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## Opportunities and Challenges: China will Lift the Ceiling on Foreign Ownership Limits in Joint-Venture Securities Companies Up to 51%

By Christophe Han and Leo Wang

On 10 November 2017, in a briefing of State Council Information Office, Mr. Zhu Guangyao, the Vice Minister of Finance indicated that China will lift the ceiling on foreign equity ownership limits in joint-venture firms involving directly or indirectly in futures, securities and funds markets up to 51%, and after three years, will remove all equity ownership limits in these sectors.

### I. New Policy

In October 2012, the China Securities Regulatory Commission (“CSRC”) lifted the ceiling on foreign equity ownership limits in joint-venture securities companies from 1/3 to 49% by amending the *Rules for the Formation of Securities Companies with Foreign Shareholders (2012 Revision)*. Under the Rules, joint-venture securities companies that have been established include Goldman Sachs Gao Hua Securities Company Limited, UBS Securities Co. Limited, Citi Orient Securities Company Limited, Zhong De Securities Company Limited, Morgan Stanley Huaxin Securities Company Limited, J.P. Morgan First Capital Securities Co., Ltd. and so on.

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In August 2013, authorities from Mainland China signed *Supplement X to the Mainland and Hong Kong Closer Economic Partnership Arrangement* with Hong Kong, and *Supplement X to the Mainland and Macao Closer Economic Partnership Arrangement* with Macao.

In August 2015, CSRC published the *Implementation of Relevant Policies concerning the Supplement X and Further Opening-up of Securities Operation Institutions* which allows Hong Kong and Macao financial institutions to invest in one joint-venture securities company with full licenses in City of Shanghai, Guangdong Province and City of Shenzhen respectively. What's more, Hong Kong and/or Macao investors' ownership percentage of the joint-venture securities companies could reach up to 51%, while mainland shareholders are not limited to securities companies.

Under the *Supplement X*, joint-venture securities companies formed between Mainland and Hong Kong, and between Mainland and Macao started applying for establishment in succession. So far, four applications for establishment of joint-venture securities companies have been approved, among which, the first batch of approved joint-venture securities companies Shengang Securities Company Limited ("Shengang Securities") and China Renaissance Securities (China) Co., Ltd. ("China Renaissance") opened for business last year. As the first approved joint-venture securities company in Mainland China pursuant to the CEPA agreement, Shengang Securities was granted the license in 10 October 2016 for engaging in businesses of securities management and any other business permitted by the CSRC. So far, Shengang Securities has established 10 branches and 4 departments in ten cities including Shanghai, Beijing, Shenzhen. China Renaissance was granted the license in 28 October 2016 for its business operations including investing in banks, asset management, brokerage, wealth management etc.. East Asia Qianhai Securities Company Ltd and HSBC Qianhai Securities Ltd which were approved for establishment in June 2017 are yet to open for business. Among those companies, the Hongkong and Shanghai Banking Corporation Limited owns 51% of shareholding in HSBC Qianhai Securities Ltd making the HSBC Qianhai Securities Ltd the first joint-venture securities company controlled by a foreign investor. Furthermore, according to CSRC's public announcement, up to now there are 18 joint-venture securities companies waiting in line for approval of establishment.

In October 2015, the People's Bank of China, Ministry of Commerce of the People's Republic of China (MOFCOM), China Banking Regulatory Commission, CSRC, China Insurance Regulatory Commission, State Administration of Foreign Exchange, Shanghai Municipal Government jointly promulgated the *Pilot Program for Further Promoting Financial Openness and Innovation in China (Shanghai) Pilot Free International Financial Center* in which joint-venture financial institutions are allowed to establish joint-venture securities companies in the Pilot Free Trade Zone. Under the Program, the shareholding percentage of foreign investors shall not exceed 49%, however the domestic shareholders are not limited to securities companies and the business scope of joint-venture securities companies is expanded.

In light of the new policy which enables the aggregate shareholding percentage of foreign investors in a joint-venture securities company in Mainland to reach 51%, foreign investors are able to control the

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securities companies through investment (including the establishment and acquisition). Unlike the previous policy which only allows the raise of the shareholding percentage of foreign investors, the new policy is truly a relaxation on the restrictions for foreign investors investing in securities business in Mainland China.

## **II. Opportunities and Challenges**

The restrictions on the shareholding percentage have always been the primary obstacles for the foreign investors to invest in securities companies in Mainland China. The announcement of the new policy shall be seen as a major breakthrough for the following reasons: 1. Although the *Rules for the Formation of Securities Companies with Foreign Shareholders (2012 Revision)* raised the upper limit of the shareholding percentage of foreign investors to 49%, the securities companies are still under control of domestic shareholders. 2. The *Supplement X* allows the establishment of Mainland-Hong Kong or Mainland-Macao joint-venture securities companies in Beijing, Shanghai and Guangdong, however the special treatment was solely enjoyed by Hong Kong and Macao financial institutions, not by transnational financial institutions. 3. The new policy lifts the restrictions on the shareholding percentage without applying restrictions on the business scope of the joint-venture securities companies. The foreign investors are expected to achieve taking control of securities companies with full licenses.

Meanwhile, we also notice that, the implementation of the new policy still poses many challenges for foreign investors who intent to take control of securities companies in Mainland China whether through ways of establishment and/or acquisition.

### **1. The Qualifications of Shareholders**

There are numerous ways for the foreign investors to achieve holding 51% shares of the joint-venture securities companies such as by establishing a new company, share transfer or share increase. Regardless of which way, they will always face the problem which is the qualifications of shareholders: 1. Other than the restrictions on the shareholding percentage, the foreign investors shall also conform to relevant provisions specified in the *Rules for the Formation of Securities Companies with Foreign Shareholders (2012 Revision)*, and the *Working Guidelines No.10 for the Examination and Approval of Administrative Licensing for Securities Companies*. 2. Foreign investors shall meet the qualifications of the principal shareholder of the securities company who is to hold more than 25% shares or is the first majority shareholder with more than 5% shares. If a foreign investor intends to hold more than 51% shares of a securities company while it is not already a shareholder in the company, or it holds less than 25% shares of the company, it must comply with further relevant provisions of the *Securities Law of the People's Republic of China* and meet any other requirements set by CSRC pertaining to the qualifications of the principal shareholder.

### **2. The Procedure of Administrative Approval**

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To establish a new securities company especially with a joint-venture structure, careful considerations are needed. In addition to preliminary feasibility studies, plans and preparations, a great deal of procedures of administrative approvals need to be obtained. The procedures include applying to State Administration for Industry and Commerce of the People's Republic of China for the approval of reservations of the company's name, the approval of the CSRC, applying to MOFCOM for undergoing the recordation formalities, the handling of the industrial and commercial registration in the place of incorporation, applying to the local bureau of the CSRC for the approval of articles of association and the appointment of directors, supervisors and senior managers and applying to the CSRC for the license for engaging in securities or futures management business. The foreign investors may be subject to the CSRC's demands of supplementing further application materials and answer to certain questions during the examination and approval process, the main purpose of which is to focus on the comprehensive examination of substantive issues, such as the qualifications of the shareholders and compliance of the establishment of the company.

### 3. The Identification of Foreign Investors

Although the new policy lifted the restrictions on foreign investors' cap on 51% shareholding percentage, the new policy hasn't given a clear definition of the "Foreign Investor". There are many requirements of establishing a joint-venture securities company under the *Supplement X*, including the citizen status of the actual controller of the Hong Kong or Macao financial institutions, the place of incorporation and the domicile of the headquarters. These requirements are aimed to prevent fake "Hong Kong or Macao investor" from enjoying the preferential policy through structure design. Therefore, we aim to draw attention to the question which needs to be further demonstrated: 1. does the round-tripping investments by Chinese residents through special purpose vehicles account as the investments of a "foreign investor"; and 2. are they eligible for the new policy?

### 4. The Supervision of Licenses

In addition to the above-mentioned items, a joint-venture securities company will also face the issue of licenses supervision. It takes a long time of accumulation before a new securities company in Mainland China grows into a certain scale. Moreover, the leading securities companies in Mainland China are way ahead of other small and medium-sized securities companies in terms of scale, market share, popularity, rating and capital. Under these business circumstances, to aim for surpassing the leading securities companies through single business segment will be obviously difficult. Consequently, the scope of business and the full license are extremely important to the joint-venture securities companies.

To sum up, during the execution of the new policy, a series of challenges such as the qualification of shareholders, the procedures of administrative approvals, the identification of foreign investors, the supervision of licenses and so on are still to be discussed and explored in the upcoming practice.

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