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Foreign Investment in Hospitals & Other Medical Institutions in China

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While the regulatory environment in China for foreign investment in hospitals and other medical institutions (collectively "**Medical Institutions**") is gradually loosening, with promising market prospective in both medical treatment and elderly care industries, enthusiasm from domestic and foreign investors in the hospital business is unprecedentedly increasing. In this article, we hope to provide you with a systematic overview of relevant Chinese laws and policies governing Medical Institutions in China and our preliminary analysis on the major legal issues surrounding the establishment of a foreign-invested medical institution in China.

1. Foreign Investment

Foreign investment in China is regulated by a number of laws and regulations, the most prominent of which is the *Industrial Catalog Guidance of Foreign Investment* (《外商投资产业指导目录》) (the "**Foreign Investment Catalog**") which is jointly promulgated by the Ministry of Commerce (the "**MOC**") and China's National Development and Reform Commission (the "**NDRC**"). Pursuant to the Foreign Investment Catalog, amended in 2011 (the "**2011 Catalogue**"), which became effective on January 30, 2012, an investment project will fall into one of four categories: "encouraged", "permitted", "restricted" and "prohibited". Sectors not listed in the Foreign Investment Catalogue are generally considered to be "permitted" by default, i.e., fully open to foreign investment but not benefiting from specific advantages such as tax incentives. For the first time since 2007, "Medical Institutions" are off the list of industries "restricted" to foreign investment. This is a de facto green light to foreign investors. The change means that it cancels the previous restriction on foreign equity up to 70% in a joint venture (the "**JV**") and further allows wholly foreign-owned enterprise (the "**WFOE**") model in medical institutions.

The signing of the *Cross-Straits Economic Cooperation Framework Agreement* (《海峡两岸经济合作框架协议》) ("**ECFA**") between China and Taiwan in 2010 allows investors from Taiwan to set up wholly owned hospitals in Shanghai as well as Fujian, Jiangsu, Guangdong and Hainan provinces. Shanghai Landseed International Hospital (上海禾新医院), the first wholly Taiwan invested hospital in the mainland, opened for business in Shanghai on June 26, 2012.

Furthermore, thanks to the implementation of Supplement VIII to the *Closer Economic Partnership Arrangement* (《内地与香港/澳门关于建立更紧密经贸关系的安排》) (the "**CEPA**") between Mainland China and Hong Kong/Macau, investors from Hong Kong and Macau, who have already enjoyed opening-up policy for a period of time, are allowed, as of April 1, 2012, to expand their business in all municipalities directly under the central



government and cities of provincial capital instead of only in Shanghai, Chongqing, Guangdong, Fujian and Hainan as previously restricted. The first wholly Hong Kong invested hospital, 深圳希玛林顺潮眼科医院, has been approved by the Ministry of Health (the “**MOH**”) on September 12, 2012. Meanwhile, the Hong Kong University-Shenzhen Hospital (香港大学深圳医院) (i.e. Shenzhen Binhai Hospital) set up jointly by the University of Hong Kong and the Shenzhen Municipal Government has started operation since this July and it has been the biggest public hospital in Shenzhen.

As to the meaning of “Medical Institutions”, some other regulations concerning Medical Institutions show that “Medical Institutions” generally include hospitals, clinics, nursing homes, emergency rooms, and institutions of that nature. All regulatory approval processes for foreign investment still apply. There are no other notable changes in the 2011 Catalogue regarding healthcare other than that the development of certain biotechnology and the manufacture of some new vaccines and medical equipment are now added to the “encouraged” list.

2. Sino-foreign Equity Joint and Cooperative Joint Medical Institutions (“JV Medical Institutions”)

On April 13, 2012, the MOH revised *Measures for the Administration of Sino-foreign Equity Joint and Cooperative Joint Medical Institutions* (《中外合资、合作医疗机构管理办法 (修订征求意见稿)》) (the “**Draft Measure**”) for public review, which has not been promulgated yet. Compared to the *Interim Measures for the Administration of Sino-foreign Equity Joint and Cooperative Joint Medical Institutions* (《中外合资、合作医疗机构管理暂行办法》) issued by the MOH and the MOC in 2000 (the “**Interim Measure**”), the Draft Measure maintains the percentage of foreign shareholding up to 70% and goes further that “the percentage can be adjusted to meet the practical needs, and restrictions on wholly foreign-owned medical institutions are being lifted”. Besides, the Draft Measure raises the capital requirement for JV Medical Institutions, from RMB20,000,000 to RMB100,000,000, and the longest business period increases to 30 years from 20 years. With regard to a foreign-invested medical institution to be established in the central and western areas or in the old revolutionary-base, minority-inhabited, border/remote, or poor areas (老、少、边、穷地区) in China, the minimum investment amount may be adjusted to RMB50,000,000. The Draft Measure makes no change to the access of foreign investment, qualification for medical insurance, tax and others. The following table reflects the difference between the Interim Measure and the Draft Measure in certain main aspects:

	Interim Measure	Draft Measure
Nature of Business	<ul style="list-style-type: none"> Not mentioned but JV hospitals are used to be regarded as for-profit hospitals Branch hospitals or clinics are prohibited 	<ul style="list-style-type: none"> Either profitable or non-profitable Only non-profitable medical institution can be established where the Chinese partner to such foreign-invested medical institution is a non-profitable medical institution Branch hospitals or clinics are prohibited Encourage JV hospitals to participate in commercial insurance
Registration Authority	<ul style="list-style-type: none"> Administration of Industry and Commerce (the “AIC”) 	<ul style="list-style-type: none"> AIC for profitable foreign-invested medical institutions Civil affair bureau for non-profitable foreign-invested medical institutions



	Interim Measure	Draft Measure
Qualification Requirements for Parties to a Foreign-Invested Medical Institution	<ul style="list-style-type: none"> • Legal person • Having direct or indirect healthcare investment or management experience • Being able to provide international advanced management experience, modes, and service modes of medical institutions • Being able to provide international advanced medical technology and equipment • Being able to make up or improve the inadequacy of local medical service capacity, medical technology, funds, and medical facility 	<ul style="list-style-type: none"> • Legal person • Having direct or indirect healthcare investment or management experience
Incorporation Conditions	<ul style="list-style-type: none"> • Minimum investment amount of RMB20,000,000 • Maximum term of foreign-invested medical institutions of 20 years • Foreign ownership capped at 70% 	<ul style="list-style-type: none"> • Minimum investment amount of RMB100,000,000; for foreign-invested medical institutions to be established in the central and western areas or in the old revolutionary-base, minority-inhabited, border/remote, or poor areas (老、少、边、穷地区) in China, minimum investment amount can be adjusted to RMB50,000,000 • Maximum term of foreign-invested medical institutions of 30 years • Foreign ownership capped at 70%, but may be adjusted under discretion of approving authorities • Establishment of wholly foreign-owned hospital will be opened gradually
Approval Authority	<ul style="list-style-type: none"> • MOH and MOC 	<ul style="list-style-type: none"> • Provincial agencies of MOH and MOC
Timeline	<ul style="list-style-type: none"> • Forty-five (45) working days for each of health approval procedure and commercial approval procedure 	<ul style="list-style-type: none"> • Twenty (20) working days for each of health approval procedure and commercial approval procedure
Notarization And Legalization	<ul style="list-style-type: none"> • No notarization and legalization requirement on application documents provided by foreign investors 	<ul style="list-style-type: none"> • All application documents provided by foreign investors shall be notarized by local notary public and legalized by local PRC embassy or consulate

The Chinese party who makes its investment in the form of state assets (including evaluation-based contribution or using the state assets as conditions for cooperation) must obtain approval from the relevant departments and must, in accordance with the regulations concerning the state assets assessment management and have the state assets to be invested evaluated by an evaluation agency recognized by the



state assets management authorities. The result of an evaluation confirmed by the state assets management authorities at the provincial level or higher may be used as the basis of the pricing of the state assets to be invested.

3. Wholly Foreign-Owned Hospitals

To implement Supplement VII to the CEPA, the MOH and the MOC jointly promulgated the *Interim Measures for Establishment of Wholly-Owned Hospitals in the Mainland by Hong Kong and Macau Service Providers* (《香港和澳门服务提供者在内地设立独资医院管理暂行办法》) on December 22, 2010 (the “**Measures**”), which went into effect on January 1, 2011.

(1) Eligible Foreign Investors

- Qualified service provider in Hong Kong or Macau under the CEPA (i.e. incorporated pursuant to the applicable laws in Hong Kong or Macau and obtained a valid business registration certificate, as well as special licenses or permits for providing the services concerned; engaged in substantive business operations, which must encompass the services to be provided in the mainland, in Hong Kong or Macau for three years or more);
- Legal persons who can bear their civil liabilities independently;
- Being able to provide advanced management experience, management modes and service modes of hospitals; and
- Being able to provide international advanced medical technology.

There is, however, no clear definition of such terms as “advanced hospital management experience” and “international advanced medical technology” under the Measures. As a result, the applicable authorities – i.e., the MOH and the MOC – are left with full discretion to determine whether a given applicant meets the foregoing requirements.

(2) Eligible Wholly Foreign-Owned Hospitals

Apart from the requirements for a service provider, the Measures also set forth detailed requirements for wholly foreign-owned hospitals to be established in the mainland, including:

- Such hospital shall be an independent legal person;
- Such hospital must reach the standards for a Class II hospital with respect to its facilities, medical devices, physicians and management systems; and
- The total investment for such hospital must be at least RMB50,000,000 in the case of a Class III hospital or RMB20,000,000 in the case of a Class II hospital, with lower total investment exceptions applicable for hospitals in the old revolutionary-base, minority-inhabited, border/remote, or poor areas (老、少、边、穷地区) in China.

Referring to the three-tier classification system in China, hospitals are categorized as either Class I (township and county level), Class II (100 – 500 beds), or Class III (over 500 beds) with Class III being the largest of the hospitals in terms of beds and doctors, and rated the highest in terms of quality.



The application for the formation of a wholly foreign-owned hospital by a Hong Kong or Macau service provider should be submitted first to the local counterpart of the MOH in the city where the hospital is to be located. The city-level health authority will evaluate whether the proposed hospital conforms to the local hospital formation plan and, if satisfied, will submit the application to the provincial-level counterpart of the MOH for review. The MOH will make the final decision based on the opinion of both its city-level and provincial-level counterparts. It is noteworthy that the hospital formation plan developed by the local government, which as noted above is a significant factor considered by local authorities, is not always publicly available; even worse, some cities have not developed their plans at all. Consequently, an applicant may face substantial uncertainties in determining whether the proposed hospital is encouraged or discouraged by the local government.

Upon the approval of the MOH, an applicant needs to seek the approval of the MOC for the formation of a for-profit wholly foreign-owned hospital, whereas only a simple registration with the MOC is required for a non-profit hospital. With the MOC's approval, a for-profit hospital will become a foreign-invested enterprise and therefore should also perform company registration formalities with the local AIC. Any change in the founder or equity of a wholly foreign-owned hospital, whether for-profit or non-profit, is subject to the approval of both the MOH and the MOC.

The recent health care system reform in mainland China, especially the policies that encourage the flow of non-governmental funds into the medical institution industry, has intrigued many foreign investors targeting the surging health care market in China. Supplement VII to the CEPA together with the Measures create an advantageous position for service providers in Hong Kong and Macau. The potential challenges, however, cannot be overlooked. As an example, whether a wholly foreign-owned hospital may be designated as a social insurance-covered hospital could affect whether it can attract sufficient patients.

4. Practice Permit for Medical Institutions

The proposed medical institution which has been approved shall, in accordance with the provisions on the procedures and requirements concerning the practice registration of Medical Institutions as contained in the *Regulations on the Administration of Medical Institutions* (promulgated on February 26, 1994) (《医疗机构管理条例》) (the "**Medical Institutions Administration Regulations**") and the *Implementation Rules for the Regulations on the Administration of Medical Institutions* (promulgated on August 29, 1994) (《医疗机构管理条例实施细则》) (the "**Medical Institutions Implementation Rules**"), apply for practice registration to the competent authority of health at the provincial level and obtain Practice Permits for Medical Institutions (the "**Practice Permit**"). The Practice Permit shall be subject to annual examination. The Practice Permits of Hong Kong/Macau wholly owned hospitals are subject to the examination every three years.

5. Favorable Taxation Policy

Foreign investments will be able to benefit from equal policy treatment regarding grants of medical insurance status and fewer market admittance restrictions. They will also be subject to a three year preferential tax policy currently enjoyed by Chinese state-owned hospitals. Both for-profit and non-profit hospitals will be eligible for the following tax exemptions although these will differ accordingly:

- For-profit: business tax, three years on value-added tax for self-produced medicine as well as three years on housing, land and vehicle and vessel usage taxes if for self-use purpose; and
- Non-profit: medical service income tax, value-added tax on self-produced medicine as well as housing, land and vehicle and vessel usage taxes if for self-use purpose.



6. Others

1) On December 3, 2010, the General Office of the State Council posted the *Notice on Forwarding the "Opinions on Further Encouraging and Guiding Private Funds to Sponsor Medical Institutions" Formulated by NDRC and MOH and Certain Other Departments* (the "**Circular No. 58**") (国务院办公厅转发发展改革委卫生部等部门关于进一步鼓励和引导社会资本举办医疗机构意见的通知) on the central government's official website, introducing a number of measures to promote the development of non-public Medical Institutions. Pursuant to the Circular No. 58, a foreign investor can sponsor not only a for-profit, but also a non-profit Medical Institution in China. Profit from for-profit Medical Institutions can be distributed to the investors, while dividends are prohibited for a non-profit Medical Institution. Non-profit Medical Institutions enjoy preferential tax and price policies. For-profit Medical Institutions are required to pay enterprise income tax, but are entitled to set their prices independently and are exempted from business tax.

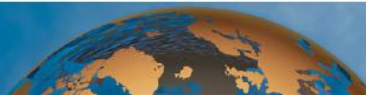
2) China's National People's Congress approved a new national development strategy for the next five years (2011 to 2015) in March 2011. *The Implementation Plan for Deepening the Reform on Medical and Healthcare System during the 12th Five-year Period* (国务院关于印发“十二五”期间深化医药卫生体制改革规划暨实施方案的通知) was issued by the State Council in this March as well. The plan intends to further loosen the entry policy for private funding, such as investment from enterprises, charity institutions funds and commercial insurance companies from home and abroad and encourage qualified individuals to open private clinic. It aims at having total 20% of all medical treatment covered by non-public hospitals by 2015, and expanding the reimbursement network of social insurance among those qualified non-public hospitals and pharmacies.

3) On April 13, 2012, the MOH promulgated *the Notice on Definition the Nature of Medical Institutions Run by Private Capital* (the "**Circular 26**") (卫生部关于社会资本举办医疗机构经营性质的通知). The Circular 26 states that privately-run Medical Institutions could register as either for-profit or non-profit, according to the nature of their business, by repealing a previous applied regulation that defined almost all Medical Institutions supported by non-public funds as for-profit hospitals.

4) On May 17, 2012, the MOH issued another *Notice on Classifying the Level of Privately-Run Hospitals* (卫生部办公厅关于确定社会资本举办医院级别的通知). It requires authority of the MOH to classify level of all privately-run hospitals (including JV hospitals) when granting establishment approval, in accordance with the function and service perimeters of the new establishment.

7. Conclusion

The policies to boost private and foreign investments in Medical Institutions are part of China's new round of medical reforms, and the moves are expected to raise efficiency for investors in Medical Institutions. The influx of foreign investments into Chinese Medical Institutions will help China meet the public's rising demands for high-quality medical services, and foreign businesses will also get the chance to break into the Chinese medical market in a way never permitted before. As is typical of China, it is permitting liberalization of the restrictions and limitations on foreign investment in the medical sphere on a limited and step-by-step basis. Should the current round of liberalization not result in unanticipated difficulties or opposition, we can anticipate further relaxation in these areas (and further competition from foreign healthcare providers) in coming years.



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Shanghai Office Managing Partner Edward Epstein focuses on mergers and acquisitions, real estate development and investment, antitrust issues and foreign direct investment, particularly in the manufacturing sector. With more than 20 years of legal experience in China, Mr. Epstein has counseled numerous multinational companies and become a sought-after expert on Chinese law. He is the editor of Troutman Sanders' monthly newsletter, China New Law Bulletin, which provides invaluable insight into China's fast-changing legal landscape.

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Steve Gravely heads our Health Care Practice Group which provides legal and strategic advice to a wide range of companies involved in the diverse health care industry. Mr. Gravely focuses his practice in the areas of health law and disaster preparedness and response issues for critical infrastructure industries. He has represented hospitals and other health care providers for over 20 years in the full spectrum of health care legal issues. Prior to becoming a lawyer, he worked as a hospital executive and holds a Master's Degree in Health Care Administration.

Our Health Care Practice lawyers led by Steven represent a broad spectrum of health care providers and organizations that provide health care products, services, and technology to the health care industry. They are experienced in a variety of health care areas, including health care regulation, mergers and acquisitions of health care entities, health information technology managed care, medical technology and intellectual properties, capital financing for health care entities, physician employment and related agreements, and health care legislation.



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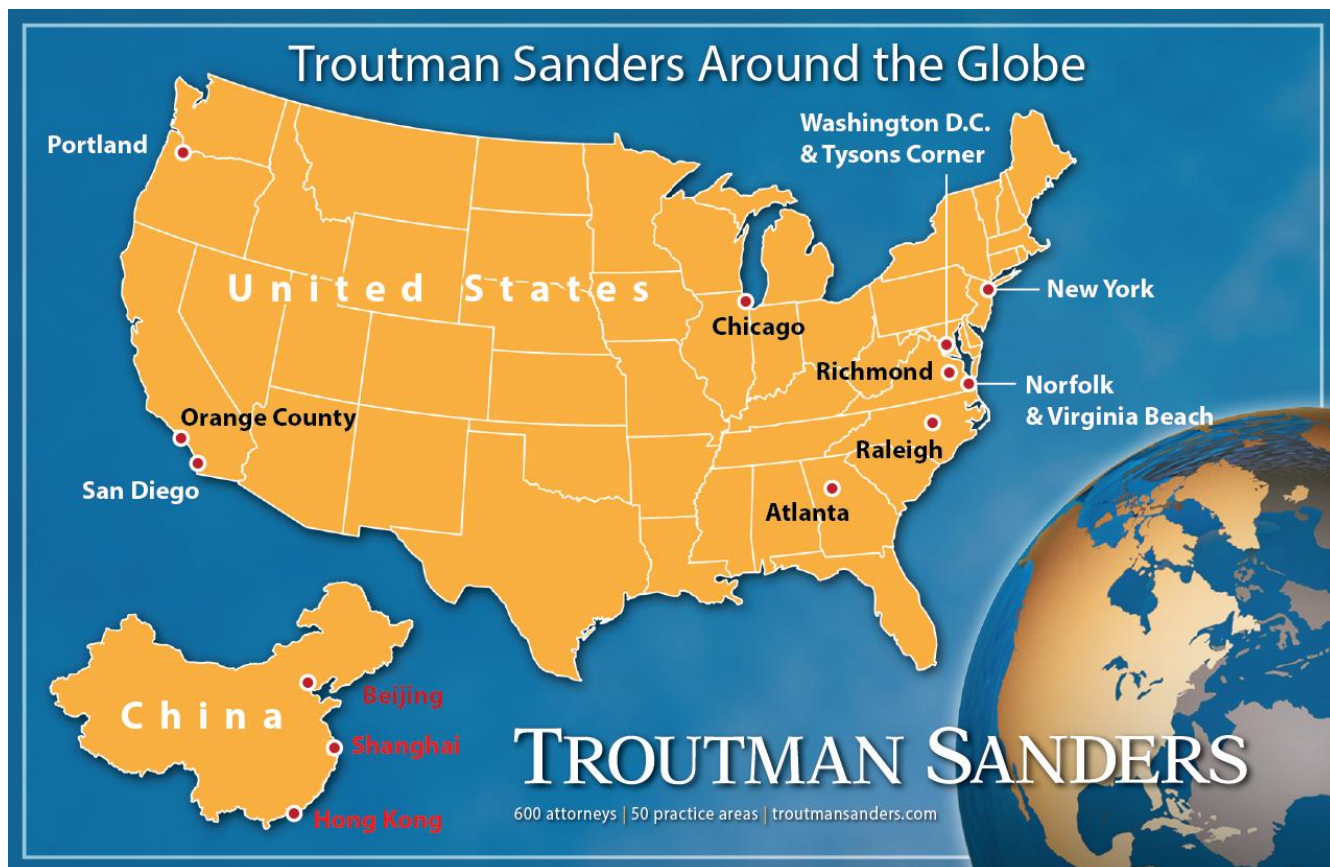
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Olivia Lee heads our Greater China Practice. She has many years of legal experience in Capital Markets, M&A, and Private Equity. She advises various foreign investors and healthcare service providers in a full range of their activities, ranging from structuring equity and debt investments, mergers & acquisitions and overseas listings to legal compliance. Her international and local legal experience have enabled her to assist investors and healthcare groups in (i) identifying and resolving potential legal issues and (ii) assisting healthcare companies in equity and debt financing and listings in Hong Kong and overseas. Olivia also advises international and local Chinese companies in in-bound and out-bound acquisitions. In the area of capital markets, she has represented issuers, underwriters and sponsors in a wide range of transactions ranging from initial public offering, reverse take-over, financing, spin-off, restructuring, private placement to issuance of derivatives in Hong Kong and North America. She is fluent in English, Mandarin Chinese and Cantonese.

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