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Launch of the Shanghai Pilot Free Trade Zone.

Introduction

On 27 September 2013, the State Council finally released details of the eagerly anticipated Shanghai Pilot Free Trade Zone (the "**Zone**"), with the issue of its "Overall Plan for China (Shanghai) Pilot Free Zone" (the "**Plan**"). The Plan, which was formally launched on 29 September 2013, seeks to ease the administrative burdens and legal restrictions that both foreign and PRC investors are currently faced with, at least within the confines of the Zone. The Government also plans to use the Zone as a testing ground for possible nationwide financial reforms and further liberalisation of the Chinese market.

The Plan introduces a number of changes to the current regulatory framework for foreign investments within the Zone:

- **relaxation** of certain foreign investment restrictions within the Zone for 18 service industries spanning six service areas, such as eligibility requirements for foreign investors, foreign shareholding limits and business scope restrictions;
- **introduction** of a "Negative List" approach towards foreign investment in the Zone, with foreign-invested entities operating in industries that do not appear on the "Negative List" subject to "post-filing" requirements, and no longer needing foreign investment approvals from the Ministry of Commerce (the "**MOFCOM**") and the National Development and Reform Commission (the "**NDRC**"). (Some approvals may, however, still be required as the national security review and anti-trust rules still apply);
- **simplification** of approval requirements for investments by Zone enterprises outside of China; and
- **facilitation** of further financial reform and promotion of new forms of trading within the Zone.

Whilst it is still too early to fully assess the impact of the Plan as the practical implementing rules in a number of areas are still awaited, the Plan has been warmly welcomed by investors. The banking sector for example has reacted swiftly to take advantage of the lessened restrictions, with eight domestic

Contents

banks[1] and two foreign banks[2] already having applied for, and received permission, to open branches in the Zone.

Further details of the Plan

Geographical coverage

The Zone consists of the following areas: (i) the Shanghai Waigaoqiao Free Trade Zone; (ii) the Shanghai Waigaoqiao Bonded Logistics Zone; (iii) the Shanghai Pudong Airport Free Trade Zone; and (iv) the Yangshan Free Trade Port Area, with an indication that the Government is willing to expand the Zone once it has the opportunity to assess the success of the pilot project. Any existing rules relating to these areas which conflict with the Plan will be adjusted as necessary in the future.

Opening up of certain service industries

The Plan removes certain foreign investment restrictions within the Zone for 18 service industries spanning six service areas, namely financial, shipping, commercial and trading, professional, cultural and social services. In a number of areas, however, further implementing rules are required before full advantage can be taken. Set out below are some highlights of the changes introduced by the Plan. For further information of the principal changes, please see Appendix I.

(i) Financial services: within the Zone the Plan permits (i) qualified foreign financial institutions to set up banks; (ii) qualified PRC private investors to set up joint venture banks with foreign financial institutions; (iii) qualified Chinese banks to undertake offshore banking; and (iv) foreign investors to set up healthcare insurance institutions. In addition, the Plan contemplates establishment of banks which only conduct a limited and specific business (as opposed to a comprehensive banking business) at some point in the future.

(ii) Commercial and trading services: the Plan permits foreign-invested entities to provide certain value-added telecommunication services within the Zone, as long as network safety can be guaranteed. The Government has, however, reserved the right for State Council approval to be required if the detailed implementing rules conflict with the existing rules, leaving scope for State Council approval to continue to be required.

(iii) Professional services: within the Zone the Plan permits: (i) establishment of Sino-foreign human resources joint venture companies (in which foreign shareholders can hold up to 70% of the equity interest); (ii) establishment of foreign-invested joint stock investment companies; and (iii) foreign-invested entities to set up credit investigation companies.

[1] *Industrial and Commercial Bank of China, Agricultural Bank of China, Bank of China, China Construction Bank, Bank of Communications, China Merchants Bank, Pudong Development Bank and PingAn Bank.*

[2] *Citibank and DBS Bank.*

(iv) Social services: the Plan permits foreign investors to set up wholly foreign-owned hospitals and other medical institutions within the Zone.

Adoption of a "Negative List" approach

The Zone adopts a "Negative List" approach towards foreign investment, with the set up of foreign-invested entities operating in industries which are not on the "Negative List" subject to reduced administrative hurdles and giving them broadly comparable treatment to domestic enterprises in terms of set up. Under the "Negative List" approach, foreign-invested entities in industries that do not appear on the "Negative List" will generally only need to make relevant filings with the Shanghai municipal government on establishment in the Zone and will no longer need to obtain prior foreign investment approvals from the MOFCOM and the NDRC. However, some foreign investment approvals may still be required as the national security review and anti-trust rules still apply to any foreign investments in the Zone.

Scope of the "Negative List"

The "Negative List" was issued on 29 September 2013 by the Shanghai municipal government, revealing the full extent of industries no longer subject to the "prior-approval" system. Comparing the "Negative List" with the current Catalogue of Industries for Guiding Foreign Investment, a number of "encouraged" industries included in the Catalogue are absent from the "Negative List", with investments in these industries within the Zone therefore not requiring prior foreign investment approval. Most of the "restricted" and "prohibited" industries featuring in the Catalogue, however, remain on the "Negative List", with the "Negative List" going even further in some cases, and including some industries which are not expressly prohibited under the Catalogue, such as investment in online gaming operations. Set out below are some examples of the impact of the "Negative List" on certain industries.

(i) *Manufacturing:* the "Negative List" reflects most of the "restricted" manufacturing industries mentioned in the Catalogue (for example, production of rice wine and other famous-brand spirits), which therefore still require prior foreign investment approval. The principal foreign investments in manufacturing industries that are now only subject to "post-filing" requirements in the Zone include "encouraged" foreign investments in agricultural and in by product food processing businesses (for example processing of vegetables, dried and fresh fruit and livestock and poultry products), food manufacturing businesses (for example development and production of infant food and health food), drink manufacturing businesses, the tobacco industry, the textile industry and the pharmaceutical industry.

(ii) *Agriculture, Forestry, Animal Husbandry and Fishery*: foreign investments which fall under the "encouraged" category in the Catalogue (for example development of new planting technologies for crops) are absent from the "Negative List", meaning they will only be subject to "post-filing" requirements within the Zone.

(iii) *Telecommunication, Intellectual Property and Finance*: these industries, which are categorised as "restricted" in the Catalogue, are still tightly controlled by the Chinese government and all feature on the "Negative List".

(iv) *Medical and Social Work*: the "Negative List" requires a minimum investment in any medical institution in the Zone (other than social service institutions for the elderly, disabled and children) by a foreign investor of a minimum of RMB20 million. In addition, a foreign-invested medical institution established in the Zone cannot set up branches and its business licence is limited to 20 years.

Filing requirements

On 29 September 2013, the Shanghai municipal government also published details of the filing requirements for foreign investors setting up foreign-invested enterprises, and participating in foreign investment projects, in the Zone in industries that are not included on the "Negative List" (i.e. those no longer subject to the usual prior foreign investment approvals). Both filings, which can be made concurrently, need to be made with the Administration Committee of the Zone, with the Committee having to process filings within a specified timeframe from receipt of all submission materials (one business day for the establishment of foreign-invested enterprises and 10 business days for participating in foreign investment projects).

Promotion of outbound investment from the Zone

Promotion as set out in the Plan

Currently, any investment by a PRC entity outside of China requires approvals from the NDRC and the MOFCOM. The Plan simplifies the process for outbound investments by entities set up in the Zone (excluding central-government owned enterprises), with outbound investments originating from the Zone that are within the authority of approval of the Shanghai municipal government being subject, in most cases, only to post-filing requirements. Certain outbound investments, however, fall outside the remit of the Committee's jurisdiction if they involve investment into any country that China does not have a diplomatic relationship with, countries that are subject to international sanctions or any industry that the NDRC considers to be sensitive. The Plan also encourages the establishment of project companies in the Zone focused on investments outside of China and supports the set up of funds, aimed at qualified investors, which invest in non PRC investments.

Filing requirements

The Shanghai municipal government has also published details of the filing requirements for investments in overseas projects and for the set up of overseas entities. The filings with the Committee, which can be made concurrently, must be processed by the Committee within five business days of receipt of all submission materials. Any investment and set up must take place within two years of the filing.

Furtherance of financial sector reform

Liberalisation of Renminbi

The Plan promotes liberalisation of the Renminbi, although at present only in general terms as the implementing rules have not yet been issued by the State Administration of Foreign Exchange. Provided risks can be controlled, the Government proposes full Renminbi convertibility for capital accounts within the Zone, with entities established in the Zone to be permitted to conduct cross-border capital account transactions, such as share acquisitions, with fewer foreign exchange restrictions. The Plan further contemplates that, in the future, there will be further trial projects for cross-border Renminbi use and cross-border financing will be liberalised for entities within the Zone, giving them full access to both domestic and foreign finance, without restriction.

Further financial reform

Under the Plan, interest rates for financial markets within the Zone will be determined by the market, enabling banks in the Zone to potentially offer higher interest rates than other banks in the rest of China. Foreign entities will also gradually be allowed to trade commodity futures within the Zone. The Plan touches on a number of different sectors and the China Securities Regulatory Commission (the “**CSRC**”), the China Banking Regulatory Commission (the “**CBRC**”) and the China Insurance Regulatory Commission (the “**CIRC**”) have already issued high-level endorsements for the Plan.

For example, the CSRC has expressed its support for qualified enterprises and individuals in the Zone being able to invest in the PRC and overseas futures markets, and for securities and futures institutions within the Zone to develop OTC trading businesses aimed at domestic investors for commodity futures and financial derivatives products. The CSRC also allows foreign parent company of an enterprise established in the Zone to issue Renminbi bonds in the PRC market. The CBRC has expressed its support for banks within the Zone to be able to conduct cross-border investments, including providing loans for cross-border transactions. Additionally, the CIRC has expressed its support for insurance companies setting up branches in the Zone to conduct Renminbi cross-border reinsurance businesses, and for insurance institutions established in the Zone to make outbound investments.

Promotion of new forms of trading

The Plan sets out various measures to promote new forms of trading. For example, the Plan encourages multinational companies to establish their Asia-Pacific headquarters in the Zone, and the set up of an international trading settlement centre in the Zone. The Plan also mentions the possible future set up of an international commodity exchange and resources allocation platform within the Zone to promote international commodity trading of energy products, basic industrial raw materials and primary agricultural products free from customs duties, a step expected to facilitate free flow of domestic and foreign commodity products.

Appendix – Summary of principal changes

Set out below is a summary of the principal changes introduced by the Plan.

1 Financial Services

Changes introduced by the Plan	Comments
Banking services	
• Qualified foreign financial institutions are permitted to set up foreign banks within the Zone.	• Qualified foreign financial institutions are already permitted to set up foreign banks in China. This change therefore does not actually "open-up" this industry and how foreign investors will benefit from this change will depend on further implementing measures, yet to be issued.
• Qualified PRC private investors and foreign financial institutions can set up Sino-foreign joint venture banks within the Zone.	• Even though the State Council has already expressed its support for PRC private investors investing in financial institutions, practical obstacles still exist for PRC private investors entering the financial industry. The Plan, however, explicitly permits PRC private investors to enter the financial industry by setting up Sino-foreign joint venture banks with foreign financial institutions within the Zone.
• Qualified Chinese banks will be allowed to conduct offshore banking, but only after the Government has improved relevant regulations and strengthened effective supervision measures.	• Currently only four Chinese banks[3] are allowed to engage in offshore banking activities. While many Chinese banks are interested in developing their offshore banking businesses, the change introduced by the Plan is somewhat limited as, at least for now, capital can only be sourced from, and utilised in, overseas markets and must be kept separate from a bank's domestic business.
• The Plan contemplates establishment of banks which are able to conduct only limited and specific business (as opposed to comprehensive banking business) at some point	• Hong Kong, which has a relatively more mature financial industry, operates a three-tier banking system and banks are permitted to conduct limited and specific businesses depending

[3] *Bank of Communications, Pudong Development Bank, China Merchants Bank and PingAn Bank.*

Changes introduced by the Plan	Comments
in the future.	on which tier they belong to (such as deposit-taking companies which specialise in consumer finance and securities). This change will help China develop a similar banking system where banks are allowed to focus on specific lines of business, instead of offering full services and will be of interest to foreign investors who are only interested in offering specific (and not comprehensive) banking services.
Healthcare Insurance services	
• Foreign-invested healthcare insurance institutions can be set up in the Zone.	• When joining the World Trade Organisation, China only allowed foreign life insurance companies to set up Sino-foreign joint ventures, with a cap on foreign shareholding of 50%. The abolition of the restriction within the Zone is expected to boost the Chinese healthcare insurance market and facilitate further cooperation between domestic and foreign healthcare insurance providers.
Finance leasing services	
• Single-plane companies and single-vessel companies (which are in effect equivalent to special purpose vehicles) established in the Zone by finance leasing companies are no longer subject to minimum registered capital requirements.	• Outside the Zone, foreign-invested financial leasing companies are subject to a minimum registered capital requirement of USD10 million. This change removes the restriction within the Zone.
• Finance leasing companies within the Zone can also operate factoring businesses linked to their primary business of financial leasing.	• Only banks and factoring companies can operate factoring businesses outside the Zone. The change opens up this industry to finance leasing companies.

2 Shipping Services

Changes introduced by the Plan	Comments
• The foreign shareholding	• Currently, there is a 49% foreign

Changes introduced by the Plan	Comments
restriction on international shipping transportation companies is lowered, with detailed rules to be issued by the Ministry of Transportation in due course.	shareholding limit on international shipping transportation companies. The Plan proposes to lower the cap although detailed rules are yet to be issued.
• Foreign ships owned or controlled by Chinese enterprises are allowed to transit import-export containers between Shanghai ports and PRC coastal ports.	• The change introduced by the Plan may increase competition between cargo shipping companies. For example, given the high production and operation costs of Chinese ships, allowing foreign ships to transit import-export containers may tempt further market entrants, although given that the change is limited to the transit of import-export containers between Shanghai ports and other PRC coastal ports, the impact may be somewhat limited.
• Wholly foreign-owned international shipping management enterprises can be established in the Zone.	• Outside the Zone, international shipping management enterprises cannot be wholly owned by foreign investors, with a cap on foreign ownership of 49%.

3 Commercial and Trading Services

Changes introduced by the Plan	Comments
Telecommunication services	
• Foreign-invested entities are allowed to provide selective designated forms of value-added telecommunication services, provided network safety can be guaranteed. The Government has, however, reserved the right for State Council approval to be required if the detailed implementing rules conflict with the existing rules.	• Foreign shareholding in any value-added telecommunication services enterprise cannot exceed 50%. The Plan on one hand sets out that this cap will not apply in the Zone provided network safety can be satisfied, although on the other hand provides that in case of any conflict with the existing rules, the State Council's approval will be required for further implementation. As the current rules over value-added telecommunication services enterprises have been issued by the State Council, this change

Changes introduced by the Plan	Comments
	effectively means that any foreign investment into value-added telecommunication services that exceed the 50% foreign shareholding cap may still be subject to State Council approval.
Entertainment and gaming consoles sales and services	
• Foreign-invested entities are allowed to engage in manufacturing and sales of entertainment and gaming consoles in the Zone. Consoles which meet the applicable censorship requirements can be on-sold within China.	• The change is a welcome liberalisation of the PRC entertainment and gaming consoles sales and services industry, with BesTV already announcing on 23 September 2013 that it will establish a joint venture with Microsoft, to sell gaming consoles and other related games and gaming software.

4 Professional Services

Changes introduced by the Plan	Comments
Credit investigation companies	
• Foreign-invested entities can set up credit investigation companies in the Zone.	• Outside the Zone, the credit investigation industry falls under the "restricted" foreign investment category and no implementing rules have been published to date. However, some foreign credit investigation companies have already established subsidiaries or branches in China conducting credit investigation businesses. Even though the Plan does not "open up" this industry to foreign investors in a material way, explicitly allowing foreign-invested entities to set up credit investigation companies in the Zone is likely to boost foreign investors' interests in this industry.
Human resources intermediary agencies	
• Foreign shareholders can hold up to 70% of the equity interest of a Sino-foreign joint venture	• The foreign shareholding in a Sino-foreign joint venture human resources intermediary agency

Changes introduced by the Plan	Comments
human resources intermediary agencies established in the Zone.	outside the Zone is capped at 50%. Under the Plan, the limit is increased to 70%.
• Qualified Hong Kong and Macau service suppliers can set up wholly-owned human resources intermediary agencies.	• Since Hong Kong and Macau service suppliers are already treated the same as PRC domestic service suppliers in certain cities and provinces such as Beijing and Shanghai, and therefore already allowed to set up wholly-owned human resources intermediary agencies in those cities and provinces, the change does not in practice further "open up" this industry to Hong Kong and Macau investors.
• The minimum registered capital required for a foreign-owned human resources intermediary agency is reduced to US$125,000.	• Outside the Zone, a foreign-owned human resources intermediary agency is subject to a minimum registered capital requirement of US$300,000.
Investment companies	
• Foreign-invested joint stock investment companies can be set up in the Zone.	• Foreign-invested investment companies outside the Zone can only take the form of a limited liability company. Allowing for use of joint stock investment companies potentially paves the way for listings of Zone investment companies in the future.
Travel agencies	
• Sino-foreign joint venture travel agencies registered in the Zone are allowed to provide overseas travel services (other than in relation to travel to Taiwan).	• The key change to the travel agency industry is that travel agencies no longer need to wait two years after establishment before they can provide overseas travel services, as they do outside the Zone.

5 Cultural Services

Changes introduced by the Plan	Comments
• The establishment of wholly foreign-owned entertainment artist agencies is permitted in the Zone in relation to services	• Outside the Zone, entertainment artist agencies cannot be controlled by a non PRC party. However, Hong Kong and Macau

Changes introduced by the Plan	Comments
provided in the wider city of Shanghai.	investors are already permitted to set up wholly-owned entertainment artist agencies in China. So, the change does not in practice "open-up" this industry to Hong Kong and Macau investors.
• Entertainment venues (such as bars and clubs) in the Zone can be operated by wholly foreign-owned entities.	• Entertainment venues outside the Zone can only be operated by Sino-foreign joint ventures.

6 Social Services

Changes introduced by the Plan	Comments
Education services	
• The establishment of Sino-foreign joint venture operational educational institutions and operational vocational training institutions is allowed in the Zone.	• Currently outside the Zone, foreign education institutions can cooperate with the Chinese counterparties to set up operational educational programmes and operational vocational training programmes, such as New York University Shanghai, but they cannot invest in a PRC entity in this sector. The Plan, however, explicitly permits establishment of Sino-foreign joint ventures in this sector within the Zone which will likely be of interest to foreign education institutions.
Medical institutions	
• Wholly foreign-owned hospitals and other medical institutions can be set up in the Zone.	• Outside the Zone, the change is likely to benefit the healthcare industry as a whole. However, the success of wholly foreign-owned medical institutions established under the Plan will be dependent on the openness of the overall regulation in the Chinese healthcare market. (On a related note the Plan also allows the set up of foreign-invested healthcare insurance institutions - see above.) • Taiwan investors are already permitted to set up wholly-owned

Changes introduced by the Plan	Comments
	hospitals in certain cities and provinces such as Shanghai and Jiangsu Province, so the change does not in practice "open up" this industry to Taiwan investors in a material way.

Linklaters

Contacts

Authors: Fang Jian and Richard Gu

Contacts

For further information please contact:

Fang Jian
Partner

(+86) 21 2891 1858

jian.fang@Linklaters.com

Richard Gu
Senior Consultant

(+86) 21 2891 1839

richard.gu@Linklaters.com

Eric Liu
Managing Associate

(+86) 21 2891 1841

eric.liu@linklaters.com

Linklaters LLP Shanghai Office
29th Floor
Mirae Asset Tower
166 Lu Jia Zui Ring Road
Shanghai 200120
People's Republic of China

Telephone (+86) 21 2891 1888
Facsimile (+86) 21 2891 1818

Linklaters.com