

Easing Rules on Establishment and Changes of Foreign-invested Enterprises

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On 3 September 2016, the National People's Congress Standing Committee approved amendments on the 4 laws in relation to inbound foreign investments¹, expanding the current foreign direct investment regulatory regime applicable within the 4 FTZs to the whole country starting from 1 October 2016.

In order to ensure the revisions will enter into force smoothly, the Ministry of Commerce of the People's Republic of China (hereinafter "MOFCOM") issued a draft of the "Interim Administrative Measures for the Record-filing of the Establishment and Change of Foreign-invested Enterprises (the "FIEs")" (hereinafter the "New Rules")² for public comment on the same date. The New Rules specified that for the FIEs not subject to the special administration measures on market entry (alternatively, the "Negative List Regime"³) all over the country, corporate establishment and changes can be conducted simply by completing the record-filing procedure. Prior regulatory approval from the MOFCOM is no longer required. Eligible FIEs will benefit from the eased administration procedures in areas including but not limited to organisational restructuring, disinvestment, cross-border financing, etc.

BACKGROUND

Previously, prior approvals from the MOFCOM need to be obtained in relation to any kind of business affairs of the FIEs (hereinafter the "Pre-approval Regime"). Piloted in Shanghai since October 2013 and then the other 3 Free Trade Zones (together, the "FTZs") since April 2015, FIEs located in these 4 FTZs have become subject to the Negative List Regime. A "Negative List" has been introduced, listing the restricted or prohibited industries for foreign investments by the Chinese government. FIEs can invest in any sector not on the list without approval. Establishment or changes of the eligible FIEs in the FTZs can be conducted simply by record-filing.

It is said that in the past three years, such regime has been proven a big success and has improved investment facilitation and standardization substantially in the FTZs. During the first half of this year, over 99% of the FIEs in the 4 FTZs were established through the record-filing system. Comparing to the prior approval system, paperwork has been reduced by 90% and the processing time has been cut from 20 to 3 working days.

¹ The 4 laws include: the Law on Wholly Foreign-owned Enterprises, the Law on Sino-foreign Equity Joint Ventures, the Law on Sino-foreign Cooperative Joint Ventures and the Law on the Protection of Investment of Taiwan Compatriots.

² MOFCOM (3 Sep 2016). Retrieved from:
<http://www.gov.cn/xinwen/2016-09/03/5105124/files/b963998b0b2e492bb612a33e407b5898.docx>
<http://www.gov.cn/xinwen/2016-09/03/5105124/files/7b165c8a33664ceb8ed9a318636fb1e1.docx>

³ MOFCOM (8 Apr 2015). Administrative Measures for the Record-filing of Foreign Investments in the FTZs (Trial Implementation) (MOFCOM Announcement No.12 of 2015). Retrieved from:
<http://english.mofcom.gov.cn/article/policyrelease/buwei/201506/20150601018263.shtml>

According to the assessment by the Development Research Centre of the State Council and other third party institutions, structural reform of the foreign investment management implemented in the FTZs has made it ripe for further expansion to the whole country.

HIGHLIGHTS

According to the New Rules, for FIEs not subject to the Negative List Regime all over the country, corporate establishment and changes can be processed by record-filing instead of obtaining prior approval from the MOFCOM.

Covered Entities

The New Rules apply to the corporate establishment and changes of FIEs not subject to the Negative List Regime in China.

- Investment companies, venture capital investment enterprises and equity investment enterprises invested by foreign investors are deemed as foreign investors and covered by the New Rules;
- Hong Kong, Macau and Taiwan investors are managed with reference to the New Rules⁴.

Supervision and Administration

The record-filing procedures can be conducted at the authorities of commerce at national/provincial/municipal levels, or those of the FTZs or the national Economic and Technological Development Zones (hereinafter the "local MOFCOM"). The local MOFCOM in charge will supervise and inspect whether the FIEs are fully in compliance with the New Rules from time to time.

FIEs need to bear the corresponding legal responsibilities for violation of filing obligations, illegal operations in the restricted or prohibited industries, or refusal to cooperate with the supervisions and inspections. In case of non-compliance activities, penalties or other punishments may be imposed, and related integrity information will be recorded and published on MOFCOM's "Foreign Investment Integrity Filing System". Moreover, other departments such as Administration for Industry and Commerce, Administration of Foreign Exchange, etc., will also be notified in a timely manner.

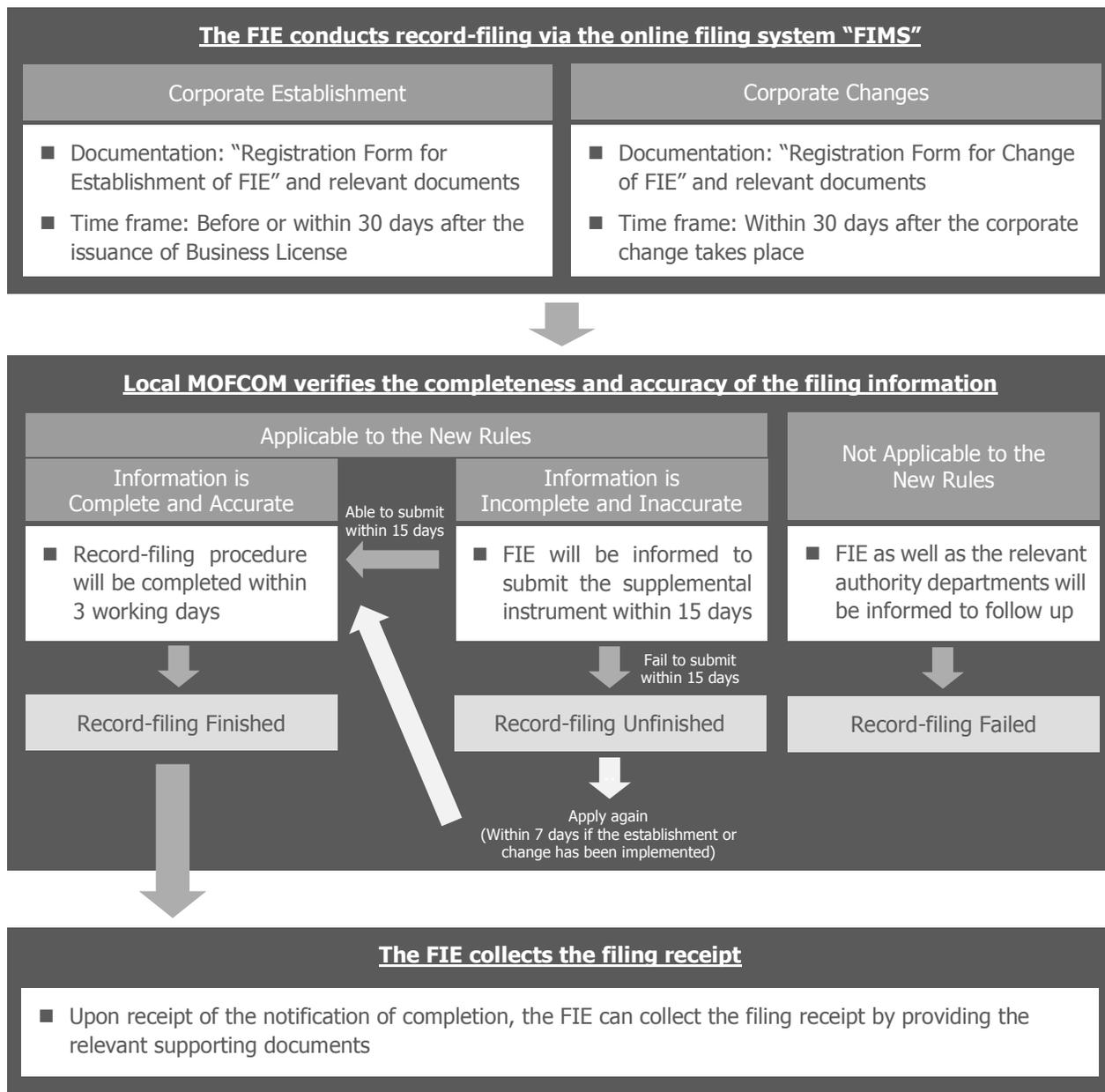
Record-filing Procedure

The whole record-filing procedure will be conducted via MOFCOM's online filing system "FIMS". FIEs are required to provide true, accurate and complete information on the FIMS, and the related supporting documents shall be kept properly. The filing results will be released on the FIMS and the FIEs can check the records online.

For FIEs established before the New Rules take effect, record-filing is not required unless there are any corporate changes applicable to the New Rules. In that case, FIEs' Certificate of Approval will become invalid at the time the filing procedure is completed.

Generally speaking, the record-filing procedure will be as follows:

⁴ For Hong Kong or Macau service suppliers that only invest in the service trade field in the Mainland China under Comprehensive Economic Partnership Agreement (CEPA), record-filing for corporate establishment and changes should be conducted in accordance with the "Trial Administrative Measures for the Record-filing of Hong Kong and Macau Service Suppliers Investing in the Mainland China" promulgated by the MOFCOM in May 2016.



Corporate Changes

Corporate changes include changes in the following categories:

- 1) Basic corporate information, including name, address, business type, duration of operation, investment industry, business scope, nature of project, registered capital, total investment, organisation structure, legal representative, details of ultimate effective controller of the FIE, contacts and contact person;
- 2) Investors' basic information, including name, nationality, address, certificate, amount of capital contribution, term and form of investment, territorial source of funds and investor type;
- 3) Equity (shares), interests in cooperation, including equity pledge;
- 4) Merger, division and termination;
- 5) Pledge of assets of a wholly foreign-owned enterprise;
- 6) Early recoupment of investment by a foreign investor of a Sino-foreign cooperative enterprise;
- 7) Entrustment management of a Sino-foreign cooperative enterprise.

COMMENTS

Adoption of Negative List Regime to replace the Pre-approval Regime on a nationwide basis is considered to be a big move on foreign direct investment policy in China. In line with the commercial system reform⁵ by the Chinese government, implementation of the New Rules will contribute to structural reform of foreign investment management and creation of a more open investment environment.

For FIEs not subject to the Negative List Regime, enormous benefits can be expected. Apparently, the administration procedures of corporate establishment and changes will be simplified substantially and the processing time will be shortened significantly. Moreover, operation-wise, the most remarkable beneficial merits for the FIEs are considered as follows:

- i) Corporate Establishment: Articles of association, joint venture contract and other application materials for corporate establishment will no longer be subject to MOFCOM's approval. Launch of newly registered FIEs is expected to increase due to investment facilitation.
- ii) Organisational Restructuring: To proceed with merger and acquisition, division or equity transfer simply by record-filing is considered to be a crucial change. It will be much easier for the FIEs to execute their corporate strategies in China in response to the changing business environment.
- iii) Capital Decrease or Disinvestment: Unlike capital increase, capital decrease or disinvestment has never been easy in China as lots of local authorities are involved and the approval procedures usually take a long time. Relaxed rules in this field may reduce the concerns of FIEs to some extent.
- iv) Cross-border Financing: Allowing pledge of equity or assets to proceed without prior regulatory approval actually offers another convenient way of cross-border financing for the FIEs to meet their financing needs.

While the finalised version of the New Rules will take effect very soon, it may take a longer time for further application in various regions unless a national or regional implementation guidance is issued, as there still remains some uncertainties and ambiguities. FIEs should better consult the local MOFCOM to ensure the filing procedures are on the right track, and conduct timely, complete and accurate record-filing in the meantime to avoid any non-compliance which may affect their credit ratings.

Furthermore, a Nationwide Negative List is expected to be issued on or before 1 October 2016. It is very likely that the Nationwide Negative List will be made based on the current FTZs version⁶, with reference to the restricted and prohibited parts listed on the Catalogue for the Guidance of Foreign Investment Industries (2015)⁷. FIEs subject to the Nationwide Negative List will still need to comply with the Pre-approval Regime. Sufficient attention should be paid to the new moves regarding this.

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⁵ In order to enhance competitiveness and market vitality, as well as to create a more international, legal and market-oriented business environment, the Chinese government has been dedicating to deepen commercial system reform, which encourage administration streamlining and power delegation. For example, promotion of the "five-in-one business license" and "unified code", which will take effect from 1 October 2016, is expected to save both cost and time for enterprises all over the country.

⁶ The State Council of the People's Republic of China (8 Apr 2015). Special Administration Measures on Market Entry for Foreign Investments (Negative List) in the FTZs. Retrieved from: http://www.gov.cn/zhengce/content/2015-04/20/content_9627.htm

⁷ National Development and Reform Commission, MOFCOM (10 Mar 2015). Retrieved from: http://www.fdi.gov.cn/1800000121_39_4830_0_7.html