Client Alert

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The Shortened Shanghai Free Trade Zone Negative List: One Small Step for Reform…

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Amidst high hopes in the foreign investment community for a streamlined framework regulating inbound investment to the PRC, China's State Council launched the China (Shanghai) Pilot Free Trade Zone (the "**SFTZ**" or "**Zone**") in September 2013. The establishment of the SFTZ somewhat disappointingly included a longer-than-expected "negative list" setting forth industry sectors subject to restrictions or prohibition from foreign investment in the SFTZ.

On June 30, 2014, the Shanghai People's Government unveiled a much-anticipated shortened list (*Special Administrative Measures on the Entry of Foreign Investment into the China (Shanghai) Free Trade Zone (2014 Negative List Revision)* (中国 (上海) 自由贸易试验区外商投资准入特别管理措施（负面清单) (2014年修订)); the "**Revised List**"). While the Revised List removes certain restrictions in sectors such as real estate brokerage, healthcare, and wholesale trade activities, the contents of the original List largely remain intact, continuing to provide regulators wide latitude to regulate foreign investment in certain sectors.

THE REVISED NEGATIVE LIST: KEY ELEMENTS

The Revised List operates in the same way that the original List did previously; that is, sectors that are not itemized on the List generally do not require pre-approval for foreign investment. (Foreign investment outside of the Zone generally requires government pre-approval, and pre-approval is reserved for projects in enumerated sectors within the Zone.) For projects involving many sectors that are established in the Zone, the pre-approval system has been replaced by a filing and notification system.

The foreign investment community viewed the original List as essentially a copy of the *Catalogue Guiding Foreign Investment*, which categorizes foreign investment in certain industrial sectors as prohibited, restricted, and encouraged, and applicable to areas outside of the Zone. The Revised List retains the same 16 industrial sector categories that were restricted or prohibited from foreign investment on the original List.[1] However, the number of regulations related to those sectors has been reduced from 190 to 139. As a result, a number of sectors afford greater opportunities for foreign participation. For example:

- **Finance**: Restrictions in the original List on foreign investment in banks, finance companies, trust companies, currency brokerage companies, small loan companies, and financing guarantee companies have been replaced with a general regulation stating that all investment in banking-related financial

[1] That is, agriculture/forestry/animal husbandry/fishery, mining, manufacturing, electricity/heating/gas and water production and supply, construction, wholesale and retail, transportation/warehousing/postal service, information transmission/software/information technology (IT) services, finance, real estate, leasing and business services, scientific research and technology services, water conservation/environmental/public facility management, education, health and social work, and culture/sports/entertainment.

institutions must comply with applicable regulations in force. Typically, “banking-related financial institutions” refer to commercial banks, urban credit cooperatives, rural credit cooperatives, and other financial institutions and policy banks that are established within China and engaged in the money deposit business for the general public. Accordingly, it appears that the Revised List intends to remove the restrictions on foreign investors from investing in finance companies, trust companies, currency brokerage companies, small loan companies, and financing guarantee companies. However, given the vague language, how this change will be implemented remains to be seen.

- **Real Estate**: In the real estate sector, foreign investors are now permitted to participate in the secondary property market (i.e., resale transactions involving existing properties), by investment on a project company basis. Additionally, a vague restriction against “land development” except in the form of joint ventures has been removed. Accordingly, foreign investors are permitted to hold up to 100% ownership in a foreign-invested company engaging in the land development business.
- **Railway**: A restriction that investment in railway cargo transportation companies can only be in the form of joint ventures has been removed in the Revised List.
- **Healthcare and Medical Service**: The requirement for an RMB20 million minimum total investment in a medical institution has been removed, as has the maximum operation period of 20 years.
- **Agriculture, Sales, Manufacturing, and Inspection Services**: Restrictions on foreign investment in cotton and green tea processing, wholesale of salt and retail of certain other food products, wholesale of certain mineral and chemical products, manufacturing of certain types of motorcycles, and quality inspection services have been removed.
- **Internet Cafes**: The prohibition on foreign investment in venues that provide Internet access remains.
- References to prohibitions on investment in the gambling and pornography industries have been removed, although gambling and pornographic content are prohibited by PRC criminal law.

To reiterate, the bulk of the Negative List remains intact. With the exceptions noted above, bans against foreign investment in traditionally heavily regulated industries in China, such as culture, sports, and entertainment, remain in place.

CONCLUSION

The release of the 2014 Revised List has been long-awaited and marks a step in the right direction in continued liberalization of foreign investment restrictions via the SFTZ. That said, the Revised List does not represent a dramatic departure from the scope of opening up reflected in the original List. The descriptive language of sectoral categories covered by the Revised List is still broad, resulting in continuing legal uncertainties for foreign and domestic investors. Furthermore, the Negative List is just one component in the package of reforms that the SFTZ would supposedly facilitate. Aside from the Negative List, key reforms such as full convertibility of the RMB and a freer market for setting interest rates have yet to be realized. The state of foreign investment reform in the SFTZ continues to reflect the gradual manner in which China conducts its experiment toward a more flexible, open market.

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