China's Foreign Investment Law—A Look Back and Ahead

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It has been five years since China's new Foreign Investment Law (the "FIL") took effect in 2020, becoming the primary law governing foreign-invested enterprises ("FIEs") in China. This article seeks to reflect some major developments in China's foreign investment regime since the FIL took effect and where it might be headed.

Relaxation of Restrictions. Foreign investment in China is generally regulated under a negative list approach in terms of market access, as confirmed by the FIL. Investments in sectors listed in the negative list are either restricted or prohibited. The negative list has been revised over the years to gradually remove restrictions on foreign investment, including the foreign ownership cap in certain sectors such as life insurance and automobile manufacturing, some of which were in place for decades. The latest negative list, which was issued by the Ministry of Commerce ("MOFCOM") and the National Development and Reform Commission ("NDRC") in September 2024, reduces the number of restricted or prohibited industries from 31 in the previous version to 29. Some foreign investors actively grasped this opportunity to set up or expand their presence in China. For example, some foreign investors in the financial services industry established wholly owned subsidiaries or bought out their local joint venture partners in China soon after the foreign ownership restriction was lifted.

The Chinese government has also revised various rules to relax requirements for foreign investments and streamline the investment process, including, among others, the Measures for the Administration of Strategic Investment in Listed Companies by Foreign Investors issued in November 2024, which lower the qualifications and some other requirements for foreign investors seeking medium- to long-term investment opportunities in China's capital markets.

Despite the further opening up of the market, foreign direct investment ("FDI") in China has stagnated in recent years, reportedly due to China's slower-than-expected economic recovery following COVID-19, lower prospects for long-term growth, geopolitical tensions and other factors reducing investor confidence. According to statistics from MOFCOM, FDI growth in China declined from 4.5 percent in 2022 to negative 13.7 percent in 2023 and further slumped 27.1 percent year-on-year in 2024, the sharpest decline on record with data going back to 2008.

More Efforts Needed to Meet Unified Corporate Governance Requirements. FIEs established before 2020 are required by the FIL to, within a five-year grace period, reorganize their corporate structure to meet the unified governance requirements under the PRC Company Law and some other regulations which historically applied primarily to domestic companies. For example, under the old FIE laws the board of directors was the highest governing authority of a Sino-foreign joint venture company, whereas this will now be switched to the shareholders' meeting. Also notably, some private investment funds sponsored by foreign managers that were structured and established as foreign-invested venture capital enterprises without legal person status in China must now be converted into limited partnerships.

These requirements may lead to difficult negotiations with joint venture and other partners. Many FIEs had not completed the required changes by December 31, 2024, when the five-year grace period ended, although the Administration for Market Regulation ("AMR"), China's business registration authority, issued notices in 2024 urging them to do so promptly. While the FIL does not specify the penalty for a failure to complete the required changes by the end of the grace period, its implementation rules provide that as of January 1, 2025, the AMR shall not register any other applications (such as a registration for change of registered address) submitted by FIEs failing to make the required governance adjustments.

Strengthening National Security Review. Since the promulgation of the FIL, China has been strengthening its national security review regime, which has begun to play a more prominent role in regulating foreign investment.

In December 2020, the NDRC and MOFCOM issued the Measures on Security Review of Foreign Investment, pursuant to which a filing obligation would be triggered by an investment in military or military-related industries or an acquisition of control over a Chinese company in certain critical industries. The term "control" is broadly defined to cover not only a holding of 50% or more of the target's stake but also other situations where the foreign investor may have a significant impact on the target, and what is considered a "critical" industry is not clearly specified. In practice, the national security review regime is largely opaque and unpredictable in terms of review and outcome, although to date the Chinese government has not been aggressively restricting or blocking transactions on national security grounds.

VIE Structure. The variable interest entity ("VIE") structure, which commonly refers to an investment structure that relies on contractual arrangements to enable foreign investors to control – but not directly own – operating companies in China, has been widely used by Chinese businesses in technology, media and telecommunications and some other regulated industries seeking overseas financing or listing. The Chinese government has not officially endorsed or denied the legitimacy of the VIE structure, and Chinese law, including the FIL, remains largely silent on the long-term viability of such structure.

In February 2023, the China Securities Regulatory Commission ("CSRC") introduced a new filing regime for overseas public offerings and listings by China-based companies, including overseas-incorporated companies operating in China under the VIE structure, which before that were not subject to regulatory approval or filing requirements in China for overseas public offerings and listings. While VIE-structured overseas listing is now subject to the new CSRC filing requirement, the regime conveys a positive signal from the Chinese regulator on acknowledging the VIE structure, and some VIE-structured companies have successfully completed the CSRC filing for their overseas listings.

Outlook. The general trend since the promulgation of the FIL suggests that China's commitment to further opening up its market to foreign investors remains strong. Given the continued economic uncertainty and downward pressure going into 2025 coupled with a complex geopolitical landscape, we expect that China will continue its efforts to ease foreign investment restrictions and attract capital inflows, while on the other hand cautiously increasing the screening of foreign investment to safeguard national security.

On February 19, 2025, the State Council, China's cabinet, released an action plan for stabilizing foreign investment in 2025, reaffirming its commitment to improving market access and the PRC's foreign investment environment. The action plan, which marks the latest effort of the Chinese government to attract foreign investment, outlines 20 key measures for this purpose, including expanding pilot programs for opening up the telecommunications, healthcare and education sectors, supporting pilot regions in effectively implementing opening-up policies related to value-added telecommunications, biotechnology and wholly foreign-owned hospitals, encouraging foreign investors to make equity investment in China, and optimizing the business environment to provide more support and services for foreign companies in China. It remains to be seen what detailed rules will be issued to implement the measures outlined in this action plan.

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We will continue to monitor developments in this area. If you have any questions about the FIL or foreign investment regulations in China generally, please do not hesitate to reach out to your regular Debevoise contacts.

Please do not hesitate to contact us with any questions.

Debevoise & Plimpton LLP, as all other foreign firms in China, is not admitted to practice PRC law. This update is based on our review of the relevant laws and on our general experience dealing with similar matters. We would be pleased to arrange for assistance from licensed Chinese counsel should you require a formal opinion on any of the matters referred to herein.

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