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China Alert

China's Relaxed Financial Sector May Aid Foreign Investors

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While the world contends with the COVID-19 crisis and its economic and financial impact, China is quietly opening its doors to its financial sector, inviting more foreign financial institutions, banks, insurance providers and other financial service companies to set up shop in China.

On March 27, the Chinese government granted approval for both The Goldman Sachs Group Inc. and Morgan Stanley to obtain majority ownership interest over their Chinese subsidiaries, demonstrating China's commitment to open its financial sector to foreign players.

China had discussed opening up its financial sector for years. In 2016, it abolished the old foreign investment approval system, which requires governmental approval for foreign direct investments in any industry not specifically permitted and changed it to a filing system under which all sectors were opened up for foreign direct investments except for certain specific industries set forth on the so-called negative list.

In 2018, China announced that it was going to relax the restrictions on foreign investment in the financial sector and subsequently adopted a series of rules and regulations easing restrictions, including:

- Allowing foreign securities companies to own controlling stakes in joint ventures;
- Allowing foreign banks to distribute, redeem and underwrite government bonds;
- Quadrupling daily quotas for mutual stock market access between mainland China and Hong Kong; and
- Allowing foreign investors to own up to a 51% ownership interest in domestic futures brokers.

On July 20, 2019, the Office of Financial Stability and Development Committee under the State Council published the Relevant Measures for Further Opening Up the Financial Sector, or the 11 measures,[1] which were viewed as a significant step taken by the Chinese government to further open its financial sector.

The 11 measures target almost all the financial subsectors and provide greater market access to foreign investors. Highlights from the 11 measures include:

Ownership Caps Removal Deadlines

Setting deadlines for removing foreign equity ownership caps in securities, fund management, futures, and life insurance sectors in 2020, a year earlier than the deadline previously published.

Insurance and Insurance Asset Management Companies

Foreign investors in insurance companies are no longer required to meet the qualification that it must have engaged in the insurance business for more than 30 years. Foreign investors can now own more than a 25% equity interest in insurance asset management companies.

Pension Fund

Foreign pension funds are permitted to establish or participate in Chinese pension fund management companies.

Asset Management Companies

Foreign financial institutions are encouraged to invest in asset management subsidiaries of commercial banks and are permitted to set up foreign-controlled asset management companies with Chinese banks or insurers' subsidiaries.

Credit Rating Agencies

Foreign rating agencies can now give rating to all kinds of bonds traded on China's interbank market and exchanges.

Bond Market

Restrictions on underwriting licenses for foreign banks have been lifted. Foreign-funded banks can now apply for type-A lead underwriting licenses in the interbank bond market and act as the lead underwriters for domestic bonds. The 11 measures also provided that the Chinese government would further facilitate foreign institutional investors' investment in the interbank bond market.

Currency Brokerage

Foreign investors will be given support to establish wholly foreign-owned currency brokerage companies in China. Wholly foreign-owned currency brokerage firms have been theoretically feasible under an existing pilot program, but no such company has been approved since the pilot program began in 2005.

The 11 measures are a welcome development for foreign financial service providers. After their publication, a series of rules and regulations were adopted or promulgated to further implement the policies announced in the 11 measures.

On October 15, 2019, the State Council published an order[2] amending the Regulation of the People's Republic of China on the Administration of Foreign-Funded Insurance Companies[3] and the Regulation of the PRC on the Administration of Foreign-Funded Banks,[4] aiming to relax the restrictions in the insurance sector and banking sector, respectively.

Insurance

With respect to the insurance sector, the amended regulations removed the two requirements that a foreign insurance company must have been engaged in the insurance business for more than 30 years, and that it must establish a representative office in China and have operated for more than 2 years at the point of applying for establishing a foreign-funded insurance company, or FFIC. In addition, foreign financial institutions are permitted to invest in the FFICs.

Banking

As for the banking sector, major changes under the amended regulations include:

- Removing the requirement that the sole/major Chinese shareholder of a joint-venture bank be a financial institution;
- Allowing foreign banks to establish foreign bank PRC branches and locally incorporated banks in China at the same time;
- Removing the minimum $10 billion total asset requirement on each foreign shareholder of a wholly foreign owned bank or a joint-venture bank, as well as the minimum $20 billion total asset requirement on each foreign shareholder of a foreign bank PRC branch;
- Lowering the minimum amount requirement for a foreign bank branch to accept the fixed term deposit from Chinese residents from RMB 1 million to RMB 0.5 million; and
- Eliminating the approval and licensing requirements for a foreign bank to conduct RMB business.

As of January 1, as announced by China Securities Regulatory Commission in a notice dated Oct. 11, 2019,[5] China removed the foreign equity ownership cap in futures companies. As of April 1, China further removed the foreign equity ownership cap in securities companies and fund management companies according to the decisions made by CSRC in its notices dated March 13, 2020,[6] and October 11, 2019, respectively.

On May 7, the People's Bank of China and the State Administration of Foreign Exchange, or SAFE, jointly issued the Administrative Provisions on Domestic Securities and Futures Investment Capital of Foreign Institutional Investors,[7] which removed the restrictions on investment quotas of qualified foreign institutional investors and RMB-qualified foreign institutional investors.

Foreign investors now no longer need to apply for any quotas under China's two inbound investment channels — the dollar-dominated qualified foreign institutional investor, or QFII, scheme and its yuan-denominated sibling, RQFII. Instead, qualified foreign investors will now be required to register in a management system for cross-border capital inward remittances and exchanges.

The administrative provisions are aimed to implement the decision announced by SAFE on Sept. 10, 2019 to remove the investment quota restrictions on both QFIIs and RQFIIs.

In addition to the above promulgated rules and regulations, China has also pledged a series of measures in the China-U.S. Phase One Trade Deal signed in January to provide greater access for U.S companies to China's financial services market[8].

In the phase one trade deal, China has affirmed certain steps it had already been taking towards opening its insurance, securities, fund management, futures and credit rating services market to foreign investments. Moreover, China has also made several commitments to further open its market to U.S. investors in the following sectors:

Banking Services

China has agreed to allow branches of U.S. financial institutions to provide securities investment fund custody services, and the parent company's overseas assets shall be taken into consideration in order to fulfill assets level requirements.

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Electronic Payment Services

China has agreed to allow U.S. electronic payment service providers to operate in China as wholly foreign-owned entities and to apply for license for bank card clearing business.

Financial Asset Management (Distressed Debt) Services

China has agreed to allow U.S. investors to directly set up local financial asset management companies with access to the primary distressed asset market. Currently foreign investors are only allowed to invest in the secondary market.

Though the implementation details of the above rules, regulations and commitments in certain areas remain unclear, a few foreign financial institutions and service providers have already started to take action.

For example, in the asset management industry, BlackRock Inc. and Neuberger Berman Group LLC have both applied to set up wholly owned mutual fund companies in China; JPMorgan Chase & Co. is seeking full control of its mutual fund management joint venture; and The Vanguard Group Inc., Fidelity Investments LLC, Van Eck Associates Corp. and Schroders PLC have all indicated their intention to apply for licenses for 100% owned subsidiaries.

In the securities industry, HSBC Holdings PLC, UBS AG, Nomura Holdings Inc. and JPMorgan, Morgan Stanley, Goldman Sachs and Credit Suisse Group AG have all obtained approval from the Chinese government for majority stakes in their respective local joint ventures.

In the insurance industry, Allianz SE had obtained the green light to set up the first wholly-foreign-owned insurance holding company, and Standard Life Aberdeen PLC had also obtained approval to provide pension insurance through its local joint venture.

In other sectors, American Express Co. and Mastercard Inc. have both obtained approval to build a bank card network and a clearing business joint-venture with local partner, and Visa Inc. is also in the process of seeking bank card clearing business license. The People’s Bank of China published a statement on June 13, 2020, stating that they have granted a network clearing license to American Express’s China joint venture, Express (Hangzhou) Technology Services.

Lastly, Moody's Corp. and Fitch Ratings Ltd. have both applied to rate Chinese domestic bonds as wholly foreign-owned companies, and on May 14, PBOC announced that it has accepted Fitch Ratings' application, making the company the second foreign credit rating agency officially approved to enter the Chinese market, after the entry of S&P Global Inc. in 2019.

There is no doubt that China's opening-up policies will attract a flow of foreign investments to China's financial sector, a $5 trillion industry. We expect to see a surge of investments from abroad, both in the form of joint ventures where foreign partners own a controlling equity interest and in the form of wholly owned foreign entities in the banking, securities, insurance and other financial services industries.

As for the private equity industry, we have not seen any significant regulatory loosening yet. However, China's opening-up policies, not to mention its government mandated drive to attract foreign investments during the economic reopening after the COVID-19 pandemic, will certainly provide more opportunities for the foreign private equity funds.

Though it is still difficult now for most foreign private equity funds to establish their own licensed financial institutions in China due to the high barriers to entry, foreign private equity funds can utilize the Qualified Foreign Limited Partners Pilot Program to set up foreign-funded limited partnerships with special business purposes to make investments in China.

In light of the newly adopted foreign investment law and the significantly shortened foreign investment negative list, qualified foreign limited partners are now permitted to apply for a more flexible scope of business and are offered more diversity in the type of investments they can make in China.

For example, with the significantly shortened negative list, foreign private equity funds are now permitted to set up foreign-funded companies in certain areas of China engaging in the commercial real estate development and management business.

As China further opens its market and relaxes the restrictions on foreign ownership, we expect there to be more channels and platforms for foreign private equity funds to invest in China.

For more information on China related topics, please see the following resources:

- Is There a Law in China Similar to the US Defense Production Act? Jasmine Yang, Edward Lebow and Liza Mark in *Law360*, May 8, 2020
- Coronavirus Brings Force Majeure Claims to LNG Contracts, Rob Patterson, Shu Shu Wong in *Law360*, March 4, 2020
- The Rise of China, Rob Patterson, Myles Mantle, Liza Mark in *LNG Industry*, March 4, 2020
- Coronavirus Fears Cast Cloud Over Dealmaking, Liza Mark in *Law360*, February 27, 2020
- Is Your China Chemical Plant in Danger of Being Shut Down, Liza Mark in *Lexology*, December 2019

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[1] Office of Financial Stability and Development Committee of the State Council, China's Central Government, "Relevant Measures for Further Opening Up Financial Sector" (Effective on July 20, 2019).

[2] State Council's Order to Amend the Regulation of the PRC on the Administration of Foreign-Funded Insurance Companies and the Regulation of the PRC on the Administration of Foreign-Funded Bank (Order No. 720).

[3] Regulation of the PRC on the Administration of Foreign-Funded Insurance Companies (Amended on Sept. 30, 2019).

[4] Regulation of the PRC on the Administration of Foreign-Funded Bank (Amended on Sept. 30, 2019.

[5] China Securities Regulatory Commission Notice (Oct. 11, 2019).

[6] China Securities Regulatory Commission Notice (March 13, 2020).

[7] Joint Statement of People's Bank of China and the State Administration of Foreign Exchange (2002) No. 2 "Administrative Provisions on Domestic Securities and Futures Investment Capital of Foreign Institutional Investors."

[8] "Economic and Trade Agreement Between the Government of the United States of America and the Government of The People's Republic of China," dated Jan. 15, 2020.