

## China's Securities Regulator Proposes to Relax Control on Foreign Investment in Securities Companies

In August 2012, China Securities Regulatory Commission (CSRC) published, for public review and comments, draft amendments (the Draft Amendments) to the Rules for the Establishment of Foreign-Invested Securities Companies (the Foreign-Invested Securities Companies Rules) and the Trial Provisions for the Establishment of Subsidiaries by Securities Companies (the Securities Companies' Subsidiaries Rules). The review period ended on September 22, 2012.

According to the official notes regarding the Draft Amendments, the proposed changes are intended to fulfill the commitments made by the Chinese government during the Fourth China-US Strategic and Economic Dialogue held in May 2012.

One such commitment is to allow foreign investors to own up to a 49-percent equity interest in a Chinese securities company. Under the Foreign-Invested Securities Companies Rules that are currently in effect, the aggregate interests owned, directly or indirectly, by one or more foreign investors in a securities company organized in China cannot exceed 1/3. The Draft Amendments will raise this foreign ownership cap to 49 percent, which represents a quite significant increase. This would be good news for foreign investors who desire to maximize their holdings in Chinese securities companies, as it would enable them to play a greater role in the management and enjoy a larger share of economic benefits.

At the same time, the Draft Amendments also make a corresponding adjustment to the minimum shareholding requirement in respect of Chinese domestic investors in a securities company. Currently, the Foreign-Invested Securities Companies Rules require that at least one domestic investor hold no less than 1/3 equity interest in a foreign-invested securities company in China. Such minimum domestic equity interest is increased to 49 percent under the Draft Amendments. Apparently, CSRC still would not allow foreign investors, individually or as a group, to be the largest shareholder in a Chinese securities company.

Another commitment made by the Chinese government during the China-US Dialogue is to allow a foreign-invested securities company that has operated continuously for at least two years and meets certain other conditions to apply for an expansion of its business scope. In China, there is a statutory limitation on how many types of securities businesses can be included in the initial business scope of a securities company—when the company is first formed, it may not conduct more than four types of securities businesses. Generally speaking, once a Chinese securities company has operated for at least two years and meets certain other conditions, it is eligible to seek CSRC's approval for expanding its business scope.

However, a securities company that is a "subsidiary" of another securities company in China is subject to the Securities Companies' Subsidiaries Rules, which currently provides that a "subsidiary" securities company must have operated continuously for at least five years (and meet certain other conditions) before it can seek regulatory approval for an expansion of its business scope. "Subsidiary" is defined as a securities company whose controlling stake is held by another securities company. Indeed, a majority of the foreign-invested securities companies in China meet the definition of "subsidiary" and therefore are effectively subject to the five-year minimum operating period before their business scope can be expanded. The Draft Amendments would amend the Securities Companies' Subsidiaries Rules to reduce the five-year minimum operating period to two years, so that foreign-invested securities companies, including those that are "subsidiaries" of other securities companies, may apply for an expansion of their business scope after two years of continuous operation.

If adopted, the Draft Amendments should have a positive impact on foreign participation in Chinese securities companies, by allowing foreign investors to take a larger stake and by permitting foreign-invested securities companies to apply for business scope expansion sooner. That being said, one thing

that foreign investors should bear in mind is that after CSRC has blessed a proposed foreign investment in a Chinese securities company, the company should obtain a foreign-invested enterprise approval certificate from the PRC Ministry of Commerce (MOC). According to the Catalogue of Industries for Guiding Foreign Investment (the Catalogue) issued by MOC and another Chinese regulator, foreign investment in securities companies is “restricted” and, consistent with CSRC’s Foreign-Invested Securities Companies Rules as currently in effect, is subject to a foreign ownership cap of 1/3. If the Draft Amendments are adopted by CSRC, there could be inconsistency between the CSRC regulation and the current version of the Catalogue, in respect of the foreign ownership cap. Although, in practice, it is unlikely that MOC would challenge a proposed foreign investment in a Chinese securities company that has been approved by CSRC, it would be prudent for foreign investors to seek some regulatory clarification and assurance in this regard.

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