IMPACT OF WTO ACCESSION ON FOREIGN DIRECT INVESTMENT INTO CHINA

Y.M. Elaine Lo
Partner
Lex Mundi European Regional Conference
Copenhagen, 10-12 May 2002
A gradual opening up of the major sub-sectors within the telecommunications sector is promised.

These sub-sectors are:

- Value-added and Paging Services
- Mobile Voice and Data Services
- Domestic and International Fixed Line Services
Value-added and Paging Services

• Upon accession
  – 30% foreign equity interest
  – Beijing, Shanghai and Guangzhou

• One year after accession
  – 49% foreign equity interest
  – Beijing, Shanghai, Guangzhou, Chengdu, Chongqing, Dalian, Fuzhou, Hangzhou, Nanjing, Ningbo, Qingdao, Shenyang, Shenzhen, Xiamen, Xian, Taiyuan and Wuhan
Value-added and Paging Services

- 2 years after accession
  - up to maximum 50% foreign equity interest
  - no geographic restrictions
Mobile Voice and Data Services  
(all analogue/digital/cellular services and  
personal communications services)

- Upon accession
  - 25% foreign equity interest
  - Beijing, Shanghai and Guangzhou
Mobile Voice and Data Services

- One year after accession
  - 35% foreign equity interest
  - Beijing, Shanghai, Guangzhou, Chengdu, Chongqing, Dalian, Fuzhou, Hangzhou, Nanjing, Ningbo, Qingdao, Shenyang, Shenzhen, Xiamen, Xian, Taiyuan and Wuhan

- 3 years after accession
  - up to maximum 49% foreign equity interest

- 5 years after accession
  - 100% foreign ownership permitted
  - no geographic restrictions
Domestic and International Fixed Line Services

- 3 years after accession
  - 25% foreign equity interest
  - Beijing, Shanghai and Guangzhou

- 5 years after accession
  - 35% foreign equity interest
  - Beijing, Shanghai, Guangzhou, Chengdu, Chongqing, Dalian, Fuzhou, Hangzhou, Nanjing, Ningbo, Qingdao, Shenyang, Shenzhen, Xiamen, Xian, Taiyuan and Wuhan

- 6 years after accession
  - up to maximum 49% foreign equity interest
  - no geographic restrictions
The Internet services sector is regulated by the Ministry of Information Industry ("MII") through an approval/licensing system.

International connections to the Internet must be made through an international gateway approved by MII.

International gateways are operated by basic telecoms carriers which are licensed by MII to provide commercial Internet access services.
Foreign Investment in Internet Services Sector

Market access in the Internet services sector after WTO entry
- similar to phased-in entry programme for value-added telecoms services sector

- Upon accession
  - 30% foreign ownership

- 1 to 2 years after accession
  - 49% to 50% foreign ownership
Foreign Investment in Internet Services Sector

Foreign investment in a major ISP which :-

• operates an inter-connected network and is approved by MII to establish its own international gateway channel

• operates an Internet backbone

• operates satellite communications and mobile satellite communication services

is currently prohibited
Foreign investment in a major ISP after WTO entry
- similar to phased-in entry programme for
domestic and international fixed line services

• 3 years to 5 years after accession
  - 25% to 35% foreign ownership

• 6 years after accession
  - up to maximum of 49% foreign ownership
New Telecoms Legislation

Foreign Invested Telecoms Enterprises Regulations
(21 December 2001)

Telecoms Regulations
(25 September 2000)

Administration of Interconnection of Public Telecoms Networks Regulations
(10 May 2001)

WTO Reference Paper on Regulatory Framework for Basic Telecoms Services
Foreign Investment in the Telecoms sector can only take the form of Chinese-foreign equity joint venture. Co-operative/contractual joint ventures are not permitted.

Maximum equity interest held by foreign investors in a telecoms JV enterprise providing basic telecoms services (excluding radio paging services) is limited to 49%

Not less than 51% of the equity interest in a basic telecoms enterprise must be owned by the State

Foreign ownership interest in a telecoms JV enterprise providing value-added telecoms services (including radio paging services) is limited to 50%
Both the WTO Reference Paper and the New Interconnection Regulations impose an obligation on the dominant telecoms carrier to provide interconnection to other competing telecoms carriers on a timely basis.

Discrimination on the choice of routing or the quality of service provided by the dominant telecoms carrier to other competing carriers is forbidden.

Criteria for the granting of telecoms licence must be publicized, and the reasons for rejecting an application must be disclosed by the Telecoms Regulatory Authority.
Prior to China’s accession to the WTO:

- Foreign banks were confined to providing banking services to, and conducting foreign currency business with, foreign invested enterprises (“FIEs”) only.
- Renminbi licence was granted to qualified foreign banks in Shanghai (in 1996) and in Shenzhen (in 1998).
Pre-WTO restrictions on Renminbi business

• Foreign banks were restricted to serving FIEs in the location where they are registered

• Lack of freedom in setting RMB deposit rates

• Lack of freedom in setting interest rates for RMB loans
  - Interest margins on RMB loans must be set within the maximum and minimum interest rates prescribed by PBOC
Pre-WTO restrictions on Renminbi business

- Ratio of RMB liabilities to foreign exchange liabilities was set at 50%
- Renminbi operating capital was capped at RMB100 million
WTO Relaxations

- Foreign Currency Business

- Upon accession, PBOC lifted all restrictions on clientele and geographical operations of foreign banks which are immediately allowed to conduct foreign currency business with all clients (including Chinese domestic enterprises and Chinese citizens)
WTO Relaxations

• Renminbi Business

Renminbi licence can be applied for by qualified foreign banks in the following cities according to the following timetable :-
<table>
<thead>
<tr>
<th>Time Period</th>
<th>Geographic Coverage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Upon China’s accession</td>
<td>Shanghai, Shenzhen, Tianjin and Dalian</td>
</tr>
<tr>
<td>Within 1 year after accession</td>
<td>Guangzhou, Zhuhai, Qingdao, Nanjing and Wuhan</td>
</tr>
<tr>
<td>Within 2 years after accession</td>
<td>Jinan, Fuzhou, Chengdu and Chongqing</td>
</tr>
<tr>
<td>Within 3 years after accession</td>
<td>Kunming, Beijing and Xiamen</td>
</tr>
<tr>
<td>Within 4 years after accession</td>
<td>Shantou, Ningbo, Shenyang and Xi’an</td>
</tr>
<tr>
<td>Within 5 years after accession</td>
<td>all geographic restrictions will be phased out</td>
</tr>
</tbody>
</table>
WTO Relaxations

- Foreign banks which are licensed to conduct Renminbi business in one city may service clients in any other cities that have been opened for Renminbi business.

- Within 2 years after China’s accession, foreign banks will be allowed to conduct Renminbi business and provide services for Renminbi transactions to Chinese domestic enterprises.
WTO Relaxations

• Within 5 years after China’s accession, all restrictions on the conducting of Renminbi business with clients (including Chinese domestic enterprises and Chinese citizens) will be completely removed
New Legislation permitting Foreign Investment in the Banking Sector

Regulations for the Administration of Foreign-Invested Financial Institutions
(20th December 2001)

Detailed Rules for the Implementation of the Foreign-Invested Financial Institutions Regulations
(29th January 2002)
New Legislation permitting Foreign Investment in the Banking Sector

Entrance Qualifications to be met by a Foreign Bank or Financial Institution when applying to PBOC to set up a Foreign-Invested Bank/Financial Institution :-

- The sole or largest foreign shareholder must be a commercial bank or financial institution
- The foreign shareholder must have already established a representative office in China for 2 years or more
New Legislation permitting Foreign Investment in the Banking Sector

Entrance Qualifications to be met by a Foreign Bank or Financial Institution when applying to PBOC to set up a Branch or a Foreign-Invested Bank/Financial Institution:

- The value of total assets of the foreign bank applying to set up a branch office must be in excess of US$20 billion, and its capital adequacy ratio must not be less than 8%

- The value of total assets of the foreign investor applying to establish a foreign-invested bank or finance company must be in excess of US$10 billion
New Legislation permitting Foreign Investment in the Banking Sector

Prudential Conditions to be met by a Foreign Bank when applying to establish a Branch or a Foreign-Invested Bank/Financial Institution:

- A sound system for supervising and regulating the banking and financial services industry exists in its home country and the foreign investor is under the effective supervision of the regulatory body in charge of such banking and financial services industry.

- Such regulatory body has given its consent to the application.

- Other prudential conditions imposed by PBOC.
Basic Criteria to be met by a Foreign Bank when submitting an application for a Renminbi Licence:-

- It has already operated a branch office in China for 3 years or more

- Such branch office has achieved profitability for at least 2 consecutive years prior to the year of filing the application

- Other prudential requirements imposed by PBOC
Pre-WTO Restrictions:

- Foreign insurance companies were only permitted to operate within a framework of a joint venture (with the foreign ownership interest limited to 50% or less)

- No branch offices of foreign insurance companies were allowed to conduct life insurance business (with the exception of AIA)

- Granting of insurance licences was decided on a discretionary basis and according to an internal quota system
Market Access after China’s entry into WTO

Qualitative criteria to be met by a foreign insurance company applying to set up a Branch Office or a Wholly Foreign-Owned or Equity Joint Venture Insurance Company (a “Foreign Invested Insurance Company”) :-

- has more than 30 years of experience in a WTO member country
- has already established a Representative Office for at least 2 consecutive years in China
- possesses total assets exceeding US$5 billion at the end of the year immediately preceding the year of making application
Prudential conditions must also be met by a foreign insurance company wishing to set up the Branch Office or a Foreign Invested Insurance Company. These include:

- a sound system for regulating the insurance industry exists in its home country and it is under the effective supervision of the insurance regulatory body in its home country

- it is in compliance with the standards of compensation capability in its home country

- the consent of the insurance regulatory body in its home country has been obtained
New Legislation permitting Foreign Investment in the Insurance Sector

Minimum Capitalisation

- a Branch Office must be allocated a minimum operating capital of RMB200 million by the foreign insurance company, which amount must be fully paid up in a freely convertible foreign currency

- a Foreign Invested Insurance Company must have a minimum registered capital of RMB200 million which must be fully paid up by its investors in cash
Upon China’s accession -
JV insurance brokerage companies may be established
subject to the foreign partner’s equity interest being
limited to a maximum of 50%

Within 3 years after China’s accession -
foreign equity interest in JV insurance brokerage
companies may be increased up to a maximum of 51%

Within 5 years after China’s accession -
wholly foreign-owned insurance brokerage companies will
be permitted
To apply for the establishment of a foreign invested insurance brokerage company, the foreign insurance broker must fulfil the following conditions:

- possesses total assets of more than US$500 million (if the application is made within the first year after China’s accession to the WTO)
- the required amount of minimum total assets will be reduced by US$100 million each year until the fourth year
- has more than 30 years of experience in a WTO member country
- has already established a representative office in China for at least 2 consecutive years
Life and Health Insurance

Life, Health and Pensions/Annuities Insurance

- **Upon accession**
  - can provide individual (not group) life insurance policies to foreigners and Chinese citizens
  - may establish JVs (up to maximum of 50% foreign ownership)
  - Shanghai, Guangzhou, Dalian, Shenzhen and Foshan opened immediately

- **3 years after accession**
  - can provide health insurance, group insurance, pensions and annuities policies in life insurance
Life, Health and Pensions/Annuities Insurance

- 2 years after accession
  - may establish Branch Offices and JVs in Beijing, Chengdu, Chongqing, Fuzhou, Suzhou, Xiamen, Ningbo, Shenyang, Wuhan and Tianjin

- 3 years after accession
  - All geographic restrictions eliminated
Non-Life Insurance

- Upon accession
  - can provide master policy or large scale commercial risk insurance, insurance for companies located abroad, property insurance, related liability insurance, credit insurance for FIEs
  - may establish Branch Offices and JVs (up to maximum of 51% foreign ownership)
  - Shanghai, Guangzhou, Dalian, Shenzhen and Foshan opened immediately
Non-Life Insurance

• 2 years after accession
  – can provide full range of non-life insurance services (except for statutory insurance business)
  – wholly foreign-owned enterprises permitted to provide non-life insurance
  – may establish Branch Offices and Foreign Invested Insurance Companies in Beijing, Chengdu, Chongqing, Fuzhou, Suzhou, Xiamen, Ningbo, Shenyang, Wuhan and Tianjin

• 3 years after accession
  All geographic restrictions eliminated
Upon accession, re-insurance services can be provided by a foreign re-insurance company or foreign insurance broker for both life and non-life insurances.

The services can be provided through a branch office, joint venture or wholly foreign-owned re-insurance company.

A minimum percentage of each policy for non-life insurance is required to be re-insured with the State-owned China Re-Insurance Company (this minimum percentage of re-insurance is initially 20%, but reducing by 5% each year). As from the fourth year after China’s accession, the requirement for compulsory re-insurance with China Re-Insurance Company will be eliminated.
China’s WTO commitments for providing market entry to foreign securities institutions and brokerage firms:

1. Upon accession -
   allowed to engage directly in the trading of foreign currency denominated B shares without having to go through a Chinese intermediary

2. Upon accession -
   representative offices in China may become “Special Members” of PRC Stock Exchanges
China’s WTO commitments for providing market entry to foreign securities institutions and brokerage firms:

3. Within 3 years after China’s accession -
   allowed to establish Joint Venture Securities Companies subject to the foreign partner’s equity interest being limited to 33.33%

4. JV Securities Company will be permitted to underwrite A and B shares in the primary market, and to trade B and H shares, RMB denominated government and corporate bonds, and also to launch securities investment funds
China’s WTO Commitments for providing market entry to foreign fund managers:

1. Upon accession -
   allowed to establish Joint Venture Fund Management Companies to conduct domestic securities fund management business, subject to the foreign partner’s equity interest being limited to 33%

2. Within 3 years after accession -
   the foreign partner’s equity interest in a Joint Venture Fund Management Company may be increased up to a maximum of 49%
New Legislation permitting Foreign Investment in Fund Management Sector

Qualitative criteria to be met by foreign investors wishing to acquire or subscribe for shares/equity of a Chinese fund management company:

1. should be a securities firm or a trust and investment company or a fund manager whose paid-up share capital is not less than RMB300 million (or its equivalent in foreign currencies)

2. no major contravention of law during the preceding 3-year period

3. possess relevant qualifications and licences

4. regulatory authority in foreign investor’s home country has established co-operation relationship with the PRC regulatory bodies in charge of the financial services and securities industries
Consultation Draft of JV Securities Rules requires a JV Securities Company to comply with the following conditions:

1. paid-up registered capital of not less than RMB500 million

2. at least 50 employees with professional qualifications to conduct securities business

3. sound internal management and risk control systems
New Legislation permitting Foreign Investment in Securities Sector

Consultation Draft of JV Securities Rules lays down the following prudential criteria to be met by a foreign investor:

1. securities regulatory body of the foreign investor’s home country has signed a memorandum of understanding with CSRC for the supervision of the securities industry and has maintained an effective co-operation relationship with CSRC

2. possesses valid qualifications to conduct securities business in its home country, and more than 10 years of experience in conducting financial business

3. risk supervision and control targets of the foreign investor have met the requirements imposed by law and/or the securities regulatory body of its home country for the last 3 years
Foreign investors are currently prohibited from owning and operating their own distribution networks in China.

Subject to meeting stringent criteria for yearly sales value and total assets value, foreign investors are permitted to invest in joint venture commercial enterprises which engage in commercial wholesaling and retailing.

With few exceptions, foreign investors cannot hold more than 49% of the equity interest in a wholesaling or retailing enterprise.
Wholesale and Commission Agent Service Sectors

WTO Market Access for Foreign Service Suppliers:

1. Upon accession - joint venture companies to engage in wholesale and commission agents’ business of most imported and domestically produced goods may be established.

2. Within 2 years after accession - foreign investors will be allowed to hold the majority equity interest in Wholesale and Commission Agent JV Companies.
WTO Market Access for Foreign Service Suppliers:

3. Within 3 years after accession - 100% Wholly Foreign-Owned Wholesale and Commission Agent Companies may be established
WTO Market Access for Foreign Service Suppliers:

1. Upon accession -
   Retail JV Companies will be permitted in Zhengzhou and Wuhan

2. Within 1 year after accession -
   - up to 4 Retail JV Companies can be established in each of Beijing and Shanghai
   - up to 2 Retail JV Companies can be established in each of the 5 Special Economic Zones and in each of Tianjin, Guangzhou, Dalian and Qingdao
WTO Market Access for Foreign Service Suppliers:

3. Within 2 years after accession -
   – foreign investors may have majority equity interest and control of Retail JV Companies
   – Retail JV Companies may be established in all provincial capitals and also in Chongqing and Ningbo

4. Within 3 years after accession -
   – 100% Wholly Foreign-Owned Retail Companies will be allowed to be established
   – all geographical restrictions and quotas on the number of foreign-invested retail enterprises will be eliminated
WTO Market Access for Foreign Service Suppliers:

5. Retailing of most imported and domestically produced commodities will be permitted upon China’s accession.
1. Upon China’s accession - foreign investors which have not less than 3 consecutive years of experience may set up a Freight Forwarding Agency JV Company, subject to their equity interest being limited to a maximum of 50%.

2. Within 1 year after accession - foreign investors may hold the majority equity interest in a Freight Forwarding Agency JV Company.
3. Within 4 years after accession -
   100% Wholly Foreign-Owned Freight Forwarding Agency Companies will be permitted

4. Foreign-invested freight forwarding agency company must have a minimum registered capital of US$1 million
Within 1 year of accession, foreign service suppliers will be permitted to hold a majority equity interest.

All restrictions on foreign equity ownership will be completely lifted within

- 3 years in the industries of storage/warehousing and freight transportation by trucks and cars
- 4 years in the industry of courier service providers
Freight Transportation by Rail

Within 3 years after China’s accession
– foreign service suppliers will be permitted to hold a majority equity interest in a Joint Venture Rail Transportation Company

Within 6 years after China’s accession
– Wholly Foreign-Owned Rail Transportation Companies may be established
1. Provision of pre-sale, after-sale, repair and maintenance services are considered to be activities conducted primarily to promote and support sales of goods.

2. Restricted to foreign service suppliers before China’s entry into WTO.

3. Within 1 year after China’s accession - foreign majority equity interest will be permitted in these services sectors.

4. Within 3 years after China’s accession - 100% wholly foreign-owned enterprises may be established to provide these services.
Advertising Agency Services

- Foreign equity ownership is currently restricted to 49%

- Foreign service suppliers may hold the majority equity interest in an advertising agency joint venture company within 2 years of China’s accession

- Wholly foreign-owned advertising agency companies will be allowed within 4 years of China’s accession
WTO accession should lead to the opening up of many industry sectors which have so far been closed to or restricted for foreign participation.

First time investments may pour into the telecoms, banking, securities, insurance and other protected sectors.
Foreign investors may increase their equity stake in joint ventures in the services industries, such as distribution, logistics, advertising, freight forwarding and transportation sectors.

Joint ventures may be converted to wholly foreign-owned enterprises in some industries.