On June 28, 2017, the National Development and Reform Commission (NDRC) and the Ministry of Commerce (MOFCOM) of the People’s Republic of China (China) promulgated the 7th updated version of the Catalogue of Industries for Foreign Investments (the 2017 Catalogue), which will come into effect on July 28, 2017. The 2017 Catalogue includes two parts: (1) a category of industries that are encouraged for foreign investments (Encouraged Industries); (2) a “negative list” of industries, in which foreign investments market entry will be subject to special administration, i.e., pre-approval and examinations (Negative List).

The 2017 Catalogue opens various additional industries to foreign investors which previously were restricted or prohibited for foreign investments, mainly in the services, manufacturing and mining sections. Also, this is the first time that the Chinese government has formally published a nationwide applicable Negative List for foreign investments. The previous seven versions of the catalogue categorized industries for foreign investments into encouraged, restricted and prohibited industries. Industries not listed in such catalogue were deemed permitted for foreign investments.

TAKEAWAYS

- China creates a nationally applicable “negative list” for foreign investment, which opens up more industries for multi-national companies.

- Foreign Investments Filing Administrative Rules will be updated and published soon by the Ministry of Commerce to clarify the filing procedures for foreign investments in the industries not on the “negative list,” which should simplify market entry regulations.

07.12.17

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Before October 1, 2016, foreign investments in all such four categories of industries were subject to substantial examination and pre-approval by the Chinese government. In October, 2016, China reformed its foreign investment market-entry regulatory regime by changing the pre-approval process for all foreign-invested projects to post-filing procedures for foreign investment in the industries not on the “Negative List”. However, during the transition period from last October to the promulgation of this 2017 Catalogue (including the nation-wide Negative List), foreign investors and China local enforcement authorities have had to use the 2015 version catalogue to determine what industries are on the Negative List, resulting in much confusion at the local government approval/filing level.

**Highlights of the 2017 Catalogue**

- The Negative List in the 2017 Catalogue includes three types of industries, (a) Restricted Industries, (b) Prohibited Industries for foreign investments, and (c) certain Encouraged Industries in which foreign investments are subject to special administrative requirements, e.g. requirements regarding the foreign investor’s equity ratio and/or executive officers (Specially Administered Encouraged Industries). Foreign investments in the industries not on the Negative List are only subject to post-establishment/changes filing with MOFCOM. Certain articles may have misunderstood that only Restricted Industries listed in the Negative List are subject to the examination and approval by MOFCOM or its counterparts. According to our confirmation with MOFCOM, foreign investment in both the Restricted Industries and Specially Administered Encouraged Industries listed in the Negative List are subject to pre-establishment/pre-change approval by MOFCOM or its counterparts. Foreign investments in the Restricted Industries with total investment of more than $300 million are also subject to project approval by the NDRC and its counterparts.

- Various industries previously prohibited or restricted for foreign investments are opened under the 2017 Catalogue, mainly in the services, manufacturing and mining sections, such as the following:
  - Highway passenger transportation (inter-city long-distance passenger transportation, excluding inside-city transportation such as taxis, buses, etc.);
  - Creditworthiness investigation and evaluation services and accounting and auditing services;
  - Construction and operation of wholesale markets for agricultural products;
  - Construction and operation of multipurpose water control projects;
  - Production of energy power batteries for new-energy automobiles;
  - Development and production of automobile electronic bus network technology or electronic controller for electronic power steering system;
  - Production of motorcycles;
  - Production of low or mid-speed diesel engines and crankshafts for marine vessels;
Processing of certain edible oil, rice, flour and raw sugar;

Production of bio liquid fuels;

Exploration and development of unconventional oil and gas, e.g., oil shale, oil sands, shale gas, etc.

Exploration or mining of precious metals (gold, silver, platinum).

- A foreign investor which has already invested in two fuel based automobile joint ventures is now allowed to establish more joint ventures in China to produce purely electric automobiles but the foreign investor’s equity ratio must be no more than 50 percent in such joint ventures. (Note that foreign investors are still be restricted from establishing more than two joint ventures for the production of fuel based automobiles);

- The 2017 Catalogue has deleted certain industries (such as gambling) where foreign and domestic investors are treated equally in term of market entry, which are already listed in the Draft Market Entry Negative List (Experimental Version) applicable to both domestic and foreign investors that was jointly published by MOFCOM and NDRC in April 2016. Foreign investors should also pay attention to such industries that are restricted or prohibited to both domestic and foreign investors, such as the restricted development and operation of theme parks, the prohibited development of golf courses and villas, prohibited development of natural conservation areas and internationally important wetlands, projects that harm military facilities and/or the gaming industries, etc.

MOFCOM’s Updated Implementing Rules

MOFCOM has been updating its filing requirements for establishment and post-establishment changes for foreign invested enterprises (FIE) since last October. On May 27, 2017, MOFCOM published for public comment its draft updates to the Interim Measures for the Record-filing Administration of Establishment and Change of Foreign-invested Enterprises (Draft Updates to FIEs Filing Measures). We expect that such Draft Updates to the FIE Filing Measures will be finalized and published soon to facilitate the implementation of the 2017 Catalogue. In such draft, MOFCOM has clarified that a foreign investor’s acquisition of domestic companies in the industries not on the Negative List is only subject to post-acquisition filing, rather than prior approval; and more specifically, a foreign investor investing in a listed domestic company should conduct filing before or within 30 days after it registers with the relevant securities registration and clearing agencies. However, a domestic company which uses its offshore affiliate(s) to acquire its on-shore affiliates is still subject to pre-acquisition approval by MOFCOM or its local counterparts. The Chinese government intends to supervise so-called “round-trip investments” by domestic companies which reflects China’s recent policies on restricting the flow of domestic capital to overseas. The Draft Updates to FIEs Filing Measures also require disclosing certain information when undertaking the filing(s), such as shareholding structure of the FIE and its foreign investor(s) and ultimate controller of both the FIE(s) and its foreign investor(s).
Pillsbury’s Observations

1. New Opportunities for Foreign Investors

Thirty industries previously prohibited or restricted for foreign investments are deleted under the 2017 Catalogue. The MOFCOM’s Draft Updates to FIE Filing Measures also further lighten the administrative burden for foreign investors when structuring or reorganizing their investments in China.

2. Amendments to Various FDI Regulations

To avoid causing confusion and to facilitate the implementation of the 2017 Catalogue and the MOFCOM’s Draft Updates to the FIE Filing Measures, a number of administrative regulations governing foreign direct investments approval and registration procedures (FDI Regulations) need to be updated by the appropriate government agencies in order to be consistent with the 2017 Catalogue, such as the Interim Regulations on Domestic Investment by Foreign-invested Enterprises jointly issued by the State Administration for Industry and Commerce (SAIC) and MOFCOM on July 25, 2000, the Regulations on Merger and Split of Foreign Invested Enterprises jointly issued by SAIC and MOFCOM on September 23, 1999 and revised on November 22, 2001, and the Provisions for Acquisition of Domestic Companies by Foreign Investors issued by MOFCOM on June 22, 2009, etc.

3. The Negative List is Not an Exhaustive List of Restrictions on Market Entry of Foreign Investment

Certain industries, where foreign investments are restricted, are not specified in the Negative List of the 2017 Catalogue. For example, the Negative List of the 2017 Catalogue doesn’t specify any equity ratio restrictions on aircraft fuel projects, while Article 6 of the current Provisions on Foreign Investment in the Civil Aviation Industry promulgated by the General Administration of Civil Aviation of China in June 21, 2002 requires the Chinese shareholder must be the controlling shareholder in any aircraft fuel projects.

Further, before making any investment, foreign investors should make an in-depth market investigation in the industry it intends to invest in. In some cases, although there are no clear and existing regulations and rules which explicitly restrict foreign investments, certain internal policies and practices of the relevant governmental authority in charge of such industry play a key role in reviewing foreign investments. For example, there are no explicit regulations or specific restrictions in the 2017 Catalogue and its previous version prohibiting non-Hong Kong/Macao foreign investors from holding more than 25 percent equity interests in an insurance agency company. However, the current practice is that the regulatory authority only allows Hong Kong or Macao investors to hold more than 25 percent equity interest in a foreign-invested insurance agency company. Another example is MIIT’s strict scrutiny on approval of foreign investments in content information provider services and value-added telecommunications (VAT), though certain limited VAT services have been opened to foreign investors in previous versions of the catalogue.
After promulgation of the 2017 Catalogue, we also reached out to the relevant authorities in charge of the above mentioned industries. The officials replied that despite the 2017 Catalogue, the above requirements on foreign investment remain the same, and they were not aware of any changes or plans to change in the near future.

We hope either the relevant industrial administrative authorities will update their respective regulations and policies in accordance with the 2017 Catalogue and make such policies transparent to the public; or the Negative List will be revised to reflect the current actual practice in various sensitive industries in China.