

# CHINA LEGAL REPORT\*

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## Measures for the Administration of Foreign-Funded Securities Companies

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## Measures for the Administration of Foreign-Funded Securities Companies

### I. Background

Since 2017, China has made steady progress in the opening up of Chinese financial industry.

The *Notice of the State Council on Several Measures for Expanding Opening Up and Vigorously Using Foreign Capital*, which was released on January 12, 2017, states that the relaxation of the service industry focuses on “the access of foreign capital to banking financial institutions, securities companies, securities investment fund management companies, futures companies, insurance institutions and insurance intermediary agencies”. Later in July, in the fifth National Financial Working Conference, President Xi emphasized the further opening of the financial market. In the notice released in August 2017, *Notice of the State Council on Several Measures for Promoting Growth of Foreign Investment*, the State Council announced that China was going to further reduce restrictions on foreign investment access. On November 10, 2017, the deputy Minister of the Ministry of Finance expressed that “China will broaden and gradually lift restrictions on foreign-funded investors in investment finance”.

Thus, on April 28, 2018, China Securities Regulatory Commission (“CSRC”) abolished the *Rules for the Formation of Securities Companies with Foreign Shareholders* (“the Rules”) and issued the *Measures for the Administration of Foreign-Funded Securities Companies* (“the Measures”) in order to meet the need to open up the securities market to foreign investors, to strengthen and improve the supervision and administration of foreign-funded securities companies and to specify the conditions and procedures for the establishment of foreign-funded securities companies.

## II. Main Content

The measures have mainly four key points as follows:

### A. Qualified Foreign Capital as the Controlling Shareholder of Joint-Venture Securities Companies

According to article 10 of the Rules, the shareholding of foreign shareholders or the stake of foreign shareholders in a securities company with foreign shareholders shall not exceed 49% cumulatively (including direct shareholding and indirect control).

Instead of a clear limitation on the proportion of foreign shareholder shareholding, article 7 of the Measures regulates as follows:

*The proportion of equity cumulatively held by foreign shareholders (including direct holding and indirect control) in a foreign-funded securities company shall conform to the arrangements of the state on opening up the securities industry.*

However, we can still understand the approach of the Measures on this issue under two aspects. The first one is the change of names of the two documents. The change in expression in the titles of the Rules and Measures, respectively "Securities Companies with Foreign Shareholders" and "the Foreign-Funded Securities Companies" implies the State Council's recognition of the foreign shareholders' obtaining of controlling capacity. The second aspect can be inferred in article 2 of the Measures. Pertaining to the definition and scope of foreign-funded securities companies, the subsection 3 refers to:

*(3) securities companies resulting from modification of domestic-funded securities companies according to the law due to the modification of actual controllers of shareholders of domestic-funded securities companies into foreign investors.*

Therefore, under the Rules, a foreign shareholder is capable of being the actual controller of a security company.

This change is a milestone in the opening up of Chinese financial market, which means the transfer of the status of foreign capital from participating in to controlling the securities companies is now confirmed by the law.

Recently, on 2 May 2018, the Swiss UBS Group, as very first global financial institution, applied for majority control to CSRC. UBS Group applied for raising its shareholding proportion in its Chinese joint-venture, the “UBS Securities Co., Ltd.”, from 24.99 percent to 51 percent for absolute control, according to information released on the website of CSRC on 2 May 2018. CSRC has accepted and is currently reviewing the application by the UBS Group.

#### B. Extension of the Business Scope of Joint-Venture Securities Companies

The Rules have enumerated the businesses that a Joint-Venture security company can operate:

*Article 5 Securities companies with foreign shareholders may engage in the following businesses:*

- 1. Underwriting and recommendation of stocks (including RMB common stocks and foreign capital stocks) and bonds (including government bonds and corporate bonds);*
- 2. Brokerage of foreign capital stocks;*
- 3. Brokerage and proprietary trading of bonds (including government bonds and corporate bonds); and*
- 4. Other businesses approved by the CSRC.*

In this article, the business scope of a Joint-Venture securities company is rather limited compared to domestic securities companies, which severely affected the competitiveness of the former.

The authority realized this problem and deleted the limitation. In article 5 of the Measures, when mentioning the establishment requirements for a foreign-funded securities company, the regulation on the business scope is:

*2) The company's initial business scope shall be commensurate with the experience of its controlling shareholder or largest shareholder in operating securities business.*

Therefore, the Joint-Venture securities companies are allowed to gradually apply to increase their business scope in accordance with the laws.

### C. Relaxed Restrictions on the Proportion of Shares Held by Foreign Shareholders in Listed Securities Companies

Before the publication of the Measures, the Rules set caps on the proportion of shares of a listed domestic-funded securities company held by foreign investors, namely 20% for single foreign investor and 25% for multiple foreign investors.

The limitation of 20% and/or 25% significantly restricted the financing capacity of a domestic securities company financing in the international market and also the investment capacity of foreign capital.

For the purpose of deepening the reform of the Chinese financial market, the Measures changed this situation by article 7:

*The proportion of equity cumulatively held by foreign shareholders (including direct holding and indirect control) in a foreign-funded securities company shall conform to the arrangements of the state on opening up the securities industry.*

The restriction of 25% and 20% is therefore abolished, but article 7 refers to the arrangements of the state on opening up the securities industry, which is 51% as of now.

#### D. Clarification of Policies on the Modification of the Nature of Domestic-Funded Securities Companies Due to the Modification of Actual Controllers

As mentioned above, one kind of foreign-funded securities companies regulated by the Measures, among others, are securities companies resulting from modification of domestic-funded securities companies due to the modification of actual controllers of shareholders of domestic-funded securities companies into foreign investors.

As an unprecedented change in the history of the opening process of the Chinese financial market, there are six articles in total in the Measures specifically regulating the requirements and procedures of this kind of transfer.

Article 14 of the Measures clarifies in detail that:

Where a domestic-funded security companies applies to change to foreign-funded securities companies, it shall also be subject to the establishment conditions of a foreign-funded securities company provided under the Measures. The newly joined foreign investors shall still meet the conditions for foreign investors as set forth under article 6 of the Measures, while in the meantime, their acquired, invested or indirectly controlled equities shall also be subject to the required ratio under article 7 of the Measures.

Article 15 of the Measures enumerates the documents needed in detail, which, later formulated in article 16, should be examined by CSRC according to the laws and replied to in a timely manner. Compared to the Rules, the following documents need to be submitted additionally:

- (1) The resolution of its shareholders' meeting regarding modification of it into a foreign-funded securities company.*

*(2) Supporting documents on the foreign shareholder's good international reputation and business performance, leading position in the world in terms of business scale, revenue, and profits in the recent three years, and long-term credit rating in the recent three years.*

The Measures also regulate the modalities for the modified securities companies to fulfill the registration requirements and other procedures. All the detailed formulations show the determination of the Chinese authority to advance in the opening up and reformation of the Chinese financial market. In addition, foreign shareholders and foreign-funded securities companies benefit from the detailed requirements in the transfer process.

### **III. Conclusion**

The abolishment of the Rules and the issuing of the Measures is a step into the right direction in the opening up of the Chinese market and will influence the financial market especially concerning securities business operation.

The Measures have taken down quantities of restrictions in this area. Among all of these, the removal of the double-restriction of both the proportion of shareholding by foreign shareholders in listed securities companies and the business scope for foreign-funded securities companies is the most significant one. The changes not only act as encouragement for foreign investment and cooperation of domestic and foreign capital, but also impose pressure on domestic securities companies and markets which will advance the reformation in another way.

According to the spokesperson of CSRC, during the process of discussion and opinion gathering of the Measure before the official issuing date, many major financial institutions have come to CSRC for

relevant information and prepared application documents. As the Measures came into effect on the issuing date, there have already been some foreign-funded securities companies besides the UBS Group, which have submitted their application, including JPMorgan and Nomura. CSRC's response to the very first application for majority control of the UBS Group is eagerly awaited. It will be seen, if UBS Group will be the very first global bank to have a majority of 51 percent of a Chinese securities venture.

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