

Title: Opening Of the Securities Industry

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The China Securities Regulatory Commission (CSRC), the watchdog of the Chinese securities market, hopes to improve the quality of Chinese investment banks by introducing international investment bankers to the domestic market. Many Chinese investment banks have a poor history of complying with securities laws, despite the frequent sanctions of the CSRC. The CSRC hopes that international investment banks will provide positive models for domestic firms, and will force the domestic investment banks to improve their performances in a more competitive environment.

On December 12, 2001, CSRC published the *Draft Rules of Approval of Sino-foreign Joint Venture Securities Companies* (the Draft Rules). Though it will likely be some time before promulgation of the final version of these rules, it will be much sooner than the deadline of three years after accession as committed by the Chinese government in the WTO Protocol of Accession. Zhou Xiao Chuan, the Chairman of the CSRC, said in a recent speech that the CSRC welcomed experienced international financial institutions to enter the China securities market and that he believed the competition would benefit both local and international market participants.

The Sectors To Be Opened

The sectors to be opened to Sino-foreign Joint Venture Securities Companies (“JVSCs”) consist of: i) the underwriting of A, B and overseas listed shares issued by Chinese companies (Overseas Listed Shares), and debentures (including government debentures and corporate debentures); ii) the brokering of B and Overseas Listed Shares, and debentures (including government debentures and corporate debentures); iii) the dealing for their own account of B shares and Overseas Listed Shares, and debentures (including government debentures and corporate debentures); and iv) other businesses approved by CSRC.

The Draft Rules don’t address some important sectors that are traditionally core business areas for investment bankers globally, including consulting (for example, advising the acquirers and the target companies in merger and acquisitions), and investment advising (for example, advising a client to buy or sell securities and publishing analytical reports). The CSRC left itself a discretionary space to allow the JVSCs to work in sectors that are not explicitly addressed by the Draft Rules; it is however unclear now to what extent the CSRC will draw a boundary in this respect.

Methods of Formation

There are two alternative ways to establish a JVSC: by registering a new joint venture company

with Chinese partners; or by purchasing the equity held by the shareholders of the domestic securities companies or the new equity issued to the foreign investors.

There are problems with both of these methods. When establishing a new company, the foreign investors must find Chinese partners that have enough cash or non-cash assets (contribution in kind is allowed by the Draft Rules if the non-cash assets are necessary for the operation of a JVSC) to make their capital contribution. Another problem a foreign investor may need to consider is how to resolve the competitive relationship between the Chinese partners and a JVSC. If purchasing the equity of a Chinese securities company, most of the difficulty lies in the creation of a new company via a "spin off". There are two main reasons to spin off certain businesses or assets out of the target company. One is the creation of a new target company without unprofitable businesses or businesses conflicting with the new strategies of the JVSC, and the other reason is that it is necessary given that the target companies have a broader business scope than the business scope of the JVSC approved by the CSRC. Under the latter circumstance, the target companies are required by the Draft Rules to spin off the businesses and assets falling beyond the initially approved business scope of the JVSC.

Entry Requirements

The requirements for JVSCs, such as minimum registered capital, internal risk control and facilities, are essentially the same as the requirements for domestic securities companies as provided in the *PRC, Securities Law*, Which conforms to the provisions in the Protocol of Accession and reflects the national treatment principle. On the other hand, the CSRC still has the power to set the appropriate threshold requirements to screen out unqualified applicants in accordance with the prudential principle under the WTO Protocol. According to the Draft Rules, those requirements include: i) the securities regulatory bodies of the foreign investors' home countries or districts have signed a cooperative memorandum with the CSRC, which eliminates investors from some territories, such as Switzerland, Canada and Taiwan because of lack of such cooperative memorandums; ii) possession of a securities business licence in the home country, 10 years' experience in the financial sector, and three years' track record without material sanctions imposed by securities regulatory bodies or judicial institutions in the home country; iii) three years' track record of risk control; iv) sophisticated internal governance; and v) good reputation and performance in the international securities market. Most of the prestigious international investment banks will have little difficulty in meeting the aforesaid requirements. To some degree, those requirements can be deemed as designated by the CSRC to attract the prestigious international investment banks.

Reconciliation Of the Draft Rules and the FIE Laws

There is no mention in the Draft Rules that the formation of JVSCs should also obtain the blessing of the Ministry of Foreign Trade and Economic Cooperation (MOFTEC) in addition to the CSRC's approval. According to the Draft Rules, the ratio of equity held by foreign investors should be higher than 25% and lower than 33%. Theoretically speaking, a JVSC is also a foreign investment enterprise (FIE), which is subject to the regulations of the FIE laws, and whose

establishment should also be approved by MOFTEC. There is no clue in the Draft Rules as to how to reconcile the FIE and securities laws, and MOFTEC has no comments on the Draft Rules yet.

At the time of writing of this article, the Draft Rules are still in only a draft form. Any interested readers may forward their comments on the regulations to the CSRC.