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Insights & Ideas

China's Regulations on Implementation of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors Issued (Author: Minyu SUN; Xu LIU)

Subsequent to *the Notice regarding the Establishment of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* (“**Notice**”) issued by the General Office of the State Council on February 3, 2010 and *the Interim Regulations regarding the Implementation of the Security Review System for Mergers and Acquisitions of Domestic Enterprises* (“**Interim Regulations**”) issued by the Ministry of Commerce (“MOFCOM”) on March 4, 2010, the MOFCOM issued the Regulations regarding the Implementation of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors (“**Regulations**”) on August 25, 2011, which have taken effect and superseded the Interim Regulations as of September 1, 2011.

The Regulations highlight and specify the following issues:

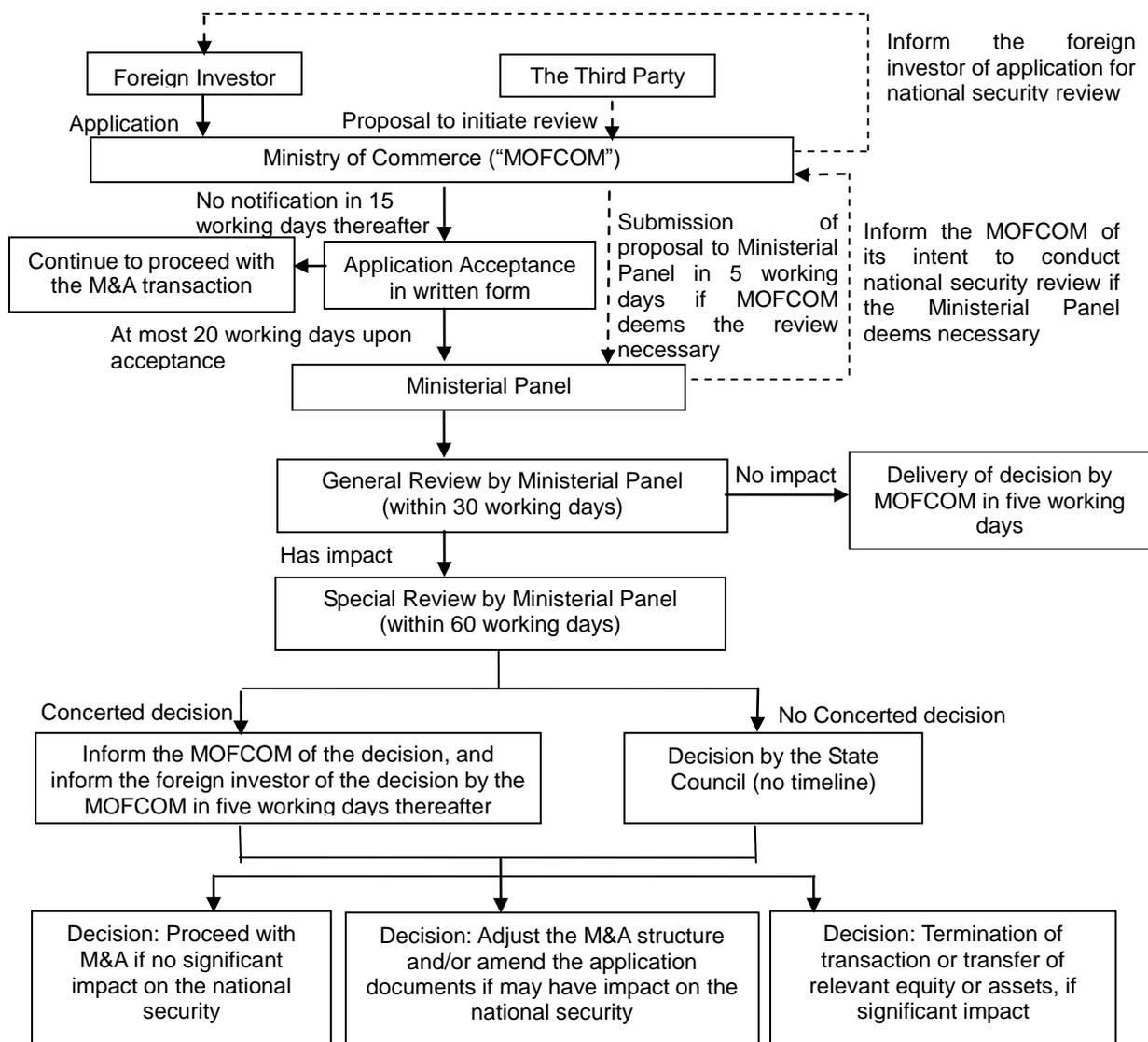
- a) Inbound investments made by a foreign-invested enterprise is subject to the national security review;
- b) Failure to initiate the national security review application where applicable would result in the suspension of review and approval of the merger and acquisition (“**M&A**”) transaction by the local MOFCOM, which in turn shall report the situation to the central MOFCOM;
- c) The Regulations explicitly state that foreign investors may not substantively circumvent the M&A security review by means including, but not limited to, nominee shareholders, trust, multi-level reinvestment, leases, loans, variable interest entities (“VIE”), or overseas transactions;
- d) The consultation before national security review application is not compulsory. An applicant may directly initiate the national security review application without prior consultation with the MOFCOM.

With respect to the national security review procedures and the required application documents, the Regulations follow the provisions as prescribed by the Interim Regulations (for details, please refer to *the MOFCOM Released Interim Provisions on the Implementation of the Security Review System for Mergers and Acquisitions of Domestic Enterprises by Foreign Investors* published in [the third edition of Han Kun Newsletter in 2011](#)).

Although this is not the first time that VIE structures be subject to regulations issued by China's regulatory authorities, due to prior discussions over VIE structures raised by the issuance of the

first batch of third-party payment licenses, inclusion by the Regulations of VIE structures into the scope of the national security review still draws great attention. However, it is worth noting that the purpose of the Regulations is to regulate national security review, not VIE structures. Theoretically, not all VIE structures are subject to the national security review; only those VIE structures which fall under the scope of the national security review are needed to be reported to the central MOFCOM for a review. Nevertheless, considering the ambiguity of the national security review scope as prescribed in the Notice, which industry being under the scope of the national security review remains unclear. Therefore, we would keep a close eye on the attitude and practice of the MOFCOM to see under which circumstances and industrial sectors VIE structures would trigger the national security review.

Below please find a chart illustrating procedures of the national security review.



Legal Updates

1. China Released Temporary Measures on Participation by Expatriates in the Chinese Social Insurance System (Author: Rong CHEN; Yuchun TANG; Chu LIU)

With more and more foreigners coming to work in China, the Chinese government has published and implemented a series of rules and regulations to regulate this matter. The new PRC Social Insurance Law (the “**Law**”), issued in July 2011, for the first time, stipulates that it applies to those foreigners who are employed to work in China. In accordance with the Law, the Ministry of Human Resources and Social Security published *the Temporary Measures on Participation in the Chinese Social Insurance system by Those Foreigners who are employed to work in China* (the “**Temporary Measures**”), which clarifies that those foreigners who are employed to work in PRC (the “**Expatriate Employees**”) should participate in the Chinese social insurance system. The Temporary Measures, published on September 6, will take effect on October 15, 2011. Salient points thereof are set forth below.

Scope of Application

The Temporary Measures apply to those foreigners who are legally employed to work in China and hold Foreigner Resident Permit (外国人居留证) and i) Foreigner Work Card (外国人就业证), ii) Foreign Experts Certificate (外国专家证), or iii) Press Card (常驻记者证); or in other cases, hold Foreigner’s Permanent Residence Permit (外国人永久居留证).

There are two circumstances in which foreigners can legally work in China: i) foreigners are lawfully employed by those corporations, public institutions, non-governmental organizations, private non-enterprise organizations, foundations, law firms, and accounting firms etc., which are registered in China (the “**Employers**”); ii) foreigners, after signing an employment agreement with a foreign company, are dispatched to work for the foreign company’s PRC branches or representative offices (the “**Domestic Employers**”).

The Temporary Measures do not apply to those foreigners whose native states have executed bilateral or multilateral treaties on social insurance with the PRC government, in which case, such treaties can apply.

Types of Insurance

Those foreigners who are employed to work in China should participate in the basic pension plan, basic medical insurance, unemployment insurance, work related injury insurance and birth insurance. The premiums should be paid by the Employers/Domestic Employers and the foreigners together in accordance with the relevant law. The Temporary Measures further clarify

that the Employers/Domestic Employers should assist the foreigners to register into the Chinese social insurance system within 30 days after the issuance of their working permits.

Suspension, Continuation, Termination and Inheritance of Social Insurance

The Temporary Measures provide that if an Expatriate Employee exits China before attaining the statutory retirement age for receiving the pension benefits, his or her social insurance accounts may be suspended until he or she reenters China to work, which indicates that his or her account can be reopened; if the Expatriate Employee requests to terminate his or her social insurance account in written form, the balances in his or her social insurance account can be withdrawn in lump sum. Similar provisions are contained in *the Certain Provisions on the Implementation of the PRC Social Insurance Law*, which states that if an individual exits China before attaining the statutory retirement age for receiving the pension benefits, his or her pension account may be maintained and the individual can receive the benefits after attaining the statutory retirement age.

The Temporary Measures provide that Expatriate Employees in China can withdraw the benefits of the social insurance from abroad; yet, they have to provide at least once per year to the relevant social insurance premium collection institutions the certificate of birth issued by the Chinese Embassy or Consulate abroad; or in other cases, certificate of birth notarized or authenticated by relevant agencies in the foreign state where the foreigners reside and then authenticated by the Chinese Embassy or Consulate. Those foreigners who lawfully enter into China can also prove their living status by presenting themselves before the relevant social insurance premium collection institutions.

The Temporary Measures provide that the balances in the social insurance accounts owned by Expatriate Employees in China are inheritable. Similar provisions are contained in *the Certain Provisions on the Implementation of the PRC Social Insurance Law*, which stipulates that the balances of the pension accounts of the individuals who participate in the basic pension plan are inheritable.

Dispute Resolution

The Temporary Measures clarify that the disputes between Expatriate Employees in China and their Employers/Domestic Employers can be solved by mediation, arbitration and judicial proceedings. If the foreigners' rights under the Temporary Measures and the Law are infringed, they can also submit the cases to the social insurance agencies or social insurance premium collection institutions.

Violation and Liability

The Temporary Measures provide that if the Employers/Domestic Employers fail to do social insurance registrations and pay social insurance premiums for Expatriate Employees, they will be punished in accordance with the Law and *the Labor Security Supervision Regulations*.

In conclusion, the Temporary Measures make further clarification that Expatriate Employees in China are entitled and obligated to participate in the Chinese social insurance system. However, more details need to be addressed, such as the premium rates.

2. Brief of Interim Provisions on Assessment of the Impact of Business Operator Concentration on Competition (Author: Zhuowei LI; Yuchun TANG)

Following issuing a draft for comments this June, the Ministry of Commerce (MOFCOM) promulgated, on a formal basis, *the Interim Provisions on the Assessment of the Impact of Business Operator Concentration on Competition* (“**Interim provisions**”) on August 29, 2011 which came into force on September 5, 2011. The following aspects of the Interim Provisions are noteworthy.

Set forth substantial provisions on business operator concentration review

As a higher-level law in the antitrust field, *the PRC Antitrust Law* (“**Antitrust Law**”) is constituted by substantial provisions which are highly abstract and procedural provisions which lack operability. In order to prevent and prohibit the business operator concentration that has or is likely to have impact of eliminating or restricting competition and to perfect the laws and regulations in the Antitrust field, MOFCOM has promulgated *the Measures for the Notification of Business Operator Concentration* (the “**Notification Measures**”), *Measures for the Review of Business Operator Concentration* (the “**Review Measures**”) and Interim provisions. The Notification Measures regulate the declaration procedure and the acceptance procedure of the declaration of business operator concentration, while the Review Measures stipulates the antitrust review process on concentration, and Interim provisions introduces the factors taking into account when reviewing concentration. Compared with the two former measures, Interim Provisions mainly focus on substantial provisions and set up rules for the review of substantial issues of business operator concentration.

Comprehensively analyze the factors to be considered during the business operator concentration review process

Article 27 of the Antitrust Law has set forth six factors that MOFCOM shall consider when conducting business operator concentration review, including the market shares of the business operators involved in concentration in a relevant market and their power of control over the market; the degree of concentration in relevant market; the impact of their concentration on access to the market and technological advance; the impact of their concentration on consumers

and the other relevant business operators concerned; the impact of their concentration on the development of the national economy; and other factors need to consider in terms of the impact on market competition. These factors are very ambiguous, and there is no guidance on how to apply the six factors in a specific case. To ease the vagueness, the Interim Provisions clarifies that the review of business operator concentration shall depend on specific circumstances and characteristics of concentration and take the six factors into consideration comprehensively. The Interim Provisions elaborates how the six factors shall be considered when assessing the impact of business operator concentration on competition and specially enumerates factors that have to take into account when judging whether the business operators participating in concentration would gain or increase market control.

Further set forth that both the positive and the negative effects of business operator concentration shall be assessed

What the Antitrust Law only regulates is the business operator concentration that has or is likely to have impact of eliminating or restricting competition; for this purpose, the Antitrust Law introduces an exemption system for concentration that has no impact or is impossible to have impact of eliminating or restricting competition, which is restated and detailed in the Interim Provisions. Articles 8 to 11 of the Interim Provisions make it clear that business operator concentration may have positive effects on technological advancement, interests of the consumers and other business operators and the development of national economy, while it may also pose negative influence in these respects. These clauses provide further guidance on the assessment of positive effects of business operator concentration.

3. Notice of the Ministry of Commerce on Relevant Matters regarding Cross-border Renminbi Foreign Direct Investment (Draft for Comments) (Author: Xiaolin TENG; Beiying HU)

With the RMB cross-border trade settlement pilot project being fully carried out within the whole country, the State Administration of Foreign Exchange (the “SAFE”) and the People’s Bank of China (the “PBOC”) have respectively issued rules regulating cross-border RMB transactions. The Ministry of Commerce (the “MOFCOM”) has recently issued the Notice of the Ministry of Commerce on Relevant Matters regarding Cross-border Renminbi Foreign Direct Investment (Draft for Comments) (the “Draft Notice”) that stipulates and clarifies the following issues raised in the practice of foreign direct investment (“FDI”) by offshore RMB.

Qualified Sources of Offshore RMB

The Draft Notice defines “cross-border RMB FDI” as foreign investors’ direct investment in China by lawfully obtained offshore RMB. Lawfully obtained offshore RMB includes two types of funds:

- a) RMB obtained by foreign investors through lawful channels offshore, including but not limited

to RMB obtained by cross-border trade settlement or issuance of offshore RMB bond or shares; and

- b) RMB that has been earned by foreign investors through foreign invested enterprises and remitted from China as dividends, share transfer proceeds, capital reductions, liquidation proceeds and early returns on investment.

It is worth mentioning that the Draft Notice specifically indicates that foreign direct investments carried out by foreign investors by RMB which is earned through foreign invested enterprises but not remitted from China as dividends, share transfer proceeds, capital reductions, liquidation proceeds and early returns on investment are still subject to the currently effective rules.

Scope of Use of Offshore RMB

According to the Draft Notice, cross-border RMB FDI as well as the re-investment of the invested enterprises shall be subject to the general regulatory rules applicable to foreign investments in China, in compliance with the national industrial policies for foreign investment, the security review on foreign mergers and acquisitions and the antimonopoly review. Foreign direct investment in real estate industry by offshore RMB shall be subject to the approvals and filings rules currently applicable to foreign invested real estate business.

In addition, the Draft Notice prohibits cross-border RMB FDI from investing in securities or financial derivative products or making entrusted loans or settling foreign or domestic debts.

We understand, as the use of offshore RMB in China is not required to go through foreign currency settlement procedures, it seems not easy to track the use of such funds in advance. Therefore, we still await the MOFCOM, the SAFE and the PBOC to stipulate further implementing rules for clarification.

Approval Procedures

- a) Standard Approval

Pursuant to the Draft Notice, all local MOFCOM shall be responsible to approving cross-border RMB FDI in accordance with the current regulations applicable to foreign investment. In addition to the standard application documents required by commercial authorities for a foreign investment project, the following documents specific to the cross-border RMB FDI shall also be submitted:

- (i) a statement regarding the source of RMB funds accompanied with supporting evidence;

- (ii) an explanation of the use of the funds, and
- (iii) an undertaking letter executed by all investors or the legal representative of the entity that the funds will not be used for the prohibited purposes mentioned above.

In the case of changes in the currency for capital contribution, a resolution by the board of directors or the highest decision-making entity and the amended contract or articles of association (or amendment agreement) shall also be submitted.

b) Special Approval

Under any of the following circumstances, local MOFCOM shall, after approving a cross-border RMB FDI application, file a form titled "General Information of Foreign Invested Enterprises" through the foreign investment approval and management system, and provincial MOFCOM shall fill in a specific form titled "Information Form of Cross-border Renminbi Foreign Direct Investment" and submit it to the MOFCOM for its examination.

- (i) the invested amount reaches or exceeds RMB300 million;
- (ii) the invested industries involves financial guarantees, financial leasing, small loans, auctions and etc.;
- (iii) the foreign invested entity is an investment company, a venture capital enterprise or private equity enterprise; and
- (iv) the foreign invested entity is in industrial sectors regulated by the nation at a macro-level, including cement, iron and steel, electrolyzed aluminum, shipbuilding and etc.

In the above cases, the MOFCOM shall complete the examination or provide opinions on the "Information Form of Cross-border Renminbi Foreign Direct Investment" submitted by provincial MOFCOM within five (5) working days upon the receipt of the same. Where the "Information Form of Cross-border Renminbi Foreign Direct Investment" passes the examination by the MOFCOM, local MOFCOM may further proceed with the relevant approval procedures.

According to the Circular of the Ministry of Commerce on Issues concerning Foreign Investment Administration (Shang Zi Han [2011] No.72) promulgated by the MOFCOM in 2011, where a foreign investor carries out investment activities in China (including establishment of a new enterprise, increase of capital of an existing enterprise, merger and acquisition of a PRC domestic enterprise, the provision of loans and etc.) with RMB funds obtained through cross-border trade settlements or otherwise lawfully obtained abroad, the provincial MOFCOM shall first submit a reporting letter to (the Department of Foreign Investment Administration of) the MOFCOM and then proceed with the relevant formalities after receiving the reply consents issued by (the

Department of Foreign Investment Administration) of the MOFCOM, which shall specify the investment currency and amount. Once the Draft Notice takes effect as it is, the power to approve a standard cross-border RMB FDI transaction will be delegated to local MOFCOM.

Miscellaneous

This Draft Notice shall be referred to as regulating cross-border RMB FDI carried out by investors from Taiwan, Hong Kong Special Administrative Region and Macao Special Administrative Region.

Important Announcement

This Newsletter has been prepared for clients and professional associates of Han Kun Law Offices. Whilst every effort has been made to ensure accuracy, no responsibility can be accepted for errors and omissions, however caused. The information contained in this publication should not be relied on as legal advice and should not be regarded as a substitute for detailed advice in individual cases.

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