

Update on China's Recent Liberalization of the Legal Regime for Foreign Investment

by Karen Yiqin Fan

With the ongoing US-China trade tension, what has been easily overlooked is China's recent liberalization of its legal regime in the areas of foreign investment and foreign investors' M&A activities in China. This liberalization involves reducing restrictions on market entry into certain industries and further opening-up of the financial sector. In particular, the last week has witnessed Shanghai Municipal Government issuing a new regulation further encouraging multinational corporations to establish their regional headquarters in Shanghai and initiating a new round of opening-up in the service sector. The positive signals sent by these new laws and policies are likely to attract a new wave of foreign investment into green-field projects and stimulate acquisitions of China-based target companies.

I. Shanghai

1. Encouraging the Establishment of Multinational Corporation ("MNC") Regional Headquarters in Shanghai

On August 13, 2019, the Shanghai Municipal People's Government released the *Several Opinions on Promoting the Development of Multinational Corporation Regional Headquarters in Shanghai* ("**Opinions**") with an aim to further develop Shanghai as the headquarters for MNCs.

Highlights of the Opinions are summarized as follows:

1. The Opinions relax the eligibility criteria for recognizing an MNC's Shanghai-based entity as its regional headquarter ("**RHQ**") in China by (i) lowering the "total assets" thresholds of an RHQ's parent company to US\$200 million and to US\$100 million for parent companies of quasi-headquarters¹ ("**Quasi-RHQ**"); (ii) entirely removing requirements of paid-in capital and restrictions on the number of Chinese entities under management of an RHQ; and (iii) removing the requirement that RHQs and Quasi-RHQs must be wholly owned by foreign investors. These new preferential policies are likely to be attractive to more MNCs, especially those asset-light businesses in the internet, technology, and e-commerce industries, and encourage

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MNCs to establish their RHQs or Quasi-RHQs in Shanghai. This would further solidify Shanghai's position as the most preferred location for setting up RHQs or Quasi-RHQs in China.

2. Shanghai Government issued the Opinions to facilitate the centralized treasury management of RHQs and Quasi-RHQs, particularly use of foreign exchange fund pools maintained by RHQs in domestic Chinese banks. Before the Opinions, RHQs have already been allowed to establish domestic and international foreign exchange funds pools in banks in China to conduct certain transactions such as centralized receipt and payment of foreign exchange funds of current items and net settlement as well as collectively operating and managing foreign exchange funds of overseas affiliates and foreign debt funds. The Opinions remove restrictions on the number of Chinese banks with which an RHQ or Quasi-RHQ can partner for the purpose of managing its foreign-exchange funds pool and the number of domestic capital accounts to be opened for such purpose. According to the Opinions, Shanghai Government is also going to support qualified RHQs and Quasi-RHQs to engage in bond and equity financing, interbank foreign exchange business and bullion business in Shanghai.
3. According to the Opinions, Shanghai will also (i) initiate a pilot program to enable affiliates managed by the same RHQ or Quasi-RHQ to share license or permits for conducting business in regulated industries, and (ii) adopt a category-based management system based on risk-levels to streamline the import and export process of experimental materials for foreign-funded R&D centers. Besides, the Opinions also include Shanghai Government's commitment to expand administrative support of housing, schooling, and medical insurance for expatriate employees of RHQs and Quasi-RHQs in Shanghai.

2. Further Opening Up in Service Sector

On August 13, 2019, the Shanghai Municipal People's Government introduced a new policy – *Several Measures of Shanghai's New Round Expansion of Opening Up Service Sector* ("**Measures**") - to boost foreign investment in the service sector of Shanghai.

The Measures are aimed at:

1. relaxing eligibility criteria for establishing investment companies in Shanghai by reducing the thresholds of foreign investor's total assets, and removing the requirement on the number of entities set up by the foreign investor;
2. piloting the establishment of wholly foreign-owned performance brokerage agencies in Shanghai;
3. piloting the establishment of wholly foreign-owned travel agencies to provide overseas tourism services for Chinese citizens;
4. piloting foreign investment in production of audio-visual products in specific parks and pilot free trade zones on a conditional basis;
5. piloting auctions of works of art conducted by foreign-funded cultural relics auction enterprises in pilot free trade zones on a conditional basis;
6. piloting foreign investment in human stem cells, gene diagnosis and treatment technologies;
7. piloting "one license with multiple domiciles" for franchised stores of RHQs of MNCs;
8. ensuring that foreign-invested enterprises enjoy national treatment in accordance with laws, and that foreign-invested enterprises be treated the same as domestic enterprises with respect of application for licenses and related qualifications;
9. relaxing the investor eligibility requirements of Qualified Domestic Institutional

Investors² by including investment management institutions established by domestic and foreign institutions in Shanghai;

10. expediting the development of commodity spot market and supporting financial institutions to provide financial services for commodity spot.

II. Nationwide

China's *Report on The Work of The Government (2019)* was restated to further expand and intensify opening up and reform on all fronts. A series of major moves have been taken in respect of opening up to foreign trade and investment in the first half-year 2019 as follows:

1. Release of Foreign Investment Law, Foreign Investment Market Entry Negative List and Encouraged Industry List

- A new *Foreign Investment Law* was released in March 2019 and is to take effect on January 1, 2020. Relevant details and impact on foreign investment can be found at: <https://www.dorsey.com/newsresources/publications/client-alerts/2019/08/china-new-foreign-investment-law>
- The *Foreign Investment Market Entry Special Administrative Measures* (also known as the “**Negative List**”), a list of industries into which foreign investment is either prohibited or restricted³, was cut from 48 items to 40. The Negative List further removes or relaxes restrictions in industries of infrastructure, transportation, culture, value-added telecommunications service, manufacturing, mining, etc.
- The *Encouraged Industries Catalogue to Foreign Investment (2019)* was issued. For investment in encouraged industries under this catalogue, foreign investors can enjoy preferential treatment in respect of taxation, land, etc.

2. Further Opening Up Financial Sector

The *Relevant Measures for Further Opening Up the Financial Sector (“11 Measures”)* was released in July 2019 to further relax restrictions on foreign investment in the financial sector. The 11 Measures touch upon almost all the financial sub-sectors and below are some of the highlights:

1. Credit Rating Agencies:
Foreign rating agencies can give ratings to all kinds of bonds that are traded on China's interbank market and exchanges.
2. Investment in Wealth Management Subsidiaries of Chinese Commercial Banks:
Foreign financial institutions are encouraged to participate in the establishment of, and make investments in, wealth management subsidiaries of Chinese commercial banks.
3. Investment in Wealth Management Companies Controlled by Foreign Investor(s):
Foreign asset management companies are permitted to invest together with subsidiaries of Chinese banks or insurance companies to establish wealth management joint ventures that are controlled by foreign investors.
4. Pension Fund Management:
Foreign financial institutions are permitted to establish and invest in Chinese pension fund management companies.
5. Currency Brokerage:
Foreign entities are supported to establish with 100% shareholding or partially invest

in Chinese currency brokerage companies.

6. Life Insurance:

Foreign shareholding cap of 51% in life insurance business will be removed in 2020, one year earlier than promised.

7. Insurance Assets Management:

Foreign shareholding cap of 25% in insurance asset management companies has been removed.

8. Insurance:

China will lower market entry requirements on foreign insurance companies by removing the requirement of 30-year operational experience in an insurance business.

9. Foreign shareholding cap in securities companies, futures companies and fund management companies will be removed in 2020.

10. Bond Market:

Qualified foreign-invested institutions are permitted to obtain class A principal underwriter licenses in the Chinese interbank bond market.

11. Easier Access to Interbank Bond Market for Institutional Investors:

China will prepare the way for foreign institutional investors to access Chinese interbank bond markets.

3. National Treatment to Foreign Investors in Senior Care Service Industry

4. More Free Trade Zones and More Delegation of Approval Power to Free Trade Zones

- Set up 6 additional pilot free trade zones and expand the coverage of Shanghai Pilot Free Trade Zone.
- Delegate more provincial-level authorization power to lower level free trade zones authorities and further shorten the foreign investment negative list applicable to free trade zones.

5. Opening Up and Support in the E-commerce Sector

- Introduce more favorable policies and measures in the e-commerce sector, including establishing more cross-border e-commerce comprehensive pilot zones in addition to the existing 35, and establishing platforms to support cross-border e-commerce business etc.

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¹ Wholly-foreign owned entities or branches of MNCs in China that actually undertake the functions of regional strategic administration, fund management, procurement and sales,

etc. but cannot satisfy the eligibility criteria for RHQs, can apply for the “quasi-headquarters” status recognized by the Shanghai Municipal Government, so that they can enjoy the preferential policies with respect to entry-exit procedures for their staff and bringing in talents, etc.

² Qualified Domestic Institutional Investors refers to domestic fund management companies, insurance companies, securities firm and other entities transacting in securities that have been approved by China Securities Regulatory Commission to raise funds within China and use part or all of the funds to invest in overseas securities markets.

³ China has been streamlining its administrative processes with respect to foreign investment following a “Negative-list” approach. Only foreign investments falling into the industry categories as set out in the Negative List are either prohibited for foreign investors or subject to approval by the Ministry of Commerce or its lower level branches.