

Legal Alert: New Legislation on Establishment of For-profit Senior Care Facility

By Michael Qu Qin

On February 17th of this year, the Ministry of Commerce (“MOFCOM”) and Ministry of Civil Affairs (“MCA”) jointly issued a *Notice on Establishment of For-profit Senior Care Institutions and Disabled Service Institutions by Service Providers from Hong Kong and Macau* (《关于香港、澳门服务提供者在内地举办营利性养老机构和残疾人机构服务有关事项的通知》)(*Notice (2013) No. 67*). This is the first national law with respect to the establishment of for-profit senior care facilities since promulgation, in December, 2012, of the amendment on the Law on Protection of Elderly’s Rights and Interests (the “Elderly Law”). In further implementation of *The Mainland and Hong Kong/Macau Closer Economic Partnership Arrangement (or Closer Economic Partnership Arrangement (“CEPA”) for short)*, the Notice, for the first time, sets forth some rules and procedures for the establishment of for-profit senior care facilities. Even though the Notice only applies to investors from Hong Kong and Macau, its impact is likely to be significant, as the Notice reveals some signals and trends from the government on how to encourage and regulate the foreign investor—a large portion of private investors - in the senior care industry. Highlights of the Notice are summarized as follows:

WFOE is explicitly expressed as a permitted investment approach

As we have explained in our previous articles, even though the Foreign Investment Industrial Guidance Catalogue has allowed foreign investment in senior care service by means of various types of investment approaches, the currently applicable laws from the central and local authorities limit the foreign investment vehicle to a Sino-foreign joint venture. The Notice addresses this outdated legislation by expressly opening the WFOE model for Hong Kong and Macau investors. Looking at the legislation reform policies for foreign-invested medical institutions, we expect the trend to be the same here — the door for Hong Kong and Macau investment opens first, followed by investment from foreign countries.

The Notice also applies to the circumstance where a facility is acquired from a domestic operator. Foreign investors have been hesitant to acquire existing - and perhaps nonperforming - facilities, mostly because the investors are uncertain how to acquire a non-enterprise (usually also not-for-profit) organization and convert it to a for-profit and corporate-governed business. It is unclear whether the upcoming *Measures for Establishing and Licensing of Senior Care Institutions* (《养老机构设立许可办法》) from the MCA, which we expect to be released before July of this year will specify rules under such circumstances, but we see clear signals that legislators have realized the necessity to regulate merger and acquisition activities in the senior care facilities sector. Joseph Christian, a fellow

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at the Harvard Kennedy School in Cambridge, Massachusetts and an expert on the senior housing industry in China, applauds the Notice, saying that “it adds some much-needed clarification to the question whether a WFOE can own and operate a senior living facility in China. Until now, there has been some inconsistency between central government policy on this issue and local practice, which has created great uncertainty on the part of investors. We hope that this policy will be extended from Hong Kong and Macau investors to foreign investors, and there is no reason why that should not happen, and happen soon.”

Qualification, approval procedures and competent government authorities

As the Notice is published by the MOFCOM and MCA, it is clear that the authorities in charge of the overall approval procedure for senior care facilities are these two ministries. The Notice requires the Ministry of Health’s approval only for medical and hygiene activities within the facilities.

As stipulated in the Notice, as of this July 1st, approval from the local counterpart of MOFCOM for the establishment of an enterprise for ownership and operation of a senior care facility shall be subject to prior licensing from the local Bureau of Civil Affairs. In addition, investors will need to provide evidence of their credibility and operational capability by means of documentation or certification issued by relevant social welfare authorities from Hong Kong or Macau, as applicable. Furthermore, at least one senior care provider within the investor group shall have conducted the same business for at least 3 years. Mr. Christian notes that “the lack of clarity as to the roles of various ministries and bureaus in the regulatory and approval process has been a source of confusion and, again, uncertainty, which may have had the effect of discouraging investment until things were sorted out. These uncertainties have been especially difficult to deal with in a new industry like senior housing, where there were no precedents to look at for guidance. It is good to see some clarification on these issues.”

Conflict may arise from the current practice

One important issue to be aware of will be the treatment of Hong Kong offshore companies. Many investors from the US or Europe will choose HK as an offshore destination and then use the HK companies as investors in domestic projects—Emeritus and Fortress are examples in their Shanghai joint venture projects. However, according to CEPA, such offshore

companies will not be treated as service providers, and therefore investors following this approach will fall outside of the administration of this Notice. But as we understand it, as the purpose of CEPA is to provide convenience and preference to service providers from Hong Kong and Macau, if these companies are unable to enjoy the treatment as real Hong Kong or Macau service providers, it is probable that they will subject to stricter rules in establishment approval than those stipulated in the Notice. Then, whether the offshore arrangement will still be popular remains a question, although it is duly noted that onshore/offshore structures do provide other benefits such as additional exit strategies and in some cases, favorable tax treatment.

It is highly likely that similar qualifications in operational experience and capability will be required for foreign investors as well. Three years of industry experience in the investors’ home country, as required by the Notice, seems to be a new concept of threshold for foreign operators, which if implemented in the future, will disqualify some foreign investors. That said, foreign investors should not worry excessively, because history from China’s practice in other industries tells us a threshold of this kind will be flexibly interpreted in practice.

It should be noted that the current practice of the Shanghai Municipal government that allows foreign investors to obtain an approval certificate and a business license for facility establishment prior to obtaining approvals from other authorities, such as the local bureaus of MCA and MOH, is conflict with this Notice and the principal of the Elderly Law, and therefore is expected to be abandoned before July 1st when relevant licensing regulation is implemented by the MCA. “This is more good news,” Mr. Christian states, adding that “the inconsistent approaches taken by different municipalities as to which approvals came first did not give much comfort to the investment community.”

Another takeaway for real estate developers

The Notice expressly prohibits any facility from providing residential options in the disguise of senior care service. This is a signal that the government wants to distinguish the policy between care service facilities and independent senior living communities (usually developed as real estate projects). The real challenge for the government remains to be how to identify the difference of these two in practice, which in fact will lead to another topic of pricing/sales model

and how the government shall regulate it. With limited space of this article, we are not going to discuss on this topic.

Conclusion

The impact of this Notice will be under the test of time and market reaction. It may raise some uncertainty for foreign investors who are in the process of establishing such senior care facilities. And

it is worth noticing that prior to this July 1st, practice may differ from place to place, and perhaps in some cities, establishment procedure will be halted by local authorities until new regulation is released. Therefore, it is advisable for investors to keep updated on the legislative status and trend in this respect, and if there are projects in proceed, please keep in active contact with competent authorities on potential policy turnaround. ■