

Setting up a Financial Institution in the People's Republic of China

CHARLTONS
易周律師行
Solicitors

Hong Kong

Shanghai

Beijing

Yangon

www.charltonslaw.com

Contents

1. Executive Summary.....	1
2. Commercial Banks.....	4
3. Securities Company.....	10
4. Securities Investment Fund Management Companies	14
5. Futures Companies	18
6. Currency Brokerage Companies.....	22
7. Enterprise Group Finance Companies.....	27
8. Tax Issues.....	34
9. Others Financial Entity Structures Permitting Foreign Investments	35
10. New regime: shanghai pilot free trade zone.....	38

Note:

We only advise on Hong Kong law. This note is based on our understanding of the position under the laws of the People's Republic of China as at 20 September 2014.

1. EXECUTIVE SUMMARY

This note has been prepared for overseas companies (the “**Company**”) to provide an overview of certain financial entities (including commercial banks, securities companies, securities investment funds management companies, futures companies, finance companies of enterprise groups and currency brokerage companies) in the People’s Republic of China (“**PRC**” or “**China**”) which the Company may consider setting up or acquiring for the purpose of carrying out, *inter alia*, trading of local and foreign securities (for clients or its own account), investment, lending, financing and other general banking activities.

As set out in detail below, foreign investment in the Chinese financial sector is subject to a number of restrictions. In September 2013, the Chinese government established the China (Shanghai) Pilot Free Trade Zone in which it intends to experiment with a number of economic reforms, including in particular the liberalisation and innovation of its financial sector. The blueprint for the new zone envisaged increased scope for private and foreign investment in the banking sector within the zone. Some nine months on, however, the proposals remain at the policy level only and further implementing regulations will be necessary to bring them to fruition. Nevertheless, there is a clear policy commitment to implementing a wide range of financial reforms on a trial basis in the zone, and the first of these, in the form of the reform of the administration of foreign exchange procedures for entities established in the zone have already been implemented. It is likely that the major reforms in terms of allowing free convertibility of the Renminbi (“**RMB**”) and relaxation of deposit interest rates will be implemented first in the Shanghai Free Trade Zone. Thus, while the restrictions on foreign investment in financial institutions in the zone are not yet any less stringent than those that apply outside the zone, with the exception of the removal of a requirement to have had a China representative office for two years prior to applying to establish another type of financial institution, setting up in the new free trade zone is likely to offer the most opportunities in the long term.

Commercial banks

According to the Annual Report issued by the China Banking Regulatory Commission (the “**CBRC**”), as at the end of 2012, banks from 49 countries and regions had set up 42 locally incorporated entities (including both wholly foreign-owned banks and Sino-foreign joint venture banks), 95 branches of foreign banks and 197 representative offices in China. Despite the rising importance of foreign-funded banks in China, restrictions remain on foreign entry to China’s banking sector.

Chinese regulatory restrictions limit the stake which foreign institutions can take in domestic banks to no more than 20%. This rules out acquisitions and means foreign banks must build their Chinese businesses from scratch. In doing so they face considerable competition from their domestic rivals which benefit from extensive branch networks; by way of example, Bank of Communications, a domestic institution of which HSBC owns 19%, has 2,690 branches,¹ while HSBC, currently has the most China branches of any foreign bank with 160.

The options for a foreign bank looking to establish or acquire a commercial bank in China are to set up one of the following:

- a locally incorporated bank in the form of a wholly foreign-owned bank (“**WFOE Bank**”);
- a Sino-foreign joint venture bank with a PRC investor (“**JV Bank**”); or

¹ “Foreign banks in China – Lenders of little resort”, The Economist, June 28th 2014

- setting up branch(es) and/or sub-branch(es) of the Company (“**Foreign Bank Branch**”) in China.

Generally, regardless of the form the Company prefers, a representative office (“**Representative Office**”) has to be set up initially; for a WFOE Bank or a Foreign Bank Branch, the Representative Office must have been in existence for at least 2 years whereas no time limit is prescribed for a JV Bank.

Securities companies

Foreign investment is allowed in a securities company which trades in A-shares (shares denominated in RMB traded on the Shanghai and Shenzhen stock exchanges), B-shares (shares denominated in foreign currencies traded on those exchanges), H shares (shares of companies incorporated in mainland China which are traded on the Hong Kong Stock Exchange), government bonds and corporate bonds. However, a foreign investor’s maximum holding in a Chinese securities company is limited to 49%, while foreign equity investment in a listed securities company is capped at 20%.

Futures companies

The *Catalogue of Industries for Guiding Foreign Investment* (外商投资产业指导目录) (Decree No.12 of the National Development and Reform Commission and the Ministry of Commerce) (the “**Catalogue**”), published in 2011, requires a Chinese party to be the controlling shareholder of a futures company. In addition, the *Provisions on Issues Relevant to Changes in the Registered Capital or Equity of Futures Companies* (关于期货公司变更注册资本或股权有关问题的规定(证监会公告[2012]11号)) (“**Futures Companies Provisions**”) promulgated in May 2012 restrict a foreign investor’s ownership (direct or indirect) of a domestic futures company to 5% (subject to certain exceptions). Draft new rules which propose allowing foreign investment in futures companies up to 49% (as for securities companies) were published by the China Securities Regulatory Commission (“**CSRC**”) on 29 August 2014. These are subject to a public consultation which will end on 28 September 2014.

Securities investment fund management companies

There were 47 Sino-foreign joint venture fund management companies in the PRC as at March 2014. The proportion of foreign investment in a fund management company is currently limited to a maximum of 49% and therefore the Company may need to look for a suitable domestic securities investment fund management company to be its partner. Further, the securities regulatory authority of the home country of the foreign shareholder must have entered into a memorandum of understanding on securities regulatory cooperation with the CSRC or any other institution recognised by the CSRC, and must maintain effective regulatory cooperation. We note that the CSRC signed a memorandum of understanding with the Russian Federal Financial Markets Service in 2008.

Currency brokerage companies

Depending on the Company’s proposed scope of business, it may also set up or acquire a currency brokerage company which is engaged specifically in financing and foreign exchange dealings for commission. Currently, the CBRC is responsible for regulating currency brokerage companies while the People’s Bank of China and the State Administration of Foreign Exchange work together to supervise foreign exchange dealings in the inter-bank market etc. to ensure monetary stability.

Other financial entities

Other financial entities which may be established or acquired in the PRC include finance companies of enterprise groups (which principally provide financial management services for members of the enterprise group), trust companies and financial leasing companies.

The Shanghai Free Trade Zone

Established in September 2013, the Shanghai Pilot Free Trade Zone is intended to be the region in which the PRC government experiments with a number of key reforms before rolling them out in the rest of the country. Key reforms proposed include the gradual opening of various sectors of the economy to greater foreign investment. Most keenly anticipated of the proposed reforms are the proposals to ultimately allow full convertibility of the RMB and allow the market to set deposit interest rates. The introduction of these reforms will however be gradual and implemented only when the government deems the timing to be right. Nevertheless, a presence in the new free trade zone will offer institutions the advantage of being among the first to benefit from China's continued opening up.

2. COMMERCIAL BANKS

Set out below are the types of commercial banks that can be funded by foreign investment.

A. Definition

According to the *Regulations of the People's Republic of China on the Administration of Foreign-Funded Banks* (中华人民共和国外资银行管理条例) (Decree No. 478 of the State Council of the People's Republic of China), which came into effect in December 2006 (“**Foreign-Funded Banks Regulations**”), there are 4 types of commercial banks that can be funded by foreign investment, namely:

(a) WFOE Bank

- A WFOE Bank is a bank established by a foreign bank or by a foreign bank together with one or more other foreign financial institutions where:
 - “foreign financial institution” means a financial institution that is registered overseas and is licensed or approved by the financial supervisory authority in its home jurisdiction; and
 - “foreign bank” means a commercial bank that is registered overseas and is licensed or approved by the financial supervisory authority in its home jurisdiction.

(b) JV Bank

- A JV Bank is a Sino-foreign commercial bank established by a foreign financial institution together with a PRC company or enterprise.

(c) Foreign Bank Branch

(d) Representative Office

- A foreign investor must set up a Representative Office before it is considered eligible to set up any form of commercial bank. The scope of activities that can be carried out by a Representative Office is however extremely limited.

The different types of commercial banks described above are collectively referred to as “**Foreign-Funded Banks**”.

B. Applicable laws

The *Law of the People's Republic of China on Commercial Banks* (中华人民共和国商业银行法), adopted in 1995 and amended in December 2003, the *Foreign-Funded Banks Regulations*, and the *Measures on the Administration of Foreign-Funded Banks* (外资银行管理条例实施细则), which came into effect in December 2006 and was last amended in 2014) are currently the main laws governing the establishment and operation of Foreign-Funded Banks.

C. The primary regulator

The CBRC is the primary approving authority for foreign investors seeking to set up a commercial bank in China. For reference, the website of the CBRC is <http://www.cbrc.gov.cn>.

D. General requirements for Foreign-Funded Banks

- (a) It must have the ability to make profits on an ongoing basis, a good credit standing and must not have materially violated any applicable laws or regulations;
- (b) The foreign shareholder of a WFOE bank or a JV Bank, and a foreign bank that plans to establish a Foreign Bank Branch or Representative Office (collectively, the “**Controllers**”) must have international financial experience;
- (c) It must have an effective anti-money laundering system;
- (d) The Controllers must have been approved by, and be effectively regulated by, the financial regulatory authority of the country or region where it is located; and
- (e) Other prudent conditions as may be prescribed by the CBRC.

E. Additional conditions that apply to Controllers of Foreign-Funded Banks

WFOE	JV Bank	Foreign Bank Branch
<p>The major shareholder must be a foreign financial institution which satisfies the following conditions:</p> <ul style="list-style-type: none"> 1) it must be a commercial bank; 2) it must have had a PRC Representative Office for at least 2 years; 3) it must have had total assets of at least US\$10 billion at the end of the year immediately preceding its application to establish a WFOE; and 4) its capital adequacy ratio must meet the requirements of the financial regulatory authority of the country/ region where it is located and of the CBRC. 	<p>The foreign shareholder must be a foreign financial institution and the majority PRC shareholder must be a financial institution. Further, the foreign shareholder must satisfy the following conditions:</p> <ul style="list-style-type: none"> 1) it must be a commercial bank; 2) it must have established a PRC Representative Office; 3) it must have had total assets of at least US\$10 billion at the end of the year immediately preceding its application to establish a JV Bank; and 4) its capital adequacy ratio must meet the requirements of the financial regulatory authority of the country/ region where it is located and of the CBRC. 	<p>The Foreign Bank must satisfy the following conditions:</p> <ul style="list-style-type: none"> 1) it must have had total assets of at least US\$20 billion at the end of the year immediately preceding its application to establish a foreign bank branch; 2) its capital adequacy ratio must meet the requirements of the CBRC; and 3) it must have had a PRC Representative Office for at least 2 years if the Foreign Bank Branch is the first branch to be established in the PRC.

F. Application process

In addition to the requirement to establish a Representative Office, the application process for establishing a WFOE Bank, JV Bank or Foreign Bank Branch consists of two key stages. The first stage is preparatory establishment and the second stage is the formal establishment.

First stage: Preparatory Establishment

WFOE Bank, JV Bank and Foreign Bank Branch

To establish a Foreign-Funded Bank, the applicant must first apply for the preparation for its establishment and submit the following application documents to the CBRC in the place where the bank is proposed to be established:

- (1) an application letter including the name, address, registered capital or operating capital of the proposed bank and the kinds of business it applies to engage in;
- (2) a feasibility study report;
- (3) a draft of the articles of association of the proposed WFOE Bank or JV Bank;
- (4) a business contract signed by all shareholders of the proposed WFOE Bank or JV Bank;
- (5) the articles of association of the shareholder(s) of the proposed WFOE Bank or JV Bank, or the articles of association of the foreign bank planning to set up the branch;
- (6) an organisational chart and a list of the principal shareholders, overseas establishments and associated enterprises of the shareholder of the proposed WFOE Bank or JV Bank, or of the foreign bank planning to establish a branch and its group;
- (7) the annual reports for the most recent 3 years of the shareholder of the proposed WFOE Bank or JV Bank, or of the foreign bank planning to establish a branch;
- (8) the anti-money laundering system adopted by the shareholder of the proposed WFOE Bank or JV Bank, or of the foreign bank planning to establish a branch;
- (9) a photocopy of the business licence or financial services permit issued by the financial supervisory authority of the home country or region of the shareholder of the proposed WFOE Bank, of the foreign shareholder of the proposed JV Bank, or of the foreign bank planning to establish a branch; and
- (10) other documents as may be required by the CBRC.

Representative Office

A foreign bank applying to open a representative office must submit the following application documents to the CBRC in the place where the proposed representative office will be established:

- (1) an application letter including the name and address of the of the proposed representative office;
- (2) a feasibility study report;
- (3) the applicant's articles of association;
- (4) an organisational chart and a list of the principal shareholders, overseas establishments and associated enterprises of the applicant and its group;
- (5) the applicant's annual reports for the most recent 3 years;
- (6) the anti-money laundering system adopted by the applicant;
- (7) photocopies of the identity certificate and academic degree certificate(s) of the proposed chief representative of the representative office, his curriculum vitae and a statement showing whether or not he has committed any malpractice;
- (8) a power of attorney in favour of the proposed chief representative of the representative office;
- (9) photocopies of the business licence or financial services permit issued by the financial supervisory authority of the applicant's home country or region, and an opinion letter of such authority in respect of the application to establish a representative office; and
- (10) other documents as may be required by the CBRC.

All foreign language documents, except annual reports, must be submitted with a Chinese translation.

Second Stage: Commencement of Business

WFOE Bank, JV Bank and Foreign Bank Branch

After the first stage is completed, the applicant is required to submit a business commencement application with the following documents to the CBRC in the place where the Foreign-Funded Bank is to be established:

- (1) a list of the names of the principal persons-in-charge of the proposed bank and their curricula vitae;
- (2) a power of attorney in favour of the proposed principal persons-in-charge of the bank;
- (3) a capital verification certificate issued by a statutory capital verification institution;

- (4) documents on security and precautionary measures and other business-related facilities;
- (5) a guarantee issued by the foreign bank establishing a branch, confirming that it will be responsible for all taxes and other indebtedness incurred by the proposed branch; and
- (6) other documents as may be prescribed by the CBRC.

G. Time frame for approval

Time frame for first stage

WFOE Bank, JV Bank and Foreign Bank Branch

The CBRC decides whether or not to approve the first stage preparation for establishment within 6 months of receiving a complete set of application documents for the establishment of a Foreign-Funded Bank, and will give written notice of its decision to the applicant. If it does not approve the establishment, it is required to provide an explanation.

In special circumstances where the CBRC is unable to complete the examination and make a decision to approve or disapprove the preparation for establishment within the timeframe, it may extend the time limit as appropriate by issuing a written notice to the applicant, although any such extension may not exceed 3 months.

Upon the grant of approval for the preparation for establishment, the applicant is required to submit an application form to the CBRC in the place where the Foreign-Funded Bank is to be established.

The applicant must complete the preparation for establishment within 6 months from the date of receiving approval for preparation, failing which it may apply for an extension of 3 months by application to the CBRC giving reasons why the extension should be granted. If it fails to complete the preparation for establishment within the extended time limit, the CBRC's decision to approve the preparation will be automatically invalidated.

Representative Office

The CBRC decides whether or not to approve the establishment of a representative office of a foreign bank within 6 months after receiving a complete set of application documents and will give written notice of its decision to the applicant. If the CBRC does not approve the establishment, it is required to provide an explanation for its decision.

Time frame for second stage

The CBRC decides whether or not to approve an application for commencement of business within 2 months after receiving a complete set of business commencement application documents. It will then give written notice of its decision to the applicant and if business commencement is not approved, the CBRC will provide an explanation for its decision. If it approves business commencement, it will issue a financial business permit to the applicant.

Business licence

After obtaining CBRC approval, the Foreign-Funded Bank must register with the Administrative Department for Industry and Commerce (“AIC”) to obtain a business licence (namely, a Business Licence for Enterprises as Legal Persons).

H. Capital requirements

A WFOE Bank and a JV Bank must have minimum registered capital of RMB 1 billion, or an equivalent amount in freely convertible foreign currencies, which must be paid up before the business licence is issued.

If a WFOE Bank or JV Bank establishes a branch in the PRC, the branch must receive from its parent bank a non-callable allocation of at least RMB 100 million, or an equivalent amount in freely convertible foreign currencies, as its operating capital. However, the total amount of operating capital allocated to all the PRC branches of a WFOE Bank or JV Bank must not exceed 60% of the registered capital of the WFOE Bank or JV Bank (as applicable).

A branch of a foreign bank must receive from its parent bank a non-callable allocation of at least RMB 200 million, or its equivalent in freely convertible foreign currencies, as its operating capital.

The CBRC may increase the basic capital requirements and the RMB portion thereof depending on the business scope of the Foreign-Funded Bank.

I. Scope of business

Subject to the approval of the CBRC, Foreign-Funded Banks may engage in the following activities:

WFOE Bank/ JV Bank	Foreign Bank Branch (RMB business can only be provided to non-PRC citizens)	Representative Office (only for non-profit business)
1) receiving deposits from the general public;	1) receiving deposits from the general public;	May engage in non-operational activities relating to the business of the foreign bank, including: 1) liaison with its foreign headquarters and other branches outside China; 2) market research; and 3) consultancy services.
2) granting short-term, medium-term and long-term loans;	2) granting short-term, medium-term and long-term loans;	
3) handling acceptance and discount of negotiable instruments;	3) handling acceptance and discount of negotiable instruments;	
4) buying and selling government bonds and financial bonds, buying and selling foreign currency securities other than stocks;	4) buying and selling government bonds and financial bonds, buying and selling foreign currency securities other than stocks;	
5) providing letter of credit services and guarantees;	5) providing letter of credit services and guarantees;	
6) handling domestic and overseas settlement;	6) handling domestic and overseas settlement;	
7) buying and selling foreign currencies and	7) buying and selling foreign currencies and acting as an agent for the purchase and sale	

acting as an agent for the purchase and sale of foreign currencies; 8) acting as an agent for insurance companies; 9) inter-bank lending; 10) bank card business; 11) providing safety-deposit box services; and 12) other businesses approved by the CBRC.	of foreign currencies; 8) acting as an agent for insurance companies; 9) inter-bank lending; 10) providing safety-deposit box services; 11) providing credit information services and consultancy services; and 12) other businesses approved by the CBRC.	
--	---	--

A branch of a foreign bank can take time deposits of RMB 1 million or more from Chinese citizens within China. A foreign bank branch can also engage in foreign exchange settlement and sale businesses with the approval of the People's Bank of China.

J. Operational requirements

The key operational requirements which must be met by Foreign-Funded Banks are as follows:

- (1) the capital adequacy ratio requirement of 8%; and
- (2) the liquidity ratio (i.e. current assets/ current liabilities) must not be lower than 25%.

K. RMB business

In order to carry out RMB business, a WFOE Bank, a JV Bank or a Foreign Bank Branch must satisfy the following conditions and receive approval from the CBRC:

- (1) it must have conducted business in the PRC for at least 3 years prior to applying to carry on RMB business;
- (2) it must have been profitable for 2 consecutive years prior to filing the application; and
- (3) other conditions as may be prescribed by the CBRC.

3. SECURITIES COMPANY

A. Definitions

“Foreign-invested Securities Companies” refer to:

- (1) securities companies that are jointly financed and established by foreign and domestic shareholders; and
- (2) securities companies converted from domestic securities companies following the transfer and subscription to the equity of the domestic securities companies by foreign investors.

B. Applicable Laws and Regulations

The key regulations governing securities companies are the *Companies Law of the People’s Republic of China* (中华人民共和国公司法), effective since July 1994 and last amended in January 2006 (“**Companies Law**”), the *Securities Law* (中华人民共和国证券法), effective since December 1998 and last amended in January 2006, the *Regulations on Supervision and Management of Securities Companies* (证券公司监督管理条例), which came into effect on June 2008) and the *Rules for Establishment of Foreign-invested Securities Companies* (外资参股证券公司设立规则), which was implemented in July 2012 and last amended in October 2012 (“**Foreign-invested Securities Companies Rules**”).

C. The primary regulator

The CSRC is the primary regulator of the securities and futures market in the PRC and is responsible for approving foreign investment and the establishment of securities companies in China. The CSRC’s website is <http://www.csrc.gov.cn>.

D. Restrictions on foreign investment

The Foreign-invested Securities Companies Rules provide that:

- (1) the total equity owned or controlled, directly or indirectly, by foreign investors in a Foreign-invested Securities Company must not exceed 49%;
- (2) except in the case of listed securities companies, at least 49% of the equity in Foreign-invested Securities Companies must be owned by a domestic securities company. When a domestic securities company is converted into a foreign-funded securities company, at least 49% of the shares must be owned by a domestic shareholder;
- (3) the total equity held or controlled, directly or indirectly, by a single foreign investor in a listed domestic securities company must not exceed 20% and the total equity held or controlled, directly or indirectly, by all foreign investors in a listed domestic securities company must not exceed 25%; and
- (4) CSRC approval is required for the entering of any agreements or arrangements by foreign investors to jointly acquire and hold 5% or more of the equity in domestic securities companies.

E. Requirements for Foreign-Invested Securities Companies

- (1) The registered capital must meet the requirements of the Securities Law (see below);
- (2) The shareholders must have the qualifications prescribed in the Rules, and the proportion and form of their capital contributions must comply with the Rules;
- (3) There must be at least 30 staff members who are qualified to conduct securities dealing in accordance with the CSRC's requirements and the company must have accounting, legal and computer professionals;
- (4) The company must have sound internal management and risk control systems and a system that separately manages the businesses of underwriting, brokerage and self-operation in terms of staff, information and business implementation etc.) and must have appropriate internal controls;
- (5) Its premises must meet the applicable requirements for business facilities; and
- (6) Other requirements as may be prescribed by the CSRC.

F. Conditions in relation to foreign investors in a Foreign-Invested Securities Company

- (1) The home country/region of a foreign investor must have a sound legal and regulatory system for securities, and the securities regulatory body of such jurisdiction must have signed a memorandum of understanding (“**MOU**”) on securities regulation with the CSRC and maintain an effective cooperative relationship with the CSRC. *(Note: We understand that the CSRC signed a MOU regarding Securities and Futures Regulatory Cooperation with the Russian Federal Financial Markets Service (FFMS) in Beijing on 8 August 2008).*
- (2) A foreign investor must have been lawfully established in its home country/region and at least one foreign investor must be an institution that has financial business qualifications. A foreign investor cannot transfer its equity in a Foreign-Invested Securities Company within 3 years after its acquisition;
- (3) The foreign investor must have conducted financial business for at least 5 years and must not have had any substantial penalty imposed on it by the securities regulatory body or by any administrative or judicial body in its home country/region in the previous 3 years;
- (4) The foreign investor's financial indicators for the previous 3 years must be in compliance with the laws of its home country/region and the requirements of the relevant securities regulatory body;
- (5) It must have a sound internal controls system;
- (6) It must have a good reputation and business performance; and
- (7) Other conditions as may be prescribed by the CSRC.

G. Scope of business

Foreign-Invested Securities Companies may engage in the following types business:

- (1) underwriting and sponsoring the issue of shares (including ordinary RMB-denominated common shares and foreign currency shares) and bonds (including government and corporate bonds);
- (2) brokerage of foreign currency shares;
- (3) brokerage and proprietary trading of bonds (including government bonds and corporate bonds); and
- (4) any other business as may be approved by the CSRC.

H. Capital requirements

The capital requirement for a Foreign-Invested Securities Company varies depending on the business which will be conducted:

- (1) minimum registered capital of RMB 50 million is required for the conduct of securities brokerage, securities investment consultation and financial advisory business in relation to securities trading and securities investment activities;
- (2) minimum registered capital of RMB 100 million is required for the conduct of any *one* of the following business: underwriting and sponsoring share issues; proprietary securities trading; and securities asset management; and
- (3) minimum registered capital of RMB 500 million is required for the conduct of any *two or more* of the following businesses: securities underwriting and sponsorship, proprietary trading, securities asset management and other securities businesses.

I. Time frame for approval

On receipt and acceptance of an application for incorporation of a Foreign-Invested Securities Company, the CSRC will examine the application and decide whether or not to approve the application. The decision will normally be reached within six months of acceptance of the application and the applicant will be notified of the outcome in writing. Unsuccessful applicants will also be informed of the reasons why approval was refused.

Upon approval of an application for incorporation of a securities company, the applicant must register incorporation with the company registration authorities and obtain a business licence (Enterprise Legal Person Business Licence) within 6 months from the date of issue of the CSRC's approval.

A securities company with foreign shareholders is then required to apply to the CSRC for a securities business permit within 15 days of obtaining its business licence. The securities company must not start or conduct any securities business before obtaining a securities business permit.

4. SECURITIES INVESTMENT FUND MANAGEMENT COMPANIES

According to the CSRC, as at March 2014, there were 91 fund management companies in the PRC, 47 of which are Sino-foreign joint venture fund management companies. The list of fund management companies is available at http://www.csrc.gov.cn/pub/zjhpublic/G00306208/201404/t20140415_247032.htm.

A. Definition

Securities investment fund management companies (“**Fund Management Companies**”) refer to corporations incorporated in the PRC which have been approved by the CSRC to conduct securities investment fund management business.

B. Applicable laws

The *Securities Investment Funds Law* (中华人民共和国证券投资基金法), effective from October 2003 and last amended in December 2012 (“**Securities Investment Fund Law**”), and *The Measures for the Administration of Securities Investment Fund Management Companies* (证券投资基金管理公司管理办法), effective from October 2004 (“**Fund Management Companies Measures**”) are the main laws and regulations establishing the entry standards and other requirements for fund management companies.

C. Primary regulator

The CSRC is the primary regulatory authority of the securities investment fund market of the PRC and is also responsible for approving foreign investment in Fund Management Companies in China. The CSRC website is <http://www.csrc.gov.cn>.

D. Restriction on foreign investments

According to the Catalogue, the proportion of foreign investment in a Fund Management Company must not exceed 49%.

E. Capital requirement

According to the Fund Management Companies Measures, a Fund Management Company must have registered capital of at least RMB 100 million, which must be contributed in full in one lump sum. Foreign investors must make capital contributions in freely convertible currencies.

F. Requirements for Fund Management Companies

General Requirements

A proposed Fund Management Company is required to meet the following requirements of the CSRC in seeking its approval for establishment:

- (1) its shareholders must comply with the provisions of the Securities Investment Fund Law and the Fund Management Companies Measures;

- (2) the articles of association of the proposed Fund Management Company must comply with the Securities Investment Fund Law, the Companies Law and the relevant requirements of the CSRC;
- (3) the proposed Fund Management Company must have senior management who are in compliance with applicable laws, administrative regulations and CSRC requirements;
- (4) it must have staff engaged in research, investment, valuation and marketing shall have obtain funds practice qualification;
- (5) it must have at least 15 senior managers and business personnel who have obtained qualifications in fund management;
- (6) the proposed Fund Management Company must have good internal control systems that are in compliance with the requirements of the CSRC for supervision, auditing and risk control;
- (7) the proposed Fund Management Company must have business premises, security facilities and other facilities which satisfy the relevant requirements relevant to fund management business;
- (8) there must be an appropriate division of work and employees' roles should be clearly delineated;
- (9) a system of internal controls must be in place covering supervision, audit and risk management; and
- (10) other conditions as prescribed by the CSRC with the approval of the State Council.

G. Conditions in relation to shareholders holding 5% or more interest in a Fund Management Company

According to the Fund Management Companies Measures, any shareholder of a proposed Fund Management Company whose capital contribution or shareholding accounts for 5% or more of the registered capital of a proposed Fund Management Company (hereinafter referred to as the “**Shareholding Proportion**”) must satisfy the following conditions:

- (1) the registered capital and net assets of such shareholder must be at least RMB 100 million and the assets must be of good quality;
- (2) the shareholder must have been in operation for at least three consecutive financial years and have sound corporate governance and internal control systems;
- (3) the shareholder must not have incurred any criminal or administrative penalty for violation of any law or regulation in the previous 3 years;
- (4) the shareholder must not have misappropriated clients' assets or committed any other conduct impairing clients' interests;
- (5) the shareholder must not be under investigation by any regulatory authority for violation of any law or regulation; and
- (6) the shareholder must have a good reputation and must have no record of breach or infringement of any requirement in relation to financial supervision, taxation, industry and commerce, etc. in the previous 3 years.

H. Additional Conditions in relation to the major shareholders of a Fund Management Company

The major shareholders of a Fund Management Company are those shareholders holding 25% or more.

The Fund Management Companies Measures provide that, in addition to the requirements in relation to shareholders holding 5% or more of a Fund Management Company (as described above), a major shareholder is additionally required to meet the following conditions:

- (1) it must be engaged in securities management, securities investment consulting, trust assets management or other financial assets management businesses;
- (2) it must have registered capital of at least RMB 300 million; and
- (3) it must have good business performance and good quality assets.

I. Additional Conditions in relation to investors of a Sino-Foreign Joint Fund Management Company (“JV Fund Management Company”)

In a JV Fund Management Company, the domestic shareholder that has the highest shareholding among domestic shareholders must meet the conditions relating to major shareholders as set out in paragraph H above.

The Fund Management Companies Measures additionally require a foreign investor of a JV Fund Management Company to satisfy the following conditions:

- (1) it must be a financial institution lawfully established under the laws of its home country/region which has financial asset management experience, is in sound financial condition and has a good credit rating, and has not been subject to any penalty imposed by any regulatory or judicial authority in the previous 3 years;
- (2) the home country/region of the foreign investor must have sound securities laws and regulations, and the securities regulatory authority in such jurisdiction must have entered into a MOU on securities regulatory cooperation with the CSRC or any other institution recognised by the CSRC and must maintain an effective relationship for regulatory cooperation; *(Note: we understand that the CSRC signed a MOU regarding Securities and Futures Regulatory Cooperation with the Russian Federal Financial Markets Service (FFMS) in Beijing on 8 August 2008)*
- (3) the foreign shareholder must have paid-up capital in a freely convertible currency equivalent to at least RMB 300 million; and
- (4) other conditions as prescribed by the CSRC with the approval of the State Council.

J. Other requirements or restrictions in relation to shareholders of a Fund Management Company

The Fund Management Companies Measures further require that:

- (1) an institution or institutions under the control of the same de facto controller cannot invest in more than two Fund Management Companies, and may hold a controlling interest in only one Fund Management Company;

- (2) major shareholders of a Fund Management Company are required to undertake in writing that they will hold the shares in the Fund Management Company for at least 3 years; and
- (3) where a single shareholder, alone or in conjunction with any related shareholders, holds 50% or more of the shares of a Fund Management Company, such shareholder, and institutions controlled by such shareholder, must not engage in the business of asset management in relation to publicly offered (or similar to public offered) securities.

K. Requirements in relation to the composition of the board of a Fund Management Company

The Fund Management Companies Measures require that:

- (1) the general manager of a Fund Management Company must be a member of the board of directors of such fund management company;
- (2) where a single shareholder, alone or in conjunction with any related shareholders, holds 50% or more of the shares of a Fund Management Company, the number of directors related to such shareholder must not exceed one third of the board of directors;
- (3) the board of directors of a Fund Management Company must include at least 3 independent directors and the Fund Management Company must appoint independent directors representing at least one-third of the board.

L. Scope of business

A Fund Management Company raises funds from the public and conducts securities investment fund management and other business permitted by the CSRC.

M. Time frame for approval

The CSRC decides whether or not to approve an application for the establishment of a fund management company within 6 months of accepting the application. In the case of an unsuccessful application, the CSRC will give reasons for the not granting approval.

N. Acquisition of shares of a Fund Management Company

The Fund Management Companies Measures require that the following events are reported to the CSRC for approval: (i) any change of shareholder holding 5% or more of the shares of a Fund Management Company; (ii) any change of shareholder holding less than 5% of the shares of a Fund Management Company where this has a significant impact on corporate governance; and (iii) any change in the percentage of shares held by any shareholder holding more than 5% of the shares of a Fund Management Company. Any change of shareholders or change to the shareholding structure of a Fund Management Company must comply with the requirements of the CSRC.

In addition, any change of (i) a major shareholder, (ii) a shareholder holding in aggregate more than 50% of the shares; or (iii) the shareholder who has nominated the largest number of directors of a Fund Management Company, will be subject to approval procedures and requirements as for a new application for the establishment of a fund management company.

5. FUTURES COMPANIES

A. Definition

Futures companies (“**Futures Companies**”) are defined as financial institutions engaging in futures business established in accordance with the Companies Law and the *Futures Trading Administrative Regulations* (期货交易管理条例), which became effective from April 2007 (the “**Futures Administrative Regulations**”).

B. Applicable laws

The Futures Administrative Regulations and the *Administrative Measures for Futures Companies* (期货公司管理办法) which became effective from April 2007) (the “**Futures Companies Administrative Measures**”) are the main laws and regulations establishing the entry standards and other requirements for futures companies.

The CSRC however published a consultation paper seeking views on its proposed *Regulatory and Administrative Measures for Futures Companies* (“**Proposed New Futures Companies Administrative Measures**”) on 29 August 2014 which, if implemented, will supersede the current Futures Companies Administrative Measures. The consultation period will end on 28 September 2014.

C. Primary regulator

The CSRC is the primary regulatory authority for the PRC’s securities and futures market and is also responsible for approving foreign investment to set up Futures Companies in China. The website of CSRC is at <http://www.csrc.gov.cn>.

D. Scope of business

The current Futures Companies Administrative Measures allow registered Futures Companies to conduct trading in commodity futures for clients. Trading in financial futures for clients requires a separate application to be made to the CSRC.

Under the Proposed New Futures Companies Administrative Measures, registered Futures Companies will continue to be allowed to trade commodity futures for clients. The following businesses will require a separate application to the CSRC: trading financial futures on clients’ behalf, trading offshore futures, futures investment consultancy or futures asset management.

E. Restriction on foreign investment

Current restrictions

According to the Catalogue, a Chinese party has to be the controlling shareholder of a futures company.

The Futures Companies Provisions promulgated in May 2012 impose the following restrictions on foreign investment, direct and indirect, in a Futures Company:

- (1) if a foreign investor, together with its related parties, *directly* or *indirectly* owns or controls 5% or more of the shares of a Futures Company, the Futures Companies Administrative Measures prevent the investor, from holding, directly or indirectly, 5% or more of any other Futures Company (i.e. a foreign investor can only hold an interest of 5% or more in one Futures Company);
- (2) a single foreign investor and its related parties are not allowed to *indirectly* own (through controlled corporations or otherwise) or control (through possession of voting rights) 5% or more of the shares of a Futures Company unless the following conditions for foreign-funded futures companies prescribed by the Catalogue are satisfied:
 - (a) the foreign investor holds shares or voting rights in a Futures Company indirectly through ownership of shares in a PRC listed company, provided that the controlling shareholder, the largest shareholder, and the person *exercising actual control* of the listed company are all Chinese investors; and
 - (b) the foreign investor holds shares or voting rights in a Futures Company indirectly through ownership of shares in a PRC securities company which is licenced to conduct more than three types of business including securities brokerage, proprietary trading and securities asset management business.

It should be noted that where foreign investors rely on the above exceptions, their investment will still be subject to the restriction contained in the current Catalogue that only a Chinese investor can be a controlling shareholder of a Futures Company .

Proposal under the Proposed New Futures Companies Administrative Measures

Under the Proposed New Futures Companies Administrative Measures, foreign investment in Futures Companies will be allowed, but subject to the limits set by the PRC government. We construe this to mean that only a Chinese investor can be a controlling shareholder of a futures company as is provided under the current Catalogue.

F. Capital requirement

According to the Futures Administrative Regulations and the Futures Companies Administrative Measures, the minimum registered capital of a proposed Futures Company is RMB 30 million. The registered capital must be paid-up capital. Shareholders are required to contribute in cash or with non-monetary assets which are necessary for the operations of the Futures Company, but the proportion of cash contribution must be at least 85%.

G. Requirements for Futures Companies

General requirements

Set out below are other current major requirements in relation to the establishment of a Futures Company:

- (1) the directors, supervisors and senior management of the proposed Futures Company must be qualified to conduct futures trading;

- (2) there must be at least 15 staff qualified to conduct futures trading;
- (3) there must be at least three senior management staff qualified to conduct futures trading;
- (4) the articles of association of the proposed Futures Company must comply with the requirements of applicable laws and regulations;
- (5) the major shareholders and the *de facto* controller of the proposed Futures Company must be able to make profits on a sustained basis, must have a good reputation and must not have materially violated any applicable laws or regulations in the previous 3 years;
- (6) the proposed Futures Company must have appropriate business premises and facilities for its operations; and
- (7) the proposed Futures Company must have sound risk management and internal control systems.

The above requirements are retained in the Proposed New Futures Companies Administrative Measures.

Conditions in relation to the shareholders of a proposed Futures Company

According to the current Futures Companies Administrative Measures, the shareholders of a proposed Futures Company must be PRC legal persons (such as a WFOE). Shareholders holding 5% or more of the shares of a proposed Futures Company are required to meet, *inter alia*, the following conditions:

- (1) their paid-in capital or net assets must be at least RMB 30 million;
- (2) the shareholder must have been operating for at least 2 complete financial years and been profitable for at least one of the most recent 2 financial years, or have paid-in capital and net assets of at least RMB 200 million;
- (3) the value of net assets must be equal to 50% or more of the paid-in capital, or its contingent liabilities must be less than 50% of the net asset value, and there must not be any other risks which could materially affect the Futures Company's financial condition;
- (4) the shareholder's accumulated long-term equity investments including its capital contributions to the Futures Company must not exceed its own net assets;
- (5) it must not have any significant unpaid debt;
- (6) the shareholder must not have had any administrative or criminal penalty imposed on it for conducting its business in violation of applicable laws or regulations in the previous 3 years;
- (7) the shareholder must not have been the subject of any investigation or order by any competent authority in relation to the conduct of business in violation of applicable laws and regulations;

- (8) the shareholder or actual controller of a financial institution, or the controlling shareholder or actual controller of a listed company, must not have abused its rights as a shareholder, avoided its obligations as shareholder or have committed any other act of bad faith in the previous 3 years;
- (9) any shareholder who is a natural person, legal representative and senior manager must not have been prohibited from entering the securities or futures market at any time in the previous 2 years, and must not have been disqualified from assuming the position of a securities or futures senior manager at any time in the previous 2 years, and none of the circumstances set out in paragraph 1 of Article 147 of the Companies Law must exist; and
- (10) other conditions as prescribed by the CSRC.

The above conditions are retained in the Proposed New Futures Companies Administrative Measures. In addition, the *Proposed New Futures Companies Administrative Measures* proposed that individuals should be eligible to be shareholders of a Futures Company if, in addition to satisfying the above conditions, the individual shareholder owns financial assets of at least RMB 30 million.

H. Timeframe for approval

The CSRC will make a decision as to whether or not to approve an application for the establishment of a Futures Company within 6 months after accepting an application.

6. CURRENCY BROKERAGE COMPANIES

A. Definitions

A currency brokerage company refers to a non-bank financial institution which is established in the PRC by electronic or other means, which is engaged specifically in financing and foreign exchange dealings and other brokerage services, for which it charges commission.

B. Applicable laws

The *Measures for the Administration of Pilot Currency Brokerage Companies* (货币经纪公司试点管理办法) (Order No. 1 [2005] of the CBRC), effective from September 2005 (“**Currency Brokerage Companies Measures**”), the *Detailed Rules for the Implementation of Measures for the Pilot Administration of Currency Brokerage Companies* (货币经纪公司试点管理办法实施细则), effective from September 2005, and the *Notice of the People's Bank of China on Currency Brokerage Companies' Access to the Interbank Market* (中国人民银行关于货币经纪公司进入银行间市场有关事项的通知) (No. 231[2006] of the People's Bank of China), are the main legislative provisions governing the establishment and operation of currency brokerage companies.

C. Primary regulator

The CBRC is the main supervisory body for currency brokerage companies. Brokerage business activities conducted by currency brokerage companies such as inter-bank borrowing and lending, the purchase and sale of bonds and foreign exchange dealings in the inter-bank market are also subject to supervision and inspection by the People's Bank of China and the State Administration of Foreign Exchange (“SAFE”). If they conduct business involving the administration of foreign exchange, they must comply with relevant requirements stipulated by SAFE, and will be subject to supervision and inspection by SAFE.

D. General requirements for a currency brokerage company

A Currency Brokerage Company must satisfy the following:

- (1) it must meet the minimum capital requirement (see below);
- (2) its articles of association must be in line with the *Companies Law*, other relevant laws and the Currency Brokerage Companies Measures;
- (3) senior management of the currency brokerage company must be familiar with the currency brokerage business;
- (4) it must have a sound organisational structure, management system and risk control system;
- (5) its business premises and safety measures must meet the needs of its business operations; and
- (6) other conditions as may be prescribed by the CBRC.

E. Conditions applicable to a foreign investor in a currency brokerage company

Foreign investors who wish to establish a wholly foreign-funded currency brokerage company, or a joint-venture currency brokerage company with a PRC party in the PRC, must meet the following conditions:

- (1) it must be a currency brokerage company lawfully established in the country or region where it is located;
- (2) it must have been engaged in the currency brokerage business for 20 years or more, and have a sound internal controls system;
- (3) it must have a good credit rating and have no record of serious violation of applicable laws or regulations;
- (4) it must have been profitable for the three years immediately preceding the application and must have had after-tax net proceeds of at least US\$ 5 million in each of those years;
- (5) it must be part of a global network and have the communication network necessary for the conduct of currency brokerage services;
- (6) it must have had a Representative Office in the PRC for at least 2 years;
- (7) its home country or region must have a sound financial supervision and management system, and the applicant must be under the effective supervision of the relevant competent authority of the country or region where it is located. The relevant competent authority of such country or region must also have entered into a memorandum for cooperation in relation to supervision with the CBRC; and
- (8) other conditions as may be prescribed by the CBRC.

F. Scope of business

A currency brokerage company and its branches may, depending on the business scope approved by the CBRC, engage in all or some of the following brokerage businesses:

- (1) transactions in foreign exchange markets in the PRC and abroad;
- (2) transactions in currency markets in the PRC and abroad;
- (3) transactions in bond markets in the PRC and abroad;
- (4) transactions in derivatives in the PRC and abroad; or
- (5) other businesses as may be approved by the CBRC.

G. Capital Requirement

The minimum capital requirement for a currency brokerage company is RMB 20 million or an equivalent amount in a freely convertible currency.

H. Establishment Requirements

Preparatory Establishment Stage

An application should be filed by the majority shareholder with the CBRC together with the following documents:

- (1) an application for the establishment of a solely invested or joint venture currency brokerage company signed by the legal representative of the investor, which includes the name, place of registration, registered capital, capital proportion of the investor, business scope, etc.;
- (2) a feasibility study report;
- (3) the articles of association of the proposed currency brokerage company;
- (4) the business licence (in duplicate) issued by the competent authority of the country or region where the investor is located, or a photocopy of the company's registration document;
- (5) an opinion in respect of the application issued by the competent authority or industrial association of the investor's home country or region;
- (6) basic information about the investor(s);
- (7) the investor's financial statements for the three preceding years which are either audited by a qualified accounting firm or accredited by the relevant competent governmental department;
- (8) an agreement, commitment or contract signed by both capital contribution parties;
- (9) a declaration issued by the legal representative of the capital contributor as to the genuineness of the application materials; and an application letter which includes the name, locality, registered capital, shareholders, share right structure, business scope, etc. of the proposed currency brokerage company; and
- (10) other materials as may be required by the CBRC.

The above documents must be in Chinese, except for those specified in paragraphs (4) to (7)) which must be accompanied by a Chinese translation of the relevant document.

Business Commencement Stage

An application for commencement of business must be filed with the CBRC with the following documents:

- (1) a report regarding completion of the preparatory establishment work and an application for commencement of business;
- (2) a capital verification certificate issued by a statutory capital verification institution in China, and the pre-approval registration document issued by the AIC regarding the name of the proposed institution;
- (3) the articles of association of the currency brokerage company;
- (4) a list of the names of the proposed senior managers of the currency brokerage company, their detailed curricula vitae and certificates of qualification;
- (5) the names of the shareholders and the amount of their respective capital contributions;
- (6) the bylaws of the businesses to be carried out and the internal risk control system;
- (7) a report on safety tests conducted on the company's business premises, equipment and systems;
- (8) a declaration issued by the legal representative of each capital contributor as to the genuineness of the application materials; and
- (9) other documents as may be required by the CBRC.

I. Time Frame for Approval

Time frame for Preparatory Stage

The banking regulatory bureau will review an application for preparatory establishment within 5 working days of receipt of an application. If the documentation submitted is incomplete, the banking regulatory bureau will notify the applicant of the additional information required. If the application documents are complete, the banking regulatory bureau will accept the application and notify the applicant in writing within 5 working days. The banking regulatory bureau will then complete its preliminary examination of the application, and submit it together with the other application documents to the CBRC within 20 working days. The CBRC will issue a written decision as to whether or not it approves the preparatory establishment within 4 months after it receives the complete set of preparatory establishment application documents.

The applicant must complete the preparatory establishment of a currency brokerage company and branch within 6 months after receipt of the CBRC's approval. It must pay the required amount of capital into a designated Chinese bank account within 30 working days of receipt of CBRC approval, and the deposit must be verified by a qualified accounting firm which must issue a capital verification report. During the capital verification period, money can only be paid into this bank account and cannot be paid out.

Time Frame for Opening Business Stage

The CBRC decides whether or not to approve an application for commencement of business within 2 months of formally accepting the application. If it approves the establishment of a currency brokerage company, it will issue a financial business permit to the applicant. If it rejects the application, it will notify the applicant giving reasons for not granting approval.

The applicant must then complete the appropriate registration formalities with the AIC which will depend on the scope of business allowed by the financial business permit. Business operations must not commence until the company has obtained an Enterprise Legal Person Business Licence.

7. ENTERPRISE GROUP FINANCE COMPANIES

A. Definitions

An “**Enterprise Group Finance Company**” refers to a non-bank financial institution which provides financial management services for its group member companies (“**Member Entities**”) in order to centralise the management of group funds and improve the efficiency of use of funds.

A finance company established by a foreign-funded investment company (“**Foreign-Funded Investment Company**”) to provide financial management services to its investment enterprises (“**Investment Enterprises**”) within the PRC is governed by the laws regulating Finance Companies of Enterprise Groups.

An “**Enterprise group**” refers to a group of enterprises which are lawfully registered in China and consists of holding companies, subsidiaries, companies investing in the holding company and subsidiaries, and other member enterprises or businesses that are linked by source of capital with the holding company and subsidiaries and share the same articles of association.

“**Member Entities**” include: any holding company; any subsidiaries in which a holding company holds at least 51% of the shares (“**subsidiary companies**”); any company in which 20% or more of the shares are held, either alone or together, by a holding company, its subsidiary companies or any other company in which a holding company and its subsidiary companies together hold less than 20% of the shares but are the largest shareholder nonetheless; and public institution juridical persons or social organisation juridical persons which are subordinate to the holding company or the subsidiary companies.

A “**Foreign-Funded Investment Company**” refers to a company established in the PRC to undertake investment activities directly which is funded entirely by a foreign investor or investors. Investment Companies include foreign-funded investment companies, as well as any enterprise registered in the PRC, in which more than 25% of the shares are held by a Foreign-Funded Investment Company, either alone or together with its investors, and at least 10% are held by the Foreign-Funded Investment Company.

B. Applicable laws

The *Measures for the Administration of Enterprise Group Finance Companies* (企业集团财务公司管理办法) issued by the CBRC (No. 5 of the Order of CBRC) and which became effective from September 2004 (“**Enterprise Group Finance Companies Measures**”), are currently the main laws regulating Enterprise Group Finance Companies.

Foreign-Funded Investment Companies are governed by the provisions of the Enterprise Group Finance Companies Measures relating to holding companies, while Investment Enterprises are governed by the provisions relating to Member Entities.

C. Primary regulator

The CBRC is the principal approving authority for foreign investment in an Enterprise Group Finance Company in China. The CBRC’s website can be viewed at <http://www.cbrc.gov.cn/index.html>.

The name of the finance company requires approval from the industrial and commercial registration organ. The words “Finance Company” cannot be used in the name of an entity without prior approval from the CBRC.

D. General requirements for an enterprise group finance company

General conditions for an enterprise group seeking to establish a finance company

The following conditions must be met by an enterprise group applying to establish a finance company:

- (1) it must be in compliance with the industrial policies of the state;
- (2) its holding company must have had registered capital of at least RMB 800 million in the year immediately preceding the application;
- (3) the group must have had total assets of at least RMB 5 billion as shown in its consolidated financial statements as at the end of the financial year immediately preceding the application, and the ratio of return on equity for such financial year must have been at least 30%;
- (4) the group's member entities must have had business income of at least RMB 4 billion and pre-tax profits of at least RMB 200 million in each of the 2 years immediately preceding the application;
- (5) it must have stable cash flow and large cash reserves;
- (6) the holding company must have been incorporated for at least 2 years, and must have experience of conducting financial management and fund management in respect of an enterprise group;
- (7) the holding company must have sound corporate governance procedures, and must not have violated any applicable laws or rules, or committed any act casting doubt on its honesty or credibility, in the preceding 3 years;
- (8) the holding company must have a core, principal business; and
- (9) the holding company must not have entered into any inappropriate related party transactions.

A foreign-funded investment company must additionally have net assets of at least RMB 2 billion in the year preceding its application, and pre-tax profits of at least RMB 200 million in each of the 2 financial years preceding its application.

Additional conditions

The following conditions also apply:

- (1) the enterprise group's funds must be in need of centralised management and must be reasonably expected to optimise the group's use of funds;
- (2) the articles of association must conform to the *Companies Law*;

- (3) the finance company must have registered capital of at least RMB 100 million, or its equivalent in a convertible foreign currency, which must be fully paid up. A finance company which conducts foreign exchange business is required to have registered capital of at least US\$ 5 million or its equivalent in a convertible foreign currency. The CBRC may alter the required minimum registered capital for finance companies if it considers it necessary for prudent supervision;
- (4) the finance company's directors and senior management must possess the qualifications required by the CBRC and it must employ suitably qualified professionals to hold key positions in areas such as risk management, and intensive fund management etc.;
- (5) it must have well-developed corporate governance procedures, internal controls, business operating procedures, and risk prevention measures, etc.;
- (6) it must have business premises, safety measures and other facilities which satisfy relevant requirements;
- (7) at least two thirds of the finance company's employees must have at least 3 years' experience of banking or financial work; and at least one third must have at least 5 years' experience of banking or financial work; and
- (8) other conditions as may be prescribed by the CBRC.

Conditions relating to the name of a Finance Company

A finance company's name must include the words "Finance Limited Company" or "Finance Limited Liability Company", and the name of the enterprise group, either in full or in short. The words "Finance Company" cannot be used by an entity without obtaining prior approval from the CBRC.

E. Establishment requirements

There are two stages to the establishment of a finance company; the preparatory stage and commencement of business stage.

Preparatory stage

The holding company must file an application for the establishment of a finance company with the CBRC together with the following documents:

- (1) an application letter which includes the name, location, registered capital, shareholders, share structure, business scope, etc. of the proposed finance company;
- (2) a feasibility study report which includes:
 - (i) the overall production and management situation of the holding company and other member entities, their cash flow analysis, position in the relevant industry and their mid and long-term development plan;
 - (ii) the purpose and functions of establishing the finance company and a business forecast; and

- (iii) consolidated balance sheets, statements of profits and losses and statements of cash flow for the most recent 2 financial years, audited by an eligible accounting firm;
- (3) a list of the member entities, and the relevant certificates issued by relevant authorities;
- (4) the "Enterprise Group Registration Certificate", photocopies of the Business Licences of the applicant and other investors, and their guarantee for capital contribution;
- (5) the Certificate of Approval of the Foreign-Funded Enterprise of the foreign-funded investment company and its investment enterprises;
- (6) testimonials signed by the legal representative of the holding company to confirm the authenticity of the abovementioned documents; and
- (7) other documents as may be required by the CBRC.

Commencement of business stage

An application for commencement of business should be filed with the CBRC with the following documents:

- (1) a draft of the articles of association of the proposed finance company;
- (2) operational guidelines and plans of the finance company;
- (3) a list of the names of the finance company's shareholders with the amounts and proportions of their respective capital contributions;
- (4) a capital verification certificate issued by a legal capital verification institution as to the capital contributions of the finance company's shareholders;
- (5) a list of the proposed directors and officers, together with detailed curricula vitae and testimonials as to their competence for such posts;
- (6) a list of persons proposed to be employed in risk management and centralised fund management, together with their detailed curricula vitae;
- (7) testimonials of the relevant staff establishing that they have been engaged in banking or financial work for at least 5 years;
- (8) the finance company's business rules and risk prevention systems;
- (9) documents relating to the finance company's business premises and other related operational facilities; and
- (10) other documents as may be required by the CBRC.

F. Operational requirements

A finance company must satisfy the following requirements in running its business:

Liability/Asset Ratio

- (1) its capital adequacy ratio must not be lower than 10%;
- (2) the amount of capital borrowed must not exceed its total capital;
- (3) the amount guaranteed must not exceed its total capital;
- (4) the ratio of its short-term securities investment to its total capital must not be higher than 40%;
- (5) the ratio of its long-term investments to its total capital must not be higher than 30%; and
- (6) the ratio of its own fixed assets to its total capital must not be higher than 20%.

Other requirements

- (1) a finance company must establish a risk management department and an audit department which are responsible for formulating risk control and auditing systems which must be reported to the board of directors annually, and reported to the CBRC;
- (2) an annual audit must be carried out by a qualified audit firm and an annual audit report, signed by the chairman of the board, must be submitted to the CBRC before 15 April of each year;
- (3) the balance sheet, statement of profits and losses, statement of cash flow, statement of appraisal of its non-on-site supervision indicators, and other statements as required by the CBRC must be submitted to the CBRC. The financial statements and documents for each financial year must also be submitted to the CBRC within 1 month after the end of the financial year;
- (4) the legal representative of a finance company is responsible for the authenticity of all financial statements bearing his signature;
- (5) by the end of April in each year, a finance company must submit to the CBRC a directory of the member entities in the enterprise group to which it belongs, and must provide information and data regarding the enterprise group's operating situation in the previous year;
- (6) before commencing business with a new member entity, a finance company must file information in relation to the new member entity with the CBRC. A finance company must also notify the CBRC if any member entity ceases to be part of the enterprise group;
- (7) a finance company must pay a deposit reserve and draw a loss reserve as required by the People's Bank of China, and write off its losses in accordance with the relevant provisions; and
- (8) a finance company must comply with the relevant provisions of the People's Bank of China on interest rate management, and those conducting foreign exchange business must comply with the relevant requirements of the SAFE.

G. Capital requirements

Amount of capital required

The minimum registered capital required for the establishment of a finance company is RMB 100 million, or its equivalent amount of convertible currency. The registered capital of a finance company conducting foreign exchange business must be at least USD 5 million or an equivalent amount of convertible currency.

When applying for the establishment of a finance company, the board of directors of the holding company must also make a written commitment to increase capital if the finance company faces difficulty in meeting its payment obligations, and to state such increased capital in the finance company's articles of association.

Additional requirements

A finance company's registered capital should be raised mainly from its member entities, although qualified institutional investors are also allowed to invest. A qualified institutional investor refers to an external strategic investor which will hold shares in the finance company for at least 5 years and has considerable management experience in the industry.

The registered capital for establishing a finance company by a foreign-funded investment company may be contributed by the foreign-funded investment company either alone or jointly with its investors.

H. Time frame for establishment

If the CBRC approves an application for preparation prior to the establishment of a finance company, the applicant must complete the preparatory work and file an application to the CBRC for commencement of business within 3 months of receipt of the approval.

If the CBRC grants approval for commencement of business, it will issue a "Financial Business Permit". The finance company may not commence business until it has registered with the AIC on the strength of the "Financial Business Permit", and has obtained a "Business Licence of Enterprise".

I. Scope of Business

General scope of business

Business which can be conducted by an Enterprise Group Finance Company are:

- (1) providing its member entities with financial and financial advice services, credit authentication, and related consulting and agency services;
- (2) assisting member entities in collecting and paying transaction proceeds;
- (3) providing approved insurance agency services;

- (4) providing guarantees to its member entities;
- (5) handling entrusted loans and entrusted investments between member entities;
- (6) handling acceptance and discount of bills for member entities;
- (7) handling internal transfer settlement between member entities, and designing programmes for settlement and clearance accordingly;
- (8) taking deposits from member entities;
- (9) granting loans to and handling financing leases for member entities;
- (10) engaging in inter-bank borrowing; and
- (11) other businesses as may be approved by the CBRC.

If a finance company meets the above conditions and: (1) has been established for at least one year and is well managed; (2) has registered capital of at least RMB 300 million (or RMB 500 million, if it engages in consumer credit, buyer's credit and financing leases for its member entities); (3) it has received approval from its shareholders in general meeting and its directors; (4) it has a sound investment decision making mechanism, risk control system, working rules and a corresponding management information system; and (5) it has appropriately qualified professionals, it can also engage in the following businesses:

- (1) issuing finance company bonds upon approval;
- (2) underwriting enterprise bonds of the member entities;
- (3) contributing share right investments to financial institutions;
- (4) investing in securities; and
- (5) undertaking consumer credit, buyer's credit and financing leasing for its member entities.

A finance company must not engage in:

- (1) any offshore business; or
- (2) any form of cross-border fund business except for the purpose of assisting its member entities in the collection and payment of transaction proceeds.

8. TAX ISSUES

As there are no specific tax provisions developed solely for taxing financial entities in the PRC, we set out below the general tax treatment that may be applicable to financial entities.

Tax law and policy are developed jointly by the State Administration of Taxation (the “SAT”) and the Ministry of Finance. The SAT is the government body responsible for collecting tax and enforcing compliance. The SAT is assisted by the state and local tax bureaus at the provincial level and below.

Corporate income tax

The *Corporate Income Tax Law of the PRC* (中华人民共和国企业所得税法) (the “CIT Law”) promulgated by the National People’s Congress took effect from 1 January 2008 and applies to both domestic and foreign-invested enterprises.

Under the CIT Law, a tax resident enterprise (a “TRE”) refers to an enterprise established in accordance with Chinese law or an enterprise established under foreign law, but which has its effective management located in China. TREs are subject to corporate income tax on their worldwide income, while non-TREs are taxable only on their China-sourced income. Enterprises registered in China are always TRE and a foreign enterprise with effective management in China may also be regarded as a TRE.

The standard corporate income tax rate is 25%. Lower tax rates are available for qualified enterprises under the PRC’s tax incentive policies which place emphasis on “industry-oriented” incentives aimed at directing investment into those industry sectors and projects encouraged and supported by the PRC government. Such industry sectors currently do not include the financial sector.

Taxable income generally includes profits, capital gains and passive income, such as interest, royalties and rents. Dividends between TREs are not taxable except where a dividend is paid on stocks publicly traded on a stock exchange which have been held for less than 12 months.

Withholding tax

A 10% withholding tax on dividends paid to a non-TRE was introduced in 2008. Previously, dividends paid by a Chinese company held as to at least 25% by foreign investors were exempted. It should be noted, however, that dividends paid out of pre-2008 earnings continue to be exempted from withholding tax. Interest, rental, royalties and other passive income, such as the gains from the sale or transfer of real estate property in a PRC company, are also subject to the 10% withholding tax. The 10% withholding tax rate may be reduced under an applicable tax treaty.

Capital gains tax

There is no separate capital gains tax; capital gains (and losses) of companies generally are combined with other operating income and taxed at the normal corporate income tax rate.

9. OTHERS FINANCIAL ENTITY STRUCTURES PERMITTING FOREIGN INVESTMENTS

There are other types of financial entities in which foreign investment is permitted. They may not however be appropriate depending on the types of activities the Company wishes to conduct in the PRC, and thus we provide only a brief overview of these financial entity types below. Please do not hesitate to contact us if you would like us to provide further details.

A. Trust companies

Trust companies in China are regulated under the *Trust Law of the People's Republic of China* (中华人民共和国信托法), which became effective in October 2001 and the *Measures of China Banking Regulatory Commission for the Implementation of Administrative Licensing Matters Concerning Non-bank Financial Institutions* (中国银行业监督管理委员会非银行金融机构行政许可事项实施办法) (No. 13 of [2007] of the People's Bank of China), which became effective from June 2007 (the "**Measures on Non-Bank Financial Institutions**").

A trust is an act by which a settlor entrusts certain property rights it owns to a trustee, who will in turn manage or dispose of the trust property in its own name in accordance with the settlor's instructions and for the benefit of one or more beneficiaries, or for other specific purposes. Trust companies receive remuneration for managing a trust.

Conditions applicable to a foreign investor

Article 9 of the Measures on Non-Bank Financial Institutions requires an overseas financial institution which invests in a PRC trust company to meet the following conditions:

- (1) it must have had total assets of at least US\$ 1 billion at the end of the year immediately preceding the application to establish a trust company;
- (2) its long-term credit must be rated good or better by an international rating agency accredited by the CBRC in the previous 2 years;
- (3) it must be financially sound and have had a positive balance for the previous 2 financial years;
- (4) its capital adequacy ratio must not be less than 8% if the foreign investor is a bank; or if it is any other type of financial institution, it must meet the minimum capital adequacy ratio set by the financial regulatory authority of its home country or region;
- (5) it must have a sound organisational structure, management system and risk control system;
- (6) it must not transfer or pledge its shareholding in the trust company within 3 years (unless directed to do so by the CBRC) and it must state this restriction in its articles of association; and
- (7) the financial regulatory authority of its home country or region must have a sound legal and regulatory system;
- (8) its home country must have a good economic condition; and

(9) other conditions as may be prescribed by the CBRC.

Restriction on foreign investment

A foreign investor cannot hold 20% or more of the shares of a PRC trust company, and a foreign investor and its related parties are not allowed to own shares in more than 2 trust companies.

B. Financial leasing companies

Financial Leasing Companies are regulated mainly by the *Measures for the Administration of Financial Leasing Companies* (金融租赁公司管理办法) and the Measures on Non-Bank Financial Institutions.

A financial leasing company refers to a non-bank financial institution established with the approval of the CBRC which is mainly engaged in financial leasing. “Financial leasing” refers to a transaction in which a lessor leases property to a lessee for use and collects rents from the lessee in return, in accordance with the terms of a lease contract. Only fixed assets are suitable for financial leasing transactions, except as may be otherwise specified by the CBRC.

Conditions applicable to financial leasing companies

Article 29 of the *Measures on Non-Bank Financial Institutions* requires a proposed financial leasing company to meet the following conditions:

- (1) its articles of association must comply with the *Companies Law* and the relevant requirements of the CBRC;
- (2) it must have qualified investors;
- (3) it must have registered capital of at least RMB 100 million or its equivalent in a freely convertible currency, which must be paid up in one lump sum;
- (4) it must have directors and senior managers who meet the post-holding qualification requirements, and employ staff who are qualified professionals familiar with the finance leasing business;
- (5) it must have a sound organisational structure and sound internal controls and risk management systems;
- (6) its business premises and safety measures must meet the needs of its business operations; and
- (7) other conditions as may be prescribed by the CBRC.

Restrictions on foreign investment

Article 31 of the Measures on Non-Bank Financial Institutions requires that when a foreign major shareholder of a finance leasing company is a foreign commercial bank, the following conditions must be satisfied:

- (1) its capital adequacy ratio must be no less than 8% and must meet the minimum capital adequacy ratio set by the financial regulatory authority of its home country or region;
- (2) it must have had total assets of at least RMB 80 billion or its equivalent in a freely convertible currency at the end of the previous year;
- (3) it must have had a positive balance sheet for the 2 preceding financial years;
- (4) it must be in compliance with the laws and regulations of its home country and must not have materially violated any applicable laws or regulations in the previous 2 years;
- (5) it must have good corporate governance, a sound system of internal controls and high-level risk management policies and procedures;
- (6) its home jurisdiction must have supervision and management rules in place, and if the investor will be a major shareholder, its home country must have a good economic condition; and
- (7) such other conditions as may be imposed by the CBRC.

10. NEW REGIME: SHANGHAI PILOT FREE TRADE ZONE

On 23 September 2013, the Chinese government established the China (Shanghai) Pilot Free Trade Zone (“**SHPFTZ**”) in one of its largest cities - Shanghai. This is the latest major initiative of the Chinese government to adapt to global economic development trends and further its opening up to the outside world. As of August 2014, ten foreign banks have opened subsidiaries in the zone. They are HSBC and Standard Chartered, Citibank, Japan's Bank of Tokyo-Mitsubishi UFJ, Sumitomo Mitsui Banking and Mizuho, as well as Hong Kong's Bank of East Asia and Hang Seng Bank, Singapore's DBS and Australia's ANZ.

The measures launched in the SHPFTZ will be very different from those in other areas of China. As a key experiment for further economic reform, the new policy focuses on: (1) financial reform; (2) upgrading the customs and supervision framework; (3) simplifying administrative requirements; and (4) creating a competitive regulatory and tax environment. However, as the pilot program was only launched one year ago and implementing rules and regulations are required to implement the various policies announced for the new zone, it is difficult to assess the precise extent of the opportunities available to companies which set up in the SHPFTZ.

A. Applicable laws

The key regulations governing the SHPFTZ are the *Notice of the State Council on Issuing the Framework Plan for China (Shanghai) Pilot Free Trade Zone* (国务院关于印发中国(上海)自由贸易试验区总体方案的通知) (the “**Notice**”), the *Decision of the Standing Committee of the National People's Congress on Authorizing the State Council to Temporarily Adjust the Relevant Administrative Approval Items prescribed in Laws in China (Shanghai) Pilot Free Trade Zone* (全国人大常委会关于授权国务院在中国(上海)自由贸易试验区暂时调整有关法律规定的行政审批的决定) and the *Measures for the Administration of China (Shanghai) Pilot Free Trade Zone* (中国(上海)自由贸易试验区管理办法). In December 2013, the People's Bank of China issued its *Opinions on Providing Financial Support for the Development of the China (Shanghai) Pilot Free Trade Zone* (关于金融支持中国(上海)自由贸易试验区建设的意见) (the “**Opinions**”) which set out a framework for financial reforms to support the SHPFTZ.

B. Scope of the SHPFTZ

The SHPFTZ encompasses four previously existing free trade zones: the Waigaoqiao Free Trade Zone (the first free trade zone in Shanghai launched in 1990), the Waigaoqiao Bonded Logistics Park (the first free trade logistics park in China established in 2004), the Yangshan Free Trade Port Area (the first free trade port in China launched in 2005) and the Pudong Airport Free Trade Zone.

The scope of the policies for the pilot free trade zone will gradually be expanded depending on the needs and the progress of the pilot programme. For the purposes of this note, we have focused on the measures favourable to foreign-funded financial institutions.

C. Negative List

Instead of classifying the industries accessible to foreign investors into Encouraged”, “Restricted” or “Prohibited” categories (which is the system which applies in other parts of China), a “negative list” approach (the “**Negative List**”) has been adopted in the SHPFTZ which details the restrictions and prohibitions on foreign investment in the SHPFTZ. Any activities not included in the list are fully open to foreign investment. The restrictions applicable to

the finance industry are however covered under Part J of the 2014 Revised Negative List which requires that all investment in banking-related financial institutions must comply with existing regulations. Banking-related financial institutions include commercial banks. Banking institutions are not therefore fully open to foreign investment in the SHPFTZ.

D. Financial reforms within the SHPFTZ

The Notice states that the SHPFTZ will open the financial services industry to qualified private capital and foreign-funded financial institutions, and support the formation of foreign-funded banks and Chinese-foreign equity joint venture banks in the SHPFTZ.

The government's goal is to extend the opening-up and innovation in the financial sector in the SHPFTZ. Thus, the government, as stated in the Notice, may gradually:

- (1) launch a pilot scheme for RMB convertibility under the capital account;
- (2) allow interest rate liberalisation in the financial markets;
- (3) allow the establishment of restricted licence banks;
- (4) establish an international trading platform and allow market oriented pricing for assets held by financial institutions;
- (5) allow the establishment of foreign-invested credit rating companies; and
- (6) allow overseas enterprises to participate in commodity futures trading.

However, it should be noted that these are long-term proposals. Further and more detailed policies, guidelines and regulations are necessary before these proposals can be implemented. Since the launch of the SHPFTZ in 2013, there has not been significant progress towards implementing any of the above proposals.

The Opinions published in December 2013 again only provide a framework for reform and implementing rules will need to be adopted to bring to fruition the policies outlined in the Opinions.

E. Banks in the SHPFTZ

Approval process for establishment

As mentioned above, the current regime requires a foreign financial institution to have had a Representative Office in China for at least 2 years before it can set up a WFOE bank or a Foreign Bank Branch. Subject to approval by the CBRC and under special circumstances, qualified banks are allowed to directly establish a WFOE Bank, a JV Bank or a Foreign Bank Branch in the SHPFTZ within a shorter time period without having to set up a Representative Office initially.

Free Transferability between Free Trade Accounts

In contrast to the tight regulations and control over foreign exchange in other parts of mainland China, banks set up in the SHPFTZ can freely convert and transfer capital between overseas accounts and a new type of dual RMB and foreign currency free-trade bank account (an “FTA”), which the central bank will treat as an offshore account. Residents of the SHPFTZ (entities and individuals) are able to open an FTA at any Shanghai bank (a “**Resident FTA**”). Non-residents of the SHPFTZ can open FTAs with banks or their branches in the SHPFTZ. Free transfer of funds is allowed between Resident FTAs and:

- offshore bank accounts;
- non-resident accounts in China which are outside the SHPFTZ;
- non-resident FTAs; and
- other Resident FTAs.

Transfers of funds are also allowed between a Resident FTA of a non-financial entity and its other bank settlement accounts for the purpose of current account transactions (essentially trade-related transactions), loan repayment, industrial investment and other permitted cross-border trading activities. Fund transfers between Resident FTAs and other Chinese bank accounts outside the SHPFTZ however remain subject to restrictions on cross-border fund transfers.

Banks must apply for a permit to open FTAs for corporate clients from the central bank. However, there have been reports that foreign banks have encountered difficulty in obtaining these permits. As at July 2014, none of the ten foreign banks which have incorporated subsidiaries in the SHPFTZ has obtained this permit.²

The Opinions also state that RMB and foreign currencies in Resident FTAs and Non-resident FTAs will be freely convertible at some point in the future, when the time is considered right. The time frame is however unclear.

Institutional direct investments outside China

For the purpose of cross-border direct investments made by investors of the SHPFTZ, the time-consuming approval requirements when receiving foreign currency from trade or licensing (please refer to “Reform of the foreign exchange administration” as set out below), or converting RMB into foreign currencies for outbound payment may be bypassed.

Individual cross-border investments

Qualified Chinese individuals who are working in the SHPFTZ will be allowed to make various outbound investments including investments in securities pursuant to rules that are yet to be issued. This will enable Chinese individuals in the SHPFTZ to buy overseas financial products whilst bypassing the current Qualified Domestic Institutional Investor (**QDII**) Program. This is quite a significant measure as the eastern city of Wenzhou has been lobbying for years for this kind of approval from Beijing to no avail, due to capital flight concerns. It should be noted that as offshore investment requires approval from various other authorities and that there has been no successful case to date of an individual actually obtaining approval for any such offshore investment, the

² “Foreign banks in Shanghai free-trade zone lack permits to transfer funds freely”, South China Morning Post, 8 July 2014

practicality of this measure remains uncertain. In addition, income derived by SHPFTZ individuals may be remitted overseas after tax deductions. This is a major relaxation as compared to the Shenzhen Qianhai Economic Zone, which does not allow non-financial firms that borrow offshore RMB to use the proceeds outside its zone.

Capital markets

While foreign-invested enterprises in the PRC are not allowed to convert their foreign currency capital to invest in the PRC securities and futures markets, the Opinions provide that SHPFTZ financial institutions and enterprises will be allowed to invest and trade on Shanghai's securities and futures exchanges at some point. Foreign parent companies of subsidiaries in the SHPFTZ will also be permitted to issue RMB-denominated bonds in China's domestic bond market, although the rules governing such issues have yet to be published.

Financing from overseas

SHPFTZ institutions including Chinese or foreign-funded enterprises, non-banking financial institutions and other economic organisations registered in the SHPFTZ will be able to obtain RMB and foreign currency financing overseas through FTAs after obtaining Government approval. It is worth noting that overseas RMB borrowed by companies in the SHPFTZ will have to be used for normal business purposes and cannot be invested in securities or derivatives. In any case, the PBOC retains the right to implement temporary regulatory restrictions as needed to minimise risk as it sees necessary.

Diversified risk-hedging tools

SHPFTZ enterprises will be able to conduct currency risk hedging based on real management needs and qualified SHPFTZ enterprises may also be allowed to make foreign securities and foreign derivative investments, pursuant to rules that are yet to be issued.

Liberalisation and reform of interest rates and foreign exchange administration

Liberalisation of interest rates

The Opinions state that certain qualified financial institutions in the SHPFTZ will be added to the list of institutions which may be permitted to issue large-denomination negotiable certificates of deposit with priority, and when conditions are right, the ceiling on interest rates for small-denomination deposits in foreign currencies in general accounts may be lifted. No clear guidance or timeframe has however been given.

Reform of foreign exchange administration

In February 2014, the SAFE issued its *Notice Concerning Support for the Implementation of Foreign Exchange Administration in the China (Shanghai) Pilot Free Trade Zone* (关于印发支持中国(上海)自由贸易试验区建设外汇管理实施细则的通知)(the "SAFE Notice"). The SAFE Notice seeks to simplify the process of foreign direct investment (FDI) and facilitate the management of capital accounts in the SHPFTZ. Under the SAFE Notice, foreign invested enterprises registered in the SHPFTZ are allowed to convert all of their foreign exchange equity capital into RMB. The relaxation does not however apply to foreign exchange received from other sources, such as loans. The converted RMB are required to be held in a special RMB account and can be used for activities within the entity's scope of business. Converted RMB cannot however be used to acquire listed securities, make loans, repay loans (including loans transferred to third parties), or purchase real estate other than for the entity's own use (except in the case of a real estate company).

The SAFE Notice also relaxes the prohibition on conversion of foreign exchange capital into RMB to fund equity investments. All foreign invested entities in the SHPFTZ are allowed to use their foreign exchange capital to invest in equity, subject to the target entity registering with its local administration of foreign exchange and opening a special RMB account to receive the proceeds.

The SAFE Notice also enables a number of cross-border transactions involving an entity established in the SHPFTZ to be processed directly by banks, without the need to register with the SAFE. The shortening of the process should give foreign-invested enterprises in the SHPFTZ more freedom in using their capital, considering that outside the SHPFTZ, SAFE circular 142 (which was designed to prevent “hot money” from flowing into China) prohibits foreign-invested enterprises from using their funds to acquire domestic companies without certain verification procedures and restrictions.

Provision of external loans

Entities in the SHPFTZ will be able under the SAFE Notice to provide foreign exchange loans to their overseas subsidiaries of up to 50% of the lender’s shareholder equity, as compared to 30% in the rest of China.

Conclusion

The PBOC’s stated goal was to implement its reforms in the Opinions within three months with the objective of a complete inauguration within a year. Time is however running out as nine months have already passed. It should also be noted that the PBOC only has administrative authority over banking, and the Opinions cannot be read in isolation without considering other governmental examination and approval procedures, which require the coordination of the State Council. The cooperation of other regulators such as the National Development and Reform Commission and the CSRC is also required. As a general comment, the pace of foreign investment reform in the SHPFTZ reflects the gradual manner in which China is experimenting in moving towards a more flexible and open market.

F. Securities Companies in the SHPFTZ

There is very little difference in the foreign investment restrictions applicable to securities companies whether they are established in or outside the SHPFTZ. According to the Negative List, the shareholding of a foreign investor in a securities company in the SHPFTZ must not exceed 49%. The scope of business of a foreign-funded securities company in the SHPFTZ is the same as for foreign-funded securities companies established outside the SHPFTZ. A foreign-funded securities company must have been established in the SHPFTZ for 2 years before it can apply to expand its scope of business and that remains subject to approval by the government.

G. Securities Investment Fund Management Companies in the SHPFTZ

As with securities companies in the SHPFTZ, securities investment fund management companies are included in the Negative List and are subject to a 49% limit on the amount of foreign investment which is allowed.

H. Futures Companies in the SHPFTZ

According to the Negative List, only futures companies incorporated in Hong Kong and Macau are allowed to establish a futures company within the SHPFTZ and the amount of investment remains subject to a 49% cap even for these futures companies.

November 2014

This note is provided for information purposes only and does not constitute legal advice. Specific advice should be sought in relation to any particular situation. This note has been prepared based on the laws and regulations in force at the date of this note which may be subsequently amended, modified, re-enacted, restated or replaced.