China's New Foreign Investment Law: the impact on financial institutions

China's new Foreign Investment Law ("**FIL**") was passed by the National People's Congress ("**NPC**") of the People's Republic of China ("**China**" or "**PRC**") on March 15, 2019. The FIL will take effect from January 1, 2020, and the existing legislation that has formed the backbone of Foreign Direct Investment ("**FDI**") regulation in China since the 1980s (currently scattered over three laws) will be repealed on the same day.

The most significant impact of the FIL is the shift of corporate governance structures and corporate actions from those set out in the laws currently governing foreign invested enterprises ("**FIE Laws**") to those provided under *the PRC Company Law* ("**Company Law")** *or the PRC Partnership Law*. The same basic premise applies to financial institutions. Historically, regulators have stipulated various rules on corporate governance which apply generally to the sector, but foreign-funded financial institutions ("**FFFIs**") have often been carved out. Going forward, the FIL will require governance structures of entities formed under the FIE Laws to align over a five year period counting from the effective date of the FIL with those under the Company Law, to be consistent with those of their domestic capital counterparts.

It is worth mentioning that the FIL also clarifies the position for FFFIs when there is uncertainty as to which prevailing rule should be chosen from several inconsistent applicable rules (the "**Inconsistency Issue**"). With the introduction of Article 41 of the FIL, and based on Article 218 of the Company Law, it is now clear that in case of inconsistency, industry rules (like the rules issued by the China Banking and Insurance Regulatory Commission ("**CBIRC**")) applicable to FFFIs will prevail over the FIL, and the forthcoming implementing rules for the FIL and other rules applicable to FIEs will continue to prevail over inconsistent provisions of the Company Law.

In reality, taking foreign funded insurance companies ("**FFICs**") as an example, after the FIL comes into force, given that *the Foreign-funded Insurance Company Administrative Regulations* ("**FFIC Regulations**") and the *Foreign-funded Insurance Company Administrative Regulations Implementing Regulations* ("**FFIC Implementing Regulations**") are basically silent on the issue of corporate governance, presumably the corporate governance provisions in the Company Law would apply to FFICs. However, the minimum registered capitalisation provisions set out in Article 7 of the FFIC Implementing Regulations which provide that equity joint venture ("**EJVs**") and wholly foreign-owned enterprise ("**WFOE**") insurance companies need to have a minimum registered capital of RMB 200 million (fully paid up in cash) would still apply. In other words, to the extent that those FFFI-sector laws are silent on a given issue, the provisions of the FIL (including the reference back to the Company Law as the main source of governance rules) will be the fall-back law for regulating FFFIs, leaving FFFIs as odd hybrids under the new FIL regime.

While the introduction of the FIL is a worthy attempt at streamlining the rules applicable to FIEs (including FFFIs), the legal regime applicable to FFFIs is still far from being comprehensive, cohesive or anywhere near systematic (the "**Conclusive List Issue**"). On the one hand, regulation in relation to many aspects, including market entry, commencement of business inspection and management differ between FFICs

and domestically-funded insurance companies ("**DFICs**") as well as between foreign-funded banks ("**FFBs**") and domestically-funded banks ("**DFBs**"). On the other hand, the regulatory distinction between FFFIs and domestically-funded financial institutions ("**DFFIs**") is inconsistent with the way other types of foreign invested enterprise ("**FIE**") are regulated under the FIE Laws. These leave us with a messy patchwork of laws applying to financial sector FIEs. Presumably those issues will resolve gradually over time once we have "across the board" equal treatment with DFFIs ("**National Treatment**").

Articles 3, 9 and 16 of the FIL, among other things, place greater emphasis on fair competition and equal treatment between foreign investors and Chinese domestic capital investors. This is consistent with the declared financial opening up policy of the Chinese government. On July 20, 2019, the People's Bank of China officially issued 11 measures to further expand the financial sector's opening up to the outside world, including encouraging FFFIs to participate in the establishment and investment of the wealth management subsidiaries of commercial banks, permitting foreign investors to contemplate investing into FFICs without being subject to the 30-year track record requirement, and fully liberalizing the 51 percent foreign shareholding restriction in a life insurance company in 2020 (which is one year earlier than originally planned).[1]

Although the liberalisation measures set out above will bring true National Treatment a step closer, given the extent to which DFFIs are entrenched within their markets and have established extensive national subsidiary and branch networks, plus fierce competition from online banks and payment companies, it will still be a steep mountain for FFFIs to climb when seeking to compete with these. We believe improving product design and corporate governance are likely to be key battlegrounds for FFFIs in China.

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1. http://www.gov.cn/guowuyuan/2019-07/20/content_5412220.htm

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