Corporate & Securities China January 15, 2015

Evaluating the Draft Amendment of the Foreign Investment Guidance Catalogue

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Recently, the National Development and Reform Commission (NDRC) and Ministry of Commerce (MOFCOM) of the People's Republic of China (PRC) jointly released a draft of the new Foreign Investment Guidance Catalogue for public comment. The 2014 Draft Catalogue would retain the framework of classifying Chinese industries into "encouraged," "restricted" and "prohibited" categories (industries not listed are "permitted"); however, it substantially reduces the restrictions on foreign investment currently in place. The 2014 Draft Catalogue would lift restrictions on foreign investment in dozens of service and general manufacture industries and would relax Chinese ownership requirements. Although foreign investors still would have to operate in some of these industries through Sino-foreign joint ventures, control by the Chinese partners would no longer be required. In addition, the 2014 Draft Catalogue would permit establishment of wholly foreign-owned enterprises (WFOEs) in a number of industries.

More WFOE-Permitted "Encouraged" Industries

Under the 2011 Foreign Investment Guidance Catalogue (Current Catalogue), dozens of industries categorized as "encouraged" are subject to restrictions on the form of foreign investment or Chinese ownership requirements. Specifically, foreign investors in those industries are required to work with Chinese partners through joint ventures or partnerships. Certain "encouraged" industries also require more than 50% Chinese ownership.

However, under the 2014 Draft Catalogue, more than half of the "permitted" industries with Chinese ownership requirements or form of foreign investment restrictions would see such requirements and restrictions removed, which would mean that foreign investors in these industries would be able to operate their businesses in China through WFOEs. These "WFOE-permitted" industries include accounting; the construction and operation of rail transit such as city metro and light rail; operation of performance venues; design and manufacture of transportation equipment such as aircraft engines and engine parts and components; airborne equipment for civil aviation and yachts; manufacture of electric machinery and equipment such as power transmission and transformation equipment; and manufacture and R&D of automobile electronic devices, such as manufacture of automobile electronic bus network technology, electronic control for power steering systems and embedded electronic integrated systems.

Fewer "Restricted" Industries

The 2014 Draft Catalogue would remove 44 industries from the "restricted" category, allowing foreign investors to invest in those industries without restrictions on forms of investment or Chinese ownership requirements.

If the amendments in the 2014 Draft Catalogue are adopted, the following industries would be "permitted" to foreign investors:

1. Many manufacturing industries, but excluding arms and ammunition manufacturing (which would remain "prohibited") and manufacturing of whole units of automobile, special automobiles, agricultural vehicles and motorcycles (which are currently in the "permitted" category)

2. E-commerce for technology, media and telecommunications business (TMT), but excluding any value-added TMT business (which would remain "restricted" and subject to 50% or more Chinese ownership requirement)

3. Development of tracts of land, construction and operation of high-class hotels, high-class office buildings and international exhibition centers, investment in real estate secondary market and real estate brokerage

4. Construction and operation of golf courses and villas, cinemas, large-scale theme parks and entertainment venues

5. In the Current Catalogue, banks, financial companies, trust companies, and currency brokerage companies are in the "restricted" category. Only banks would remain in the "restricted" category in the 2014 Draft Catalogue[1]

6. Currently, provision of legal services by foreign investors is "restricted". The 2014 Draft Catalogue would remove the legal industry from the "restricted" category. However, the 2014 Draft Catalogue would specify that Chinese law related service is "prohibited"

Rollbacks

While the 2014 Draft Catalogue lifted or eased many restrictions, some industries would be rolled back and be under tighter control.

1 The 2014 Draft Catalogue would include the China Banking Regulatory Commission (CBRC) regulations on foreign ownership in banks. Specifically, the maximum foreign ownership in Chinese bank is capped at 20% for any single foreign financial institution investor and 25% if the investor group includes more than 1 foreign financial institution.

Auto Industries

The manufacture of whole units of automobile, special automobiles, agricultural vehicles and motorcycles are currently “permitted.” However, they are also subject to the Policy on Development of Auto Industry issued by NDRC in 2004 (Auto Industry Policy). To conform to the NDRC’s policy, the 2014 Draft Catalogue would add these industries to the “restricted” category. Specifically, the Chinese shares in Sino-foreign joint venture manufacture of whole units of automobile, special automobiles (excluding agricultural vehicles) and motorcycles may not be less than 50%. Each foreign investor would be allowed to establish no more than two joint ventures in China to manufacture whole units of automobiles of the same category (passenger cars, commercial cars or motorcycles). However, a joint venture may acquire and own existing domestic automobile manufacturers.

Medical Institutions Industry

The 2014 Draft Catalogue would make the medical institutions industry “restricted” and investors would only be able to operate medical institutions through joint ventures, while the industry is currently “permitted.”

Educational Services

The 2014 Draft Catalogue imposes more stringent restrictions on foreign investment in educational sector, which excepting high school education is currently “permitted.” Higher education and day-care would be “restricted” and limited to joint ventures with Chinese control. High school education would remain “restricted” with Chinese control. Compulsory education – grades 1 to 9 – would be “prohibited.”

Some Observations

Despite the rollbacks in the 2014 Draft Catalogue, the draft shows an encouraging trend. No doubt NDRC and MOFCOM have received comments from industries that are affected. Our hope is that the final version sent by NDRC and MOFCOM to the State Council will not have the rollbacks (or have fewer or less severe rollbacks). Whether or not that will happen remains a matter of conjecture.

Note that some industries may be subject to specific, additional restrictions imposed by agencies having jurisdiction over those industries. In the case of the automobile industry and the banking industries, the 2014 Draft Catalogue would include amendments to conform to the auto and banking industry regulators’ rules, but NDRC and MOFCOM may not have taken into account restrictions put in place by other agencies in every other case. Therefore, it is prudent to check other regulations.

If you have any questions about the content of this advisory, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

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