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An Overview of the Latest Changes to China's 2014 Industry Catalogue for Foreign Investment

On 4 November 2014, the National Development and Reform Commission (**NDRC**) and the Ministry of Commerce (**MOFCOM**) jointly issued the *Catalogue for the Guidance of Foreign Investment Industries* (Consultation Draft) (**2014 Consultation Draft**). The consultation period ended on 3 December 2014. If the 2014 Consultation Draft were to be eventually promulgated without further amendment, it will be the primary source of guidance for a foreign investor to ascertain whether its potential investment in an industry in China is possible, and if so, what level of government approval is required and whether any restriction applies, such as limitation on the percentage of foreign shareholding. Similar to the past versions of the Catalogue, the 2014 Consultation Draft lists a number of industries and classifies them according to whether foreign investment is encouraged, restricted or prohibited. An industry which is not expressly listed is deemed to be one in which foreign investment is permitted.

China's guidance policy under the 2014 Consultation Draft

The 2014 Consultation Draft is geared towards:

- enhancing an open investment policy by granting foreigners easier access in a greater number of service and manufacturing industries;
- changing the regulation of foreign investment by encouraging foreign investment in energy-saving and environmental protection industries, while decreasing the number of restricted industries and limitations on foreign shareholding; and
- optimizing the economic structure by encouraging foreign investment in modern agriculture, hi-technology, advanced manufacturing, energy-saving, environmental protection, new energy, and modern service industry, in particular the research and development sector.

Major changes introduced by the 2014 Consultation Draft

Compared to the existing *Catalogue for the Guidance of Foreign Investment Industries* revised in 2011 (**2011 Catalogue**), the 2014 Consultation Draft has substantially reduced the number of restricted industries from 79 to 35. Industries which still require foreign investment by way of an equity or cooperative joint venture have been reduced from 43 to 11.

A more detailed look at the major changes to some key industries under the 2014 Consultation Draft is set out below.

Financial industry

While the 2014 Consultation Draft has reclassified foreign investment in financial companies, trust companies, currency brokerage companies and insurance brokerage companies from restricted to permitted category, the limitations on foreign shareholding and the business scope of securities companies have been relaxed. In particular, the 2014 Consultation Draft has expanded the business scope of securities companies to include the underwriting and sponsoring of RMB common shares, foreign shares, government bonds and corporate bonds, the brokerage of foreign shares and the brokerage and proprietary trading of government bonds and corporate bonds. A foreign-invested securities companies may further apply to extend its business scope after two years of establishment provided certain requirements are fulfilled. The foreign shareholding ratio allowed in securities companies has been increased from 33.3% to 49%, which is consistent with the amended Rules on the Establishment of Foreign-invested Securities Companies issued by the China Securities Regulatory Commission in 2012.

For banks, the shareholding allowed to be held a foreign financial institution (including its affiliate) where it acts as a promoter or strategic investor in a Chinese-funded commercial bank is limited to 20%. The aggregate shareholding that could be held by several foreign financial institutions in a Chinese-funded commercial bank must not exceed 25%. This is consistent with the Implementing Measures on Administrative Approvals for Chinese-funded Commercial Banks issued by the China Banking Regulatory Commission in 2013. In addition, only foreign banking financial institutions may invest in rural commercial banks.

The 2014 Consultation Draft does not change China's foreign investment policy with regard to insurance companies, securities investment fund management companies and futures companies.

Manufacturing industry

The 2014 Consultation Draft has removed a number of manufacturing industries from the list in which foreign investment was restricted. Foreign investors may therefore invest in a much wider range of manufacturing industries, including the making of certain beverages, chemical raw materials and chemical product, chemical fiber, general equipment and special equipment (excluding weapons and ammunition manufacturing industry belonging to the prohibited category). All these industries are now reclassified into the permitted category in which foreign investors may invest without restriction on the investment method or shareholding ratio.

Medical and Pharmaceutical industry

Production of medicine (such as certain kinds of vitamins), narcotics and raw materials of psychotropic drug of category 1 are now reclassified from the restricted to the permitted category.

Foreign investment in the formation of medical institutions are, however, subject to more stringent regulation. Under the 2011 Catalogue, it is classified as a permitted industry for foreign investment. Yet in practice, it has still generally been very difficult for foreign investors to set up wholly foreign-owned medical institutions. Under the 2014 Consultation Draft, foreign investment in medical institutions is reclassified into the restricted category and is limited to the formation of cooperative joint venture.

Automobile industry

Under the 2011 Catalogue, foreign investment in the production, research and development of automobile electronic equipment is encouraged albeit some areas are still subject to the formation of equity or cooperative joint ventures, such as the industries of electronic controller of electric power steering system and embedded electronics system integration. The 2014 Consultation Draft now removes these restrictions so that foreign investors may establish wholly foreign-owned enterprises or joint venture enterprises without the need of a Chinese party.

The years from 2007 to 2014 has witnessed a significant change in China's policy on foreign investment in the production of an entire vehicle. While it was previously encouraged, the 2014 Consultation Draft, for the first time, classifies the production of an entire vehicle, vehicles for specific purposes and motorcycles in the restricted category for foreign investment. This reflects China's trend in tightening up foreign investment in this area, which may implicitly be aimed at encouraging the development of its self-owned branded vehicles.

For the above industries which are newly classified as restricted, the 2014 Consultation Draft now requires that the Chinese party's shareholdings in such industries must not be lower than 50%, and that a foreign investor may establish no more than two joint ventures that produce the same type (including passenger vehicles, commercial vehicles and motorcycles) of vehicle. The only exception is where the foreign investor merges with or acquires another domestic automobile enterprise with a Chinese partner. These restrictions are similar to the requirements stipulated in the amended Automobile Industry Development Policy promulgated in 2009.

Communication and internet industries

In general, foreign investors are encouraged to invest in emerging business in communication and internet industries. The 2014 Consultation Draft removes the foreign shareholding restriction on e-commerce under the value-added telecommunications industries, which reflects China's intention to promote e-commerce. At present, foreign investment in e-commerce within the Shanghai Free Trade Zone is limited to 55%. It awaits to be seen whether other areas of China will adopt a similar requirement following the official promulgation of the revised Catalogue.

Foreign investment in the development of the internet of things (IoT) is now listed in the encouraged category. This change indicates China's determination to attain a leading position in the IoT sector.

It is noteworthy that network publishing service is stipulated as a prohibited category under the 2014 Consultation Draft. This accords with the policy stipulated in the Several Opinions on the Introduction of Foreign Investment in the Cultural Sector jointly promulgated by the Ministry of Culture, Ministry of Commerce, NDRC and other relevant state authorities in 2005.

Infrastructure and real estate industries

In comparison with the 2011 Catalogue, the 2014 Consultation Draft removes restrictions on foreign investment in real estate development. Specifically, real estate industry is reclassified from the restricted to the permitted category and there is no longer any restriction on foreign investment in land development, the construction and operation of high-end hotels, office buildings, international exhibition centers and large theme parks. In addition, the foreign shareholding limit has been relaxed for construction and operation of infrastructure such as urban subway and light rail.

Education industry

In contrast to the relatively open policy towards foreign investor in other industries, China imposes greater restrictions on foreign investment in the education sector. The 2014 Consultation Draft includes higher educational institutions and childcare institutions in the restricted category, with the investment method limited to the formation of cooperative joint ventures controlled by the Chinese party. The same requirement for Chinese controlling shareholding applies to ordinary high school education. Foreign investment in compulsory education remains to be prohibited under the 2014 Consultation Draft.

Mining industry

The 2014 Consultation Draft further removes restrictions on foreign investment in the mining industry. Four areas (reduced from eight under the 2011 Catalogue) remain in the restricted category, including prospecting and mining special and scarce coal (Chinese controlling shareholding required), precious metals (including gold, silver and platinum groups), graphite, and the mining and beneficiation of lithium mineral. The previous requirement of investing via an equity or cooperative joint venture has been removed from most mining industries classified in the encouraged category.

Wholesale, retail and logistics industries

The wholesale and retail of tobacco, cigarettes and other tobacco products are newly added to the prohibited category. However, the direct selling, mail order, online sale, distribution of audiovisual products, and the wholesale, retail and delivery of vegetable oil, sugar, crude oil, pesticides and fertilizer are reclassified from the restricted to the permitted category.

Approval and filing requirements

In addition to the changes under the 2014 Consultation Draft, the State Council has released the *List of Investment Projects subject to Government Approval* (2014 version) on 18 November 2014, which clarifies the approval and filing requirements of foreign-invested projects. Please refer to our separate client briefing on this State Council document[1].

Conclusion

The 2014 Consultation Draft reflects China's determination and effort to reform the regulation of foreign investment and paves the way for potentially significant changes in laws and regulations concerning foreign investment. The change of China's policy as indicated in the 2014 Consultation Draft, which reduces restrictions on foreign investment, is likely to facilitate more local industries to enter into free market competition.

It should be noted that the 2014 Consultation Draft may be modified following the close of the consultation period on 3 December 2014. We will keep you posted on any future development.

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1 CC's Briefing titled "*State Council further simplifies the approval requirements for cross-border investments into and out of China*" of December 2014.

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