Open for business: China ignores 'background noise' and forges ahead with opening up its financial sector

October 2019

Hogan Lovells

Open for business: China ignores 'background noise' and forges ahead with opening up its financial sector

On 20 July, 2019, the Office of the Financial Stability and Development Committee under the State Council ("**FSDC**") unveiled 11 new measures[1] (the "**New Measures**") to substantially further open up China's financial sector to foreign investment. Immediately thereafter, the relevant regulators, namely, the People's Bank of China ("**PBOC**"), the China Securities Regulatory Commission ("**CSRC**") and the China Banking and Insurance Regulatory Commission ("**CBIRC**"), released pre-prepared explanatory comments on the New Measures on their official websites.[2] In this Note, we will look at each of the New Measures, together with the corresponding explanatory comments.

Then on 11 October 2019, the CSRC announced an acceleration of the timetable for full liberalisation of the fund management, securities and futures sectors to foreign investment. These policies, when read together, should substantially open up (among others) China's bond underwriting market, insurance sector, fund management, securities and wealth/asset management industries, allowing foreign investors to tap into a trillion-dollar market and compete with their domestic counterparts on a more level playing field.

PBOC: further opening-up of bond market

Allowing foreign-funded institutions to conduct credit rating business for all kinds of bonds in China's interbank and exchange-traded bond markets

The credit rating business has been progressively opened up in recent years. In July 2017, the PBOC issued the *Announcement on Matters relating to Opening-up of the Credit Rating Industry* (People's Bank of China Announcement [2017] No.7) ("**PBOC Announcement No.7**"), specifying the opening-up policies of the credit rating industry in the interbank bond market. In March 2018, the National Association of Financial Market Institutional Investors ("**NAFMII**") issued rules[3] detailing the specific procedures and requirements for the evaluation of credit rating agencies. Foreign-funded credit rating institutions may apply to conduct credit rating business for certain bonds. Foreign-funded credit rating institutions which have passed evaluation registration may carry out credit rating activities based on the type of bond rating business for which registration has been accepted. On 4 September 2018, the PBOC and the CSRC jointly issued Announcement [2018] No.14 ("**PBOC/CSRC Announcement**"), making it clear that the PBOC, CSRC and NAFMII will collaborate with each other in reviewing or registering the business qualifications of credit rating agencies in the bond market, and that those credit rating agencies that have carried out credit rating business in either the interbank or the exchange-traded bond markets will be offered 'green light channels' for mutual recognition of their credit rating business qualifications in other bond markets. The new measures set out

1 For the original text of 11 measures, please refer to http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3863019/index.html.

2 For the original text of the explanatory comments, please refer to PBOC: http://www.pbc.gov.cn/goutongjiaoliu/113456/113469/3863024/index.html;

CSRC: http://www.csrc.gov.cn/pub/newsite/zjhxwfb/xwdd/201907/t20190720_359550.html;

CBIRC: http://www.cbirc.gov.cn/cn/doc/9102/910201/0ADE598BBEC04B89906188DE5D1B487A.html.

3 See *Rules on Interbank Bond Market, Evaluation of Registrations by Credit Rating Organisations* issued by the NAFMII, effective 27 March 2018.

in PBOC Announcement No.7 set the scene for more foreign-funded credit rating institutions to enter the Chinese market.

Standard & Poor's Credit Rating (China) Ltd. ("**S&P China**"), a wholly-owned subsidiary of S&P Global was established in Beijing on 28 January 2019, and was approved to conduct credit rating services in all categories in the Chinese interbank bond market, including financial institution bonds, debt financing instruments of non-financial enterprises, structured products and overseas entity bonds. On 12 July 2019, S&P China released its first-ever rating report, which adopted a special rating system for the Chinese market in order to converge with China's home-grown rating system. However, S&P China has not yet obtained a rating qualification for the exchange-traded bond market. Nevertheless, based on the above PBOC/CSRC Announcement No.14, S&P China is eligible to apply for an exchange-traded bond market qualification, as it has already obtained a rating qualification for another relevant market.

Allowing foreign institutions to obtain a category A lead underwriting license in China's interbank bond market

Under the interbank bond market rules, bond underwriters are divided into two categories: (i) lead underwriters; and (ii) underwriters. Previously, foreign-funded banks were rarely allowed to become underwriters. In 2013, NAFMII further sub-divided lead underwriters into two categories: Category A and Category B, of which only the latter was open to foreign-funded banks.[4] The difference between the two categories mainly lies in that Category A lead underwriters may conduct lead underwriting business nationwide for debt financing instruments of non-financial enterprises, while Category B lead underwriters may only conduct lead underwriting business within a specified scope, and need to conduct lead underwriting business jointly with Category A lead underwriters (which must be banks) for one year. After the one-year period has expired, they can conduct lead underwriting business on their own without collaboration with Category A lead underwriters.

Currently, only six foreign-funded banks have obtained interbank bond market underwriting licenses, with only three[5] of them qualified as underwriters and another three[6] qualified as Category B lead underwriters, but with their underwriting business scope further limited by the PBOC to debt financing instruments issued by offshore non-financial enterprises. In practice, this means that foreign-funded banks can only underwrite Panda Bonds, a rather small market (about RMB165 billion) when compared against the domestic credit bond market (about RMB7.3 trillion).[7]

The New Measures will allow foreign-funded institutions to obtain Category A lead underwriter qualifications and expand their business into underwriting issuance of all types of debt financing instruments nationwide. That means that foreign-funded institutions will be able to tap into the trillion-dollar credit bond market, and compete with their domestic counterparts on a more level playing field.

It has also been reported that the NAFMII is organizing market members to jointly study and formulate market assessment standards for Category A lead underwriting qualifications for foreign-funded institutions. Furthermore, in order to link Category A and Category B qualifications, the existing market assessment standards for Category B lead underwriter qualifications for foreign-funded institutions

---

4 See the *List of Underwriting Institutions for the Debt Financing Instruments of Non-Financial Enterprises*, http://www.nafmii.org.cn/hygl/hygl/cxhy/201902/t20190222_75943.html

5 Deutsche, Citigroup and JPMorgan Chase.

6 HSBC, Standard Chartered and BNP Paribas.

7 See the 21 Financial Report: https://m.21jingji.com/article/20190722/herald/bd7effc22569040ef3b9b12c26905b61.html

will also be revised. The formulation of the relevant assessment standards is expected to be completed and promulgated in the near future. The new assessment standards system will take full account of the linkage between the businesses of parent companies and subsidiaries of foreign-funded institutions inside and outside China, and intensify the level of due diligence investigations on the overseas parent companies of foreign-funded institutions.

Based on the comments made by PBOC, rules will be formulated to strengthen due diligence to be carried out on overseas parent companies of foreign-funded institutions, as the business of a parent company is closely linked to that of its subsidiaries. It could be argued that this is not 'national treatment', but is arguably justifiable at least to some extent given that the parent companies of domestic capital banks are already subject to regulatory oversight and supervision by PBOC, while the overseas parent companies of foreign-invested institutions are outside PBOC's geographical jurisdiction.

Taking further steps to facilitate foreign institutional investors to invest in interbank bond market

Currently, foreign investors can invest in China's interbank bond market through multiple channels, such as the Qualified Foreign Institutional Investor ("**QFII**") and Renminbi Qualified Foreign Institutional Investor ("**RQFII**") schemes, bond connect and direct investment in the interbank bond market ("**direct investment**"). However, using different market channels is costly and cumbersome to foreign investors in terms of market entry, bond transfers, fund transfers, and so forth. In order to further facilitate foreign institutional investment in the interbank bond market and to improve investment efficiency, integration of the policy requirements for different available channels, and opening up of bond and fund accounts is needed.

After soliciting opinions from settlement agents, custodians and foreign institutional investors, the PBOC, together with the State Administration of Foreign Exchange ("**SAFE**"), drafted the *Circular on Issues concerning Further Facilitating Foreign Institutional Investors' Investment in the Interbank Bond Market* (the "**Bond Market Circular**"), which was released for public comment in May 2019. The final version was issued on 16 October 2019 with largely minor amendments, and will take effect from 15 November 2019. The Bond Market Circular resolves the issues relating to the transfer of bonds, transfer of funds and repeated record filings where the same foreign institutional investor has made investments through different channels, and streamlines foreign investment in the market. It allows the same foreign institutional investor to carry out non-trading bilateral transfers of bonds between bond accounts opened under the QFII/RQFII schemes and those opened under direct investment arrangements, and to directly transfer (bilaterally) the funds between QFII/RQFII custody accounts and direct investment fund accounts. Furthermore, if a foreign institutional investor invests through both QFII/RQFII and a direct investment channel, it will only be required to record-file once with the PBOC Shanghai Headquarters.

CSRC: scrapping foreign ownership limits ahead of schedule

Removing the cap on foreign investors shareholdings in securities companies, fund management companies and futures companies from 2021 to 2020

China announced in 2018 it would relax the restrictions on the proportion of foreign investment in securities companies, fund management firms and futures companies (together the "**Relevant Sectors**") to allow up to 51% foreign investment, and to remove foreign equity ceilings totally in the Relevant Sectors within three years (that is, by 2021). The CSRC thereafter promulgated the *Foreign-invested Securities Companies Administrative Measures* and the *Foreign-invested Futures Companies Administrative Measures* and other administrative provisions to allow foreign investors to take a maximum 51% equity stake in companies operating in the Relevant Sectors. So far, UBS Group AG, Nomura Holdings Inc. and JPMorgan Chase & Co. have been approved by the CSRC to take majority stakes in local securities ventures. It is reported that JPMorgan plans to raise its stake to 100% when the rules allow.[8]

The New Measures bring forward the timetable by a year, echoing what Premier Li Keqiang disclosed in a special speech at the opening ceremony of the Davos Forum on 2 July 2019. The message had not been unambiguously communicated previously, as the then forthcoming *Special Administrative Measures on the Market Access of Foreign Investment (Negative List) (2019 Edition)*[9] ("**2019 Negative List**") which became effective on 30 July 2019 still refers to the 2021 timetable.

In a move that could be seen either as another indication that despite all the 'background noise' of the ongoing trade negotiations between China and the US, China wishes to make it clear that it remains open for foreign direct investment business and/or, alternatively, a direct reflection of the preliminary deal that has been struck with the US, The China Securities Regulatory Commission ("**CSRC**") announced on 11 October 2019 that it will be moving forward the date for full liberalization to foreign investment for the securities, fund management and the futures sectors from 2021 to 1 April 2020 for the fund management sector, to 1 December 2020 for the securities sector, and from August 2021 to 1 January 2020 for the futures sector, respectively. It also hints by saying that it will continue to provide "highly efficient" services to underpin establishment of, or changes to, securities and fund management joint ventures that it will facilitate the buy-outs of Chinese partners by those foreign investors in existing joint ventures who henceforth want to go it alone. All of this will be received positively by the foreign investment community.

CBIRC: opening-up of market access for insurance companies

Bringing the period within which the cap on shareholdings for foreign investors in life insurance will be removed ahead of schedule

Similar to New Measure No.4 above, all remaining restrictions on the foreign

8 See Bloomberg News: China Opens Up Financial Sector to More Foreign Investment, 20 July 2019, https://www.bloomberg.com/news/articles/2019-07-20/china-vows-targeted-measures-as-financial-stability-risks-rise

9 Issued by National Development and Reform Commission and Ministry of Commerce on 30 June 2019, effective 30 July 2019.

shareholding ratio in life insurance companies will also be lifted in 2020, a year ahead of the schedule promised in 2018. Currently, under the 2019 Negative List, foreign investors are allowed to hold up to 51% of the equity in life insurance companies. The CBIRC will revise the *Foreign-invested Insurance Companies Administrative Regulations* and other relevant laws and regulations to implement the further liberalization.[10]

Removing the requirement that domestic insurance companies must hold not less than 75% of the shares of insurance asset management companies

At present, under the Administration of Insurance Asset Management Companies Interim Provisions (the "**Insurance Asset Management Provisions**") issued by the then China Insurance Regulatory Commission ("**CIRC**") on 21 April 2004, domestic capital insurance companies must hold not less than 75% of the equity in insurance asset management companies. This New Measure will allow foreign investors to hold shares in insurance asset management companies without any cap on the percentage of shares held. To implement this, the now China Banking and Insurance Regulatory Commission ("**CBIRC**") will need to revise the Insurance Asset Management Provisions. However, CBIRC has indicated it will also tighten scrutiny with respect to shareholder qualifications for entering the market, and enhance ongoing compliance requirements for insurance asset management companies.

Expanding Market access of foreign insurance companies by removing the operating Track Record Qualification for foreign shareholders

Under the old *Foreign-invested Insurance Companies Administrative Regulations* (the "**FIE Insurance Company Regulations**") first issued by the then CIRC in December 2001, amended in 2013 and 2016, applicants for the establishment of foreign-funded insurance companies must be foreign insurance companies that have more than 30 years of experience in operating insurance business.

Therefore, a foreign insurance company that intended to establish an insurance subsidiary in China had to have been engaged in the insurance business for more than 30 years. In recent years, with the deepening of opening-up, most major international insurance companies have already entered the China market, and play an active role in China's insurance market. However, many younger and more innovative foreign insurance companies, with their own unique business models have found themselves blocked by this very demanding track record requirement. Scrapping the 30 years' track record requirement will help diversify the range of insurance market players and enhance market competition as well as drive the development of new, more innovative products.

To implement this New Measure No.7, the State Council promulgated its *Decision on Amending "Foreign-invested Insurance Companies Administrative Regulations" and "Foreign-Invested Banks Administrative Regulations"* ("**State Council Decision**") on 15 October, 2019, which took effect on the same date. The State Council Decision formally removed the 30 years' insurance business experience requirement. In addition, it also removed the requirement for a foreign insurance company applying for the establishment of a foreign-invested insurance company in China to have operated a representative office for two years.

Furthermore, by amending the FIE Insurance Company Regulations and *Foreign-Invested Banks Administrative Regulations,* the State Council's Decision also implemented many of the financial opening-up measures in the

[10] See Financial Times Interview with a CBIRC spokesperson, 20 July 2019, http://www.cbirc.gov.cn/cn/doc/9102/910201/0ADE598BBEC04B89906188DE5D1B487A.html

insurance and banking industry announced in May 2019, as described in our separate client note,[11] including the following:

- Removing the USD10 billion total asset requirement for a foreign bank to establish a foreign–invested bank as well as the USD20 billion total asset requirement for a foreign bank to establish an overseas bank branch in China.
- Allowing other types of overseas non-insurance financial institutions to buy equity interests in foreign-invested insurance companies established in the PRC.
- Relaxing the requirements for Chinese shareholders in Sino-foreign JV foreign-invested banks, removing the requirement that the only or main Chinese shareholder must be a financial institution.
- Allowing overseas insurance group companies to invest in establishing insurance-type institutions.
- Removing approval requirements for foreign-invested banks to operate RMB business, and allowing foreign-invested banks to operate RMB business immediately upon commencement of business.
- Allowing foreign-invested banks to operate agency collection and payment business.

CBIRC: opening-up of other financial institutions

Encouraging overseas financial institutions to participate in wealth management subsidiaries of commercial banks

Following the recent regulatory decision to separate wealth management/asset management businesses from banking operations,[12] Chinese banks have, since January 2019, been racing to set up wealth management/asset management firms. Under the *Wealth Management Subsidiaries of Commercial Banks Administrative Measures,* the wealth management subsidiaries of banks may be wholly funded by commercial banks, or co-funded by commercial banks, domestic/foreign financial institutions or non-financial enterprises. However, in practice, although many commercial banks in China such as Bank of Ningbo and Bank of Nanjing, which already have foreign shareholders, have indicated that they wish to set up wealth management companies via joint ventures ("**JV**") with foreign investors, they have nonetheless still decided to go it alone in order to speed up the initial approval process for their wealth management subsidiaries.

The New Measures encourage overseas financial institutions to buy into wealth management subsidiaries of commercial banks, and CBIRC has gone on record to state that it will guide qualified banks towards bringing in foreign investment to their wealth management operations, a sector where foreign investors are likely to have a longer track record in what remains a relatively young industry in China.

Allowing overseas asset management companies to form wealth management/asset management JV with

11 See China's new Foreign Investment Law: the impact on financial institutions [Link].

12 See *Wealth Management Subsidiaries of Commercial Banks Administrative Measures*, issued by the CBIRC, effective 2 December 2018.

subsidiaries of Chinese banks or insurance companies

When global asset management companies ("**AMCs**") were allowed to start their onshore businesses in China in 2002, when the first mutual fund JV was established, they were confronted with a 33% foreign ownership limit.[13] Although the limit was relaxed to 49% in 2004, the shareholding restriction has always been a big issue for foreign JV partners who cannot achieve the degree of shareholding control necessary for them to fully implement their strategies and management systems, which in turn meant Chinese clients could not get a full international service in the area of public funds.

In 2016, the Private Fund Management ("**PFM**") scheme was launched to enable overseas managers to establish wholly-owned subsidiaries in China and to raise private equity-type funds from qualified investors.[14] Many global managers have taken this route to build their onshore presence, mainly because of the ability to exert complete control over their subsidiaries. Yet in practice, another issue has emerged: global asset management brands and their track records have not been fully recognized in China, and many global AMCs have found it extremely hard to raise their assets under management ("**AUM**") from Chinese investors by their own efforts alone.

The dilemma seems to be that you cannot have your cake and eat it: if a foreign investor wishes to have full control over its China onshore private fund business, it paradoxically may struggle to reach the targeted AUM, as Chinese partners have less interest in raising capital for such a fund, while if it takes a minority position and relinquishes control, it may find it easier to raise funds as its Chinese partners will be motivated to raise funds.

New Measure No.9 seems to have provided a solution to this dilemma. An overseas AMC can henceforth form a strong partnership with a local player with funding resources (its parent being either a bank or an insurance company) to form a wealth management/asset management JV, while having a controlling interest in the JV. The designer of this route seemed to have a clear understanding of the practical issues faced by global asset managers and a genuine desire to make this type of partnership really work.

It is fair to say that relaxations of market access restrictions mean that the previously-mentioned mutual fund JV model has already gone some way towards resolving the control issue: the overseas JV partner has, since 2018, been permitted to increase its shareholding percentage to 51%, and now, as mentioned above, New Measure No.4 will remove the ceiling on foreign ownership by 2020. This new solution may be particularly attractive to overseas managers who have only recently begun to think about their China strategy as compared to the mutual fund JV route. The reason why these new wealth management/asset management JV vehicles are likely to be popular with foreign investors are set out below:

(1) the visibility and availability of potential local partners. They will be wealth management subsidiaries of either Chinese banks ("**Banking Wealth Management Subsidiaries**") or insurance companies ("**Insurance Asset Management Firms**"), both regulated by the CBIRC. Currently, over ten banks in China have been approved to establish Banking Wealth Management Subsidiaries and many more are in the pipeline. In addition, there are over twenty Insurance Asset Management Firms established by Chinese insurance companies. So there are plenty of partners out there, although

13 See *Establishment of Fund Management Companies with Foreign Capital Equity Participation Rules* issued by the CSRC, effective 1 July 2002 and repealed 16 September 2004.

14 See Answers to Questions on the Registration and Record filing of Private Equity Funds (X), http://www.amac.org.cn/xhdt/zxdt/390744.shtml

'cannibalisation' of existing businesses may be an issue.

(2) ready funding support from potential JV partners' parent organizations. It has been reported that the AUM for banks which have set up or are in the process of setting up Banking Wealth Management Subsidiaries is RMB 15.9 trillion, and RMB 16.1 trillion for Insurance Asset Management Firms.

(3) a wider investment scope. Mutual fund JVs are regulated by the CSRC and can only invest in public markets, whereas Banking Wealth Management Subsidiaries and Insurance Asset Management Firms, both regulated by CBIRC, can invest in both public and private markets. There is no detailed information about the investment scope for future Sino-foreign JVs in this area, but presumably it should be based on national treatment and be the same as that currently enjoyed by the Chinese partners.

(4) a clearer matching of skill sets and target clients. As compared to the mutual fund route (a JV with a securities company which may engage in any/all of securities business, securities investment consultancy, trust assets management or other financial assets management), it may be easier for a global AMC with strong High Net Worth Individual ("**HNWI**") experience to make the internal argument for investing in a JV with a Chinese bank subsidiary, and the same applies to a JV with a Chinese insurance asset management firm for a global AMC with a notable pension/insurance client focus.

New Measure No.9 allows global AMC to form a JV with Banking Wealth Management Subsidiaries and Insurance Asset Management Firms, thus benefitting from clearer matching of skill sets and target clients than would be the case when partnering with a securities company under the mutual fund route. For a global AMC with strong HNWI experience, it is likely to be more familiar with banking wealth management while a global AMC with pension/insurance client focus will be more familiar with insurance asset management. Therefore, the former would naturally gravitate towards Banking Wealth Management Subsidiaries, while the latter would naturally gravitate toward Insurance Asset Management Firms.

Allowing overseas financial institutions to set up and hold shares in pension fund management companies.

Currently, China's pension management market focuses on the management of enterprise annuity funds with limited scale and growth. However, pension management companies in China are still at the pilot stage, and so far only China Construction Bank ("**CCB**") pension management firm has been approved. A CBIRC spokesperson has indicated that, at the next stage, CBIRC will promote legislation, and collaborate with other relevant authorities to improve the licensing work for pension management companies and to allow overseas financial institutions to set up and hold shares in pension management companies on case-by-case basis.[15]

Supporting foreign investors establishing wholly-owned or joint-venture currency brokerage companies

The State Council approved the development of pilot currency brokerage companies in 2005.[16] Since the launch of the pilot scheme, five currency brokerage companies have been established and are actively trading in foreign exchange markets, currency markets, bond markets and derivatives markets within China and abroad. At present, all of the world's top five money brokers have established money broker JVs in China. Yet no wholly-foreign-owned money brokers have been established to

15 See Financial Times Interview with the Spokesperson of the CBIRC. 20 July 2019, http://www.cbirc.gov.cn/cn/doc/9102/910201/0ADE598BBEC04B89906188DE5D1B487A.html

16 See *Pilot Currency Brokerage Companies Administrative Measures* issued by the then China Banking Regulatory Commission, effective 1 September 2005.

date. This seems to be due to a regulatory issue. When China introduced money brokerages in 2005, an official at the then CBRC (now CBIRC) said that they would allow money broker JVs in the initial stages, but kept silent on WFOEs. Based on the practical experience of some companies with the CBRC, pilot companies under the *Pilot Currency Brokerage Companies Administrative Measures* had to be JVs. Neither WFOEs nor wholly-domestic-owned enterprises were allowed. The intention of the legislator was that as China lacked experience in this sector, they hoped Chinese companies could acquire expertise from their foreign partners, who had to be top international money brokerages.

Wider context of the investment environment – foreign exchange reform

The New Measures may signify another major step toward opening up China's financial sector, but they need to be seen in the wider context of the foreign investment environment in China. Leaving aside current trade tensions, many foreign investors have hesitated before investing in China due to concerns about China's currency controls and having cash trapped in China. One of the most tricky issues in this regard, where China is clearly still not a level playing field, is the issue of equity-based reinvestments in China by foreign invested enterprises ("**FIE**").

To understand this we need to look back at the history of the issue. The RMB obtained by the conversion by an FIE of its foreign currency registered capital was not permitted to be used for equity re-investments in China under *Circular of the General Affairs Division of the State Administration of Foreign Exchange on Relevant Operating Issues concerning the Improvement of the Administration of the Payment and Settlement of Foreign-Invested Enterprises' Foreign Exchange Capital (SAFE General Affairs No. 142 of 29 August 2008)* (**"Circular 142"**) issued by the SAFE on 29 August 2008.

The *Circular* on *Reforming the Administration of Foreign Exchange Settlement of Capital of Foreign-invested Enterprises* issued by SAFE effective 1 June 2015, appears to overwrite and repeal the relevant parts of Circular 142, and allows FIEs to carry out equity investments in China using foreign currency registered capital in its original currency as well as the RMB obtained from conversion of foreign currency capital funds, but the question remains whether a non-investment FIE needs to have "investment" in its business scope in order to carry out domestic equity investment. In practice, SAFE usually adopts the attitude that such business scope is needed, but in practice it is extremely difficult, if not impossible for a non-investment-type FIE to apply for a business scope with "investment" in it. Therefore, only investment-type FIEs are allowed to make domestic equity investments.

In early July, China announced some foreign exchange reforms in the Shanghai Pilot Free Trade Zone ("**Shanghai FTZ**") to facilitate trade financing, relax cross border funds transfers and promote cross-border financings.[17] Most notably, it provides express support for non-investment FIEs within Shanghai FTZ to use foreign exchange capital account income or RMB funds derived from conversation of foreign exchange to make equity investments within China.

This helps companies within the Shanghai FTZ to overcome the perennial issue with companies that are not set up as holding companies, foreign invested venture capital investment enterprises or the like not being able to use their converted registered capital (including any capital increase) to make downstream investments, thus preventing early stage companies that do not have significant retained

[17] See *Circular of Shanghai Branch of the State Administration of Foreign Exchange ("**SAFE**") on Issuing the Implementing Rules for Further Promoting the Pilot Program of Reform of Foreign Exchange Control in Shanghai FTZ (Edition 4.0)* promulgated by the SAFE Shanghai Branch, effective 10 July 2019.

earnings (which can be reinvested in downstream equity investments) from expanding their businesses through domestic M&A activities. What this does is once again in the ongoing 'game of ping-pong' where the FTZ gain and then lose their unique selling points, is to 'send the ball' over the net to make the Shanghai FTZ a more attractive place to set up in for those taking advantage of the New Measures. However it is an open question as to how long this advantage over other parts of China will last. Policies in Shanghai FTZ are frequently expanded to other FTZs and are often a prelude to national implementation. Removing the re-investment restriction on FIEs nationwide would potentially reduce the attractiveness of the Shanghai FTZ (and potentially other FTZs), 'sending the ball' back over the net away from the FTZ side over to other parts of China, but would provide a major boost to the domestic Chinese M&A market.

Conclusion

The New Measures reinforce and implement China's commitments to open up its financial sector and send a message that China is serious about opening up its financial sector. Many opportunities will be created by the New Measures, especially in the interbank bond market, insurance, asset management, and futures. Whilst there may be many short-term challenges as the New Measures bed down and more implementing rules are issued, with a middle class roughly the size of Europe (and growing) and upside growth opportunities in many sectors, such as insurance, where per capita spending still lags significantly behind more developed countries, or in financial services in a market which is top-heavy in real estate investment and lacking alternative investment asset classes, the long-term prospects of the Chinese financial sector remain attractive. Foreign investors would be advised to analyse these developments carefully to formulate plans and to execute rapidly to get 'ahead of the pack'.

Contacts

Andrew McGinty
Partner, Hong Kong
andrew.mcginty@hoganlovells.com

Jun Wei
Partner, Shanghai
jun.wei@hoganlovells.com

Shengzhe Wang
Counsel, Shanghai
shengzhe.wang@hoganlovells.com

Alicante
Amsterdam
Baltimore
Beijing
Birmingham
Boston
Brussels
Budapest*
Colorado Springs
Denver
Dubai
Dusseldorf
Frankfurt
Hamburg
Hanoi
Ho Chi Minh City
Hong Kong
Houston
Jakarta*
Johannesburg
London
Los Angeles
Louisville
Luxembourg
Madrid
Mexico City
Miami
Milan
Minneapolis
Monterrey
Moscow
Munich
New York
Northern Virginia
Paris
Perth
Philadelphia
Riyadh*
Rome
San Francisco
São Paulo
Shanghai
Shanghai FTZ*
Silicon Valley
Singapore
Sydney
Tokyo
Ulaanbaatar*
Warsaw
Washington, D.C.
Zagreb*

*Our associated offices
Legal Services Center: Berlin

www.hoganlovells.com