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client alert

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NEW MEASURES PERMIT FOREIGN INVESTORS TO CONTROL CHINESE SECURITIES COMPANIES

On 28 April 2018, the China Securities Regulatory Commission ("**CSRC**") released the *Administrative Measures for Foreign-Invested Securities Companies* ("**2018 Measures**"), which replace the *Rules on the Establishment of Foreign-Invested Securities Companies* ("**2012 Rules**") in effect since 11 October 2012. Among the most significant changes to the Chinese financial market brought by the 2018 Measures is that qualified foreign investors are now allowed to control securities companies in China.

During the meeting between President Xi Jinping and U.S. President Donald Trump last November, China committed to further opening up its financial market to foreign investors[1]. The CSRC released the 2018 Measures as a strategic step for implementing various policies that have been formulated since then in accordance with this commitment.

This Client Alert highlights the key points of the 2018 Measures and its potential impact on foreign investment in Chinese securities companies.

KEY CHANGES UNDER THE 2018 MEASURES

Compared with the 2012 Rules, the key changes brought by the 2018 Measures are:

- **Increased shareholding cap for foreign shareholders**

  Under the 2012 Rules, the total proportion of rights and interests of joint venture ("**JV**") securities companies held directly and indirectly by foreign shareholders could not exceed 49%[2]. The 2018 Measures now provide that the aggregate equity directly held and indirectly controlled by foreign shareholders in a JV securities company must be in line with arrangements made by the State with respect to the opening up of the securities sector. In this regard, the 2018 Measures increase the shareholding cap for foreign investors in JV securities companies to 51%. Moreover, based on China's commitment to open up the securities market, this shareholding cap should eventually be removed by 2021[3].

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1 Deeply Studying the Principles of the 19th National Party Congress and Sticking to Reforming and Opening the Capital Market in the New Era - Talk Given by Li Chao, Vice President of the CSRC, at the 8th Caixin Summit (深入学习贯彻党的十九大精神 坚定不移推进新时代资本市场改革开放——李超副主席在第八届财新峰会上的讲话), 16 November 2017, available at http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/201711/t20171116_327184.html

2 Pursuant to Supplement X to the *Closer Economic Partnership Arrangement*, qualified investors from Hong Kong or Macau investing in JV securities companies in certain cities in China may hold up to 51% of the interests in a JV securities company.

3 State Council Information Office Briefing on the Economic Results of the Meeting between the Heads of China and the U.S. in Beijing (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), 10 November 2017, available at http://www.gov.cn/xinwen/2017-11/10/content_5238617.htm#1

- **Wider business scope for JV securities companies**

  Under the 2012 Rules, the business scope of JV securities companies was limited to the following activities:

  - Underwriting and custody of stocks and bonds;
  - Brokerage of stocks denominated in a foreign currency;
  - Brokerage and proprietary trading of bonds; and
  - Other activities approved by the CSRC.

  The 2018 Measures remove this restriction and in essence allow JV securities companies to engage in more types of activities. Under the *Interim Provisions on the Examination and Approval of the Business Scope of Securities Companies*, new securities companies will be limited to having four types of business activities as approved by the CSRC when they begin operations, but every year they may apply to engage in two additional activities. The 2018 Measures also require that the initial business scope of JV securities companies be commensurate with that of the controlling shareholder or the securities experience of the largest shareholder.

- **Higher standards for foreign shareholders**

  The 2012 Rules set the following standards (among others) for the foreign shareholders of JV securities companies:

  - At least one foreign shareholder must be a financial institution;
  - Foreign shareholders must have been established for more than one year and not have any record of violations in the last five years;
  - Foreign shareholders must have sound internal control systems, good reputation and business performance; and
  - Foreign shareholders must meet other prudential criteria specified by the CSRC.

  The CSRC intends to attract more high-quality foreign investors and therefore sets higher standards in the 2018 Measures. In addition to the above, the 2018 Measures impose the following requirements on foreign shareholders:

  - All foreign shareholders should be financial institutions; and
  - The business scale, income and profits of foreign shareholders must be world leaders for the past three years, and their long-term credit standing must have been at a high level for the last three years.

- **Updated regulations for foreign investors in listed securities companies**

  Under the 2012 Rules, the proportion of shares in a listed, domestically funded securities company directly held or indirectly controlled by a single foreign investor could not exceed 20%, while the proportion of shares in a listed, domestically funded securities company directly held or indirectly controlled by multiple foreign investors could not exceed 25%.

  The 2018 Measures remove this rule so that the shareholding cap for foreign investors in a listed, domestically funded securities company is the same as for non-listed securities companies (i.e. 51%). Moreover, any foreign investor who holds 5% or more of the shares in a listed, domestically funded securities company acquired by buying securities on a securities exchange or who jointly holds such shares with another party(ies) pursuant to an agreement or arrangement must meet the qualifications for foreign shareholders under the 2018 Measures.

DEVELOPMENT IN PRACTICE

According to news reports, certain foreign investors have already submitted applications to the CSRC based on the 2018 Measures. For example, J.P. Morgan Broking (Hong Kong) Ltd has applied to the CSRC to establish a JV securities company with it holding 51% of the shares[4]. Also, UBS Securities Co Ltd ("**UBS China**") applied to change its actual controller to UBS AG (Switzerland) by increasing the latter's foreign shareholding ratio to 51% (UBS AG has de facto control over UBS China via contractual arrangements)[5].

In addition to the 2018 Measures, other laws and regulations may be changed to further open up the Chinese financial market. According to an announcement by the National Development and Reform Commission ("**NDRC**") on 17 April 2018, the *Catalogue of Industries for Guiding Foreign Investment (2017 Revision)* will be revised soon, with an expected release before the end of the year[6]. Such revision will not only reflect existing changes to laws and regulations in the financial sector, but also implement more measures to further open up the financial industry.

4 CSRC News Briefing (证监会新闻发言人高莉答记者问), 10 May 2018, available at: http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/201805/t20180510_338018.html

5 UBS Seeks Regulatory Nod for 51% Controlling Stake in China JV (瑞银寻求监管机构批准其对中国合资证券公司控股51%), 3 May 2018, available at https://www.nasdaq.com/article/ubs-seeks-regulatory-nod-for-51-pct-controlling-stake-in-china-jv-20180503-00003

6 NDRC News Briefing on Updating the Negative List for Foreign Investment Access and Opening the Manufacturing Industry (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), 17 April 2018, available at http://www.gov.cn/xinwen/2018-04/17/content_5283379.htm

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