

## New Rules for Shanghai Free Trade Zone

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October 4, 2013

On September 29, 2013, China launched its long-awaited Shanghai Free Trade Zone (SFTZ), which is widely viewed as the most significant milestone in the country's economic reform since the establishment of Shenzhen Economic Special Zone in 1980. The SFTZ is expected to lead the way for broader financial reforms for the whole country. It's also expected to fiercely compete with Hong Kong as an international trade hub.

Two days before the SFTZ's launch, the State Council announced rules governing the activities of the free-trade zone (the "Rules"). The Rules introduce several policy initiatives and lay a foundation for the Shanghai government to issue implementation measures. The Shanghai government has issued six implementation regulations since the SFTZ was launched.

### **1. Size of the Free Trade Zone**

The size of the SFTZ is approximately 29 square kilometers, and includes the Waigaoqiao duty-free zone, the Waigaoqiao duty-free logistics park, the Yanshan duty-free port and the Pudong international airport duty-free area. The free-trade zone may eventually cover the entire 1,210 square kilometer Pudong district in Shanghai.

### **2. Overall Objectives**

The main objectives of the free-trade zone are, within the next 2 to 3 years, to (i) further open services sectors to foreign investors and reform the foreign investment administrative system; (ii) vigorously develop headquarter economy and new trading form; (iii) accelerate RMB convertibility of capital account items and fully open the financial services sector to foreign investors; (iv) establish a policy system supporting investment and innovation; and (v) explore new reforms serving the country as a whole.

### **3. Changing Government's Roles**

According to the Rules, a new administration system consistent with advanced international investment and trade rules will be established. For example, the new administration system will replace certain existing prior governmental approvals requirements with a one-step service platform for acceptance, integrated review and approval and an enhanced supervisory process to coordinate the administration and efficient operations of these functions. The new system will also permit qualified foreign investors to distribute their profits/dividends from their investment overseas at their sole discretion and establish an intellectual property disputes mediation/assistance system for the free-trade zone.

### **4. Relaxing Restrictions on Certain Service Sectors**

Certain restrictions in the financial services, shipping services, commercial and trade services, specialty services and social services sectors will be relaxed in the free-trade zone, including suspension or cancellation of restrictions on foreign investor qualifications, equity ratios applicable to foreign investment, restrictions on business scope and other restrictions. Please see annex for more details.

### **5. New Negative List Approach for Foreign Investment**

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The free-trade zone will give national treatment to foreign investments in those sectors that are not included in a new a “negative list” published by Shanghai Municipality Government on October 1, 2013. This “negative list” is similar to the Foreign Investment Industrial Guidance Catalogue issued by the Ministry of Commerce and the National Development and Reform Commission for companies operating in the free-trade zone. Foreign investments in the sectors listed in the “negative list” are subject to restrictions or prohibitions. For foreign investments in sectors not listed in the “negative list”, pre-approval from the relevant government agencies will be replaced with a registration procedure with Shanghai Municipal Government (except for those domestic investment projects the State Council reserves for pre-approval). National security review and review under the anti-monopoly laws will still apply in the free-trade zone.

**6. Registering Outbound Investments**

Outbound investments by domestic or foreign invested entities in the free-trade zone are encouraged. As a general rule, companies within the free-trade zone will no longer need prior approvals for outbound investment activities. Instead, they will only need to register the investment project with the Shanghai Municipal Government. Investors are also encouraged to establish special purpose vehicles in the free trade zone to conduct outbound equity investment and qualified investors are encouraged to set up outbound equity investment funds.

**7. Transforming and Upgrading International Trade**

The free-trade zone is intended to nurture new international trade forms and functions and provide core competitive advantages in technology, brand, quality and service. Measures will be implemented to prompt and encourage international trade in the free-trade zone and encourage: (i) multinational companies to set up Asia-Pacific headquarters and operation centers with trading, logistics and settlement functions in the free-trade zone; (ii) companies in the free-trade zone to engage in offshore business; (iii) companies to set up international bulk commodity trading and resources distribution platforms in the free-trade zone to trade energy products, basic industrial raw materials and bulk agricultural products; (iv) expansion of futures bonded delivery pilot programs and authorize warehouse receipt pledging and financing functions; (v) outsourcing biological medicine, software information, management consultation and data services; (vi) financial leasing companies to set up project subsidiaries in the zone to conduct inbound and outbound leasing business; (vii) foreign investors to form third party inspection and authentication institutes whose inspection results are acceptable under international standard; and (viii) pilot inbound and outbound high technology and high value added maintenance businesses; and (ix) cross border e-commerce service business to set up pilot programs in customs, inspection and authentication, tax refunding and cross-border payment and logistics to support these activities. Chinese central government or Shanghai government will issue relevant implementation measures.

**8. Upgrading International Shipping Service**

Shanghai started to set up an international shipping center in 2009. Since then, the Chinese central government and the Shanghai government have made significant efforts and infrastructure investments toward establishing Shanghai as a leading international shipping center. The free-trade zone will build upon these efforts by enabling Shanghai to take advantage of connections among the Waigaoqiao port, the Yangshan deep water port and the Pudong international airport hub to implement a new international shipping operation model and develop shipping finance, international vessel transportation, international vessel management and international agency trade and business. First, freight pricing index derivatives transactions are encouraged within the free-trade zone. Second, domestic companies will be allowed to own or control non-Chinese registered flag ships and foreign trade export-import containers can be allowed

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to conduct transshipment carriage business between Shanghai ports and other seaports in China. Pudong international airport is encouraged to have more international transfer flights. Third, tax incentives for “Convenience Flag” vessels will be available to encourage qualified vessels to register in Shanghai. Finally, the free-trade zone will implement the successful international vessel registration policies instituted in Tianjin.

### **9. Innovating Financial Services**

Innovative foreign exchange administration policies will be established in the free-trade zone. Pilot programs will be implemented to ease current restrictions applicable to the convertibility of RMB capital account items, liberalize interest rates and permit RMB to be used in cross border transactions. The price for assets in financial institutions will be at market rate. Companies will be encouraged to leverage inbound and outbound resources and markets to liberalize cross border financing. Foreign debt administration policies will be further reformed in the free-trade zone.

Multinational companies will be encouraged to set up global or regional foreign exchange operation centers to centralize their foreign currency exchange activities.

### **10. Enhancing Financial Service Functions**

Financial service sectors in the free-trade zone will be fully opened to qualified private investors and foreign financial institutions. Wholly foreign owned banks and Sino-foreign equity joint venture banks will be permitted in the free-trade zone. The financial markets will be allowed to set up transaction platforms open to the global marketplace. Foreign companies will be gradually allowed to participate in commodity futures transaction. Equity escrow companies will be encouraged to set up comprehensive financial service platforms in the free-trade zone. RMB cross border reinsurance businesses will be encouraged in the free-trade zone.

### **11. Improving Legal System**

High standard investment and trade regulatory mechanisms will be established to serve the needs of the free-trade zone. The Standing Committee of the People’s Congress has suspended certain administrative approvals otherwise required under various laws and administrative rules for three years starting from October 1, 2013, including certain approvals under the People’s Republic of China Foreign Investment Law, People’s Republic of China Sino-foreign Equity Joint Venture Law and People’s Republic of China Sino-foreign Cooperative Joint Venture Law.

### **12. Innovating Regulatory Mechanisms**

#### *a. “Frontier Opening”*

The import merchandise into the free-trade zone has been simplified by allowing companies to use an import manifest before going through the declaration procedures with in charge customs with a list of imported merchandise. Procedures on international transit, reconsolidation and distribution are to be further simplified. An “inbound quarantine and relaxed export-import inspection” model is also to be adopted in the free-trade zone. The free-trade zone will also explore establishing a relatively separate goods trade zone to prompt trade convenience and a services trade zone to further open the services sectors.

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### *b. "Second tier efficient and complete control"*

The free-trade zone will optimize the customs inspection system, strengthen electronic information networking and enhance regulation by comparing import & export merchandise lists, managing books, registering physical merchandise at customs inspection, and analyzing risks to connect the frontier regulatory model with the second tier regulatory model. Regulatory agencies are to strengthen their management of electronic books to prompt smooth flow of merchandise among customs surveillance zones. As a general rule, companies within the zone will be allowed to conduct business or reinvest outside the zone, unless special rules impose other requirements.

## **13. Implementing New Tax Policies**

### *a. New tax policies encouraging investment*

All companies registered with the free-trade zone or their individual shareholders are entitled to pay incomes taxes in installments over a five year period for those amounts equal to their assets' increased evaluated value as a result of non-monetary assets investments or other assets reorganization activities. Highly skilled personnel or personnel in short supply will be permitted to pay income tax applicable to company shares or equity received as incentive compensation in installments.

### *b. New tax policies encouraging trade*

Financial leasing companies and their project subsidiaries that are registered with the free-trade zone may participate in a pilot financial leasing export tax refunding program. All domestic financial leasing companies or project subsidiaries set up by financial leasing companies, if registered with the free trade zone, are entitled to import VAT benefits if they, after receive approval from relevant Chinese government agencies, purchase an airplane whose net weight is not less than 25 tons and lease the airplane to a domestic airline. All companies registered with the zone will still be subject to import VAT and consumption tax if they manufacture, process and sell their merchandise to inland and duty can be imposed based on the particular imported raw materials and actual inspection situation. Manufacturing companies or production service companies which are registered with the zone are not subject to any tax for imported machinery or equipment for their operations.

As of September 30, 2013, 36 enterprises have registered in the free-trade zone, including 25 companies (including subsidiaries and joint ventures of multinational companies, such as Microsoft, SAIC, PBS, State Grid, CITIC Securities, Chia Tai Group, Shengda, Steinweg, Almaco, and Porsche), 8 Chinese banks (Bank of China, Industry and Commerce Bank of China, China Construction Bank, China Agriculture Bank, Bank of Communication, China Merchant Bank, Pudong Development Bank and Shanghai Bank) and 2 foreign banks (Citi Bank and Development Bank of Singapore).

## **ANNEX**

### **FURTHER MEASURES TO OPEN SERVICE SECTORS IN THE FREE TRADE ZONE**

#### **1. Financial Services Sector**

##### *a. Banking*

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Qualified foreign financial institutions are allowed to form wholly foreign owned banks. Qualified domestic private investors and foreign financial institutions are allowed to form Sino-foreign equity joint venture banks. When certain conditions become mature, a pilot program can be adopted and banks with restricted license shall be allowed. Qualified Chinese banks are allowed to conduct offshore business, subject to improved regulations and enhanced supervision.

### *b. Specialized Health and Medical Insurance*

Foreign investors are allowed to form wholly foreign owned health and medical insurance institutions under a pilot program.

### *c. Financial Leasing*

There will be no minimum registered capital requirement for single aircraft or single vessel subsidiaries set up by financial leasing companies within the free-trade zone. Financial leasing companies will now be allowed to conduct a commercial factoring business provided that it is related to their primary business.

## **2. Shipping Services Sector**

### *a. Ocean Cargo Transportation*

Restrictions on the equity ratio by foreign investors in a Sino-foreign equity joint venture or a Sino-foreign cooperative joint venture for international vessel transportation will be relaxed and implementation measures will be issued by the State Council transportation administration authorities. Domestic companies are allowed to own or control non-Chinese registered flag ships. Foreign trade export-import containers are allowed to conduct transshipment carriage business between Shanghai ports and other seaports in China.

### *b. International Vessel Management*

Foreign investors are allowed to form wholly foreign owned international vessel management subsidiaries.

## **3. Commercial Services Sector**

### *a. Value Added Telecommunications*

Foreign investors are allowed to set up wholly foreign owned entities to engage in certain value added telecommunication business, provided that network information security will be secured. Approval by the State Council is required if current administrative regulations require the approval.

### *b. Sales and Services of Entertainment and Game Consoles*

Foreign investors are allowed to set up wholly foreign owned entities to manufacture entertainment and game consoles for export sales outside of China and, if approved by the relevant culture administrative authorities, for sales in the China market.

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### **4. Specialty Services Sector**

#### *a. Legal Service*

Cooperation mechanism between Chinese law firms and foreign (Hong Kong, Macau & Taiwan) law firms will be explored.

#### *b. Credit Investigation*

Foreign investors are allowed to set up wholly foreign owned credit investigation entities.

#### *c. Travel Agency*

Sino-foreign equity joint venture travel agencies registered within the free-trade zone are allowed to engage in overseas tourism business (not including Taiwan).

#### *d. Human Resources*

Foreign and domestic investors can form Sino-foreign human resources equity joint ventures in which foreign investors can own a maximum 70% equity. Investors from Hong Kong or Macau are allowed to form wholly owned human resources entities. The minimum registered capital for wholly foreign owned human resources entities is reduced from 300,000 USD to 125,000 USD.

#### *e. Investment Management*

Foreign investors are allowed to form wholly foreign owned joint stock holding company for investment management services.

#### *f. Engineering Design*

Investor's previous engineering design records will no longer be needed on their initial qualification application for setting up wholly foreign owned engineering design entities (not including engineering survey entities) if their engineering services are provided within the free-trade zone.

#### *g. Construction Service*

Wholly foreign owned construction entities engaged in Sino-foreign joint construction projects in the free-trade zone are not subject to Sino-foreign equity ratio restrictions.

### **5. Culture Services Sector**

#### *a. Performance Brokerage*

Foreign investors are allowed to form wholly owned performance brokerage entities to provide services in the free-trade zone.

#### *b. Public Place for Entertainment*

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Foreign investors are allowed to form wholly owned entertainment places to provide service in the free-trade zone.

**6. Social Services Sector**

*a. Education Training and Vocational Skills Training*

Foreign and domestic investors are allowed to form Sino-foreign cooperative educational training joint ventures and Sino-foreign cooperative vocational skills joint ventures.

*b. Medical Services*

Foreign investors are allowed to form wholly owned medical institutions.

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