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China to Allow Foreign Control of Securities Firms: CSRC Officially Promulgates Measures for Administration of Foreign Investment in Securities Firms

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On 28 April 2018, the China Securities Regulatory Commission ("**CSRC**") officially promulgated the *Measures for Administration of Foreign Investment in Securities Companies* (the "**Official Measures**")¹, following CSRC's issuance of a public comment draft of the same (the "**Draft Measures**")² on 28 March 2018. The Official Measures are widely considered a significant move to further open up China's domestic financial sector.

How will the Official Measures affect foreign investment in securities firms in China? This newsletter begins with a background of the previous foreign ownership limitations in China, interprets the key regulatory changes and impacts on foreign investment in securities firms as stipulated in the Official Measures, and briefly analyzes the regulatory trends for further implementing China's other commitments to ease restrictions on foreign investment in the financial sector.

Background

At present, there are 13 foreign-invested joint venture (JV) securities firms in China, including four JV securities firms approved under the Closer Economic Partnership Arrangement (CEPA). Global financial giants have until now mainly operated in China through minority-owned JV

¹ 《外商投资证券公司管理办法 (正式稿)》 [Measures for Administration of Foreign Investment in Securities Companies (Official Version)] (China Securities Reg. Comm., Decree No. 140; promulgated and effective 28 Apr. 2018), *available at*: http://www.csrc.gov.cn/pub/zjhpublic/zjh/201804/t20180428_337509.htm (Chinese).

² 《外商投资证券公司管理办法 (征求意见稿)》 [Measures for Administration of Foreign Investment in Securities Companies (Draft for Comment)] (China Securities Reg. Comm.; issued 9 Mar. 2018, for public comment until 8 Apr. 2018), *available at*: <http://www.csrc.gov.cn/pub/zjhpublic/zjh/201803/P020180309603189338426.pdf> (Chinese).

securities firms, among which most are limited to investment banking services due to the current regulatory constraints.

CSRC issued the Official Measures to replace the *Rules on the Establishment of Securities Companies with Foreign Equity Participation*³, last amended by CSRC in 2012 (the "**2012 Rules**"). Under the 2012 Rules, the total proportion of shares, or of rights and interests, held directly or indirectly by foreign shareholders in a JV securities firm could not exceed 49%.

However, with the significant development and rapid changes in China's domestic securities markets, the 49% foreign ownership cap could no longer meet the need for the continuous development and opening up of the securities sector in China.

During U.S. President Donald Trump's visit to China in November 2017⁴, China made the commitment to raise the cap on direct or indirect equity ownership by a single or multiple foreign investors in JV securities, fund management and futures companies to 51%, and there will be no equity cap limitation on such investments three years after the implementation of the proposed rules. Meanwhile, the strategic significance of further opening up the financial sector was also reiterated at other meetings, including the 19th National Party Congress and the National Finance Working Conference in 2017 as well as the meetings of the National People's Congress and the Chinese People's Political Consultative Conference held this March.

In this context, the Official Measures have been issued by CSRC as an effort to implement the strategic decision at the 19th National Party Congress to "significantly ease market access, further open the service sector..."⁵ and to deliver the commitment of further opening up China's securities markets made at the high-level meeting between Xi Jinping and Donald Trump.

Key Changes in the Official Measures

The key changes in the Official Measures can be summarized in the five main areas as below:

a. Lifting shareholding cap for foreign shareholders

The first key regulatory change is lifting the cap on foreign shareholding in securities firms to

³ 《外资参股证券公司设立规则 (2012 年修订)》 [Rules on Establishment of Securities Companies with Foreign Equity Participation (Revised in 2012)] (China Securities Reg. Comm., Decree No. 86; promulgated and effective 11 Oct. 2012, annulled by the Official Measures on 28 Apr. 2018).

⁴ 《新闻办就中美元首北京会晤经济成果相关情况举行吹风会》 [State Council Information Office Holds Briefing Regarding the Economic Results of the Meeting between the Heads of China and the U.S. in Beijing] (10 Nov. 2017), *available at*: http://www.gov.cn/xinwen/2017-11/10/content_5238617.htm#1 (Chinese).

⁵ 《决胜全面建成小康社会，奋力夺取新时代中国特色社会主义伟大胜利》 [Secure a Decisive Victory in Building a Moderately Prosperous Society in All Respects and Strive for the Great Success of Socialism with Chinese Characteristics for the New Era] (delivered by Pres. Xi Jinping at the 19th National Congress of the Communist Party of China, 18 Oct. 2017), *available at*: http://www.xinhuanet.com/english/download/Xi_Jinping's_report_at_19th_CPC_National_Congress.pdf (English).

51% from the previous 49%. According to the Official Measures, the total proportion of the shares held directly and indirectly by foreign investors in a JV securities firm shall not exceed the 51% cap according to China's commitment to open up its securities sector. It is further expected that the 51% ceiling on foreign shareholding in securities firms will be eventually scrapped in 2021.

b. Broadening business scope for JV securities firms

JV securities firms will be allowed to engage in a wider range of services in incremental steps. Newly established JV securities firms are allowed to apply for securities business activities based on their specific circumstances. Specifically, according to the *Securities Law of the People's Republic of China (Revised in 2014)* and the *Interim Provisions on Examination and Approval of the Business Scope of Securities Companies (Revised in 2017)*⁶, a newly established JV securities firm may apply to engage in four of the following services:

- a) securities brokerage business;
- b) securities investment advisory business;
- c) financial advisory business related to securities trading and securities investment activities;
- d) securities underwriting and sponsoring business;
- e) securities business on its own account;
- f) securities asset management; and
- g) other securities business.

One year after regulatory approval and each year thereafter, the JV securities firm may apply to engage in two additional services as indicated above.

As a general requirement under the Official Measures, however, the initial business scope of a JV securities firm shall correspond to the relevant experiences of the controlling shareholder or the largest shareholder in conducting securities business.

c. Updating regulations on foreign holding of listed securities firms

CSRC has also raised the ceiling for shareholding of foreign investors of listed securities firms in China.

According to the Official Measures, the total proportion of shares held directly and indirectly by all foreign investors in a listed securities firm now corresponds to the updated cap for unlisted

⁶ 《证券公司业务范围审批暂行规定 (2017 年修订)》 [Interim Provisions on Examination and Approval of the Business Scope of Securities Companies (Revised in 2017)], Art.7 (as revised by China Securities Reg. Comm.; promulgated and effective 7 Dec. 2017), available at: http://www.gov.cn:8080/gongbao/content/2018/content_5286376.htm (Chinese)

securities firms, which shall not exceed the current cap of 51% according to China's commitment to open up its securities sector. Similarly, the 51% ceiling on foreign shareholding in listed securities firms will be eventually scrapped in 2021. It is also notable that the previous 20% ceiling on the shareholding of a single foreign investor in a listed securities firm has been removed.

d. Clarifying regulations for a change of nationality by actual controllers of domestic shareholders

The Official Measures address a new occurrence which has arisen in recent regulatory practice where the actual controller of a shareholder in a domestic securities firm changes his or her nationality from Chinese to that of a foreign country. This change of nationality leads to the issue of indirect shareholding by a foreign investor in a domestic securities firm. The Official Measures provide that if the actual controller of a shareholder in a domestic securities firm is changed from a domestic investor to a foreign investor, the relevant foreign investor must comply with the relevant eligibility requirement and shareholding cap for foreign shareholders.

Where foreign investors do not meet the relevant criteria and requirements as specified in the Official Measures, they are required to complete the relevant rectification and remediation measures within three months.

e. Updating criteria and qualifications for shareholders

a) Raising the bar for foreign shareholders in JV securities firms

CSRC has expressed the intention to raise the bar for foreign investors planning access to China's domestic securities markets, by updating the criteria for foreign shareholders in a JV securities firm. According to the Official Measures, the foreign shareholders in a JV securities firm shall satisfy the following criteria:

- i. their home country or region has a sound legal and regulatory system for securities business, and has concluded a memorandum of understanding on securities regulatory cooperation with CSRC or any institution recognized by CSRC and maintains constructive relations of regulatory cooperation with CSRC or any institution recognized by CSRC;
- ii. they are lawfully established financial institutions in their home countries or regions, and all of their financial ratios have, for the last three years, conformed to the legal requirements applicable in their respective home countries or regions and to the requirements of their respective securities regulator;
- iii. they have been operating securities business for no less than 5 years, and have not received any serious penalty from any securities regulator, administrative or judicial organ, or been investigated by any relevant authorities due to severe

- violation of any law or regulation in their respective home countries or regions within the last 3 years;
- iv. they have sound internal control systems;
 - v. they have good international reputations and business performance records, with internationally leading track records in terms of business scale, revenue and profit, and high-level long-term credit within the last 3 years; and
 - vi. any other prudential criteria specified by CSRC.

As compared with the 2012 Rules, the Official Measures set higher requirements for foreign investors, requiring that they must be financial institutions with a sound international reputation, and good business and credit records over the past three years. This change reflects a higher standard from CSRC to attract high-quality foreign investors with good international reputations and leading management experience.

b) Updating the qualifications for PRC shareholders in JV securities firms

Another noteworthy change involves the qualification requirements for PRC shareholders in JV securities firms. According to Article 8 of the 2012 Rules, at least one of the PRC shareholders in a JV securities firm had to be a domestic securities firm. There were only two exceptions to this rule, including: (i) where a foreign investor may have acquired some equity (previously less than 49%) in an existing domestic securities firm which was 100% owned by PRC corporates and thus converted the domestic securities firm into a JV securities firm; or (ii) where a qualified Hong Kong/Macao financial institution could have partnered with eligible PRC corporates to set up a JV securities firm in certain pilot zones under special CEPA arrangements.

The Official Measures relax this domestic securities firm shareholder requirement. CSRC has announced that the qualification requirements for PRC shareholders in a JV securities firm will be the same as those applicable to shareholders in a domestic securities firm. In both the Draft Measures and Official Measures, CSRC has also deleted the requirement that "in a JV securities firm, at least one of its PRC shareholders must be a domestic securities firm". This means that JV securities firms will no longer be required to have a domestic securities firm as its PRC shareholder. In other words, foreign investors will be allowed to partner with eligible PRC corporates to set up a JV securities firm.

c) Other key proposed requirements for shareholders' qualifications

We should also note that CSRC has issued the *Provisions on Administration of Equity of Securities Companies (Draft for Comment)*⁷ on 30 March 2018 (the "**Draft Equity Provisions**"),

⁷ 《证券公司股权管理规定（征求意见稿）》 [Provisions on Administration of Equity of Securities Companies (Draft for Comment)] (China Securities Reg. Comm.; issued 30 Mar. 2018, for public comment until 29 Apr. 2018), available at: http://www.csrc.gov.cn/pub/zjhpublic/zjh/201803/t20180330_336014.htm (Chinese).

to regulate the equity and shareholders of PRC securities firms (including JV securities firms), which may impose additional eligibility requirements on foreign and PRC shareholders. The Draft Equity Provisions propose to classify shareholders of PRC securities firms into the following four categories based on their level of shareholding and their influence on firm operations and management:

- i. "controlling shareholders" refer to shareholders holding more than 50% equity in a securities firm, or shareholders holding less than 50% equity while their voting rights are sufficient to have significant influence on the resolutions of the (general) shareholders' meeting;
- ii. "major shareholders" refer to shareholders holding more than 25% equity in a securities firm, or the largest shareholder holding more than 5% equity in securities firms;
- iii. shareholders holding more than 5% equity in a securities firm; and
- iv. shareholders holding less than 5% equity in a securities firm.

Each type of shareholder would be subject to different qualification requirements with respect to net assets, profitability, credit records, etc. These qualification requirements would also apply to domestic and foreign investors in terms of their equity investment in PRC securities firms (including JV securities firms). In particular, where a foreign investor seeks to have a controlling stake in a JV securities firm, it would need to satisfy additional qualification requirements applicable to controlling shareholders under the Draft Equity Provisions, including, among others, having net assets of no less than RMB100 billion (approximately US\$15.9 billion), maintain profitability for the most recent 5 years and have business revenues of no less than RMB100 billion (approximately US\$15.9 billion) for the most recent 3 years. Some foreign investors have expressed concerns over these proposed capital requirements, although the requirements as drafted would also apply to domestic investors. It is yet to be seen how these concerns may be addressed in the finalized rules.

Outlook

a. Increasing foreign investment in securities firms

In the past, the key issue with regard to foreign investors establishing JV securities firms has been whether the investors could have control over the JV securities firms. There are some precedents where foreign investors have had control over JV securities firms, but those precedents are exceptional and cannot be followed by other international investors. International investors will undoubtedly welcome China's move to permit foreign investors to take majority stakes in JV securities firms as stipulated in the Official Measures. For foreign investors who have invested in JV securities firms as minority shareholders in China, they may

consider increasing their current shareholdings to become the controlling shareholders of the JV securities firms.

During CSRC's news briefing on the issuance of the Official Measures on 28 April 2018⁸, CSRC officially announced that qualified foreign investors may submit applications for the change of the actual controller of existing JV securities firms or for the establishment of new JV securities firms, and CSRC will release updated operating guidelines in due course. CSRC also indicated that some international financial institutions in Europe and Asia have kicked off their initial communications with CSRC and plan to submit applications to CSRC based on the Official Measures. According to the latest media releases⁹, UBS Securities Co., Ltd. ("**UBSS**") has submitted an application to change its actual controller to UBS AG by increasing the foreign shareholding percentage to 51% (previously UBS AG has had *de facto* control over UBSS through contractual arrangements). CSRC has accepted the UBSS application, and it is currently pending official review and approval by CSRC. Once the application is approved, UBSS may become the first JV securities firm with a foreign controlling shareholder in China.

b. Opening up of fund management and futures sectors

During the CSRC news briefing, CSRC also confirmed that it has allowed foreign investors to hold 51% stakes in fund management companies ("**FMCs**") in China, and the shareholding cap of 51% will be eventually removed in 2021. Qualified foreign investors may submit applications for the change of actual controllers of existing JV FMCs or for the establishment of new JV FMCs according to current FMC-related regulations and operating guidelines.

Following the news briefing, CSRC later issued the *Measures for Administration of Foreign Investment in Futures Companies (Draft for Comment)*¹⁰ on 4 May 2018 for public comment until 4 June 2018, which provide clear guidance and specific requirements to be followed by foreign investors for their investment in futures companies on shareholders' qualifications, holding of equity stakes, and senior management personnel, etc. Similarly, the fundamental goal is to honor China's commitment to allow foreign controlling stake in the futures companies.

c. Other policy initiatives

In addition, the National Development and Reform Commission officially announced on 17 April

⁸ 《证监会新闻发言人就〈外商投资证券公司管理办法〉答记者问》 [News Briefing by CSRC on the Release of *Measures for Administration of Foreign Investment in Securities Companies*] (28 Apr. 2018), available at: http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/201804/t20180428_337508.html (Chinese).

⁹ *UBS seeks regulatory nod for 51 pct controlling stake in China JV*, REUTERS (3 May 2018), available at: <https://www.nasdaq.com/article/ubs-seeks-regulatory-nod-for-51-pct-controlling-stake-in-china-jv-20180503-00003> (English).

¹⁰ 《外商投资期货公司管理办法 (征求意见稿)》 [Measures for Administration of Foreign Investment in Futures Companies (Draft for Comment)] (China Securities Reg. Comm.; issued 4 May 2018, for public comment until 4 Jun. 2018), available at: http://www.csrc.gov.cn/pub/zjhpublish/zjh/201805/t20180504_337678.htm (Chinese).

2018¹¹ that it is working jointly with other relevant departments to address the opening up of China's financial sector by updating the *Special Administrative Measures for Foreign Investment Access (Negative List for Foreign Investment Access)* in the *Catalog for the Guidance of Industries for Foreign Investment (Revised in 2017)*¹². The 2017 negative list still classifies securities firms, FMCs and futures companies as restricted to foreign investment, thus requiring Chinese parties to hold a relative majority of shares. The new negative list for foreign investment access is expected to be officially promulgated by the first half of 2018.

All the policy initiatives discussed in this article have clearly shown the Chinese government's dedication to further open up its financial sector, which will offer broader business opportunities to those foreign investors interested in China's securities markets. We expect China will further open up its financial sector and that specific regulations will be released soon.

¹¹ 《国家发展改革委就制定新的外商投资负面清单及制造业开放问题答记者问》 [News Briefing by NDRC on Updating the *Negative List for Foreign Investment Access* and Opening up the Manufacturing Industry] (17 Apr. 2018), available at: http://www.gov.cn/xinwen/2018-04/17/content_5283379.htm (Chinese).

¹² 《外商投资产业指导目录（2017年修订）》 [Catalog for the Guidance of Industries for Foreign Investment] (Nat'l Dev. Ref. Comm., Min. of Fin., Decree No. 4; promulgated Jun. 28, 2017, effective Jul. 28, 2017) 2017 ST. COUNCIL GAZ. 31, available at www.gov.cn/gongbao/content/2017/content_5237697.htm (Chinese).

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