New FTZs Launched in China

On April 21, three new Pilot Free Trade Zones of China (FTZs) were officially established in Guangdong, Tianjin and Fujian, following the lead of the Shanghai FTZ program that was launched in 2013. The Shanghai FTZ has been a testing ground for China’s economic and institutional reforms. Some of the Shanghai FTZ’s ground-breaking measures have already been implemented nationwide, such as the shift from a paid-in capital registration system to a capital subscription system. The three new FTZs will join the Shanghai FTZ in some major reform efforts. At the same time, each of the four FTZs will have additional mandates. Along with the launch of the three new FTZs, the Shanghai FTZ was also expanded from four geographic areas to seven, with the introduction of the Lujiazui (the financial center of Shanghai), Jinqiao and Zhangjiang areas. In this issue of China Update, we will discuss a few of the key changes associated with this round of FTZ expansion.

Shortened “Negative List” for Foreign Investment

In the past, the establishment of, and major changes (e.g. change of business scope, share transfer) to foreign investment enterprises (FIEs) were subject to governmental approval. From 2013, the Shanghai FTZ pioneered the use of the “Negative List” classification, which allows those industries not on the Negative List to be subject to the less burdensome governmental filing requirement instead of pre-approval.

The State Council has applied the Negative List to all four FTZs. The list has been shortened from the 139 items found in the Shanghai FTZ 2014 version to 122 items, which reflects the government’s desire to attract new foreign investment.

With respect to the filing procedures mentioned above, the Ministry of Commerce (MOFCOM) promulgated the Administrative Measures for Foreign Investment Enterprise Filing in the Pilot Free Trade Zones (Pilot), which applies to all FTZs. These measures were adapted from the 2013 version of the Shanghai FTZ. The highlights of these changes include:

1. MOFCOM will maintain an integrity and creditworthiness records system, recording relevant information of FIEs collected during governmental filing, registration, supervision, examination and similar processes. The information may be publicly announced and shared with other agencies.

1 Special Administrative Measures for the Market Entry of Foreign Investment in the Pilot Free Trade Zone (Negative List), Guo Ban Fa [2015] No. 23, promulgated by the State Council on April 8, 2015, implemented from the same date.

2 MOFCOM Announcement No. 12 [2015], promulgated on April 8, 2015, for implementation from May 8, 2015.
2. More details are provided regarding MOFCOM's examination procedures, including the scope, method and steps that will be followed for each examination.

**Tightened National Security Review of Foreign Investment in FTZs**

On the same day that the new Negative List and filing measures were issued, the State Council released the *Pilot Measures on National Security Review of Foreign Investment in the Pilot Free Trade Zones*³ (the FTZ Security Review Measures).

The current nationwide regulations governing the national security review for foreign investment include an official notice issued by the State Council in 2011⁴ and the implementing provisions issued by MOFCOM in 2011.⁵ The FTZ Security Review Measures reflect the following key changes from the 2011 nationwide notice procedures:

1. While only mergers and acquisitions of domestic companies are subject to review under the 2011 nationwide notice, greenfield investments and foreign investments using the VIE structure are now subject to review under the FTZ Security Review Measures.

2. In addition to the review criteria/factors contained in the nationwide notice, additional factors will be considered such as influence on national cultural security and public morality and influence on national network security.

3. Significant cultural and information technology products and services, if related to national security, are also subject to the review under the FTZ Security Review Measures.

We expect MOFCOM to issue an implementing regulation with respect to the FTZ Security Review Measures. The aforementioned changes clearly reflect a governmental intention to tighten the national security review procedures for foreign investment.⁶

**Distinct Local Characteristics of Each FTZ**

In addition to the application of the “Negative List” and the national security review procedures described above, each of the four FTZs has additional mandates. For example, the Shanghai FTZ, in addition to being the leading testing ground for the national economic and institutional reforms, will carry on its mission for financial sector reforms and innovations, including the exploration of free convertibility of the renminbi. The Guangdong FTZ will play an important role in the economic integration of Hong Kong and Macau with the Mainland. The Tianjin FTZ will promote finance leases as well as further integration of the local economy with that of the neighboring

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³ Guo Ban Fa [2015] No. 24, promulgated on April 8, to be implemented from May 8, 2015.
⁶ On July 1, 2015, the Standing Committee of the National People's Congress issued the new *National Security Law*, providing that, among others, foreign investment and internet information technology products and services that affect or may affect national security are subject to national security review, which echoes the aforementioned developments in FTZs regarding information technology products and services.
areas, Beijing City and Hebei Province. Finally, the Fujian FTZ will explore avenues for further economic cooperation with Taiwan.

If you have any questions regarding this Sidley Update, please contact the Sidley lawyer with whom you usually work, or

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Sidley China Practice

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