Chinese foreign investment law reform: From approval requirement to filing

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In recent years, China has been dedicated to revamp its case-by-case approval-based foreign investment regulation mechanism, and it has reformed its foreign investment law very considerably and transformed the approval-based mechanism into a filing/registration-based regulation mechanism. The new regulation mechanism largely lowers the administrative and compliance costs of establishing a foreign investment enterprise (FIE) in China, provides easier access to the Chinese market, and reduces friction in trade with China for foreign companies.

The main details of the new rules governing foreign investments in China are highlighted in the "Interim Measures for Record-filing Administration of the Establishment and Change of Foreign-invested Enterprises" (the "Interim Measures") announced by the Chinese Ministry of Commerce (MOFCOM) on 8 October 2016, and the "Revised Interim Measures for Record-filing Administration of the Establishment and Change of Foreign-invested Enterprises" (the "Revised Interim Measures") issued by MOFCOM on 30 June 2017.
The Interim Measures introduced the filing-based regulation for establishing FIEs in China, replacing the previous requirement of obtaining prior approval from MOFCOM. In addition, the Revised Interim Measures extended the application of the filing-based regulation to the conduct of M&A transactions by foreign companies in China. The recent reform means that foreign investments in China, either by establishing a FIE or conducting M&A, are now subject to less strict regulation compared to before.

The timeline for reforming foreign investment law in China

1. Previous FIE law (has been revised): It mostly covered the Law of the People's Republic of China on Chinese-Foreign Equity Joint Ventures, the Law of the People's Republic of China on Chinese-Foreign Contractual Joint Ventures, the Law of the People's Republic of China on Wholly Foreign-Owned Enterprises. These laws laid down MOFCOM's case-by-case approval mechanism for establishing a FIE in China.


3. Resolution by NPC to Revise FIE law: On 3 September 2016, the Standing Committee of the National People's Congress adopted the "Resolution on Revising the PRC FIE law", and MOFCOM published draft measures to implement the changes.

4. Interim Record Filing Measures: On 8 October 2016, MOFCOM officially announced and put into force the Interim Measures intended to implement the "Resolution by NPC to change FIE law", which abolished the approval requirement for foreign investment and replaced it with a filing process (the "Filing Process"), as long as it does not fall into the restricted or prohibited

6. Interim Record Filing Measures (Revised): On 30 June 2017, MOFCOM issued the Revised Interim Measures, which further provided that the record-filing mechanism also applies to foreign investors’ mergers and acquisitions of domestic non-foreign funded enterprises and strategic investments in listed companies, provided that they do not involve any special administrative measures or any merger and acquisition of affiliates.

Purpose of filing with MOFCOM for a FIE in China

From the perspective of the regulatory authorities, the purpose of the reform was to loosen the regulation of foreign investments in China, promote a more efficient foreign investment management system, and create a lawful, international and convenient business environment for FIEs by transforming the current requirement for approval by MOFCOM into the Filing Process with MOFCOM.

It is known that the previous case-by-case approval-based foreign investment regime is no longer in line with the ever-growing foreign investments in China. A previous guiding catalogue classifies foreign investments in China into four groups: the encouraged, the permitted, the restricted, and the prohibited groups. But the problem with the approval mechanism and the catalogue is that no matter which group a foreign investment falls into, it will be subject to the approval mechanism in any case, which will therefore significantly increase both the compliance costs and the time costs for a foreign investor.
Scope of the Filing Process

To apply the Filing Process, the precondition is that the foreign investment does not fall into the Negative List of the 2017 Catalogue. Case-by-case approval will apply if the investment is covered by the Negative list. Generally speaking, the Filing Process will apply to the establishment of and changes to a FIE (see Box 1), unless the FIE falls into the Negative List.

1. Establishment of a Foreign Investment Enterprise.

2. Changes to a FIE:
   - basic information on the FIE
   - basic information on any investors of the FIE
   - equity (shares) and cooperation interests
   - merger, demerger and termination
   - mortgage of the property or rights and interests of the FIE
   - advance recovery of investment by the foreign party to a Contractual Joint Venture
   - entrusted business management

3. Foreign-invested investment companies, venture capital enterprises, and equity investment enterprises.

   Box 1: Scope

The Filing Process

To ensure that the process is simplified, the registration authority performs the registration through the integrated foreign investment management information system (the “integrated management system”) (see Figure 1). When filing for the establishment of a FIE, its representative must before issue of
the business licence, or within 30 days after issue thereof, fill out and submit online the application form for the registration of the establishment of the FIE (the “Application Form for Establishment”) and relevant documents through the integrated management system in order to complete the registration process.

When filing for a change to a FIE, its representative must within 30 days after the occurrence of the change fill out and submit online the application form for the registration of the change (the “Application Form for Change”) and relevant documents through the integrated management system in order to complete the registration process.

This Filing Process significantly enhances efficiency, provided that the matter falls within the scope of filing as prescribed by the Interim Measures. The registration authority must within 3 working days complete any registration applied for by foreign investors.
SUPERVISION BY MOFCOM

Under the new supervision mechanism, MOFCOM is the supervision authority for the FIE and its operation in China.

Specifically, the competent departments of commerce may conduct random supervision and inspection upon tip-offs or according to suggestions or information provided by relevant authorities. Additionally, where a FIE or its investors fail to complete filing formalities, have filed false records, refuse to cooperate in case of supervision and inspection, or refuse to implement the decision of administrative penalty, the competent department of commerce may conduct inspection.

According to the Interim Measures, a FIE failing to follow the Filing Process will be subject to compliance risks. If a FIE or its investors fail to fulfil the filing obligations within the prescribed time limit or are guilty of any material omission in the course of the Filing Process, such FIE or investors will be ordered by the competent department of commerce to take corrective action within a prescribed time limit. If they fail to take corrective action within the prescribed time limit, or if the circumstances are serious, a fine of no more than 30,000 Chinese Yuan will be imposed. However, in practice, it is usually the business operation or plan of a foreign investor in China at stake, so the repercussion for the business operation could be significant in case of non-compliance.

Inclusion of M&A

The Interim Measures did not only simplify the foreign investment compliance process, but also lowered the friction for doing business in China. However, they also unavoidably left some issues untackled such as the ambiguity as to whether the Filing Process was also applicable to M&A conducted by foreign investors in China. The legislators obviously also realized the loophole and therefore in 2017 issued the
Revised Interim Measures, which include M&A in the Filing Process.

Scope of application

It should be noted that the Filing Process does not apply to related-party M&A, nor does it apply to businesses falling into the Negative List. Specifically, the Filing Process applies to:

1. Merger with or acquisition of non-foreign-invested enterprises in China, either by acquiring shares in domestic non-foreign-invested enterprises, or by foreign investors subscribing for additional shares in domestic companies and converting them into FIEs.

2. Strategic investments in listed companies by foreign investors.

Filing Process

Instead of the case-by-case approval under the previous supervision mechanism, the Filing Process is applied to complete a transaction. The Filing Process does not only largely reduce the document submission requirement (for instance, the asset evaluation report is no longer required), but it also considerably lessens the registration time by the authorities, namely from 30 to 3 business days.

In summary, the new supervision mechanism and the Filing Process definitely reduce the friction for foreign companies doing business in China, simplify the administrative requirements, and lower the compliance cost, when it comes to establishing a FIE or conducting M&A transactions in China. The new reform caters to the increasing need for foreign investments in China, and it is expected that there will be an uptrend in foreign investments in the coming years.