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Financial Market Liberalization May Trigger Merger Filing

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On 28 June 2018, the National Development and Reform Commission ("**NDRC**") and the Ministry of Commerce ("**MOFCOM**") jointly issued the *Special Administrative Measures for Foreign Investment Access (Negative List for Foreign Investment Access)* (the "**2018 Negative List**")¹. The newly published 2018 Negative List officially allows foreign control of securities firms, fund management companies ("**FMCs**"), futures companies and life insurance companies in China, which is widely considered a significant move to further open up China's financial services sector.

China's recent relaxation of foreign investment restrictions in the financial services sector will no doubt increase the number and size of acquisition transactions by foreign financial institutions of Chinese counterparts. Thus far, there have been notably few merger filings in relation to foreign acquisitions of Chinese financial institutions. Will that change? This article will analyze the relevant legal issues relating to merger filings in anticipation of the expected wave of increased foreign investment in China's financial services sector.

a. Merger filing requirements generally

Determination of notifiability requires a two-step analysis: whether a transaction is a "concentration", and whether it meets certain turnover thresholds. Under the Anti-monopoly Law of the People's Republic of China ("**AML**"), concentrations refer to mergers of undertakings,

¹ 《外商投资准入特别管理措施(负面清单)(2018年版)》[Special Administrative Measures for Foreign Investment Access (Negative List for Foreign Investment Access) (2018 Version)] (28 June 2018), available at: <http://www.mofcom.gov.cn/article/b/f/201806/20180602760432.shtml> (Chinese)

or the acquisition of control or the ability to exert decisive influence over other business undertakings. The turnover thresholds for merger filings include prior fiscal year aggregate business turnover (RMB 10 billion turnover worldwide or RMB 2 billion turnover in China) and individual business turnover (RMB 400 million turnover in China for at least two undertakings to the concentration). Special rules for turnover calculation are provided for financial institutions (10 times the standard threshold amounts). The time needed to complete a merger control filing varies significantly. Simplified procedure filings may take fewer than two months to clear. Normal procedure filings typically take four to six months, and could take as long as one to two years if there are serious competition concerns. In general, the State Administration for Market Regulation ("**SAMR**") clears most transactions without imposing any conditions. In 10 years of AML enforcement, the merger filing authorities have only issued 38 conditional clearances and only two cases were prohibited (one of them being Coca Cola's acquisition of Huiyuan Juice Company). Failure to report a notifiable transaction leads to fines (22 such cases to date). Theoretically, SAMR can order the unwinding of a transaction that has been closed to restore competition to the status quo ante, but this severe punishment has never before been imposed.

b. Relationship between AML enforcement authorities and industry regulators

SAMR, which is authorized by the AML to review merger filings, is now the only antitrust enforcement agency in China following the recent PRC State Council's institutional reforms. The financial services sector is heavily regulated by the relevant industry regulators, and traditionally these industry regulators have been heavy-handed when reviewing and approving acquisitions by foreign financial institutions of Chinese financial institutions. Traditionally, however, MOFCOM, the predecessor to SAMR, gave great deference to industry regulators with respect to merger filings, especially in regulated industries. There are few precedents in the financial services sector that are instructive about the regulatory boundaries between SAMR and industry regulators. The primary reason is that foreign financial service providers were not previously permitted to take controlling interests in Chinese financial institutions by way of acquisition.

c. The regulatory environment may now change

2018 marks the tenth year since the AML took effect, yet there have been few merger filings concerning foreign investment in the financial services sector. Over the past ten years, there have been only several merger filings that have involved foreign financial institutions acquiring shares of, or setting up a joint venture with, Chinese financial institutions. Examples include Warburg Pincus's acquisition of Fortune SGAM Fund Management Co., Ltd. (美国华平投资有限公司收购华宝兴业基金管理有限公司股权案), as well as the establishment of a joint venture among WL Ross and Co. LLC, Huabao Investment Co., Ltd. and other business operators (WL 罗斯有限责任公司与华宝投资有限公司等经营者新设合营企业案), etc.

This is partly due to the foreign ownership restrictions in respect of financial institutions.

However, it is clear that restrictions on foreign investment in the financial services sector are being relaxed, and it is anticipated that more merger filings will be made by foreign acquiring entities when they take control of Chinese financial institutions as a result of these new regulatory developments.

At the 2018 Boao Forum for Asia on 11 April 2018 (the "**2018 Boao Forum**"), China announced a series of opening-up commitments which offer broader development opportunities to foreign market players in the financial services sector, specifically:

- In the banking industry, China committed to (1) removing the limit on foreign ownership in commercial banks and offering equal treatment for foreign banks and domestic banks; (2) allowing foreign banks to open both subsidiaries and branches in China in parallel; and (3) substantially expanding the business scope of foreign-invested banks.
- In the securities industry, China committed to raising the limit on foreign ownership in securities firms up to 51%, and to removing this limit after three years. The permitted scope of business of foreign controlled securities firms will also be expanded in incremental steps.
- In the funds industry, China committed to raising the limit on foreign ownership in FMCs up to 51%, and to removing this limit after three years.
- In the futures industry, China committed to raising the limit on foreign ownership in futures companies up to 51%, and to removing this limit after three years.
- In the insurance industry, China committed to raising the limit on foreign ownership in life insurance companies up to 51%, and to removing this limit after three years.

Following the official announcement of these commitments at the 2018 Boao Forum, we have observed that some commitments have already been fulfilled by way of regulatory changes. For example, we have discussed the raising of foreign shareholding limit in securities firms to 51% in one of Han Kun's previous articles, "[China to Allow Foreign Control of Securities Firms: CSRC Officially Promulgates Measures for Administration of Foreign Investment in Securities Firms](#)"; in addition, on 28 April 2018, the Chinese regulator also confirmed that it now permits foreign investors to hold 51% stakes in FMCs in China, and the shareholding cap of 51% will eventually be removed in 2021². Other opening-up measures in the financial services sector have also entered the planning or consultation stage, such as in the futures and insurance industries.

Further, according to the 2018 Negative List jointly issued by NDRC and MOFCOM as we have

² 《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).

mentioned above in the *Executive Summary*, the previous requirements have been removed on the holding of a relative majority of shares by Chinese parties in securities firms, FMCs, futures companies and life insurance companies, which means that, effective 28 July 2018, foreign investors will officially be allowed to take controlling stakes of up to 51% in the these four types of financial institutions, and the 51% limit will be further removed by 2021.

As reported by the media, some international financial institutions have kicked off their initial communications with the regulators or have even submitted applications to take majority control of domestic financial institutions either by way of acquisition or by capital increase.

d. Possible strategies for foreign acquirers in relation to merger filings in China

Some acquirers prefer not to submit merger filings for business reasons. To achieve this objective, an acquirer must structure the transaction in a way so that it is not legally required to submit a merger filing. In minority acquisition transactions, this typically means veto rights are significantly watered down so that the acquirer only obtains veto rights associated with the protection of its minority interest, which does not result in the acquirer gaining control and thus the acquisition does not constitute a concentration transaction. If a foreign investor now takes a controlling interest in a domestic financial institution, this "dancing around the veto rights" approach may not work for outright acquisition of control transactions because it is clear that the acquirer will have obtained control of the target company by its 51% shareholding in the target financial institution. However, with respect to existing foreign minority joint venture financial institutions where the minority shareholder has significant veto rights, there may be room to argue that the quality of control by the foreign investor has not improved in a substantive way, because the shareholding increase from a minority to 51% does not in fact give the foreign investor increased control over the target company. Please contact us for specific legal advice on structuring transactions to suit your business needs or those of your clients.

e. Consequences for failure to file

SAMR may impose administrative penalties in cases of failure to submit merger filings or closing the transaction before obtaining clearance. The most frequent penalty is a fine, which is currently capped at RMB 500,000, with account taken of the nature, extent, and duration of the violation. For serious violations, SAMR also has the authority to order firms to dispose of shares, assets, and businesses to restore competition to the status quo ante, although none of these measures have been taken against an undertaking to date. During a SAMR failure to file investigation, refusal or obstruction of the investigation can lead to fines or even criminal charges. Refusal and obstruction typically include refusal to provide materials and information, the provision of false materials and information, or the concealment, destruction or transfer of evidence.

Concluding Remarks

The financial services sector in China is dominated by Chinese financial institutions. Foreign-invested companies have played only a minor role to date and have taken relatively little market share, even in specialized industry sub-segments. With the upcoming relaxation of foreign investment restrictions, it is possible that a foreign acquisition in this area could cause serious competition concerns in terms of substantial market share. In addition, antitrust regulators may also consider other factors that may affect competition, such as entry barriers based on technology and knowhow, conglomerate effects (capital availability and customer bases), etc. So far, MOFCOM/SAMR have not indicated how they will review merger filings for acquisition transactions by foreign financial institutions, and it is not clear how much deference SAMR will give to the relevant financial industry regulators. We will certainly see more merger filings as a result of the further opening-up of the financial services sector, and most of these filings may be cleared without conditions under the simplified filing procedure. Until now, foreign investors in the financial services sector have not been accustomed to submitting merger filings for their investments, and it is therefore necessary to be mindful that competition law will come to play a more important role in acquisition transactions as foreign investment restrictions are gradually withdrawn.

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