Legal Alert:

Encouraging Regulations on Licensure and Administrative Measures for Senior Care Facilities

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As of 1st July, the Ministry of Civil Affairs ("MCA") has implemented two Measures to regulate the establishment and operation of senior care facilities, as required under the amendment, adopted in December, 2012, of the Law on the Protection of the Rights and Interests of the Elderly ("Law"). The Law went into effect in 1996 and had not been amended until the end of last year, despite the ever-increasing awareness of issues facing the elderly as demographic and cultural changes have been taking their toll. The amendment is perhaps best known for urging family members to care for the elderly, but it also requires governments at all levels to incorporate planning for the elderly into their overall economic and social development plans and ensure that funds are available to implement the plans; and mandates that the government ensure a basic living and basic medical care for the elderly.

The two Measures - Measures for the Establishment and Licensing of Senior Care Facilities (the "Licensing Measures") and Administrative Measures for Senior Care Facilities (the "Administrative Measures") - are the most current and complete regulations providing guidance to domestic and foreign operators in respect to the establishment and operation of senior care facilities[1].

Our careful review of the Measures provided some comfort and some surprises, as well as some confusion and some concerns, but generally speaking, these are very welcome and encouraging regulations, echoing the national strategy of attracting more private capital into the industry. The Measures are far more general and less stringent than regulations in effect in many other countries,

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[1] Pursuant to the Measures, a senior care facility is an institution where congregate accommodations and care service are provided. As for the service to be provided, it refers to living care, rehabilitation nursing, spiritual comfort, cultural and entertainment, etc.

also reflecting the strategy of attracting investment into the industry. We will discuss the pros and cons of this approach later in this Newsletter.

Below are some highlights of the Measures:

1. New establishment requirements and allocation of approval responsibility among different government authorities

☐ county level of the MCA will carry out the licensing and administration duties for those activities within its territory;

☐ approval from the MCA to obtain an Establishment License for Senior Care Facility is a condition precedent for an operator to open for business. Approval requirements are:
(i) proper facility name, facility article of association and internal rules;
(ii) premises, equipment and places for activities in compliance with relevant specifications in construction standards, environmental protection, fire safety and sanitation;
(iii) employ management, professional and service personnel commensurate with the services to be provided;
(iv) proper funds to support the facility's service and scale;
(v) more than 10 beds;
(vi) other requirements pursuant to laws and regulations..

☐ senior care facility can set up its own medical institution or establish cooperation with other medical institutions nearby in order to be qualified to provide medical services in the facility. Approval and due procedure from the local bureau of the Ministry of Health ("MoH") is required if a medical institution is to be set up;

☐ examination and acceptance of the condition of the facility will be one of the most important criteria in the licensing procedure. For example, operators must apply for and obtain approval or acceptance of construction completion, environmental protection, fire safety and sanitation from different authorities before a license is granted.

A point to be noted is that the regulators require facilities that have already been established to meet the requirements of the Licensing Measure within 1 year after the effective date of the Measures (in some cases in rural areas within 2 years). So we advise facilities now under operation to look carefully at the requirements set forth in the Measures.

2. Fully open to foreign capital

Foreign investment in a senior care facility using the corporate form of wholly foreign-owned enterprise ("WFOE") was previously prohibited. However, given the fact that the Guidance Catalogue for Foreign Investment long ago put senior care service in the "encouraged" category, the restriction that a only joint venture investment vehicle is allowed is out of date. Pursuant to the Licensing Measures, both foreign individuals and organizations can invest in a domestic facility through a WFOE.

The Licensing Measures have created an anomalous and probably unintended situation that is worth mentioning. The Mainland and Hong Kong Closer Economic Partnership Arrangement ("CEPA"), which applies to service providers from Hong Kong and Macau, requires that operators have a track record of relevant experience for more than 3 years in Hong Kong or Macau before they can be qualified to open facilities in Mainland China. However, the Licensing Measures contain no requirement for special expertise on the part of foreign investors or operators, as long as they employ qualified professionals in accordance with the Measures. As a result CEPA, a measure that is aimed at facilitating and attracting investors in senior care from Hong Kong/Macau, actually imposes a stricter requirement on those investors than the Licensing Measures impose on investors from other countries and regions.

3. Low barriers to entry will bring more business opportunities

Apart from the liberalized policy on foreign investment, the Measures also lower some entry thresholds for senior care facility investors. We see it reflected in three aspects: (a) there is no master plan zoning or planning for senior care facility to comply with as pre-condition of licensing although that is required in establishing a medical institution[2]; (b) the minimum number of beds is 10, far less than was previously required (for example Shanghai currently requires at least 50 beds); and (c) personnel qualification, such as that of caregivers, technical staff or management people, is only required to the extent in compliance with the services to be provided within the facility. And the number and working experience of personnel is not specifically required.

We can see that the government is trying to attract more private investors into the senior care facility business. Developers formerly dedicated a portion of their self-owned community infrastructure facilities for the use of catering, entertaining or accommodation. Now, with the barriers lowered, other choices and opportunities emerge for the developer or landlord to turn these properties (even just a small portion of them as long as the building specifications can meet the needs) into small or medium-sized senior care facilities. Also, with these elderly service functions available around a community, where almost 30% of the residents will be elderly people by year 2050, the operator/developer of such a facility can definitely achieve more than just getting some profit from the senior care facility. If that is the direction the regulators have in mind, we couldn't agree more.

[2] We noticed that in the Administration Measure, local authorities have the responsibility to promulgate and implement construction planning for senior care facilities, but there is no mention of reviewing any master zoning or planning in licensing procedure.

4. An established facility can open branches in other cities

This is very important, as it broadens the options for investors to structure their capital. When speaking with a government official half a year ago I raised the question whether a branch is allowed and it was not clearly answered; instead, I was asked why it would be beneficial for investors to consider opening a facility as a branch instead of as an independent enterprise. The answer is simple. Even though a WFOE is allowed for foreign investors, many will still choose to set up facilities as joint venture enterprises, since cooperation with a Chinese partner will usually bring more advantage than disadvantage at this moment. A headquarter/branch structure can definitely simplify shareholder structure at the partnership level. Of course, there is preference from local governments for another JV or WFOE for a new facility establishment other than just a branch, due to the investment and tax revenue consideration. That is another topic of bargaining power with local governments we will be happy to discuss on another occasion.

It should be noted that the establishment of branches will also be subject to the approval procedures as required in the Measures.

5. A less regulated pricing administration

The Administrative Measures have only one provision on pricing administration, which is that a "senior care facility should determine the price standard of its service in accordance with its organization type, business nature, the hardware condition, operational standard, service quality and level of care, etc., and abide by relevant national price regulation."

It is disappointing to see that the pricing supervision is so incomplete in that (a) although the final release of the Measures add the "organization type and business nature" as another element in determining price, it still doesn't provide details as to the difference in pricing mechanisms for for-profit and not-for-profit facilities. In practice, some domestic investors will choose to establish not-for-profit facility in order to enjoy substantial subsidies and other preferential policies. With the possible opening up policy[3] for foreign investment in not-for-profit facilities (like what foreign-invested hospitals do), not-for-profit facilities will definitely be another option for foreign investors. While there is no distinguished pricing regulation in place, the market is obviously less regulated; and (b) it is silent on the legitimacy of entrance fees, membership fees or deposits, be they lump-sum or paid monthly, refundable or non-refundable.

We may anticipate that such pricing models as lump-sum entrance fees, transferrable membership cards and deposits will still prevail in the marketplace, and the Measures seem content to leave more

[3] We note that investors from Taiwan have just been allowed to establish not-for-profit senior care facilities in the provinces of Guangdong and Fujian, according to the agreement between the two Straits.

room for local governments to regulate these pricing models.

Admittedly, there are many issues that need to be clarified in practice. They are, for example:

- We mentioned above that the generality and relaxed nature of the Measures have good and bad points. On the "good" side of the ledger, the Measures seem intended to assure investors that governments will not be putting obstacles in the way of their investment, and we applaud this. On the opposite side of the ledger, though, we worry that the lack of specificity might result in confusion and inconsistencies in the application by local governments of the principles embodied in the measure.

- There are different types of senior care facilities, but now they are only categorized as one type, hospitals being the only other option, and the Measures make no attempt to differentiate among the different types of senior living products. How will the regulators deal with different forms of facilities, like the U.S. deals with assisted living, skilled-nursing home or memory care, etc. is unclear. In addition, many CCRC-type of senior communities, some of which include all product types, are under construction right now. Specific licensing requirements for those communities should be in place, but are still unseen.

- We find in the final version of the Measures versus the drafts, that MCA deleted some valuable points, which we believe its initiative is to clarify and simplify the entire licensing and registration procedure[4]. However, in the final Measures, some of the provisions in the drafts with respect to approval responsibility and sequence among different authorities—such as the most problematic issues as to whether and to what extent MoH and AIC[5] will be involved in the licensing and registration—have not been preserved. We would have liked to have seen a more comprehensive effort, drawing all Ministry and departmental stakeholders into the process, so that cross-departmental procedures could have been laid out, and all product types and services offered in each product type could have been addressed by the appropriate governmental bodies. We hope that something along these lines can develop soon.

- a related point - how to deal with conflicts between national and local regulation, and deviation of understanding and practice among different functional authorities (as the Measures are promulgated solely by MCA). For example, the definition and distinction between care services and medical services – what constitutes "medical services"? - are still unclear, which may result in an arbitrary decision on whether a specific service, for example, some kinds of rehabilitation assistance, should fall under the administration of MoH.

[4] In the draft of the Measures, registry of a business license for a facility is a step after the issuing of Establishment License from MCA; and approval from local counterpart of MoH is not a condition precedent for MCA in approval procedure if no medical service is intent to be provided in the facility. However, in the final Measures these two aspects have deleted or rectified.

[5] The "Administration of Industry and Commerce".

- government-led accreditation seems to be just a pro forma procedure. The Administrative Measures only require that the local MCA to establish an accreditation mechanism covering the areas of personnel, equipment, service, management, credit, etc., and release the overall appraisal of senior facilities to the public. No further implementation detail is provided.

In closing, we would say that the Measures were a good step forward, both in substance and for what they symbolize, but more work needs to be done to bring a coherent and comprehensive set of regulations into effect to achieve the goal of truly stimulating the growth of the senior living industry in China. We are not by any means suggesting over-regulation; merely an appropriate level of regulation so that investors and operators know the rules that they are playing by and feel confident that they will be consistently applied.

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Joseph Christian is a fellow at the Harvard Kennedy School in Cambridge, Massachusetts, where he is researching and writing on the senior housing industry in China, with particular focus on the applicability of the U.S. experience in the industry to China's nascent industry.

A practicing attorney for over thirty years, the primary focus of his practice has been real estate, representing institutional investors and developers in large commercial transactions across the U.S. and in Asia. A specialty of his practice has been the senior housing industry in the U.S., where he has represented institutional investors in the sector since 2000. From October 2008 to December 2011, he was based in Hong Kong, where he co-headed the Asia real estate group of DLA Piper. During that time, he worked closely with several U.S.-based operators and investors, as well as Chinese developers and insurance companies, in their exploration of the senior housing market in China.

His professional experience has earned Mr. Christian the reputation as an expert on the senior housing industries in the U.S. and China, and he has chaired, presented and spoken on panels at several senior living conferences in Shanghai and Hong Kong. A speaker and writer on U.S. and Asian real estate issues, Mr. Christian is an Instructor at the Harvard Graduate School of Design's Executive Education program.

Mr. Christian is a member of IAHSA and of the Pacific Council on International Policy, based in California. While in Hong Kong, he was a member of the Asia Pacific Real Estate Association; the Asian Association for Investors in Non-Listed Real Estate Vehicles; the Urban Land Institute – Asia Pacific, where he served on the Executive Committee; and the American Chamber of Commerce, where he served on the Real Estate Committee.

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Michael Qu Qin is a PRC-qualified lawyer in Co-effort Law LLP based in Shanghai, China, where he practices in the areas of real estate, foreign investment and mergers and acquisitions. He has extensive experience as a lawyer for over ten years. Since 2010, he has specialized in the senior housing industry, representing foreign and domestic investors in the sector. Prior to joining Co-effort Law LLP, he was in-house counsel in METRO Group China. Prior to that, he had been practicing in another law firm since 2002. In his practice, Michael has successfully represented investors in the real estate, senior housing, asset management, retail and hospitality sectors in dealing with commercial transactions and disputes.

Michael is active in the senior care industry, and he regularly publishes the China Senior Housing and Care Newsletter, a legal publication that provides valuable insight into the development of the China senior housing and care industry and helps investors doing business in China. He is a frequent speaker at real estate and senior care seminars.

A legal professional who has been involved in the emergence of the senior care industry for years, Michael is now focusing primarily on assisting private investment in the field, providing counsel regarding company and capital formation, project development and acquisitions, regulatory issues on operation, corporate finance, and related issues.

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The impressive line-up of speakers includes a collection of influential high-level experts, business professionals, early movers, strategists and consultants.

Yan Qingchun, Deputy Director, China National Committee of Ageing
Lv Shiming, Vice Chairman, China Disabled Persons' Federation
Zhang Fan, Deputy of the Social Welfare Department, Shanghai Civil Affairs Bureau
Bromme H. Cole, President, Hampton Hoerter Healthcare
Philip Hall, Director & Chairman, Healthcare, Jones Lang LaSalle
Barbara Nopen, Director of China Operations, Merrill Gardens
Prof. Tim Heath, Vice Provost of Research, Nottingham University
Hans Ding, CEO, VSI IntelTech
Hu Shixian, CEO, Taiwan Heng An Nursing Group
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Roger Battersby, Managing Partner, PRP Architects
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Sai Xubo, Director, Emi Clinic(Japan)
Andrew Cowen, Director, The Future Health Care Group (UK)
Benjamin Shobert, Founder & Managing Director, Rubicon Strategy Grou
Hsu Ching Yun, Adjunct Professor, Faculty Director of Nutrition and Health Sciences, Chang Gung University of Science and Technology
Andrew Oksner, Founder & CEO, GSL Properties
Jeffrey Carmichael, COO, RockBridge Senior Living Communities

Michael Qu will be the moderate of panel discussion on the topic of Sustainable Strategies for Senior Market over the next 3-5 years.

Joseph Christian will speak on topic of business models.

You may find more speakers on www.careshow.com.cn
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