December 30, 2017

Banking & Finance Law

CBRC to Further Liberalize Foreign-funded Bank Regulation

TieCheng YANG | Yin GE | Ting ZHENG | Cecily YANG

On 28 December 2017, the China Banking Regulatory Commission ("**CBRC**") issued the *Decision on Amending the Measures of the China Banking Regulatory Commission for Granting Administrative Licensing to Foreign-funded Banks (Draft for Public Comment)* (the "**Draft Measures**") with an aim to further open up the banking industry as mandated by the central government. The Draft Measures reduce the number of administrative licensing items, simplify the administrative licensing procedures, and further unify the market access standards for Chinese- and foreign-funded banks. This newsletter is intended to present a brief outline of the amendments proposed in the Draft Measures that may have a significant impact on foreign-funded banks ("**FFBs**") in China.

I. Rules for FFBs to invest in, establish or acquire stakes in Chinese-funded banking financial institutions to be clarified

In March 2017, the CBRC General Office issued the *Circular on Issues Related to Conducting Certain Business by Foreign-funded Banks* (the "**FFB Circular**"). Article 5 of the Circular permits FFBs, including wholly foreign-owned banks and Sino-foreign joint venture banks, to legally invest in domestic banking financial institutions if they can control risk. On 5 July 2017, CBRC issued the *Decision of the China Banking Regulatory Commission on Amending the Measures of the China Banking Regulatory Commission for Granting Administrative Licensing to Chinese-funded Commercial Banks* (the "**CB Licensing Rules**") which specify the conditions for FFBs to acquire equity in a Chinese-funded commercial bank to facilitate the implementation of the FFB Circular Article 5. The CB Licensing Rules further clarify that the requirements for foreign financial institutions to invest in Chinese-funded commercial banks as promoters or strategic investors will apply by reference to the requirements for FFBs to invest in Chinese-funded commercial banks. The major requirements for FFBs include:

a. Total assets of at the end of the previous year are, in principle, not less than USD10 billion;

b. Long-term credit ratings by international rating agencies recognized by CBRC have been good for the past two years;

c. The bank has been profitable for the past two consecutive fiscal years; and

d. Capital adequacy ratio of the bank must achieve the average capital adequacy ratio of the banking industry generally and not be less than 10.5%.

If an FFB invests in a Chinese-funded bank as a strategic investor, it must follow the principles of long-term shareholding, optimizing the governance of the Chinese-funded bank, co-operating in business and avoiding competition.

The Draft Measures list detailed requirements for eligibility, administrative procedures and application materials for an FFB to invest in, establish or acquire a domestic financial banking institution. The eligibility requirements for FFBs mainly include:

a. having a sound corporate governance structure;

b. having robust and effective risk management and internal controls;

c. having strong, consolidated management capabilities;

d. meeting major prudent regulatory indicator regulatory requirements;

e. outstanding equity investments do not, in principle, exceed 50% of net assets (according to consolidated accounting statements);

f. having a sound and compliant information technology system and information security system, a standardized data management system, and technology and measures that ensure the effective and safe operations of business on an ongoing basis;

g. having no record of serious violations of laws and regulations or material cases caused by internal management failures over the past two years (this requirement may be waived if the investment is to establish or acquire equity in a Chinese-funded banking institution to implement inclusive financial policies, etc.);

h. profitability for the past three consecutive fiscal years; and

i. possessing a good regulatory rating, etc.

All the above conditions are in line with those prescribed in the CB Licensing Rules with respect to applications by a Chinese-funded bank to invest in, establish or acquire a domestic financial institution. With regard to the licensing procedures, CBRC or its local branch will review the qualifications of the shareholders of the Chinese-funded commercial bank together with a review of the FFB's proposed investment. This is also consistent with the administrative licensing procedures applicable to Chinese-funded banks.

The Draft Measures also clarify that the rules applicable to foreign financial institutions that invest in, establish or acquire domestic banking financial institutions as promoters or strategic investors will apply by reference to FFBs that make such investments. Thus, an FFB that intends to invest in a Chinese-funded commercial bank must satisfy additional qualification requirements that are applicable to foreign financial institutions under the CB Licensing Rules. In addition, the foreign investor shareholding percentage limitations under the CB Licensing Rules will also apply (i.e., the shareholding of a single foreign financial institution or affiliates controlled by it or under common control with it as the promoter or strategic investor of a single Chinese-funded commercial bank cannot exceed 20%, and the shareholding of several foreign financial institutions and affiliates controlled by them or under common control with them as the promoters or strategic investors cannot exceed 25%, the "**Shareholding Restrictions**").

It is worth noting that on 10 November 2017, at the briefing by the State Council Information Office on economic outcomes achieved during the China-U.S. presidential meeting in Beijing, Mr. Zhu Guangyao, the vice Minister of the Ministry of Finance, mentioned that China had decided to remove the Shareholding Restrictions, and to level the playing field for Chinese and foreign investors to make equity investments in the PRC banking sector. During the 9th China-Britain Economic and Financial Dialogue held on 16 December 2017, China made similar commitment with regard to the proposed changes to foreign restrictions in the financial services sector. During a press conference to discuss the Draft Measures, CBRC also confirmed that the next step will be to promote the revising of existing legislation and supervisory systems, and implementing policies and actions to further open up the banking industry. It is expected that CBRC will amend the CB Licensing Rules and remove the Shareholding Restrictions. We also expect that CBRC will expressly confirm that investments in Chinese-funded banks by FFBs will not be subject to any shareholding restrictions.

II. Four business administrative approvals to be removed

To implement the post-event reporting system for FFBs and foreign bank branches in China that engage in custody services, the Draft Measures remove the administrative approvals for custody services for overseas wealth management and securities investment funds. Additionally, the Draft Measures introduce a reporting system to replace administrative approvals for overseas wealth management services and the withdrawal of interest-bearing assets by liquidating foreign-funded financial institutions. As a result, FFBs and foreign bank branches in China can begin to enjoy national treatment while conducting the above-mentioned services in terms of administrative procedures.

III. Market access standards for Chinese and foreign investors to be unified

The Draft Measures also set forth unified market access standards for Chinese and foreign investors as follows: two separate approvals for preparatory establishment and business commencement for sub-branches are combined, and thus only approval for business commencement is required; the conditions for foreign banks to issue debt and capital-raising instruments are optimized; the procedures for FFB senior management qualification reviews are simplified – where there is only a lateral move or a transfer to a lower position between foreign banks of the same nature and quality, only a filing is required (as opposed to pre-approval).

The deadline for the public to comment on the Draft Measures is 27 January 2018. We will continue to keep an eye on the market discussion and regulatory trends and share with you our analysis on the impact of the new regulations on the investments and business operations of foreign banks in China.

Important Announcement

This Legal Commentary has been prepared for clients and professional associates of Han Kun Law Offices. Whilst every effort has been made to ensure accuracy, no responsibility can be accepted for errors and omissions, however caused. The information contained in this publication should not be relied on as legal advice and should not be regarded as a substitute for detailed advice in individual cases.

If you have any questions regarding this publication, please contact **Mr. TieCheng YANG (86 10 85164286; tiecheng.yang@hankunlaw.com)** or **Ms. Yin GE** (**8621-60800966; yin.ge@hankunlaw.com**).