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Insights & Ideas

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Further Opening of China's Healthcare Market — Introduction to the Policies Concerning Foreign-invested Medical Institutions (Authors: Loretta LI, Feng YAN, and Haoze LI)

It was not until the late 1980s that foreign capital began to enter the healthcare industry in China. With the policy of reform and opening up, China's medical and health services could not meet the ever-growing demand of foreign patients. On February 10, 1989, the Ministry of Health ("**MOH"**) and the former Ministry of Foreign Trade and Economic Cooperation ("**MOFTEC**") (now the Ministry of Commerce, "**MOFCOM"**) issued the *Several Provisions on the Establishment of Hospitals and Clinics by Foreigners or Overseas Chinese and the Medical Practice in the People's Republic of China by Foreign Doctors*(invalid now), which permitted one to two pilot non-profitable wholly foreign-owned hospitals or clinics to be invested by overseas Chinese and one to two pilot Sino-foreign equity/cooperative joint venture (the "**EJV/CJV**") hospitals or clinics to be established by foreigners and overseas Chinese. The hospitals or clinics aforementioned were subject to the approval of MOH and MOFTEC. Since the promulgation of this regulation, there has been a gradual expansion in the development of foreign-invested medical institutions in China.

1. Early rules regulating foreign-invested medical institutions

On November 5, 1996, MOFTEC distributed the *Principles and Procedures for the Approvals of Foreign-invested Enterprises in Certain Industries* (Wai Jing Mao Zi Fa [1996] No.752) which further clarified the principles and procedures for approvals with respect to the establishment of foreign-invested medical institutions. It also stipulated that the Chinese party in a Sino-foreign EJV/CJV medical institution must be an enterprise legal person involved in the healthcare industry and registered within the People's Republic of China. Furthermore, the project establishment and the feasibility study report of the foreign-invested medical institutions should be examined and approved by MOH, while the related contracts and the articles of association should be submitted to MOFTEC for approval. According to the *Catalogue of Industries for Guiding Foreign Investment* revised in December 1997, medical institutions were categorized as a foreign investment restricted industry. The establishment of a Sino-foreign EJV/CJV medical institution could only proceed on the condition that the Chinese party would either have the controlling interests or play a leading role in such medical institution.

2. The *Interim Measures for the Administration of Sino-Foreign EJV/CJV Medical Institutions* and other relevant regulations

On May 15, 2000, MOH and MOFTEC promulgated the *Interim Measures for the Administration of Sino-Foreign Equity/Cooperative Joint Venture Medical Institutions* (the "**Interim Measures**"), which

expressly prohibits the establishment of wholly foreign-owned medical institutions in China, and makes a comprehensive provision on setting up Sino-foreign EJV/CJV medical institutions in China.

(1) Conditions of the Chinese and foreign parties in a Sino-foreign EJV/CJV medical institution

The parties in a Sino-foreign EJV/CJV medical institution shall have experience directly or indirectly related to medical and healthcare investment and administration, as well as meet the following requirements:

(i) being able to provide advanced international management expertise, and service modes of medical institutions;

(ii) being able to provide advanced international medical technologies and equipment; or

(iii) being able to compensate for or improve the inadequacy of local medical service capacity, medical technologies, funds, and medical facilities.

(2) Conditions of a Sino-foreign EJV/CJV medical institution

A Sino-foreign EJV/CJV medical institution must be an independent legal person with a total investment of no less than RMB 20 million, and the proportion of equity interests or the rights and interests of the Chinese party thereto shall not be less than 30%.

(3) Examination and approval on the establishment of a Sino-foreign EJV/CJV medical institution

According to the Interim Measures, the establishment of a Sino-foreign EJV/CJV medical institution shall be examined and approved by MOH and MOFTEC respectively.

(4) A Sino-foreign EJV/CJV medical institution shall be for-profit

According to the *Implementation Opinions on the Classified Administration of Urban Medical Institutions* jointly issued by MOH, the State Administration of Traditional Chinese Medicine, the Ministry of Finance, and the State Planning Commission on July 18, 2000, a Sino-foreign EJV/CJV medical institution is generally defined as a for-profit medical institution.

3. MOFCOM delegating the power of examination and approval

According to the *Notice of the Ministry of Commerce on Issues Regarding the Examination and Administration of Foreign-invested Enterprises in Some Service Industries by Provincial-level Commerce Authorities and China National Economic and Technical Development Zones* (Shang Zi Han [2009] No.6), the commerce departments of provinces, autonomous regions, municipalities directly under the central government, cities specifically designated in state plans, sub-provincial cities, Xinjiang Production and Construction Corps, and China national economic and technical development zones (together the "**Provincial-level Commerce Departments**") are responsible for

the examination and approval of the establishment of and subsequent changes to Sino-foreign EJV/CJV medical institutions with total investments under USD50 million. The *Decision of the State Council on the Fifth Batch of Administrative Examination and Approval Items to be Canceled and Delegated to Lower Administrative Levels*, promulgated in 2010, also provides that the establishment and change of Sino-foreign EJV/CJV medical institutions below the designated range shall be examined and approved by the provincial-level commerce departments.

However, according to the *Notice on Properly Managing the Work on Administrative Examination and Approval Items to be Canceled and Delegated to Lower Administrative Levels* issued by MOH's General Office on August 24, 2010, the examination and approval of Sino-foreign EJV/CJV medical institutions shall still be submitted level by level up to MOH according to the Interim Measures.

4. Gradually easing restrictions on wholly foreign-owned medical institutions

In order to further open up the healthcare industry, the General Office of the State Council forwarded the *Opinions of the National Development and Reform Commission, the Ministry of Health and other Departments on Further Encouraging and Guiding Social Capital in the Establishment of Medical Institutions* (Guo Ban Fa [2010] No.58, the "**No.58 Notice**") on November 26, 2010, which stipulates the following:

(i) the establishment of medical institutions by foreign capital shall be regarded as foreign-invested projects under the permitted categories;

(ii) overseas medical institutions, enterprises, and other economic organizations are permitted to establish medical institutions in the form of equity or cooperative joint ventures, and the restrictions on equity proportion for foreign capital are to be gradually removed;

(iii) the practice of allowing eligible overseas capital to set up wholly-funded medical institutions in China will be conducted on a pilot basis and then gradually expand; and

(iv) overseas capital is permitted to set up for-profit or non-profit medical institutions.

In response, the latest revised version of the *Catalogue of Industries for Guiding Foreign Investment (2011)*, effective as of January 30, 2012, no longer restricts foreign capital entering the healthcare industry.

5. The Ministry of Health delegating the power of examination and approval and permitting the establishment of non-profit medical institutions

In accordance with the requirements of the No.58 Notice, MOH issued the *Notice of the Ministry of Health on Adjusting the Examination and Approval Authority of Sino-Foreign Equity or Cooperative Joint Venture Medical Institutions*, formally delegating the power of examination and approval to

provincial-level health administrative departments, and permitting the establishment of either for-profit or non-profit Sino-foreign EJV/CJV medical institutions.

6. Policies favorable to Taiwan service providers

The Association for Relations across the Taiwan Straits and the Taiwan Straits Exchange Foundation signed the *Cross-strait Economic Cooperation Framework Agreement* (**the "ECFA"**) on June 29, 2010, which permits Taiwan service providers to establish wholly-owned hospitals in Shanghai, Jiangsu, Fujian, Guangdong, and Hainan.

On December 22, 2010, MOH and MOFCOM jointly issued the *Interim Administrative Measures for the Establishment of Wholly-owned Hospitals by Taiwan Service Providers in the Mainland*, which regulates the establishment of for-profit and non-profit wholly Taiwan-owned hospitals in Shanghai, Jiangsu, Fujian, Guangdong, and Hainan provinces.

- Conditions of Taiwan service providers

  Taiwan service providers shall be legal persons capable of independently assuming civil liabilities. They shall also have experience directly or indirectly related to healthcare investment and management, and be able to provide advanced hospital management expertise, management and service models, or leading international medical technologies.

- Conditions of wholly Taiwan-owned hospitals

  Wholly Taiwan-owned hospitals shall meet the basic criteria for second-level or higher hospitals. The total investment in a second-level wholly Taiwan-owned hospital shall be not less than RMB 20 million, and the total investment in a third-level wholly Taiwan-owned hospital shall be not less than RMB 50 million. However, the total investment may be appropriately reduced if the wholly Taiwan-owned hospital is to be set up in under-developed regions such as ethnic minority areas, border regions, or poverty-stricken areas.

- Examination and approval of wholly Taiwan-owned hospitals

  The examination and approval of wholly Taiwan-owned hospitals adopts a three-tier "Examination and Approval System". This means that the local health administrative departments at the level of cities divided into districts shall report the application for the establishment of wholly Taiwan-owned hospitals level by level to MOH for examination and approval. After obtaining MOH approval, for-profit wholly Taiwan-owned hospitals shall be approved by MOFCOM and obtain the Approval Certificate of Foreign-invested Enterprises issued by MOFCOM, while non-profit ones shall go through the record-filing formalities with MOFCOM.

It is worth noting that local governments such as Xiamen impose more favorable rules on Taiwan-owned hospitals. According to the *Notice on the National Development and Reform Commission on Printing and Distributing the Overall Plan of Xiamen Municipality on the Comprehensive Reform Pilot Program for Deepening Cross-strait Exchange and Cooperation* and the *Notice of the General Office of Xiamen Municipality on Forwarding the Measures of the Municipal Administrative Bureau for Industry and Commerce on Implementing the Overall Plan on Comprehensive Reform Pilot Program of Deepening Cross-strait Exchange and Cooperation*, when Taiwan service providers set up EJV/CJV hospitals in Xiamen, there is no special requirement on the total investment in such hospitals.

7. Policies favorable to Hong Kong or Macao service providers

According to *Supplement IV of* the *Mainland and Hong Kong Closer Economic Partnership Arrangement* and the *Mainland and Macao Closer Economic Partnership Arrangement* (collectively referred to as "**CEPA**") and the *Supplementary Provisions to the Interim Measures for the Administration of Sino-Foreign Equity or cooperative Joint Venture Medical Institutions*, since January 1, 2008, the minimum total investment in a Sino-foreign EJV/CJV medical institution established by Hong Kong or Macao ("**HK/Macao**") service providers has been lowered to RMB 10 million. In addition, the HK/Macao service providers can establish individual clinics, subject to the obtainment of a Mainland Doctor Qualification Certificate and approval by the provincial-level health administrative departments.

According to Supplement V of CEPA and the S*upplementary Provisions (II) to the Interim Measures for the Administration of Sino-Foreign Equity or cooperative Joint Venture Medical Institutions*, since January 1, 2009:

- HK/Macao service providers may establish wholly-owned outpatient departments in Guangdong Province without limitation on the total investment;
- there is also no limitation on the total investment of EJV/CJV outpatient departments established in Guangdong Province by HK/Macao service providers; and
- the establishment of wholly-owned or EJV/CJV outpatient departments by HK/Macao service providers in Guangdong Province shall be examined and approved by the health administrative department and the commerce department of Guangdong Province respectively.

According to Supplement VII of CEPA, the *Notice of the Ministry of Health and the Ministry of Commerce on the Implementation of Supplement VII to the Mainland and Hong Kong Closer Economic Partnership Arrangement and Supplement VII to the Mainland and Macao Closer Economic Partnership Arrangement* and the *Interim Administrative Measures for the Establishment of Wholly-owned Hospitals by Hong Kong/Macao Service Providers in the Mainland* (the "**Wholly**

HK/Macao-owned Hospitals Interim Measures"), since January 1, 2011:

- the minimum total investment requirement shall not apply to EJV/CJV hospitals established by HK/Macao service providers in Guangdong Province;
- no restrictions are imposed on the ratio of capital investment between HK/Macao service providers and Mainland partners in establishing EJV/CJV hospitals in Shanghai, Fujian, Guangdong, Hainan, and Chongqing; and
- HK/Macao service providers may set up wholly-owned hospitals in Shanghai, Fujian, Guangdong, Hainan, and Chongqing.

Since April 1, 2012, the scope of regions where HK/Macao service providers may establish wholly-owned hospitals in the Mainland has been expanded to include all municipalities directly under the control of the Central Government and provincial capitals.

Wholly-owned hospitals set up by HK/Macao service providers must meet the following requirements in accordance with the Wholly HK/Macao-owned Hospitals Interim Measures:

(1) Conditions of the service providers

The HK/Macao service provider shall be a legal person capable of independently assuming civil liabilities, shall have experience directly or indirectly related to medical and healthcare investment and management, and shall be able to provide advanced hospital management expertise, management and service models, or internationally leading medical technologies.

(2) Conditions of the wholly HK/Macao-owned hospitals

Wholly HK/Macao-owned Hospitals to be established shall meet the basic criteria for second-level or higher hospitals. The total investment in a third-level wholly HK/Macao-owned hospital shall be not less than RMB 50 million, while the total investment in a second-level wholly HK/Macao-owned hospital shall be not less than RMB 20 million. If such hospital is to be set up in under-developed regions such as ethnic minority regions, border regions, or poverty-stricken areas, the requirements for the total investment may be appropriately reduced.

(3) Examination and approval of wholly HK/Macao-owned hospitals

The examination and approval of wholly HK/Macao-owned hospitals adopts a three-tier "Examination and Approval System". This means that the local health administrative departments at the level of cities divided into districts shall report the application for the establishment of wholly HK/Macao-owned hospitals level by level to MOH for examination and approval. After obtaining the approval of MOH, for-profit wholly HK/Macao-owned hospitals shall be approved by MOFCOM and obtain the Approval Certificate of Foreign-invested Enterprises issued by MOFCOM, while non-profit ones shall go through

the record-filing formalities with MOFCOM.

Supplement IX to CEPA was signed in June 2012, according to which the PRC government guarantees that:

(i) HK/Macao service providers are allowed to establish medical institutions in Mainland China in the form of a single proprietorship, or in the form of an EJV/CJV;

(ii) the establishment of such medical institutions other than wholly HK/Macao-owned hospitals and wholly HK/Macao-owned nursing homes shall follow the standards and requirements of medical institutions set up by Mainland institutions or individuals;

(iii) The establishment of such medical institutions other than wholly HK/Macao-owned hospitals and wholly HK/Macao-owned nursing homes shall be examined and approved by provincial-level health administrative departments; and

(iv) the establishment of wholly HK/Macao-owned hospitals in Guangdong province shall be examined and approved by the health administrative departments of Guangdong province.

On December 7, 2012, MOH promulgated the *Circular on Issues Concerning the Establishment of Medical Institutions in Mainland China by Hong Kong and Macao Service Providers* on its official website. The aforesaid four guarantees under the Supplement IX will be put into practice from January 1, 2013.

8. New development of regulations

On April 13, 2012, MOH promulgated the *Measures for the Administration of Sino-Foreign Equity/Cooperative Joint Venture Medical Institution (Draft for Comments)* ("**Amended Draft**"). However, it not only retains the restrictions on foreign capital in the Interim Measures but also sets new restrictions. A summary of the Amended Draft is as follows:

(1) Sino-foreign EJV/CJV medical institutions may be for-profit or non-profit, but if the Chinese party is a non-profit institution, the EJV/CJV medical institutions shall only be non-profit.

(2) The requirement for the minimum total investment of Sino-foreign EJC/CJV medical institutions is to be increased to RMB 100 million. For those medical institutions to be set up in under-developed regions such as ethnic minority regions, border regions, or poverty-stricken areas, the minimum total investment could be appropriately reduced to RMB 50 million.

(3) The maximum duration of such EJV/CJV is to be raised to 30 years.

(4) The proportion of equity interests in EJV/CJV medical institutions owned by foreign parties is still limited to no more than 70%.

The promulgation of the Amended Draft has gained wide attention as many insiders in the healthcare industry believe that the biggest obstacles faced by foreign capital when entering into this industry in China are the personnel and the medical insurance systems. Due to the current system of registration for licensed doctors and the lack of qualifications as an appointed hospital of medical insurance, it is difficult for foreign-invested medical institutions to obtain doctor and patient resources. The Amended Draft does not make any improvements in such areas, and it is highly expected that the *Measures for the Administration of Sino-Foreign Equity/Cooperative Joint Venture Medical Institution* to be formally promulgated in the near future, and that this Measure's implementation rules would make substantial breakthroughs. However, it is anticipated that with the trend of encouraging various kinds of capital into the healthcare industry, the restrictions on the proportion of foreign capital will be gradually removed.

9. A brief conclusion

We can see that since 1989 when the foreign doctors were allowed to practice in China, the healthcare industry has experienced a gradual opening up to foreign capital, and some foreign investors have already reaped major profits from China's medical services market. For example, Chindex International Inc., which established the first foreign-invested hospital, the Beijing United Family Hospital, has already set up several hospitals and clinics in Tianjin, Shanghai, and Guangzhou.

Due to closer relations between the Mainland and Hong Kong, Macao, and Taiwan, investors from such regions may enjoy more favorable policies than those from other countries or regions. By September 2012, a total of 19 wholly HK/Macao-owned clinics and outpatient departments have obtained the Approval Certificate for the Establishment of Medical Institutions in Guangdong Province. The Landseed International Hospital, which is wholly owned by a Taiwanese company called the Landseed International Medical Group, has been open for business since June 26, 2012.

According to statistics provided by Deloitte China, the Chinese medical service market is growing at an annual rate of 18%, and the total scale of the market by 2015 is expected to be RMB 3.16 trillion. The allure of China's medical service market due to increasingly favorable government policies thus has the potential to encourage foreign investors to utilize their technological advantages and financial strength to enter the market as well as introduce high-standard medical services.

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Legal Updates

1. SAFE Releases Regulation to Improve the Foreign Exchange Administration of FIPEs (Authors: Evan ZHANG, Shen LIN, Baoyu WANG)

On November 19, 2012, the State Administration of Foreign Exchange (the "SAFE") issued the *Notice on the Issues Concerning the Administration of Foreign Exchange of Foreign-Invested Partnership Enterprises* (Hui Fa No. 58 [2012]) (the "**Notice**"), which will come into force on December 17, 2012.

On March 1, 2010, the *Measures for the Administration of the Establishment of Partnership Enterprises in the Territory of China by Foreign Enterprises or Individuals* (the "**Administrative Measures**") issued by the State Council, and the *Administrative Regulations for the Registration of Foreign-Invested Partnership Enterprises* (the "**Administrative Regulations**") issued by the General Administration for Industry and Commerce were implemented, which laid the legal grounds for the establishment of foreign-invested partnership enterprises (the "**FIPE**"). However, no specific stipulation has been set forth in the Administrative Measures or Administrative Regulations with respect to the foreign exchange administration of FIPEs. This has created a certain amount of ambiguity regarding FIPEs' foreign exchange matters, particularly in the areas of foreign exchange registration, exchange settlement, etc. As a result, the development and popularity of FIPEs has been restricted. In some places, a standard FIPE cannot even be established due to such foreign exchange issues.

The Notice provides more detailed regulations for the foreign exchange administration of FIPEs, which further increases the feasibility of foreign exchange issues concerning FIPEs.

Application scope

First, the Notice clarifies that it regulates FIPEs, which include foreign partnerships established in China by two or more foreign enterprises or individuals (collectively the "**Foreign Partners**"), as well as the partnerships established in China by Foreign Partners and Chinese natural persons, legal persons, or other entities.

Foreign exchange registration

Pursuant to the requirements of the Notice, FIPEs, like other foreign-invested enterprises, shall apply for foreign exchange registration. The Notice further stipulates that where an FIPE is: 1) newly established 2) a domestic partnership that became an FIPE due to the Foreign Partners joining the partnership, or 3) formed from the Foreign Partners accepting part or all of the shares of

the original domestic partners in the partnership, such FIPE shall within 30 days after obtaining its business license, apply to the local SAFE branch for registration[1]. Where the registration information of an FIPE is changed, it shall, within 30 days after completing the amendment registration with the relevant registration authorities, apply to the local SAFE branch to change its foreign exchange registration[2]. Where an FIPE is dissolved and liquidated, the liquidator shall, within 30 days after consummating the cancelling registration with the industrial and commercial authorities, go to the local SAFE branch to cancel its foreign exchange registration[3].

Account management

With respect to the management of foreign exchange accounts, the Notice stipulates that an FIPE shall, after completing its foreign exchange registration, open a foreign exchange account at the designated bank for accepting Foreign Partners' capital contributions in foreign exchange. The Notice also states that the account shall be managed in reference to the relevant provisions on the administration of foreign exchange capital accounts of foreign-invested enterprises.

Where Foreign Partners need to wire in foreign exchange contributions before the FIPE completes its foreign exchange registration, the Notice allows the FIPE to apply to the relevant SAFE authorities for opening a foreign investor's upfront expense account.

Registration of capital contributions in foreign exchange

In order to strengthen the supervision of Foreign Partners' capital contributions, the Notice further requires that when the Foreign Partners contribute capital to an FIPE, the partnership shall apply to the local SAFE branch for the confirmation of capital contributions in foreign exchange[4]. The

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[1] The materials required for foreign exchange registration are as follows: (1) The *Application Form for Foreign Exchange Registration of Foreign-invested Partnerships* signed by all partners, by the managing partner, or the designated representative; (2) A business license and Organization Code Certificate (originals examined and copies retained); (3) A basic information list that contains all the registered items of the partnership and bears the search seal of the registration authority, or a printed list of Internet search results (hereinafter referred to as "**Information Lists**"); Where there is no capital contribution information of the partners in the Information Lists, a confirmation letter of all partners regarding the capital subscribed or actually contributed by each partner shall also be submitted (where capital is contributed in the form of cross-border RMB, the amount of capital contribution in RMB shall be indicated); and (4) Any other materials required by the foreign exchange administration.

[2] The materials required for the change of foreign exchange registration: (1) The *Application Form for Foreign Exchange Registration of Foreign-invested Partnerships* signed by all partners or by the managing partner or the designated representative; (2) Where a business license has been changed, the changed business license shall be submitted (originals examined and copies retained); (3) Where Information Lists have been changed, the changed Information Lists shall be submitted; Where a partner increases or decreases the amount of his/her/its capital contribution to the FIPE, but there is no information of the capital contribution change in the Information Lists , a letter of confirmation of the capital subscribed or actually contributed by the partner signed by all partners or the personnel designated by the partnership agreement shall also be submitted; and (4) Other materials required by the foreign exchange administration.

[3] The materials required for cancelling foreign exchange registration: (1) A written application signed by all partners or by the managing partner or the designated representative and foreign exchange registration certificate; (2) The liquidation reports signed by all partners; and (3) Any other materials required by the foreign exchange administration.

[4] The required registration materials shall be provided in reference with the requirements for the capital contribution and verification confirmation of foreign investors in foreign-invested enterprises.

Notice also clarifies that before an FIPE completes its foreign exchange capital contribution registration, the capital contributed in such FIPE by the Foreign Partners shall not be transferred or settled for use in China. In addition, the income of the Foreign Partners from the liquidation, capital decrease, transfer of partnership property shares, and profit distribution of such FIPE shall not be used for the offshore payment in foreign exchange or domestic re-investment.

Profit remittance and reinvestment

The Notice provides clear guidelines for issues concerning profit remittance and reinvestment in FIPEs. When an FIPE intends to remit profits to its Foreign Partners, it shall apply to the bank with the relevant materials[5] and record the relevant information of the remittance through the SAFE system.

Where Foreign Partners intend to invest (including capital increase or reinvestment) in China with the profits[6], they shall apply for registration with the local SAFE branch and bring the relevant materials[7].

Payment of consideration of shares transfer

The Notice stipulates that, where the domestic partners of an FIPE remit the consideration of the accepted property shares of the Foreign Partners, they shall, after the FIPE applies for changing its foreign exchange registration with the local SAFE branch, purchase foreign exchange, and make the payment to the bank where the domestic partners are located. The bank shall check the corresponding tax certificates and foreign exchange registration information when dealing with such foreign exchange purchase and payment procedures.

The Notice also provides that where the Foreign Partners accept the partnership share of the domestic partners, the FIPE shall apply for changing its foreign exchange registration with the local SAFE branch. The original domestic partners shall, in accordance with the foreign exchange registration information, directly open special foreign exchange accounts for domestic asset liquidation at local banks to receive the consideration paid by the Foreign Partners. The foreign exchange capital in these accounts shall be settled in accordance with the existing provisions on

[5] Materials required to remit an FIPE's profits to its Foreign Partners are as follows: (1) A written application signed by all partners or by the managing partner or the designated representative; (2) A profit distribution resolution made by all partners in the form prescribed by the *Partnership Law* and the way of profit distribution agreed in the partnership agreement; (3) The tax certificates for profits attributable to Foreign Partners; and (4) Any other materials required by the bank.

[6] "Profits" here refers to the capital from withdrawal or liquidation of an FIPE and capital from the transfer of partnership property shares of such FIPE

[7] Materials required for Foreign Partners' re-investment are as follows: (1) A written application signed by all partners, by the managing partner, or the designated representative; (2) The certificates for sources of the above-mentioned income and corresponding tax certificates; (3) The business license and articles of association (or partnership agreement) of the reinvestment project; (4) If the reinvestment project is a foreign-invested enterprise, the enterprise's approval documents, approval certificate, and foreign exchange registration certificate shall also be provided; and (5) Any other materials required by the Foreign Exchange Administration.

foreign exchange administration, pursuant to the Notice.

FIPE for investment

Lastly, the Notice provides that other issues concerning the foreign exchange administration of FIPEs mainly engaged in investment business shall be stipulated separately by the relevant departments.

The Notice has set unified regulations on the national level for the foreign exchange administration of FIPEs, which enhances the feasibility of FIPEs in respect to foreign exchange. We will keep a close eye on the trends of relevant regulations regarding FIPEs, and inform you of any future developments.

2. New SAFE Circular Simplifies Direct Investments Approval Procedures (Authors: Irene CAI, Xinfeng ZHANG)

In order to deepen reform in the foreign exchange administrative system and simplify foreign exchange administrative procedures for direct investment, the State Administration of Foreign Exchange ("**SAFE**") promulgated *the Circular of the State Administration of Foreign Exchange on Further Improving and Adjusting the Foreign Exchange Administration Policies on Direct investment* ("**Circular 59**") on November 21, 2012. Circular 59 cancels and adjusts several licensing items of foreign exchange administration of direct investment. Circular 59 became effective on December 17, 2012. The following contains a selection of the main highlights of Circular 59.

Remove approval for the opening of and payment into foreign exchange accounts under direct investment

Under Circular 59, the foreign exchange accounts under direct investment include the following:

(a) Upfront expense foreign exchange accounts;

(b) Foreign exchange capital accounts, margin accounts (such as the dedicated accounts of margins remitted from overseas and the dedicated accounts for margins transferred domestically);

(c) Accounts of assets realization (such as the accounts of domestic assets realization and overseas assets realization).

The opening of the aforementioned accounts is not subject to approval from the SAFE, and banks will handle the procedures for opening such accounts for applicants in accordance with the registered information in the SAFE database. Under Circular 59, the settlement of foreign exchange in upfront expense accounts, and payment into accounts of assets realization and

dedicated accounts for the provisions of loans abroad do not require approval by the SAFE.

Circular 59 also allows capital accounts and accounts for assets realization to be opened at different locations, and the restrictions on the number of capital accounts and on the quota of capital flowing into one capital account are removed.

Remove approval for reinvestment by foreign investors with legal income obtained in China

Under *the Circular of the State Administration of Foreign Exchange on Issues Concerning Improving Foreign Exchange Administration for Foreign Direct Investment* ("**Circular 30**"), which has been repealed by Circular 59, the following transactions made by foreign investors were subject to approval by the SAFE:

(a) the conversion of development funds, reserve funds (or capital reserve funds or surplus reserve funds), unallocated profits, dividends payable and interests thereof into capital increase,

(b) the conversion of registered foreign debt and the interest in the current period of a foreign-invested enterprise ("**FIE**") into the capital increase of such enterprise, and

(c) reinvestment sourced from early recovery of investment, liquidation, share transfer, or capital reduction.

After Circular 59 came into effect, when foreign investors make capital contributions or reinvestments through the above-mentioned methods, SAFE approval will not be required. After the invested company completes its foreign exchange registration with the SAFE, banks shall handle procedures for funds transfer, and accounting firms shall conduct capital verification and confirmation in accordance with the registered information.

Simplify foreign exchange administration for reinvestment by foreign-invested investment companies

Circular 59 revokes approval for the domestic transfer of investment funds by foreign-invested investment companies, as well as the domestic transfer of foreign exchange profits, dividends and bonuses by an enterprise invested by a foreign-invested investment companies to such foreign-invested investment company. Banks shall file the information in the SAFE database for record keeping purposes.

It is worth noting that, pursuant to *the Circular of the Ministry of Commerce and the State Administration of Foreign Exchange on Further Improving Administrative Measures for Foreign-invested Investment Companies* ("**Circular 1078**"), SAFE approval is required for foreign-invested investment companies that use their RMB profits, legal income from early recovery of investments, liquidations, equity transfers, or capital reductions to make domestic investments directly. Circular 59 did not repeal Circular 1078 expressly, nor does it provide whether such

approval is still required. However, under Circular 1078, procedures for the above-mentioned approval shall refer to those for reinvestments made by foreign investors, which has been removed by Circular 59. In addition, pursuant to *the Official Responses of the SAFE to Reporters' Questions regarding Adjusting Foreign Exchange Administration Policies on Direct Investment*, SAFE approval is not required in the reinvestments or conversions of capital increase made by foreign-invested investment companies with legal income obtained domestically. Therefore, we anticipate that the approval by the SAFE for the reinvestment of foreign-invested investment companies with domestic legal income may also be abolished.

Circular 59 also revokes the foreign exchange registration requirement for domestic companies invested by foreign-invested investment companies, and the capital verification inquiry procedures for capital contributions made by foreign-invested investment companies. However, in case of co-investment by foreign investors and foreign-invested investment companies, the formalities of foreign exchange registration and capital verification and confirmation for foreign investment shall still be complied with.

Under Circular 59, the administration for foreign-invested venture capital enterprises, foreign-invested equity investment enterprises, and other foreign-invested enterprises mainly engaging in investments shall fall under the provisions on foreign-invested investment companies.

Simplify the formalities for equity acquisition by foreign investors

As mentioned above, approval for the opening of and payment into assets cashing accounts is not required. In addition, Circular 59 provides that when foreign investors pay equity transfer price through offshore remitted funds, such foreign investors are not required to conduct on-site foreign exchange registrations personally or delegate the transferors to do the same. Instead, the SAFE will automatically complete the registration for equity acquisitions made by foreign investors through its database after the bank conducts the filing for payment into the assets cashing accounts.

Revoke approval for the purchase and payment of foreign exchange under direct investment and the filing procedures for the settlement of foreign exchange capital by FIEs

The SAFE approval is not required for the purchase and external payment of foreign exchange made by FIEs for paying the earnings of foreign investors from the reduction of capital, liquidation of early recovery of investment, the purchase and external payment of foreign exchange by domestic organizations. In addition, individuals paying transfer prices for shares held by foreign parties in FIEs, as well as the outward remittance of funds in dedicated accounts for the provisions of loans abroad do not require SAFE approval.

Circular 59 also provides that with regard to the payment needs of FIEs where the existing regulations make no provisions but meet the principles of authenticity and self use within the business scope. Banks shall handle the procedures for foreign exchange settlements and

payments upon duly examination, and go through the record-filing procedures through SAFE database on an item-by-item basis.

Revoke the approval for domestic transfer of foreign exchange under direct investment account

The domestic transfer of foreign exchange funds in upfront expenses accounts for the purpose of direct investment and other domestic transfer of foreign exchange funds under direct investment for the purpose of investment, transaction, operation or other dealings under capital account no longer require SAFE approval. Banks shall handle the transfer procedures after examining and verifying the materials according to relevant regulations.

Simplify the capital verification and confirmation procedures for FIEs

The requirement for the submission of application materials in paper form by accounting firms going through the capital verification and confirmation procedures at the SAFE has been revoked. Now, all application materials must be submitted in electronic form into the SAFE database. In addition, the reduction of capital contributions made by foreign investors into FIEs no longer needs to go through capital verification and confirmation procedures.

Relax the control over the provisions of loans abroad

Pursuant to Circular 59, the restrictions over the source of funds and subject qualification for the provisions of loans abroad have been relaxed. Domestic entities are now permitted to use foreign exchange loans obtained domestically to provide loans abroad, and FIEs are permitted to provide loans to their overseas parent companies.

Define the time of foreign exchange registration for special purpose companies of domestic residents, and simplify the procedures for capital repatriation

Appendix 1 of Circular 59, *the Operation Rules of Direct Investment Foreign Exchange Business under Capital Account (SAFE Version)*, specifies that the time limit for foreign exchange registration and making changes to the foreign exchange registration for special purpose companies of domestic residents is 10 business days, which shortens the previous 30 business days' period in practice.

As mentioned above in Section 1, Circular 59 revokes the approval for the opening of and payment into assets realization accounts. Banks may go through the procedures directly for the opening of and payment into such accounts upon application when domestic residents repatriate capital gains from offshore special purpose companies.

Define the duties of banks

Circular 59 stipulates that when conducting foreign exchange business for direct investment, banks shall mainly be responsible for reviewing tax payment certificates and other supporting documents based on registered information from the SAFE with respect to the amount of foreign exchange receipt, payment and settlement and the principle of authenticity. The banks shall be also responsible for filing of the relevant information and data for record keeping purpose.

All things considered, Circular 59 removes several foreign exchange administration items that have in the past required SAFE approval. Due to the adjustment made by Circular 59, banks are now allowed to go through the relevant foreign exchange business procedures for FIEs directly. At the same time, the SAFE shall inspect and supervise cross-border capital flow and exchange through utilizing information in its database filed by banks.

3. MOFCOM's Conditional Approval for Joint Venture to Be Established by ARM, Giesecke & Devrient, and Gemalto (Authors: Tracy ZHOU, Arong)

On December 6, 2012, the Ministry of Commerce of the People's Republic of China ("MOFCOM") published the Announcement on the Conditional Approval of the Anti-monopoly Review of the Joint Venture to be established by ARM, Giesecke & Devrient, and Gemalto (MOFCOM No. 87[2012], the "Announcement 87"[8]).

Background

The proposed concentration is the joint venture to established by ARM Holdings plc ("ARM"), Giesecke & Devrient GmbH ("Giesecke & Devrient"), and Gemalto N.V. ("Gemalto"). ARM is mainly engaged in the licensing of intellectual property related to application processors for consumer electronics. The joint venture will be engaged in a Trusted Execution Environment ("TEE[9]"), which will heavily rely on ARM's TrustZone technology that belongs to the licensed intellectual property related to ARM's application processors. There exists a vertical relationship that stretches across the business of ARM and the proposed business of the joint venture.

Procedures of review

On May 4, 2012, MOFCOM received the notification filing of the proposed joint venture between

[8] For more information relating to this MOFCOM announcement, please refer to the following link: http://fldj.mofcom.gov.cn/aarticle/ztxx/201212/20121208469841.html

[9] TEE refers to a security solution that may develop an independent execution environment running around the operation system within the application processor of a device, and can protect the resources and data of the trusted application process.

ARM, Giesecke & Devrient, and Gemalto. After the applicants submitted the supplemental materials as required, MOFCOM officially filed the case on June 28. On July 27, MOFCOM decided to conduct further review, and on October 25, it chose to prolong the review and set a deadline of December 24. Through its review, MOFCOM raised competition concerns about the joint venture, and the applicants submitted their commitments to MOFCOM on November 8. On December 6, MOFCOM approved the commitments and cleared the proposed joint venture subject to certain conditions. From MOFCOM's receipt of the filing to its final decision, the review process lasted for more than seven months.

Content of review

Section 2 of *the Anti-monopoly Law of the People's Republic of China* ("Anti-monopoly Law") provides that the Anti-monopoly Law is applicable to monopolistic practices outside the territory of the People's Republic of China, which serves to eliminate or restrict competition in the Chinese domestic market. In Announcement 87, MOFCOM alleged that ARM is an internationally renowned market leader in the licensing of intellectual property related to application processors for consumer electronics. The downstream development and integration of TEEs by the joint venture is based on ARM's TrustZone technology. There is a potential risk that after the establishment of the joint venture, ARM may try to discriminate the developers of the TEE other than the joint venture by taking advantage of its dominance in the market of the licensing of intellectual property. ARM may also try to design its intellectual property in a way that would intentionally reduce the performance of a third party's TEE solutions in order to prevent others from competing fairly, and thereby restricting competition in the TEE market.

Restrictive conditions

In light of the abovementioned potential risks from this joint venture in the TEE market, MOFCOM approved the transaction based on the following restrictive conditions:

Following the establishment of this concentration, ARM shall disclose the security monitoring code and other information that is necessary to develop alternative TEE solutions based on its TrustZone technology related to application processors; including relevant licenses, and standards and conditions of authorization.

ARM must not design its intellectual property in a manner that would reduce the performance of a third party's TEEs.

These commitments of ARM will remain in effect for a period of eight years after MOFCOM's decision was made, and ARM must report its compliance annually to MOFCOM for examination. Should there be any material change in the external environment or in the joint venture, ARM may request that MOFCOM adjust or discharge the obligations. MOFCOM may supervise the compliance of ARM by itself or through a monitoring trustee.

Comments

(1) **Relevant anti-monopoly approvals**

The formation of a joint venture between ARM, Giesecke & Devrient, and Gemalto is the third anti-monopoly case regarding a joint venture that has been conditionally approved by MOFCOM. The summary of the other two precedent joint venture cases is as follows:

(a) Announcement on the Conditional Approval of the Joint Venture between General Electric (China) Ltd. and China Shenhua Coal to Liquid and Chemical Co., Ltd. (MOFCOM No. 74[2011], "Announcement 74").

The parties involved in Announcement 74 are General Electric (China) Ltd. ("GE China") and China Shenhua Coal to Liquid and Chemical Co., Ltd. ("Shenhua Coal"). The joint venture to be established by GE China and Shenhua Coal is committed to the licensing of technology for the gasification of liquefied coal slurry ("LCS") services. Shenhua Group (the parent company of Shenhua Coal) is the largest supplier of coal (the raw material used in LCS gasification) in China. GE Infrastructure Technology (a subsidiary of General Electric), which has the biggest market share for the licensing of LCS gasification technology, will license the LCS gasification technology to the proposed joint venture in this transaction. MOFCOM concluded that the joint venture between GE China and Shenhua may provide LCS gasification technology licensing services in a manner that would leverage Shenhua Group's position in the raw coal supply market. MOFCOM also believed that these technology licensing services would restrain the supply of raw coal, thereby restricting competition in the market for the licensing of LCS gasification technology.

The restrictive conditions state that through the establishment of a joint venture to provide LCS gasification technology licensing services, GE China and Shenhua Coal shall not compel the licensees to use the technologies of the joint venture. In addition, GE China and Shenhua Coal shall not increase the cost of using alternative technologies through either restricting the raw coal supply or conditioning such supply on the licensing of technologies of the joint venture.

(b) Announcement on the Conditional Approval of the Joint Venture between Henkel Hong Kong and Tiande Chemical (MOFCOM No. 6[2012], "Announcement 6").

The parties involved in Announcement 6 are Henkel Hong Kong Holding Ltd. ("Henkel Hong Kong") and Tiande Chemical Holdings Limited ("Tiande Chemical"). The joint venture to be established by Henkel Hong Kong and Tiande Chemical, namely Degao Holdings, will produce cyanoacrylate monomer, a product of ethyl cyanoacetate. Tiande Chemical is one of the two suppliers in the market for ethyl cyanoacetate, accounting for 45-50% of the market share in the global market and the Chinese domestic market. Henkel AG & Co. KGaA ("Henkel Holdings"), the parent company of

Henkel Hong Kong, produces cyanoacrylate monomer, mainly used in its downstream production of cyanoacrylate adhesive. Prior to the transaction, the orders of ethyl cyanoacetate from Henkel Holdings accounted for 5% of the output of Tiande Chemical; substantially all the joint venture's demand of ethyl cyanoacetate is expected to be purchased from Tiande Chemical. Therefore, Henkel Hong Kong and the joint venture would consume one fourth of Tiande Chemical's production capacity. MOFCOM concluded that, the establishment of the joint venture between Degao Holdings, Henkel Hong Kong, and Tiande Chemical might give the joint venture more favorable treatment over other cyanoacrylate monomer manufacturers. This would result in the superiority of Tiande Chemcial in the cyanoacrylate monomer market being extended beyond the joint venture to reduce the competitiveness of other cyanoacrylate monomer manufacturers, thus restricting competition in the cyanoacrylate monomer market.

MOFCOM imposed restrictive conditions by requesting Tiande Chemical to supply ethyl cyanoacetate to all downstream customers on a "fair, reasonable and non-discriminatory" basis. Specifically, Tiande Chemical shall not be allowed to charge unreasonably high prices, offer more favorable terms for supply to Weifang Degao (the new subsidiary of Degao Holdings), or exchange competitive information with Henkel Hong Kong or the joint venture.

(2) Comments on announcement 87

In the three joint venture transactions that have been conditionally approved by MOFCOM, the business activities of the parties involved (i.e. the partners of the joint venture) did not overlap in their respective industries. However, one of the partners (such as ARM, Shenhua Coal, and Tiande Chemical) usually takes a large market share or maintains a strong control over the upstream or related market. For that reason, MOFCOM focuses on determining whether such partner(s) have ability and/or incentive to abuse its/their dominant position in such related markets to eliminate competition in the relevant markets. Similar to the two precedent cases, MOFCOM came to the same conclusion with the recent joint venture case regarding the joint venture between ARM, Giesecke & Devrient, and Gemalto. MOFCOM stated that the ARM partner's dominant control over the upstream market might enable it to discriminate other competitors in the TEE market or design its own intellectual property in a manner that would reduce the performance of TEE solutions developed by other competitors in order to restrict competition.

According to *the Measures for Review of Concentration of Business Operators*, in order to eliminate or mitigate the effect of restricting competition caused by the concentration, the following restrictive conditions can be proposed by the merging parties in order to obtain MOFCOM's approval:

- Structural conditions: divesting part of the assets or operations of the merging parties, etc.; and/or

- Behavioral conditions: providing access to infrastructure such as websites or platforms, licensing essential techniques, terminating exclusive agreements, etc.

Similar to most of MOFCOM's previous decisions in connection with vertical integration that were approved with restrictive conditions[10], the conditions proposed by the merging parties and approved by MOFCOM in this case are also behavioral conditions such as nondiscriminatory treatment to other business operators. In addition, the restrictive conditions here have a valid term of eight years. The published anti-monopoly conditional approvals demonstrate that MOFCOM has a trend of imposing restrictive conditions with a term in cases involving technology advantages, while imposing usually indefinite nondiscriminatory commitments in cases involving material supply advantages.

[10] Examples of this include the aforementioned two precedent joint venture cases, the acquisition of Delphi Corporation by General Motors, and the acquisition of Motorola by Google.

Important Announcement

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