



A Review of China's Reforms to FDI Administration Regime in 2016

Over the Year 2016, the Chinese government has overhauled its regime of administration over foreign direct investment (“**FDI**”) by promulgating a series of amendments to laws and new regulations to introduce a record-filing process to replace the pre-approval process, and to shift its focus from pre-approval to post-filing supervision. The new FDI administration regime simplifies administrative formalities and establishes a more efficient system for FDI. It will certainly bring significant and positive influences on foreign investors who plan to invest in China as well as those who are now operating businesses in China through foreign invested enterprises (“**FIE**”). This article will review those noteworthy changes brought by the new FDI administration regime.

1. Pre-approval Process Changed to Filing Process under MOFCOM's Administration

(a) Introduction of Record-Filing Process

Prior to the introduction of record-filing process, establishment and modifications in many aspects of a FIE were subject to pre-approval of the Ministry of Commerce or its local counterparts (“**MOFCOM**”) on a case by case basis under the previous FDI Administration regime. A number of documents which contain detailed and substantive information about FIE and/or the related transactions need to be submitted for MOFCOM's review and comments, including feasibility study report, charter documents and/or transaction documents such as joint venture contract, share transfer agreement or capital increase agreement, depending on the type of the FIE and the specific transaction the FIE is involved in. MOFCOM normally took 20 working days in average to complete the pre-approval process¹. It was not uncommon that foreign investors and/or FIEs were

¹ According to the Sino-foreign Equity Joint Ventures Law, MOFCOM may take up to three months to complete the review and the approval. Nevertheless, in practice, it took MOFCOM 20 working days in average to complete the review and the approval.

required by MOFCOM to revise these documents back and forth several times before MOFCOM decides to issue approvals. The charter documents, the transaction documents and the concerned transactions would not become effective until approvals were granted by MOFCOM. The pre-approval process was time-consuming and lack of economic efficiency, and the relevant transactions became uncertain because of MOFCOM's comments on the charter documents and the transaction documents.

On October 8, 2016, MOFCOM promulgated the *Interim Administrative Measures for Recordation of Establishment and Modification of FIE* (“**FIE Recordation Measures**”) to introduce a “record-filing process” nationwide². Establishment and modifications of FIEs under this process will only require recordation filing with MOFCOM, with a few exceptions to which pre-approvals are still applicable.

Under the record-filing process, foreign investors and/or FIEs only need to make record-filing through an online system of MOFCOM either before their registration with the Administration for Industry and Commerce (“**AIC**”) or as late as 30 days after the registration with AIC for establishment or modifications. The application documents required for filing are also significantly reduced. Apart from a declaration form, foreign investors and/or FIEs are only required to submit identity certifications with respect to investors and FIEs; while the typical application documents such as feasibility study

² The record-filing process was first introduced for FDI in Shanghai Pilot Free Trade Zone according to the *Notice of the State Council on Issuing the Framework Plan for China (Shanghai) Pilot Free Trade Zone* in 2013.

report, the charter documents and the transaction documents under the previous process will not be required for review anymore under the new process. MOFCOM will only conduct formality check instead of substantive review on these documents. It will take 3 working days to complete the formality check and the filing. Compared to the previous process, the record-filing process will be much more straightforward and efficient.³

Most importantly, the record-filing process brings more certainty, predictability and flexibility. First, establishment of FIEs will only be subject to AIC's registration, and modifications to FIEs become effective upon the adoption of the resolution by the highest authority of FIEs themselves (i.e., board of directors as to joint ventures; shareholder(s) as to wholly foreign owned enterprises) rather than MOFCOM's pre-approval. Therefore, transactions involving establishment or modifications of FIEs become more certain and predictable as the risk of failure to obtain pre-approval inherent in the previous regime never exists. Moreover, for the same reason, in a share transfer or a joint venture transaction regarding a FIE, the parties will benefit from such flexibility that the timing of closing of the transaction will be controlled by the parties. Second, as transaction documents will not be subject to MOFCOM's review and comments, the parties will have more autonomy on the commercial arrangements in the transaction

³ It is also worth noting that under the record-filing process, foreign investors are required to disclose information in relation to their ultimate controlling party. To identify the ultimate controlling party, MOFCOM requires to trace up to individuals, listed companies, international organizations or foreign governments who ultimately control the foreign investors by shareholding, contract, entrustment or other methods.

documents so long as such arrangements will not be prohibited by the laws.

(b) Exceptions to Filing Process

As mentioned above, while the record-filing process applies to establishment or modifications of most FIEs, there are certain exceptions to which the requirement of pre-approval of MOFCOM still apply. First, the pre-approval process will apply to the foreign investments in the restricted sector and certain industries in the encouraged sector which have requirements in respect of shareholding or composition of senior management pursuant to the *Catalogue of Industries for Guiding Foreign Investment* jointly issued and revised from time to time by the National Development and Reform Commission (“NDRC”) and MOFCOM. Second, acquisition of Chinese domestic enterprises by foreign investors and foreign investments in Chinese listed companies remain subject to MOFCOM’s pre-approval.

2. Heightened Post-filing Supervision by MOFCOM

(a) Inspection

In order to prevent the aforesaid record-filing process from being abused and to ensure the filed information is true and accurate, the FIE Recordation Measures have introduced a system of supervision and inspection, and specified MOFCOM’s powers of supervision and inspection on FIEs. Further to the FIE Recordation Measures, on December 13, 2016, MOFCOM promulgated the *Guidance of Supervision and Inspection on FIEs’ Establishment and Alternation Filing*

(“**Guidance of Supervision and Inspection**”) which sets forth MOFCOM’s implementation measures in respect of the supervision and inspection. In general, MOFCOM will implement its supervision and inspection in the following four methods:

- Random Inspection
- Inspection per Whistle-blowing
- Inspection per Other Governmental Bodies’ or Judiciary Institutions’ Suggestions
- Discretionary Inspection

Of the four methods, random inspection will be taken by MOFCOM as the primary method. The local counterpart of MOFCOM will conduct random inspections on FIEs within its jurisdiction at least twice a year. MOFCOM will notify the FIE of the inspection date and the documents subject to the inspection at least three days before the inspection. MOFCOM’s inspection will mainly focus on:

- Whether the record-filing process has been duly fulfilled;
- Whether the filed information is true, accurate and complete;
- Whether the FIE is engaged in any industry falling under sectors from which foreign investment is prohibited;
- Whether the FIE is engaged in the industry falling under the restricted sector without pre-approval;
- Whether any condition of the FIE may trigger the national security

review exits.

(b) Penalties

The penalties imposed on the FIE in violation of FIE Recordation Measures appear to be moderate. The investors and/or the FIEs will be ordered to correct their misconducts and a fine up to RMB30,000 may also be imposed. However, in addition to the monetary penalties, the violation will also be recorded in the enterprise integrity system, reported to other relevant authorities and disclosed to the public. Compared to the monetary penalty, the latter ones would result in worse impact on FIEs' business activities due to loss of creditability with the market as well as the government.

3. Registration Process of AIC and Project Approval/Filing Process of NDRC Remain Unchanged

(a) Registration Process with AIC

AIC is in charge of the registration of all types of enterprises. Under the previous FDI administration regime, the registration process of AIC cannot be initiated until and unless foreign investors and/or FIEs have obtained approvals from MOFCOM. Similar to the previous practice of MOFCOM, AIC also reviews charter documents and transaction documents, but normally AIC focuses on the charter documents and, in case of a share transfer transaction, the share transfer agreement.

In the wake of the adoption of the record-filing process by MOFCOM, the registration with AIC will no longer be conditioned upon pre-approval process with MOFCOM except for a few cases as discussed in Section 1(b) of

this article. Apart from the removal of this prerequisite, the registration process of AIC and the application documents required for AIC's review remain unchanged. However, since MOFCOM will no longer review the substance of the application for FIEs' establishment and modifications, the role of AIC becomes more important under the new FDI administration regime. We expect that AIC may be more cautious when examining the registration of FIEs. Thus, it is likely that AIC may, more often than before, raise comments and require foreign investors and/or FIEs to modify the application documents (including charter documents and, in case of a share transfer transaction, the share transfer agreement). In order to avoid the nuisance that the charter documents and the share transfer agreement are required to be revised by AIC after execution, it is advisable for foreign investors/FIEs to unofficially present these documents to AIC for comments as soon as they are finalized but before executed by investors and/or FIEs.

(b) Project Approval/Filing Process of NDRC

Under the previous FDI administration regime, where a foreign investment involves fixed assets project in China, such project remains subject to approval or filing process of NDRC depending on the specific industry and the total investment amount. The process of NDRC is prerequisite to both the pre-approval process of MOFCOM and the registration process of AIC. Under the new FDI administration regime, the project approval and filing process of NDRC remain unchanged and the applicable regulations, namely the *Measures for the Administration of the Approval and Recordation of Foreign Invested Projects*

which were promulgated by NDRC in 2014 remains effective.

Conclusion

The series of measures to reshape the FDI regime in 2016 signals the Chinese government's determination to strengthen efforts to attract more foreign investments. These measures not only significantly shorten the timeframe of FIE's establishment and modifications process, but also bring foreign investors and FIEs more liberty and certainty with respect to their commercial arrangements. Nevertheless, we believe that the FDI administration regime still has room for further improvement. Obviously, China did not stop its footstep. On December 28, 2016, the State Council passed the *Circular on Measures for Further Opening Up and Active Use of Foreign Investment*, according to which we can expect that there will be more effective measures favoring foreign investments to be implemented in 2017.⁴

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⁴ For detailed discussion about this circular, please refer to our previous article (<http://www.chinalawvision.com/2017/01/articles/investment-1/foreign-direct-investment/china-purports-to-adopt-new-measures-to-boost-foreign-investment-in-2017/>).

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