

SEPTEMBER 2016 ■ NO. 1

Asia Practice

China Adopts New Regulatory Regime for Foreign Invested Enterprises

Action Item: China reforms its regulatory regime for managing FIEs by replacing existing MOFCOM approval requirements with a filing procedure nationwide. Beginning October 1, 2016, the incorporation of or a major change to an FIE that is not subject to national market access restrictions requires only an online filing and is no longer subject to MOFCOM approval.

The National People’s Congress Standing Committee adopted significant amendments to China’s laws regarding Foreign Invested Enterprises (“FIEs”) on September 3, 2016, (the “FIE Amendment”) to ease the approval and examination burdens for most FIEs. On the same day, the Ministry of Commerce (“MOFCOM”) published draft rules for comment (“MOFCOM Rules”), with the comment solicitation period ending on September 22, 2016. The FIE Amendment and the MOFCOM Rules will become effective on October 1, 2016.

Both the FIE Amendment and the MOFCOM Rules significantly simplify MOFCOM’s regulatory regime for managing FIEs and shorten the processing time for foreign direct investment. The highlighted features are summarized below.

MOFCOM Approval Regime is Replaced by a Filing Process

Since 2013, the four free trade zones (“FTZs”) of Shanghai, Tianjin, Guangdong, and Fujian have adopted the “negative list” system for FIEs. In the FTZs, for those FIEs whose business does not fall within the negative list, the MOFCOM approval regime has already been replaced by a filing process administered by the FTZ authorities. However, the MOFCOM approval regime is still applied nationwide for the incorporation of and major changes to an FIE. With the FIE Amendment, China is extending the negative list system and filing process nationwide.

The FIE Amendment generally provides that an FIE whose business is not subject to national market access restrictions may be established or changed by way of filing with MOFCOM. The MOFCOM Rules further specify that the following actions relating to a non-restricted FIE may be taken through simply filing an online application: incorporation, division, merger, dissolution, extension of term, change of registered capital, change of capital contribution timeline, equity transfer, transfer of rights or obligations under a joint venture contract, entrusting third parties to manage a joint venture, etc.

Negative List

The applicability of the MOFCOM approval regime or a filing process depends on whether the FIE is subject to national market access restrictions. The details of the national market access restrictions will be set forth in a national Negative List to be issued by the State Council effective on October 1, 2016, and it is believed that there will be few changes to the Negative List as compared with the negative lists currently used in the FTZs. After the national Negative List is issued, the FTZs' negative lists will be replaced by the national Negative List.

Filing Process Requirements

- **Competent authority.** Under the current MOFCOM approval regime, the application for incorporation of or major change to an FIE is typically required to be submitted to MOFCOM at city district or prefecture levels (depending on the business sector engaged in and the total investment amount of the FIE). Under the new filing process, the filing application is required to be submitted to MOFCOM at the provincial level, and MOFCOM at the prefecture or district levels has no involvement.
- **Where to file.** The entire filing process will be completed online. FIEs must provide information and upload documents to the MOFCOM online system, and provincial MOFCOM will also provide its feedback through this online system.
- **When to file.** The filing for incorporation must be made after the FIE's name reservation approval, and is made either before the issuance of the FIE's business license or within 30 days after the issuance of the FIE's business license. If an FIE (including an FIE established before October 1, 2016) undergoes a major change, it must file the change with MOFCOM within 30 days after occurrence of the change.
- **Information and documents required.** The required paperwork for the filing has been simplified to include an application form; a letter of undertaking and other supporting documents, such as name reservation documents or business license; a POA appointing the representative handling the application, identification documents of investors; etc. It is noteworthy that the

MOFCOM Rules require FIEs to disclose more extensive information than the current foreign investment approval regime in several respects, such as the requirements for information on the FIE's and investors' ultimate control persons when incorporating an FIE or changing such ultimate control persons, and the requirements for disclosing source of funds.

- **Time required.** Provincial MOFCOM will only perform a cursory review of the filed documents to confirm their completeness and accuracy and that the FIE does not fall under the national Negative List. If a filing is confirmed by MOFCOM to be outside the Negative List and with no further information required to be submitted, MOFCOM must issue a notification of completion of filing within three working days after submission.

Post-Investment Supervision

While releasing most FIEs from the approval regime, MOFCOM has nevertheless intensified its scrutiny of FIEs. MOFCOM and its branches are entitled to conduct regular spot checks on FIEs that fail to comply with the MOFCOM Rules. In the case of an FIE's violation of filing obligations, such as failing to file on time, concealing or omitting major facts, or filing misleading or false information, the FIE will be ordered to rectify or terminate any non-compliance operations, and a fine of up to RMB 30,000 may be imposed. The MOFCOM Rules also provide that findings of non-compliance of FIEs will be shared with other government departments and will be disclosed through MOFCOM's publication system.

Our Comments

FIEs will significantly benefit from the new FIE Amendment and MOFCOM Rules. Firstly, they will enhance transaction certainty. Under the current approval regime, most transactions involving FIEs are subject to approval of MOFCOM at a district or prefecture level. Since some MOFCOM officers at the district or prefecture levels may have inconsistent understanding of applicable laws and regulations (especially regarding transactions with terms which are unfamiliar to the officers), some applications may not be understood and therefore not approved. Under the new filing process, all the filing applications will be submitted online to provincial-level MOFCOM and the officers will only perform a cursory review, thus consistent understanding

and application of laws and regulations will be improved, and applications will not be as easily challenged by MOFCOM so long as the documents are complete, accurate, and the matters do not fall under the Negative List. Secondly, as it takes only three working days to complete the filing process, it will significantly shorten the administrative processing time to complete transactions.

As the FIE Amendment and MOFCOM Rules are still in the early stages of implementation, there are questions that remain open. According to the MOFCOM Rules, changes of registered capital or share ownership, mergers, and division will be subject to filing requirements rather than approval requirements. However, under the current MOFCOM regulations and implementation rules for FIEs, decrease of registered capital, merger, division, and acquisition of domestic companies by foreign investors

are subject to MOFCOM approval. It is still unknown if these regulations or provisions will be amended by MOFCOM to be consistent with the MOFCOM Rules and which regulations will be applied by MOFCOM for the above mentioned transactions. We expect MOFCOM to issue clarifications in this regard.

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1. FIEs include wholly foreign-owned enterprises and Sino-foreign joint ventures. The FIE Amendment also applies to Chinese entities receiving equity investments from a foreign invested investment company, foreign invested venture capital company, or foreign invested equity investment company.