime would result in 1,000-1,830 transactions being notified per year—a huge-step change given that only 12 transactions have been reviewed on national security grounds since the current regime was introduced in 2003.

The Government expects some transactions in the following 17 key sectors will face mandatory notification: civil nuclear; communications; data infrastructure; defence; energy; transport; artificial intelligence; autonomous robotics; computing hardware; cryptographic authentication; advanced materials; quantum technologies; engineering biology; critical suppliers to government; critical suppliers to the emergency services; military or dual-use technologies; and satellite and space technologies.

The mandatory regime will be reinforced by a voluntary notification system whereby parties are encouraged to notify "trigger events" they consider may be of interest from a national security perspective. This will be accompanied by an expansive "call-in" mechanism to enable the Government to review non-notified transactions up to five years post-completion (a period equivalent to the Italian, French and German regimes), reduced to six months if the Government has become aware of the transaction. In particular, the Government will have a retroactive ability from commencement of the new legislation to "call in" transactions for review where the transaction occurred following the introduction of the Bill.

The Bill defines a set of "trigger events" which enable the Government to scrutinise a broad range of transactions including low levels of minority shareholding, namely:

[44] Source: https://www.nytimes.com/2020/06/17/business/european-union-china-deals.html
[45] Source: Nikkei Asia, 3 April 2020
[46] Source: Financial Times, 31 December 2020

- Where a person acquires more than 25%; 50%; and 75% of votes or shares in an entity (or is able to block or pass a corporate resolution).
- Where a person's shareholding or voting rights increase above 15%.
- For the voluntary regime, a lower threshold applies for acquisitions involving "material influence". This is a familiar concept from the UK merger control context (and can be triggered by acquisitions of shareholdings as low as 10-15%).

The Bill will also cover transactions involving a broad range of asset types, including land, tangible moveable property and, with respect to IP, any idea, information, or technique with industrial, commercial or other economic value.

There will be no turnover or market share safe harbours below which transactions will fall outside the remit of the Government's national security review procedures.

While the UK Government has emphasised that the UK remains open for investment and that the proposed foreign investment regime is designed to mitigate national security risks in a proportionate manner, the Bill clearly signals the end of the UK's lighter touch approach to foreign investment screening and brings the UK into line with its international peers. If the 1,000-1,830 notifications per year forecast in the Impact Assessment is accurate, this would imply that foreign investment rules will be an increasingly important consideration for international investors and will need to be factored into deal feasibility, contractual conditionality and transaction timetables at an early stage of the process.

The UK foreign investment reforms are driven in part by perceived concern over investment from China: for example, the UK Government's recent concerns in relation to Canyon Bridge (backed by Chinese state-owned China Reform holdings) to obtain gradual control over UK semiconductor chipmaker Imagination Technologies, and the recent decision in relation to Huawei's involvement in Britain's 5G networks. However, interventions have not been limited to Chinese investors. The UK government has also intervened in the past year in deals involving North American private equity and financial investors (such as Cobham/Advent and Inmarsat/Connect Bidco).

Conclusion

In conclusion, the new FIL and associated legal measures have done a significant amount to accelerate and encourage foreign investment into mainland China through M&A by streamlining processes, offering reassurances on equal treatment, widening the range of business activities available for foreign investment, and improving capital market access for foreign investors. The new Measures are a vital complement to the FIL, and form a necessary component of China's policy response to foreign investment.

China's rapid and robust handling of the Covid-19 pandemic has meant not only that deal flow has recovered, but has also highlighted the strength and attractive prospects of the mainland Chinese economy, making it an even more attractive destination for foreign investment including M&A.

Nevertheless, the pandemic has led to a lengthening in deal duration, new areas for negotiation and due diligence between acquirors and sellers, and reappraisals of business models across industries. In addition, ongoing tensions in relation to trade and foreign investment scrutiny are also a headwind to deal flow. Dealmakers and policymakers therefore have a significant opportunity to accelerate investment into mainland China by engaging in dialogue, education and networking.