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# Legal Commentary



CHINA PRACTICE • GLOBAL VISION

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## Capital Market Law

### China to Allow Foreign Control of Securities Firms: Measures issued by CSRC for Administration of Foreign Investment in Securities Companies (Draft for Comment)

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On 9 March 2018 the China Securities Regulatory Commission ("**CSRC**") issued the *Measures for Administration of Foreign Investment in Securities Companies (Draft for Comment)* (the "**Draft Measures**")<sup>1</sup>, and requested public comments until 8 April 2018. The CSRC's issuance of the Draft Measures is widely considered a significant move to further open up China's domestic financial sector.

How will the Draft Measures affect foreign investment in securities companies in China? This newsletter begins with a background of the current foreign ownership limitations in China, interprets the key regulatory changes and impacts on foreign investment in securities companies as proposed in the Draft 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 companies in China, including four JV securities companies approved under the Closer Economic Partnership Arrangement (CEPA). Global financial giants mainly operate in China through minority-owned JV securities companies, among which most are limited to investment banking services due to the current regulatory constraints.

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<sup>1</sup> 《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).

CSRC has issued the Draft Measures to replace the *Rules on the Establishment of Securities Companies with Foreign Equity Participation*<sup>2</sup>, last amended by CSRC in 2012 (the "**Current Rules**"). Under the Current Rules, the total proportion of shares (or of the rights and interests held directly or indirectly) by foreign shareholders in a JV securities company cannot exceed 49%.

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

At the meeting between the Chinese President Xi Jinping and the U.S. President Donald Trump in November 2017<sup>3</sup>, 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 19<sup>th</sup> National Party Congress and the National Finance Working Conference in 2017 as well as the most recent meetings of the National People's Congress ("**NPC**") and the Chinese People's Political Consultative Conference ("**CPPCC**").

In this context, the Draft Measures have been issued by CSRC as an effort to implement the strategic decision at the 19<sup>th</sup> National Party Congress to "significantly ease market access and further open the service sector"<sup>4</sup> and to deliver the commitment of further opening up China's securities markets at the high-level meeting between Xi Jinping and Donald Trump.

## Key Proposed Changes in the Draft Measures

According to the *Statement of Drafting on the Measures for Administration of Foreign Investment in Securities Companies*<sup>5</sup>, key proposed changes in the Draft Measures can be summarized in the five main areas as below:

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<sup>2</sup> 《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., Order No. 86; promulgated and effective 11 Oct. 2012), available at:

[http://www.csrc.gov.cn/pub/newsite/filb/fifg/bmgf/zjgs/gsslbg/201310/t20131021\\_236602.html](http://www.csrc.gov.cn/pub/newsite/filb/fifg/bmgf/zjgs/gsslbg/201310/t20131021_236602.html) (Chinese).

<sup>3</sup> 《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》[Information Office Holds Briefing Regarding the Economic Results of the Meeting between the heads of China and US in Beijing] (10 Nov. 2017), available at: [http://www.gov.cn/xinwen/2017-11/10/content\\_5238617.htm#1](http://www.gov.cn/xinwen/2017-11/10/content_5238617.htm#1) (Chinese).

<sup>4</sup> 《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 at the 19<sup>th</sup> 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](http://www.xinhuanet.com/english/download/Xi_Jinping's_report_at_19th_CPC_National_Congress.pdf) (English)

<sup>5</sup> 《关于〈外商投资证券公司管理办法〉的起草说明》[Statement of Drafting on the Measures for Administration of Foreign Investment in Securities Companies] (China Securities Reg. Comm.; issued 9 Mar. 2018), available at: <http://www.csrc.gov.cn/pub/zjhpublic/zjh/201803/P020180309603189492100.pdf> (Chinese).

### **a. Lifting shareholding cap for foreign shareholders**

The first key regulatory change is to lift the cap on foreign shareholding in securities companies to 51% from the current 49%. According to the Draft Measures, the total proportion of the shares held directly and indirectly by foreign investors in a JV securities company shall not exceed the 51% cap according to China's commitment to open up its securities sector, and shall not be less than 25% in principle. JV securities companies converted from domestically-funded securities companies shall not be subject to the 25% minimum foreign investor shareholding requirement. It is further expected that the 51% ceiling on foreign shareholding in securities companies will be eventually scrapped three years after the proposed rules take effect.

### **b. Broadening business scope for JV securities companies**

JV securities companies will be allowed to engage in a wider range of services in incremental steps. For example, a newly established JV securities company may apply to engage in four of the following services as provided in the *Securities Law of the People's Republic of China (Revised in 2014)*<sup>6</sup>:

- i. securities brokerage business;
- ii. securities investment advisory business;
- iii. financial advisory business related to securities trading and securities investment activities;
- iv. securities underwriting and sponsoring business;
- v. securities business on its own account;
- vi. securities asset management; and
- vii. other securities business.

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

### **c. Updating regulations on foreign holding of listed securities companies**

CSRC has also proposed to raise the ceiling for both the total and single shareholding of foreign investors of listed securities companies in China.

According to the Draft Measures, the total proportion of shares held directly and indirectly by all foreign investors in a listed securities company shall not exceed the current cap of 51% according to China's commitment to open up its securities sector, which is consistent with the

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<sup>6</sup> 《中华人民共和国证券法（2014年修订）》 [Securities Law of the People's Republic of China (Revised in 2014)], Art. 125 (as revised and adopted by Standing Comm. National People's Cong., Pres. Order No. 14; promulgated and effective 31 Aug. 2014), available at: [http://www.npc.gov.cn/npc/lfzt/rlyw/2015-04/23/content\\_1934291.htm](http://www.npc.gov.cn/npc/lfzt/rlyw/2015-04/23/content_1934291.htm) (Chinese).

updated cap for foreign shareholding in unlisted securities companies.

With regard to the shareholding of a single foreign investor, the ceiling set by CSRC will be raised from 20% to 30%.

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

The Draft Measures address a new occurrence which has arisen in recent regulatory practice where the actual controller of a shareholder in a domestically-funded securities company 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 domestically funded securities company. The Draft Measures provide that if the controlling shareholder or actual controller of a domestically funded securities company is changed from a domestic investor to a foreign investor, the relevant foreign investor must comply with the relevant eligibility requirement for foreign shareholders, but their shareholding could be less than 25%.

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

**e. Improving criteria for foreign shareholders**

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 company. According to the Draft Measures, the foreign shareholders in a JV securities company 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 for no less than 5 years, and have not received any serious penalty from any securities regulator, or from an administrative or judicial organ 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 Current Rules, the Draft Measures set higher requirements on 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.

## **Outlook**

In the past, the key issue with regard to foreign investors establishing JV securities companies has been whether the investors could have control over the JV securities companies. There are some precedents where foreign investors have had control over JV securities companies, 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 companies as contemplated by the Draft Measures. For foreign investors who have invested in JV securities companies as minority shareholders in China, they may consider increasing their current shareholding to become the controlling shareholders of the JV security companies.

Following the issuance of the Draft Measures, it is expected that China will further open up its other financial sectors, such as asset management, futures, etc., and relevant specific regulations will be released soon.

## ● **Important Notice**

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