

Client Alert.

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CSRC Further Opens China's Investment Banking Market – But Just a Little

By Xiaohu Ma, Paul McKenzie, Sherry Yin, and Jun Deng

The China Securities Regulatory Commission (“**CSRC**”) recently amended the *Rules on the Establishment of Foreign-Invested Securities Companies* (外资参股证券公司设立规则; the “**FISC Rules**”)¹ to raise the cap on the permissible foreign stake in securities companies (“**FISCs**”) from one-third to 49%. This amendment took effect on October 11, 2012. The FISC Rules also increase the minimum stake a single domestic securities company must hold in an FISC to 49%.

There are currently 11 FISCs operating in China. Except for China International Capital Corporation, which was established before the FISC Rules were issued, foreign investment in each of the other 10 FISCs does not exceed 33%, consistent with the previous FISC Rules. The previous FISC Rules also required that the domestic shareholders of an FISC include a domestic securities company holding not less than a 33% interest, thus preventing a foreign investor from becoming the largest shareholder in an FISC. Allowing up to 33% foreign ownership in the securities industry implemented one of China's commitments when it entered the World Trade Organization in 2001. Since then, China has been under constant pressure from its trading partners to further open its securities industry to foreign investors.

Keen to tap into China's capital markets, global investment banks that have invested in FISCs have reportedly used different means, including setting up an executive committee, to achieve greater control over FISC operations, notwithstanding the 33% equity cap.

Raising the cap to 49% potentially gives foreign investors more say in the internal governance of FISCs. However, by keeping permissible foreign investment below 50% and by also raising the minimum stake of the domestic securities company to the same 49% level, this liberalization does not achieve what many foreign investors in the sector had hoped, which is to permit foreign investors to take a controlling position in FISCs.

The amended FISC Rules, however, are silent as to whether the increase in the minimum stake of the domestic securities company to 49% applies to existing FISCs. Further CSRC clarification is required on this point. We also note that the increase in the foreign investment cap to 49% provided in the amended FISC Rules is not reflected in the Foreign Investment Industrial Catalogue (as amended in 2011) (外商投资产业指导目录) (the “**FIE Catalogue**”), which as of the date of this alert still stipulates a 33% cap. It is likely that the Ministry of Commerce and the National Development and Reform Commission will update the FIE Catalogue in due course to reflect the increase of the cap.

These minimum/maximum equity stakes do not apply to listed FISCs. The amended FISC Rules expressly provide that FISCs listed on a domestic stock exchange are not required to have a single domestic securities company with a 49% or greater interest, provided that domestic shareholders collectively hold a controlling interest in the listed FISC. Subject to

¹ The FISC Rules were originally promulgated by CSRC on June 1, 2002, and were subsequently amended by CSRC Circular 52, which took effect on January 1, 2008. The latest amendments to the FISC Rules were announced by CSRC in the *Decisions Concerning the Amendments to the Rules on the Establishment of Foreign-Invested Securities Companies* (Decree No. 86) on October 11, 2012.

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CSRC's approval, foreign investors are permitted to acquire a stake in a listed securities company, but the foreign stake cannot exceed 20% held by a single foreign investor and an aggregate 25% held by foreign investors.

Another regulatory development that will affect FISCs is the CSRC's announcement, concurrent with its announcement of the amendments to the FISC Rules, of a major change to the *Tentative Rules for the Establishment of Subsidiaries by Securities Companies* (证券公司设立子公司试行规定) (the "**Subsidiaries Rules**").² The Subsidiaries Rules stipulate that following establishment of a subsidiary of a securities company, such subsidiary must operate for a minimum period of time before it is eligible to apply for an expansion of its authorized scope of business. The change announced by CSRC is a reduction of the waiting period from five to two years. Given the mandatory shareholding in FISCs by domestic securities companies, FISCs are subject to this waiting period. The FISC Rules contemplate that FISCs might engage in a broad range of business, including the underwriting or sponsorship of stock and bond offerings, brokerage services relating to foreign stocks, brokerage services relating to bonds, and other business as approved by CSRC. However, as a practical matter, CSRC typically does not permit all of these business lines to be included in the business scope of an FISC when it is first established. This change in the Subsidiaries Rules is therefore seen as particularly important for FISCs, as it presumably means that FISCs will be permitted to operate with a full scope of permissible securities business more quickly.

Contact:

Xiaohu Ma

852 2585 0868

xma@mofo.com

Paul McKenzie

86 10 5909 3366

pmckenzie@mofo.com

Sherry Yin

86 10 5909 3566

syin@mofo.com

Jun Deng

852 2585 0878

jdeng@mofo.com

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² The Subsidiaries Rules were originally promulgated by CSRC on December 28, 2007. The latest amendments to the Tentative Subsidiaries Rules were announced by CSRC in the *Decisions Concerning the Amendments to the Tentative Rules for the Establishment of Subsidiaries by Securities Companies* on October 11, 2012.