

Recently, foreign investment in medical institution has reflected itself in four major trends: still very small margin among total investment in the industry of China's medical service; mostly locate in developed cities such as Shanghai and Guangdong; only have a targeted consumers of foreigner working or travelling in China or some wealthy people; and mainly as specialist clinics with small scale, investment and seemingly sound profit.

While the regulatory environment for foreign investment on medical institution is gradually loosening, with promising market prospective in both medical treatment and elderly care industries, enthusiasm from private investors is unprecedentedly increasing. We hope to in this article provide a systematic laws and policies for navigate foreign investors along their route ahead to the hospital business.

A gradual open market for foreign investment

Actually, as of a decade ago, foreign investors' first entry into the market of medical service, market entry policy have been developing from prohibiting to fully opening—the progress is as follows:

--Prior to year 2000, foreign investment in medical institution is prohibited.

--In July of year 2000, pursuant to commitment of Chinese government after entering into WTO, Ministry of Health and former Ministry of Economic and Trade issued *the Interim Measures for the Administration of Sino-foreign Equity Joint and Cooperative Joint Medical Institutions*, allowing a foreign share or equity up to 70% within a JV, but strictly prohibiting investment by means of Wholly Foreign-owned Enterprises (WFOE).

--In 2007, Chinese government promulgated a revised *Foreign Investment Industrial Guidance Catalogue*, which further opened many industries for foreign capital. The Catalogue encouraged medical service for elderly and disabled in healthcare, sports and social welfare, allowed pharmaceutical manufacturing on ordinary products, but still keep investment in medical service under control, even required a majority stake of domestic investor in a JV in some cases.

--In December of 2010, Opinions of the National Development and Reform Commission, the Ministry of Health and Other Ministries on *Further Encouraging and Guiding*

the Establishment of Medical Institutions by Social Capital (Circular No. 58) specially opened the market for private capital, including six measures in detail. Circular No. 58 requires to further expand the opening-up of medical institutions and adjust the establishment of medical institutions by overseas capital as the permitted foreign investment projects; permit the establishment of medical institutions by overseas and domestic medical institutions, enterprises and other economic organizations in the form of joint venture or cooperative joint venture, and gradually cancel the restriction on the equity proportion of overseas capital; carry out the pilot establishment of foreign-funded medical institutions in China by qualified overseas capital and gradually relax restrictions. The Circular simplifies the procedure by requesting the establishment of Sino-foreign joint venture and cooperative joint venture medical institutions to be subject to the examination and approval of provincial health departments and commercial departments, and meanwhile the establishment of wholly foreign-funded medical institutions shall be subject to the examination and approval of the Ministry of Health and the Ministry of Commerce. Until then,

investment in medical institution is fully open for foreign investors.

--In July of 2011, Shanghai's first wholly foreign-owned (Taiwan) hospital, Landseed Hospital, opened its clinics officially. Usually approval for foreign investment in medical institution are subject to both Ministry of Health and Ministry of Commerce, which can lasts for as long as one year.

--In December of 2011, *new Foreign Investment Industrial Guidance Catalogue ("New Catalogue")* was issued by National Development and Reform Commission ("NDRC") and Ministry of Commerce. The New Catalogue removes the foreign investment in medical institution from restricted catalogue, which means it cancels the previous restriction on foreign equity of 70% in a JV and further allows WFOE model in medical institution. Furthermore, investors from Hong Kong and Macau, who has already enjoyed opening-up policy for a period of time, are allowed, as of April 1st 2012, to expand their business in all municipalities directly under the Central Government and cities of provincial capital instead of only in Shanghai, Chongqing, Guangdong, Fujian and Hainan as previously restricted, thanks to the implementation of CEPA.

Dormant Investment is Expected to Decrease

What worth mention is before the fully opening-up of foreign investment policy on medical institution, a lot of dormant or anonymous investment are taken place in order to circumvent the restriction. The dormant investment refers to a legal situation where the actual investor (the Dormant Investor) who makes capital contributions to the enterprise is not the one whose name is documented on the articles of association, the register of shareholders or other legal documents, but in the name of others (the Nominal Shareholder). In Practice, by means of certain arrangement, domestic shareholders in a JV become only nominal partners—foreign investors are the actual investors.

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For foreigners who are the actual investors, biggest concerns are possible dispute that may arise with their domestic nominal shareholder(s). Pursuant to Provisions of the Supreme People's Court on *Several Issues concerning the Trial of Disputes Involving Foreign-Funded Enterprises (I) (the "Provision")*, if the dormant investment satisfies the following three requirements concurrently, the court can recognize directly the status of a Dormant Investor as a shareholder along with its equities in the foreign invested enterprise (FIE): a) The Dormant Investor has actually made the investment in the FIE; b) Shareholders other than the Nominal Shareholder recognize the Dormant Investor's status as a shareholder; and c) The people's court or the parties concerned have obtained the consent of the FIE examination and approval authority for changing the Dormant Investor into a shareholder during the legal process. As such, as long as these requirements are satisfied, dormant investment can be legitimized during the judicial proceeding in case legal dispute arise.

Given the fact China has fully opened-up the market for foreign investors on medical institution, according to the Provision, as long as the dormant investment contract reached by and between the dormant and nominal investors is wisely designed and valid, the rights of dormant shareholder under the contract can be protected. So to design and sign a contemplating dormant investment contract seems more necessary. Of course, we still recommend foreign investors under nominal arrangement to correct the dormant investment model in light of the opening up policy.

A series of regulations are expected to be published

With the current encouraging policy on private investment in medical institution, more regulations from Ministry of Health (MOH), Civil Affairs Bureau and Ministry of Commerce, among other administrative authorities are expected to be issued in the near future. These new regulations will help foreign investors to better estimate the regulatory environment. Recently Chinese authorities have, for example, issued the following provisions:

On April 13th, MOH promulgated *the Notice on Definition the Nature of Medical Institutions Run by Private Capital* ("Circular 26"). The Circular said that privately-run medical institutions could register as either for-profit or nonprofit, according to the nature of their business, by repealing a previous applied regulation that defined almost all medical institutions supported by non-public funds as for-profit hospitals. Requirement on transition between for-profit and nonprofit will be regulated in another circular.

The Circular has encouraged private sector to invest in nonprofit medical institutions, which may escalate the investment from private funds into medical care regime. According to prevailing policy, nonprofit hospitals run by private capital can enjoy the same preferential policies on land usage, tax treatment, utility charges as public hospitals. However, nonprofit hospital shall implement strict pricing rules on medical service and medicine prescription as required by government. Earning from nonprofit hospital can only be used for development purpose instead of dividends payment to shareholders.

The Implementation Plan for Deepening the Reform on Medical and Healthcare System During the 12th Five-year Period was issued by the State Council on this March. The Plan intends to further loosen the entry policy for private funding, such as

investment from enterprises, charity institutions funds and commercial insurance companies from home and abroad, and encourage qualified individual to open private clinic. It is aimed for non-public hospital to cover totally 20% of all requirement of medical treatment by 2015, and expand the reimbursement network of social insurance among those qualified non-public hospitals and pharmacies. According to MOH, 13,519 public hospitals and 8,864 privately-run hospitals are operating in China as of March.

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Meanwhile, MOH issued another *Notice on Classifying the Level of Private-run Hospitals* on May 17. It requires authority of MOH to classify level of all private-run hospitals (include JV hospitals) when grant establishment approval, according to the function and service perimeters of the new establishment.

Sino-foreign Joint Venture is Still Dominant

On April 13th, MOH revised *Measures for the Administration of Sino-foreign Equity Joint and Cooperative Joint Medical Institutions* (“*new Measure*”) for public review, which has not been promulgated yet. Compared with current prevailing Interim Measure, the new Measure indicates some changes as follows:

	current requirement	new revision
increase the minimum investment volume	no less than RMB 20 million	no less than RMB 100 million (no less than RMB 50 million in mid-western areas and other remote or poor areas)
restriction on foreign investment	no more than 70%	no more than 70% in principle, but can adjust the proportion at appropriate time and will gradually open-up for foreign investors to establish WFOE
Stipulation on nonprofit medical institution	not mentioned but JV is used to be regarded as for-profit hospitals	specifically stipulates nonprofit business can be an option
extend maximum business term	no more than 20 years	no more than 30 years
decentralize of qualification approval power	Ministry of Health	Provincial branch of MOH department
decrease of qualification approval time	within 45 working days	within 20 working days
decentralize foreign investment approval power	Ministry of Commerce (MOFCOM)	provincial branch of MOFCOM
decrease of foreign investment approval time	within 45 working days	within 20 working days

Actually the new Measure is to further implement the policies in Circular 58 and *the Notice of MOH on Adjustment of Approval Power on Sino-foreign Joint Medical Institution*, among others. The regulator’s intent to firstly focus on administration on JV medical institution reflects the voice from government that Sino-foreign Joint Medical Institution is still the prefer business model welcomed in China.

As a conclusion, privately-run hospitals used to be under government’s supervision, during a time unregulated behavior on pricing or fraud to consumers always happens. Now the government has switched its function from supervision to guidance, in order to cater to its encouraging policies.

Reaction from the market is not that positive. Quite a few areas such as practice rule for physicians, qualification for hospitals to reimburse expense from social insurance are still in urge of reform to thoroughly implement the encouraging policies for private capital. Industry insider says the biggest hurdle for foreign investment is personnel and social insurance policy. As long as the current situation that physicians are locked in limited place for practice, and reimbursement qualification from social insurance is coupled with government-determined pricing mechanism remains unchanged, foreign investor may have less motivation to pace up, under a market environment that are seemly in lack of both physicians and patients. By limitation to the content of this article, we are going to discuss this later on.

If you need legal assistance with regard to the regulatory analysis in this article, please contact the author Michael Qu via email: quqin@co-effort.com