New Legislation on Foreign-funded Financial Institutions in China

——— David Yu

After approximately 13 years' negotiations, China became a WTO member on December 11, 2001. It is expected that China will open its doors much wider than before after entering the WTO. To honor China's commitments to the WTO, now the China's legislatures are busy cleaning up and amending the laws and regulations that are not in conformity with WTO rules. China's financial service, as an extremely important sector in its service trade, has attracted a great deal of attention both at home and abroad. On December 12, 2001 the State Council promulgated the Regulations of the People's Republic of China Concerning the Administration of Foreign-funded Financial Institutions (the "New Regulation"), which has replaced the Previous Regulation (the "Previous Regulation") enacted by the State Council on February 25, 1994.

The New Regulation governs the following financial institutions established and engaging in financial services business in China in accordance with the relevant laws and regulations of the PRC:

1.Foreign-funded banks with the headquarters in China ("Wholly-foreign-funded Bank");

2.Branches of foreign banks in China ("Foreign Bank Branch");

3.Banks jointly established by foreign financial institutions and Chinese companies or enterprises ("Equity Joint Venture Bank");

4.Foreign-funded financial companies with headquarters in China ("Wholly-foreign-funded Financial Company"); and

5.Financial companies jointly established by foreign financial institutions and Chinese companies or enterprises ("Equity Joint-Venture Financial Company").

Compared with the Previous Regulation, the New Regulation has made the following significant amendments in line with the commitments that China has made when joining the WTO.

The Investors

The New Regulation loosens the restrictions on the Chinese investor of the Equity Joint Venture Banks and the Equity Joint Venture companies, while no substantial changes are available to the foreign investors. According to Article 2 of the New Regulation, Chinese companies and enterprises including non-financial institutions are allowed to invest into the Equity Joint Venture Banks and the Equity Joint Venture companies. Although he New Regulation has not provided the requirements and qualifications of the Chinese investors of the Equity Joint Venture Banks and the Equity Joint Venture companies, it appears that the forthcoming implementing rules of the New Regulation will specify the requirements and qualifications in this regard.

Many countries including China have strengthened the supervision over financial institutions after the Asia financial crisis in 1997. The New Regulation follows this tendency as well when specifying the documents the foreign investors shall submit for approval. When applying for setting up the foreign-funded financial institutions, in addition to other conditions set out in the Previous Regulation, the foreign investors shall be under the effective supervision by the competent authorities where the foreign investor located and shall have obtained approval of such authorities for setting up a financial institution in China. Further, the foreign investors shall meet the prudent requirements set by the PBOC. However, the New Regulation does not specify the prudent requirements, as expected, the forthcoming implementing rules will set out these prudent requirements, which may include the corporate governance, risk management system, internal control system, management information system, no record of violation of law or other misconducts and anti-money-laundering system, etc..

The Registered Capital

According to the New Regulation, the respective minimum registered capital of a Wholly-foreign-funded Bank, an Equity Joint Venture Bank, a Foreign-funded Financial Companies and an Equity Joint Venture Financial Company remains unchanged. However, the investors of these financial institutions are required to fully contribute the registered capital into these financial institutions, which replaced the corresponding stipulation of contributing 50% of the registered capital as the paid up capital of the Previous Regulation. Also, the New Regulation grants the People's Bank of China ("PBOC") the right to increase the minimum capital requirement and to set out the proportion of the contribution of the registered capital in RMB, aiming to adjusting the requirements of the registered capital and contribution in RMB when China gradually opens its financial market to the foreign investment as Chinese government has committed.

It draws more attention that, unlike any other foreign-funded enterprises in China, the investors of a proposed foreign-funded financial institution are required to make the contribution of the registered capital before the financial institution formally obtains approval from the PBOC and the Business license, according to Article 14 of the New Regulation.

Scope of Business

The New Regulation also reflects China's commitment to open its financial market in terms of the business scope of the foreign-funded financial institutions. In addition to those prescribed by the Previous Regulation (except those replaced by the New Regulation), either of the Wholly-foreign-owned Bank, the Foreign Bank Branch and the Equity Joint Venture Bank may also engage in any and all of the following business subject to approval of the PBOC:

1.the letter-of-credit services;

2.inter-bank loans;

3.deposit-taking (replacing the restriction on domestic currency and the client);

4.short-term, medium-term and long-term lending (replacing foreign currency lending);

5.bill-acceptance and bill-discounting (replacing foreign currency bill-discounting);

6.guarantee (replacing foreign currency guarantee);

7.bank card business (replacing foreign currency credit card payment) ;

8.foreign and domestic settlement (replacing import and export settlement);

9.foreign currency exchange (replacing foreign currency dealing and brokerage); and

10.buying and selling government bonds, financial bonds and foreign currency securities other than stocks (replacing approved foreign currency investment).

Subject to approval of the PBOC, either of the Wholly-foreign-owned Financial Company and the Equity Joint Venture Financial Company may also engage in any and all of the following business, in addition to those prescribed by the Previous Regulation (except those replaced by the New Regulation).

1.deposit of RMB 1,000,000 (replacing USD100,000) or equivalent free convertible currencies in minimum of each deposit with a maturity of not less than three months;

2.short-term, medium-term and long-term lending (replacing foreign currency lending);

3.bill-acceptance and bill-discounting (replacing foreign currency bill-discounting);

4.buying and selling government bonds, financial bonds and foreign currency securities other than stocks (replacing approved foreign currency investment);

5.guarantee (replacing foreign currency guarantee);

6.foreign currency exchange (replacing foreign currency dealing and brokerage); and

7.inter-bank loans.

The New Regulation also allows the foreign-funded financial institutions, within the approved business scope, to develop and adapt new business products, subject to the approval of the PBOC. It is reported that the term of new business products means the financial products or services not available in China or those have been provided in China but are relatively risky. Further, it seems that the foreign-funded financial institutions is not required to obtain the permit of foreign currency business from the State Administration on Foreign Exchange, according to the New regulation. As to the restriction on the foreign financial institutions' RMB business, again, the New Regulation grants the PBOC the capacity and power to set out the limitation on the geographic area and the customers, it is believed that the PBOC will follow China's commitments to the WTO when setting the rules.

Supervision and Administration

Aiming to follow the progress of granting national treatment to the foreign-funded financial institutions, the New Regulation adapts some of the rules as same as or similar to those applicable to the financial institutions with domestic investment. Except for the Foreign Bank Branch, the foreign-funded financial institutions, inter alia, are required to meet the requirements such as capital adequacy ratio of not less than 8%, the ratio of the balance of floating assets to the balance of floating liabilities shall not be lower than 25%, the ratio of the outstanding of loans granted to the same enterprise or the affiliates shall not exceed 25% of its capital, the ratio of the fixed assets to the equity interests shall not exceed 40%, the ratio of the deposit in foreign currencies taking in China to the total assets in foreign currencies in China shall not exceed 70%, etc..

In addition, the foreign-funded institutions are required, inter alia, to submit to the PBOC for approval and register with the State Administration on Industry and Commerce or its branches when adjusting the business scope, amending the articles of association and changing the shareholder(s) who holds not less than 10% of the capital or the total amount of shares. Also, the New Regulation increases the amount of penalty and adapts criminal liabilities for violation of the regulations.

On December 26, 2001, the Banking Supervision Department of the PBOC released the draft implementing rules to the New Regulations for soliciting comments. It is expected tat the New Regulation as well as the forthcoming implementing rules will pave the way for the foreign-funded financial institutions to completely access to the China's commercial banking market.