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Legal Updates

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1. Great Evolution — Key Insights into Rules for Payment Institutions

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Introduction

On 17 December 2023, the State Council of the People's Republic of China (the "**PRC**")[1] promulgated the Regulations on the Supervision and Administration of Non-Bank Payment Institutions (the "**Regulations**").

The official release of the Regulations marks the finalization of nearly two years of discussions and revisions of the Regulations on the Non-Bank Payment Institutions (Draft for Comment) (the "**Draft**") which was proposed by the People's Bank of China (the "**PBOC**") on 20 January 2021, and signifies the evolution of the regulatory framework for the PRC's non-bank payment sector. The new regulatory framework is built on the regulatory experiences of the past thirteen years, aligning more closely with current regulatory needs, market dynamics, and product developments. The Regulations play a crucial guiding role in facilitating the sound and healthy development of the non-bank payment sector.

Comprehensive influences of the Regulations

I. Acknowledging the industry value and providing policy grounds for the healthy development of the non-bank payment sector

The Regulations fully recognize the crucial role and positive impact of the payment sector in the PRC's current payment and settlement system, and provide a stable and predictable policy environment for the future operations and development of payment institutions.

Following the cleansing process of the "decade of internet finance", numerous internet financial operations have exited the stage. Over the past five years, the third-party payment industry has also undergone various challenges, including "centralized depository of reserve funds", "cutting off the direct connection with commercial banks" and "comprehensive rectification of large payment platforms". Even the existence of the third-party payment sector had been a topic of the market.

In this context, the issuance of the Regulations not only strengthens and clarifies the compliance requirements for payment institutions at the micro level but, more importantly, it also safeguards and guides the stable development of the industry, delineating clear compliance boundaries and directions for practitioners.

II. Achieving evolution of regulatory rules and aligning regulatory logic with the dynamic market landscape

Looking back at the PRC's financial regulatory history, few financial sectors have experienced such a thorough transformation in the industry structure and regulatory rules in just over a decade, as witnessed in the third-party payment sector. Rapid developments in the market, technology, and

[1] For the purpose of this newsletter, references to the PRC are exclusive of Hong Kong, Macau and Taiwan.

business needs have led to a significant transformation of third-party payment business models from the three typical categories of “internet payment”, “prepaid card issuance and acceptance”, and “bank card acquiring” to a multitude of new undefined business models, such as QR-code payments, facial recognition payments, and palm print payments. In terms of regulatory measures, there have been several disruptive regulatory adjustments, including “centralized depositary of reserve funds”, “cutting off direct connection with commercial banks” and “disconnecting inappropriate links with financial products”.

Against this backdrop, the Regulations overturn the previous regulatory framework comprehensively. The Regulations thoroughly reshape and integrate the regulation of the payment sector with a more scientific and reasonable approach, provide regulatory requirements in a more explicit and simplified manner, highly aligned with the current market situation, and reserve sufficient space for the future innovation of the payment sector, showcasing a high level of legislative expertise.

III. Elevating administrative penalties and accountability, and intensifying the regulation of the industry

Chapter V of the Regulations elaborates the penalties that may be imposed on payment institutions through eleven articles. Based on the severity of illegal activities, three levels of liabilities are set.

Note that “the confiscation of illegal gains together with a fine of up to five times the illegal gains” applies to all types of misconducts, fully aligning with Article 46 of the Law on the People’s Bank of China. Compared to the old rules, the Regulations provides stricter penalty requirements, and we expect there to be more cases with large fines being imposed against payment institutions.

Furthermore, the Regulations innovatively include controlling shareholders and actual controllers of payment institutions within the scope of administrative liabilities. For certain misconducts, regulatory authorities may directly hold controlling shareholders and actual controllers accountable.

IV. Detailed requirements await further legislative refinement, and continuous observation is required for the subsequent impact

The Regulations introduce several innovative regulatory tools, such as “two categories of payment business”, “systemically important non-bank payment institutions” and “linkage between net assets and the daily average balance of reserve funds”. However, details of these tools are not provided, leaving room for future legislative refinement by the PBOC.

Moreover, the Regulations will take effect on 1 May 2024, while questions regarding how to connect the existing licenses with the Regulations during the transition period are also left to subsequent legislation.

It is expected that, with the promulgation of the Regulations, several new rules will be introduced and updated in the near future. The impact on payment institutions requires continuous observation.

Key takeaways

I. Payment products and services

1. Two new categories of payment services

Under the existing regulatory rules, the payment business is classified into three categories, namely "internet payment", "prepaid card issuance and acceptance", and "bank card acquiring". Such classification is based on criteria related to "technology" or "payment medium or tools", for example, "internet payment" relies on the "internet" without interaction between the electronic device of the payer and the device of the payee, the "acquiring business" can only be conducted for bank cards and does not cover other payment methods.

While such classification provides clarity to regulated entities and a straightforward understanding of the applicable licenses, it limits the flexibility of regulatory rules and struggles to adapt to the rapidly evolving market and technology. It is clearly pointed out in the Q&A of the Regulations that with technological innovations and business developments, new methods such as QR-code payment and facial payment have emerged, and the existing classification method cannot effectively meet the needs of market development and regulation.

The Regulations adopt a functional classification method, radically reclassifying the payment business into two categories, namely the "operation of stored value accounts" and "payment transaction processing", based on the criterion of whether the institution is allowed to receive pre-paid funds from the payers, and establish the regulatory approach accordingly.

Compared to the Draft, the Regulations remove the definitions and core regulatory requirements for "operation of stored value accounts" and "payment transaction processing", retaining only general provisions. According to the Q&A of the Regulations, the next steps of the PBOC include formulating detailed implementation rules for the Regulations and refining other related regulatory documents. It is expected that further clarification on pending issues will be provided, and the market players shall keep abreast of regulatory updates.

2. Easing restrictions on payment institutions for operations that do not need a prior approval

Under the Draft, strict restrictions were imposed on the business scope of payment institutions, requiring them not to engage in activities beyond the scope specified in the payment license. We are of the view that such requirement is too stringent, imposes restrictions on payment institutions offering services such as information services, clients-referral services, and technical services which are not subject to qualification requirements, and does not align with the market practice.

The aforesaid restrictions are relaxed under the Regulations. Payment institutions are only restricted from engaging in other activities that require prior approvals, preserving the possibility for payment institutions to carry out innovative business within legal boundaries and contributing positively to the development of the payment sector.

3. Avoiding a "one-size-fits-all" approach to corporate payment accounts

The opening of corporate payment accounts has long been a challenge for payment institutions. This issue arises from the regulatory positioning of payment institutions which emphasizes "small amounts" and "convenience for the public" and distinguishes them from banks. Both regulatory rules and window guidance have discouraged payment institutions from opening payment accounts for B-end clients as explicitly stated in the Draft.

The Regulations remove the "one-size-fits-all" approach and propose a principle requiring "the state to guide and encourage non-bank payment institutions to cooperate with commercial banks, providing payment services to B-end clients through bank accounts". We understand that B-end clients also include a large number of small and micro-enterprises, therefore, opening payment accounts for B-end clients does not necessarily contradict the positioning of "small amounts" and "convenience for the public". The revision in this regard is commendable.

4. Completely removing rules regarding payment information service institutions

The Draft has previously introduced a new type of institutions in the payment industry, i.e. "payment information service institutions" which are not allowed to engage in payment business and do not need to hold a payment license, but only need to file with the Payment and Clearing Association of China. According to the definition in the Draft, the integrated payment institution is a kind of payment information service institution.

Since the release of the Draft in 2021, financial regulation in various sectors has explicitly strengthened the requirement of "licensed institutions and qualified personnel". Under such regulatory approach, it is not reasonable to directly regulate the institutions that do not need to be licensed under the Regulations. We expect that the regulatory approach for such institutions will be further clarified in rules to be issued subsequently.

5. Clarifying applicable scope of the cross-border payment license

In terms of cross-border payment business, the Regulations explicitly provide that overseas institutions providing cross-border payment services for domestic users shall obtain a domestic payment license.

Therefore, in cross-border scenarios, if overseas payment institutions provide payment services that are not part of the cross-border process, such as purely assisting domestic customers with offshore payments and merchant acquiring, theoretically, there is no need to obtain a payment license domestically. We believe that such rule aligns with the current market practice of domestic payment institutions collaborating with overseas payment institutions or banks and is therefore reasonable to some extent.

II. Business management

1. Antitrust regulation: clarifying PBOC's regulatory boundaries

The Draft provides that the PBOC may request the national antitrust regulatory department to conduct antitrust reviews of payment institutions based on the dominant position in the market, and clearly defines the scope of relevant markets and criteria for determining the dominant position, aiming to strengthen antitrust supervision of leading payment institutions.

However, the Regulations remove the aforementioned antitrust-related provisions and only retain the principle stating that non-bank payment institutions shall not engage in monopolistic or unfair competition practices that hinder fair market competition. Such revision is more reasonable and scientific in terms of both clarifying the regulatory boundaries of the PBOC and determining entities engaged in monopolistic activities.

2. Regulation of leading institutions: establishing a regulatory mechanism for systemically important non-bank payment institutions

Article 38 of the Regulations establishes the legal basis for payment institutions to be classified as systemically important institutions. Moreover, based on the Guiding Opinions on Improving the Regulation of Systemically Important Financial Institutions, if identified as a systemically important non-bank payment institution, a payment institution may be subject to additional compliance obligations such as "additional capital requirements", "leverage ratio requirements", "establishment of a risk management committee", "consolidated risk management", "information reporting and disclosure", etc. The specific requirements await further clarification from the PBOC.

3. Business risk management: preventing material risks and strengthening user management

In recent years, financial regulators have increasingly emphasized the prevention of material risks. Article 5 of the Regulations explicitly states that payment institutions shall focus on "anti-money laundering and counter-terrorism financing, anti-telecom and online fraud, prevention and disposal of illegal fundraising, and combating gambling" which are common risks in the payment industry. To ensure effective risk prevention, Articles 21 and 22 outline requirements from the perspective of user management. Specifically:

- Conducting ongoing and effective due diligence on users;
- No outsourcing of core business and technical services related to fund security and information security;
- Independently conducting due diligence on, signing payment service agreements with, and continuously monitoring risks of merchants;
- Not providing services to merchants established or operated illegally.

4. Service agreement management: further clarifying content, disclosure and modifications of service agreements from the perspective of financial consumer protection

Financial consumer protection has been a focus of regulators in recent years. To implement regulatory requirements for financial consumer protection and fully protect the legitimate rights and interests of users, Article 20 of the Regulations outlines requirements for the management of user service agreements. Specifically:

- **Agreement content:** defining essential terms (such as "rights and obligations of the institution and the user", "payment business process", etc.) and prohibited content (such as "excluding or restricting competition", "increasing user responsibilities", etc.);

- **User notifications:** requiring reasonable means to alert users to important terms in the agreement and explanations of the terms as requested by users;
- **Agreement disclosure:** requiring disclosure in prominent locations at business premises, official websites, mobile applications (i.e., apps), etc.;
- **Agreement modifications:** fully seeking user opinions, and after a 30-day public announcement in the locations specified in item (iii), reaching consensus with users in written form, such as electronic documents.

5. Regulation of cross-border business: requiring adherence to multiple applicable regulations, removing provisions of the Draft regarding "cutting off direct connection with commercial banks"

There has been no unified and clear regulatory rule for cross-border payment business of payment institutions, and due to the significant differences between cross-border payment business and domestic payment business, the regulatory requirements have been unclear for a long time. Article 19 of the Regulations clarifies the applicable rules for cross-border payment business, stating that "if a payment institution provides payment services for cross-border transactions, it shall comply with relevant regulations on cross-border payments, cross-border RMB business, foreign exchange management, and the cross-border transmission of data." Considering that the PBOC has issued the draft administrative measures for cross-border payment services in 2021, after establishing the regulatory framework for the payment sector under the Regulations, we expect the release of rules in the cross-border payment sector.

It is worth noting that the Regulations remove the provisions regarding "cutting off the direct connection with commercial banks in cross-border payments" of the Draft. To some extent, this reflects that such topic may not be a key regulatory focus in the short term, and the timing and whether it will be implemented in the future remain to be observed.

III. Data and system management

1. Emphasizing the independence of payment Institutions' business and systems

The Regulations further emphasize the requirement for the independence of payment institutions' business and systems. For example, Articles 18 and 21 of the Regulations require (i) payment institutions shall have necessary and independent business systems, facilities and technology to ensure the timeliness, accuracy, continuity, security, and traceability of payment business; (ii) the business systems and backups of payment institutions shall be stored domestically; and (iii) payment institutions are prohibited from outsourcing core business and technical services related to fund security and information security to third parties. Additionally, Article 22 of the Regulations reiterates core business management requirements, providing that payment institutions shall independently conduct due diligence on merchants, sign payment service agreements, and engage in continuous risk monitoring, which are consistent with regulatory rules such as the Administrative Measures on Bank Card Acquiring Business and the Circular on Strengthening the Outsourcing Management of Bank Card Acquiring Business, and have now been elevated to the level of administrative regulations.

2. Reiterating localization requirements for "critical information infrastructure operators" and those processing a specified quantity of personal information

According to Article 33 of the Regulations, if the network facilities, information systems of a payment institution are identified as "critical information infrastructure" or if "the quantity of personal information processed reaches the quantity specified by the cyberspace administration", the processing of personal information collected and generated domestically shall be conducted within the territory of the PRC. If it is necessary to transfer personal information abroad, applicable regulations shall be abided by, and the user's separate consent is required to be obtained. Also, the payment institutions shall process important data as required by applicable laws and regulations. These provisions echo the requirements of the Personal Information Protection Law (the "**PIPL**"), the Cybersecurity Law, the Data Security Law and the Regulations on the Security Protection of Critical Information Infrastructure.

3. Strengthening personal information protection

Article 32 of the Regulations stipulates requirements for the protection of personal information by payment institutions. Overall, the Regulations embody the relevant requirements explicitly outlined in the PIPL. For information sharing with affiliates, the Regulations require payment institutions to inform users of the names and contact information of affiliates, obtain the user's separate consent for the content, purpose, term and protection methods of the information sharing, and supervise the affiliates to ensure compliance and manage risks. Such requirement is notably more stringent than the Draft and is the first financial regulation to explicitly regulate the user information sharing with affiliates.

IV. Equity management

In recent years, regulatory authorities have placed significant emphasis on the management of equity in financial institutions, striving to improve mechanisms for constraining the behavior of majority shareholders. The Regulations follow relevant rules for traditional financial institutions such as banks, insurance institutions, and securities companies, strengthening the equity management of payment institutions and enhancing constraints on majority shareholders. Specifically:

1. Introducing various regulatory requirements for major shareholders, controlling shareholders and actual controllers

The Regulations impose constraints on major shareholders, controlling shareholders, and actual controllers of payment institutions from the perspective of qualification requirements, prohibitive behaviors, etc. Unlike the Draft, the definitions of major shareholders, controlling shareholders and actual controllers are not explicitly provided. Given the definitions of different types of shareholders in different financial institutions are not the same under the existing laws and regulations, the definitions of these shareholders of payment institutions need to be further clarified in the implementation rules of the Regulations.

2. Providing management requirements on equity pledges by major shareholders

The Regulations require major shareholders of payment institutions to report in advance to the PBOC regarding the pledge of their equity in payment institutions, and the pledged equity shall not exceed 50% of the total equity held by the major shareholder in the payment institution. Such requirements help prevent shareholders from abusing equity pledges to hold equity of payment institution on behalf of others, engage in improper related-party shareholding, or transfer equity in a disguised way.

3. Explicitly prohibiting holding equity in certain ways

The Regulations provide that the controlling shareholders and actual controllers of payment institutions are prohibited from using specific purpose vehicles or entrusting others to hold equity to circumvent regulation, which reveals a clearer and more prudent attitude towards payment institutions adopting the variable interest entity (the "**VIE**") structure, and further indicates the requirements of implementing the principle of penetrating regulation and preventing regulatory arbitrage.

4. Imposing restrictions on the number of payment institutions a shareholder can hold equity in

Similar to regulatory requirements on some traditional financial institutions, the Regulations also impose requirements on the number of payment institutions a shareholder can hold equity in. It specifies that "the same shareholder shall not directly or indirectly hold 10% or more of the equity or voting rights of two or more non-bank payment institutions of the same business type. The same actual controller shall not control two or more non-bank payment institutions of the same business type, except as otherwise provided by the state." That said, for payment institutions, a single shareholder is restricted to holding 10% or more equity or acting as the actual controller in only one payment institution of the same business type.

5. Providing risk-based regulatory measures for payment institutions for the first time

With frequent occurrences of risk events in financial institutions, both laws and regulations applicable to traditional financial institutions and the previously released Financial Stability Law (Draft for Comment) have provided regulatory measures and responsibilities of major shareholders in the event of financial risk events. In such context, the Regulations for the first time explicitly grant the PBOC the right to take risk-based regulatory measures against payment institutions, including the fulfillment of capital replenishment undertakings by major shareholders, restrictions on material asset transactions, and adjustments to and restrictions on directors, supervisors, executives, and their rights. It is expected that, at least, major shareholders of payment institutions may be required to sign undertaking letters regarding capital replenishment when establishing or invest in a payment institution.

2. Overview of Policies for Further Opening up the Services Sector in Beijing

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On November 23, 2023, the State Council published the *Official Reply of the State Council on the Work Plan for Supporting Beijing in Promoting the Construction of a Comprehensive Demonstration Zone for Further Opening up the National Service Sector* (the "**Reply**"). The Reply approves in principle the *Work Plan for Supporting the Construction of Beijing's Comprehensive Demonstration Zone for Further Opening up the National Service Sector* (the "**2023 Plan**"), and provides Beijing's current round of policies for further opening up the service sector at the highest administrative level. Based on the recent introduction of favorable policy tools to promote further economic recovery, the Reply signals "opening up", which can be regarded as a clear response to General Secretary Xi Jinping's oft-mentioned phrase that "the door of PRC's opening up will not be closed, but will only be wider". The Reply recites specific tasks to promote a deepening of reform; among these, further opening up fields in the service sector are the most prominent and will be the focus of this article.

Background of the Plan

On the one hand, it goes without saying that the current international environment is complicated and the world economy is sluggish, which has brought many impacts on the development of our country. Although the domestic economy has recovered thanks to a series of economic stabilization measures taken by the CPC and the government and the efforts of the people nationwide, the market demand is still insufficient, and some structural problems are prominent. Recently, the CPC and the relevant authorities have continued to optimize a number of phased policies, studied and promulgated a number of targeted new measures, and actively planned a number of reserve policies, systematically implemented a set of "combined punches" of policies, and continued to consolidate the momentum of China's economic recovery. The 2023 Plan approved in this Reply can be regarded as a powerful outward punch.

Among the foreign investment access policies and systems currently in place in China, the Special Administrative Measures (**Negative List**) for the Access of Foreign Investments in China (excluding the pilot free trade zones) (the "National Negative List") and the Special Administrative Measures (Negative List) for the Access of Foreign Investments in Pilot Free Trade Zones (the "**FTZs Negative List**") applicable to 20 pilot free trade zones in China are the most well-known foreign investment industry policies and systems. Beijing, as the only political center in the country, has a clear strategic position as the capital city, but its specific industrial policies on foreign investment are easy to be ignored. In fact, based on the strategic position of a capital city, Beijing took the responsibility of serving the national major strategies as the starting point. Beijing's pilot program for expanding opening up in the service industry was initiated by the Overall Plan of Beijing Municipality for the Comprehensive Pilot Program for expanding opening up in the service industry approved by the State Council on May 5, 2015. On February 22, 2019, the State Council approved the Work Plan for Fully Promoting the Comprehensive Pilot Program for expanding opening up in the service industry in Beijing (hereinafter referred to as the "**2019 Plan**"), and the State Council authorized Beijing to make a breakthrough attempt under the framework of existing foreign investment access policies at that time. In 2020, Beijing's second version of the Plan (i.e., the Work Plan for Deepening a New Round of Comprehensive Pilot Program for expanding opening up in the service industry and Building a National Comprehensive Demonstration Zone for expanding opening up in the service industry in Beijing, hereinafter referred to as the "**2020 Plan**") also obtained support from the state level in the aforesaid manner, and the 2020 Plan put forward for the first time the task and requirements of building a national comprehensive demonstration zone for expanding opening up in the service industry. The release of the 2023 program in a specific period of time not only a continuation of the previous pilot expansion, but also a way to specific tasks released a more powerful signal, worthy of our attention.

Key takeaways from the 2023 for foreign investment access in the services sector

The 2019 Plan implemented measures to further open up tourism, telecommunications, accreditation institutions, elderly care, culture and entertainment, and other service sectors. The 2020 Plan further expanded opening up of education and training institutions, telecommunications, culture and entertainment, tourism, elderly care, manufacturing of audio and video products, and other sectors. On this basis, the 2023 Plan will further exert efforts in the following areas, and its spirit can be seen in a review from the development perspective of sorting out the historical context.

I. Telecommunications service sector

Both the 2019 Plan and the 2020 Plan reflect Beijing's pilot measures for further opening up the telecommunications sector, and the opening-up path of relevant business has gradually been opened up in Beijing on a case-by-case basis. The relevant evolution is shown in the following table:

Plan	Pilot program measures	Territorial scope
2019 Plan	Removes the restrictions on foreign equity ratio in value-added telecommunications services such as store-and-forward services, domestic multi-party communication services, and Internet access services (only applicable to the provision of Internet access services to users)	Demonstration zones and parks for the comprehensive pilot program for expanding opening up in the service sector in Beijing
2020 Plan	Removes restrictions on foreign equity ratio in information services (only applicable to app stores)	Haidian Garden of Zhongguancun National Independent Innovation Demonstration Zone
	Removes the restrictions on foreign equity ratio in value-added telecommunications services such as Internet access services (only applicable to the provision of Internet access services to users)[2]	Demonstration zones and parks for the comprehensive pilot program for expanding opening up in the service

[2] Although the 2020 Plan does not explicitly provide for this pilot program, as officially authorized by the 2020 Plan pursuant to the Official Reply of the State Council on Approving the Temporary Adjustments to Implementation of Relevant Administrative Regulations and Departmental Rules Approved by the State Council in Beijing on October 8, 2021, this pilot program still remains valid.

Plan	Pilot program measures	Territorial scope
		sector in Beijing
	Opens up domestic Internet virtual private network services to foreign investors (with the foreign equity ratio not exceeding 50%)	Demonstration zones and parks for the comprehensive pilot program for further opening up the service sector in Beijing
2023 Plan	Removes the restrictions on foreign equity ratios in value-added telecommunications services such as information services (only applicable to app stores, excluding online publishing services) and Internet access services (only applicable to the provision of Internet access services to users)	**Whole of Beijing**

As shown in the table above, as compared with the 2019 Plan and the 2020 Plan, there are further changes in the following two aspects of the pilot program in the 2023 Plan:

- The 2023 Plan continues the policy of removing foreign investment restrictions on app stores, but expressly excludes online publishing services. The policy of removing foreign investment restrictions on app stores in the information services sector is consistent with the opening-up policies applicable to the free trade zones provided by the *Opinions of the Ministry of Industry and Information Technology and the People's Government of Shanghai Municipality on Further Opening up Value-added Telecommunications Services to Foreign Investors in the PRC (Shanghai) Pilot Free Trade Zone*. However, the 2023 Plan expressly excludes "online publishing services". We understand that the exception here helps to respond to the problem of conflict of foreign investment access when game app stores (such as the Apple App Store and Steam) in the market involve both "information service business" and "online publishing business", which is a beneficial improvement to the existing policies on foreign investment access for application stores;
- Different from the 2019 Plan and the 2020 Plan, where the pilot policies are limited to pilot demonstration zones and demonstration parks or Zhongguancun Haidian Garden, the 2023 Plan extends the scope of the pilot program to the whole of Beijing (subject to the future provisions of a formal authorization reply issued by the State Council), which is expected to attract more foreign-invested enterprises to participate in the pilot program.

II. Health and medical services sector

We note that, unlike the previous two Plans, the 2023 Plan explores new breakthroughs in the existing foreign investment restrictions or prohibitions with respect to medical institutions and stem cells and genes in the health and medical services sector, including "supporting qualified foreign, Hong Kong, Macao and Taiwan doctors to set up clinics in Beijing" and "exploring equity incentives for foreign, Hong Kong, Macao and Taiwan employees of pharmaceutical R&D enterprises in the stem cells and genes fields."

In terms of medical institutions, according to the national negative list, the pilot zone negative list and the Interim Measures for the Administration of Sino-Foreign Equity Joint Venture and Sino-Foreign Cooperative Joint Venture Medical Institutions, foreign-invested medical institutions in PRC can only be established in the form of equity joint venture and the foreign shareholding ratio cannot exceed 70% (currently, the restriction has been lifted to 90% in only a few regions). Judging from the wording of the 2023 Plan, we understand that this time Beijing has an opportunity to break with the existing foreign investment restrictions for medical institutions, allowing foreign investors to hold a greater proportion, or even 100%, of the shares in domestic medical institutions (provided that the medical institutions are limited to clinics and foreign investors are only identified as "qualified foreign, Hong Kong, Macao or Taiwan doctors"). We have reason to believe that this beneficial move is likely to be a test of the further liberalization of foreign investment policies in the field of medical institutions.

In terms of the field of "stem cells and genes", subject to the provisions of the national negative list and the pilot zone negative list, both the national negative list and the pilot zone negative list prohibit foreign investment in the development and application of human stem cells and gene diagnosis and therapy technologies. However, the 2023 Plan specifies that it will "explore equity incentives for foreign, Hong Kong, Macao or Taiwan employees of pharmaceutical R&D enterprises in the stem cells and genes fields." Although the previous two plans have not made such an attempt, it seems that Beijing has chosen to provide equity incentives for foreign, Hong Kong, Macao or Taiwan individuals to break with the above equity ratio restrictions. This measure can be regarded as a pioneer "pressure-bearing test" in this field, and the industry should welcome it and have reason to expect further breakthroughs.

III. Culture and education sector

We noticed that the 2023 Plan also attempts to liberalize the current "access permit" system to a certain extent in the fields of culture and education. For example, it delegates the power to approve foreign-invested enterprises' establishment of performance venues, entertainment venues, and Internet service venues to the district level, and it supports wholly foreign-owned enterprises' establishment of vocational skills training institutions. Considering that the restrictions on the proportion of foreign investment in the relevant industries have been relaxed, but there are still corresponding restrictions on approval levels in the relevant industry rules, the 2023 Plan makes corresponding breakthroughs. The comparison between the 2023 Plan and existing rules in the relevant industries is briefly shown in the following table.

Relevant Industries	Industry Regulations	Breakthroughs in the 2023 Plan
Performance venues	Regulations on Administration of Commercial Performances (Amended in 2020) Article 10: The competent department of culture under the State Council shall file an application with the competent department of culture under the State Council if it intends to engage in business activities of commercial performances or the performance venue operator intends to engage in	The approval authority is delegated to the district level.

Relevant Industries	Industry Regulations	Breakthroughs in the 2023 Plan
	business activities of performance venues.	
Entertainment venues Internet Service	*Notice of the Ministry of Culture and Tourism on Adjusting the Approval for Entertainment Venues and Business Premises of Internet Access Services,* Article 1: Foreign investors are permitted to establish entertainment venues within the territory of the PRC in accordance with the law, and the restriction on the proportion of foreign investment is removed. Foreign investors who intend to engage in business activities of entertainment venues shall file an application with the provincial culture and tourism authorities, and the application materials, establishment conditions and procedures are the same as those for the domestic investors. This provision shall apply mutatis mutandis to the establishment of entertainment venues in the Mainland by investors from Hong Kong Special Administrative Region, Macao Special Administrative Region and Taiwan.	
Occupational Skills Training Institutions	Regulations of the People's Republic of China on Establishment and Operation of Sino-Foreign Cooperative Educational Undertakings Article 60: Administrative measures on for-profit Sino-foreign cooperative training institutions registered with the market regulator shall be promulgated separately by the State Council. Administrative Measures for Sino-foreign Cooperative Vocational Training Agencies (Revision 2015) Article 11: The establishment of a Sino-foreign cooperative vocational skills training institution shall be subject to the examination and approval by the administrative department of labor and social security of the people's government of the province, autonomous region or centrally-administered municipality where the institution is to be located.	The 2023 Plan reiterates the 2020 Plan, and it is provided in the Administrative Measures of Beijing Municipality on Establishment of For-profit Foreign-invested Vocational Skills Training Institutions, effective as of 15 August 2022, that the approval authority is delegated to district-level human resources and social security authorities.

The 2023 Plan is a breakthrough in the approval level for the above foreign investment access licensing system, which was not mentioned in the previous two plans, reflecting Beijing's demonstration and leading role in deepening the new round of reform and opening up of the service industry. Based on our observation, in the field of vocational skills training, in addition to local policies for foreign-invested vocational skills training institutions in Shanghai which clearly vest the approval authority of the district-level human resources and social security authorities, there are also some local authorities trying to delegate such authority. The 2023 Plan also appears to be an active response to such demand from the market players[3].

IV. Financial service sector

Significantly different from the 2019 Plan and the 2020 Plan, the 2023 Plan for the first time puts forward clear policies and tasks for deepening the reform and opening up of the financial service sector, clarifies the attitude of foreign financial institutions, investors of foreign financial institutions and cross-border financial service providers to apply for financial business in compliance with the statutory forms, and explores specific measures such as supporting insurance asset management companies to issue RMB-denominated asset management products overseas in reasonable scale, supporting venture capital and equity investment institutions to carry out market-oriented cooperation with various financial institutions to provide financing services for investee enterprises, and exploring specific measures such as the establishment of a trust property registration mechanism with the real estate and equity as trust property.

V. Professional service sector

The 2023 Plan makes a breakthrough in China for the first time by "allowing qualified overseas individuals to engage in securities investment consulting and futures trading consulting business". This initiative not only expands "licensed operation" in these heavily regulated areas, but is expected to recognize persons who have corresponding overseas licenses. It may also break the fixation on "commercial presence", and make more useful attempts in terms of the physical locations of those who provide business, methods, and other aspects. Such initiatives are also likely to recognize and foster the emergence of more innovative business models in professional financial services – it is foreseeable that a licensed representative person in Hong Kong may soon be able to open a fee-for-service or gratuitous professional service public account to offer securities advisory services, or that a person who has passed the U.S. Series 3 examination may be able to start an advisory business related to futures in Beijing. This contextualized scenario gives us a better sense of the pace of these opening up initiatives.

Conclusion

To sum up, Beijing's powerful policies for further opening up of the service industry can be regarded as "inside and outside". Under the current situation, Beijing has shown the intent to further improve on its existing foreign investment policies. It is believed that the release and soon entry into force of the counter-cyclical adjustment policies will give the market a further boost. We should similarly prepare for the arrival of the real spring tide at the end of the cycle.

[3] Measures for Administration of the Examination and Approval of For-profit Foreign-invested Vocational Skills Training Institutions (Hu Ren She Gui [2021] No.2).

3. Here Comes the Newly Effective Corporate Transparency Act

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Historically, ownership information of a private U.S. business entity (i.e. the persons who own or control a company) is not public information, and when people (including Chinese investors) create or form a business entity in the U.S. such as a corporation or an LLC by filing incorporation or formation documents with the secretary of state or similar office of a particular state such as Delaware, they are not required to include any ownership information in such documents. However, with the Corporate Transparency Act ("**CTA**") became effective on January 1, 2024, it represented a major shift in the regulatory landscape regarding corporate ownership and transparency in the U.S.

Starting on January 1, 2024, under the Beneficial Ownership Information Reporting Rule promulgated by the U.S. Department of the Treasury's Financial Crimes Enforcement Network ("**FinCEN**") pursuant to the CTA ("**Reporting Rule**"), many U.S. business entity whether existing or to newly form and many foreign business entities doing business in the U.S. will be required to file their Beneficial Ownership Information ("**BOI**") on the electronical filing system of FinCEN. FinCEN will store BOI reports in a centralized database and only share this information with authorized users for purposes specified by law.

To help Chinese investors doing business in the US understand the CTA and know how to comply with its reporting requirements, below please find our brief overview of CTA and its key requirements.

Purpose of the CTA

The CTA was enacted as part of the National Defense Authorization Act for Fiscal Year 2021. Its primary aim is to prevent the misuse of corporate entities for illicit activities, such as money laundering and terrorism financing, by requiring the disclosure of beneficial ownership information.

Key requirements of the CTA

Scope of applicability: The CTA applies to two types of **reporting companies**: domestic and foreign. A domestic reporting company would include a corporation, limited liability company, or any other entity created by the filing of a document with a secretary of state or similar office under the law of a U.S. state. A foreign reporting company would include a corporation, limited liability company, or other entity formed under the law of a foreign country such as China and that is registered to do business in any U.S. state. Under the CTA, certain entities, such as those publicly traded, certain regulated entities like banks, and companies that meet specific criteria (e.g., employing a certain number of employees and having a physical presence in the U.S.), are exempt from the reporting requirements.

Reporting requirements: The Reporting Rule requires any reporting company to file BOI reports to FinCEN. Reports shall contain information about the entity itself and two categories of individuals: (1) Beneficial Owner; and (2) Company Applicant.

The CTA defines a Beneficial Owner as an individual who owns or controls at least 25% of the ownership interests of a company or has substantial control over it.

Also, under the CTA, an individual should be deemed as have exercises substantial control over a reporting company if the individual meets any of four general criteria: (1) the individual is a senior officer; (2) the individual has authority to appoint or remove certain officers or a majority of directors of the reporting company; (3) the individual is an important decision-maker; or (4) the individual has any other form of substantial control over the reporting company.

An individual who owns or controls at least 25% of the ownership interests of a company or has substantial control over it can be either a U.S. or a foreign national.

A reporting company can have multiple beneficial owners. There is no maximum number of beneficial owners who must be reported. FinCEN expects that every reporting company will be substantially controlled by one or more individuals, and therefore that every reporting company will be able to identify and report at least one beneficial owner to FinCEN.

The Reporting Rule also requires a US reporting company created on or after January 1, 2024, or a foreign reporting company first registered to do business in the US on or after January 1, 2024, to report its Company Applicant which normally should be the individual who directly filed the document that first created a domestic reporting company, or first registered a foreign reporting company in the US. This individual would have actually physically or electronically filed the document with the secretary of state or similar office, or an individual who directs or controls such filing action.

What to report and reporting timeline

The Reporting Rule requires a reporting company to identify itself and report four pieces of information about each of its beneficial owners and company applicants: name, birthdate, address, and a unique identifying number from an acceptable identification document (and the image of such document).

As to the reporting timeline, if a reporting company already exists as of January 1, 2024, it must file its initial BOI report by January 1, 2025. If a reporting is created or registered to do business in the United States on or after January 1, 2024, and before January 1, 2025, it will have 90 calendar days after receiving actual or public notice that the company’s creation or registration is effective to file its initial BOI report. If a reporting company is created or registered on or after January 1, 2025, it will have 30 calendar days from actual or public notice that its creation or registration is effective to file its initial BOI report.

Confidentiality, access, and data protection

The CTA stipulates that the access to the beneficial ownership information is limited to specific U.S. federal and state agencies, financial institutions for due diligence purposes, and, under certain conditions, foreign law enforcement entities. Therefore, private parties should not be able to access the BOI reported by a reporting company to FinCEN.

Consequence for not report BOI in the required timeframe

Under the CTA, willful failure to report complete or updated beneficial ownership information to FinCEN, or the willful provision of or attempt to provide false or fraudulent beneficial ownership information may result in a civil or criminal penalties, including civil penalties of up to $500 for each day that the violation continues, or criminal penalties including imprisonment for up to two years and/or a fine of up to $10,000. Senior officers of an entity that fails to file a required BOI report may be held accountable for that failure.

Implications of the CTA for Chinese investors

The CTA may affect Chinese investors in many aspects, including:

- **Mandatory reporting for new and existing entities**: Unless exempted by the CTA, Chinese investors will need to report the details of the beneficial owners of all domestic and foreign entities which they created or formed in the U.S. or which they registered to do business in the U.S.

- **Detailed information requirement**: Chinese investors will need to obtain and report personal information about the beneficial owners of their business entities, including names, addresses, dates of birth, and identification numbers (e.g., passport numbers).

- **Implications for entity formation**: Chinese investors setting up a U.S. business entity will need to be prepared to separately disclose beneficial ownership information to the reporting system of FinCEN soon after the entity is incorporated or formed. This adds an additional layer of compliance during the entity formation process.

- **Impact on business privacy**: The CTA's reporting requirements may impact the privacy considerations of some Chinese investors who may hope to have a more anonymous business structure.

- **Penalties for non-compliance**: Failure to comply with the CTA could lead to substantial civil and criminal penalties on the Chinese investors.

- **Additional state compliance obligation**: In addition to the CTA on the federal level, New York State has passed the LLC Transparency Act which requires certain business entities created or formed in New York State or registered to do business in New York State to report their beneficial ownership information. Therefore, Chinese investors doing business in New York States should also comply with the reporting requirement of New York LLC Transparency Act.

Looking ahead

The CTA represents a pivotal change in U.S. corporate transparency. For Chinese investors, understanding and adapting to these changes is not only crucial for compliance but also for the successful navigation of the U.S. business environment.

We will continue to monitor developments related to the CTA and provide updates and insights in the future issues.

Important Announcement

If you have any questions regarding this publication, please contact:

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