Establishing a financial institution in China

by Henry Liao and William Deng, Schinders Law

A Q&A guide to establishing a financial institution in China.

This Q&A is part of the global guide to establishing a financial institution in…. Areas covered include the main governing regulations, commonly used legal structures, licences and authorisations and the tax position.

For a full list of jurisdictional Q&As visit *www.practicallaw.com/ebi-guide*.

Law stated as at 01-Aug-2019

Resource Type
Country Q&A

Jurisdiction
China

Market trends

1. **What were the main trends in the financial services industry in the last 12 months?**

Banking institutions

Recent trends in China's financial services industry were as follows:

- As part of a general effort to transform the industry including de-leveraging and tightened supervision, shadow banking activities were brought into the scope of regulation and were reduced.
- The People's Bank of China lowered the reserve requirement ratio five times in 2018 to encourage financing for small and micro businesses and private enterprises.
- China's banking industry has gradually been becoming more globalised and this has recently been accelerated by the implementation of specific measures for the opening-up of China's financial market.

Insurance institutions

Social and technological developments have affected the insurance industry as follows:

- The ageing population has provided insurance institutions with new business opportunities such as an increased need for commercial endowment insurance.
- The government has encouraged insurance institutions to develop "green" or ecological insurance, represented mainly by environmental pollution liability insurance to cover compensation for damage caused by pollution.
- Data security and privacy protection have become increasingly important for the development of insurance institutions. The Network Security Law came into effect in China in June 2017 and the Personal Information Protection Law is still under formulation.

Investment institutions

Recent trends in investment institutions in China were as follows:

- In 2018, the Asset Management Association of China renewed the Notes for Registration of Private Equity Fund Managers, the Notes for Recordal of Private Equity Funds and relevant Q&As. This led to a reinforcement of the supervision on registration and recordal of private equity funds. The self-regulation system of private equity funds has been improved and the number of recorded private equity funds and registered private fund managers has increased.

- The scale of issued securities has widened as a result of the government policy of supporting the financing of small and micro businesses and private enterprises (*see above, Banking institutions*).

Regulatory framework

2. What are the relevant principal regulations for financial services in your jurisdiction?

The major laws and regulations on financial services in China are:

- Company Law of the People's Republic of China (PRC).
- The PRC Law on the People's Bank of China.
- Banking Supervision and Administration Law of the PRC.
- Insurance Law of the PRC.
- Securities Investment Fund Law of the PRC.
- Measures for the Administration of Trust Companies.
- Regulation on the Supervision and Administration of Financing Guarantee Companies.
- Measures for the Administration of Financial Asset Investment Companies.
- Interim Measures for the Administration of the Business Activities of Online Lending Information Intermediary Institutions.

3. What are the principal regulatory bodies for financial services in your jurisdiction?

The principal regulatory bodies for financial services are:

- People's Bank of China (*www.pbc.gov.cn/*).
- China Banking and Insurance Regulatory Commission (CBIRC) (*www.cbrc.gov.cn/cn/index.html*).
- China Securities Regulatory Commission (CSRC) (*www.csrc.gov.cn/pub/newsite/*).
- State Administration of Foreign Exchange (*www.safe.gov.cn/*).

4. What financial services (if any) fall outside the scope of/are exempted from regulation?

No financial service falls outside the scope of regulation in China.

Legal structures

5. What are the most commonly used legal structures for establishing a financial institution?

Local companies

Most domestic financial institutions in China are joint stock limited liability companies (JSLCs), set up by state-owned enterprises and/or large groups.

The JSLCs must set up their board of shareholders, board of directors, board of supervisors and the senior management according to the PRC Company Law.

Further, for banks which are JSLCs (most of the nationwide banks) the board of directors must include non-executive directors and can include specialised committees such as strategy committee, audit committee, risk management committee, affiliated transaction control committee and nomination committee.

Foreign companies

Many foreign-invested banks in China are wholly foreign owned enterprises (WFOEs) with limited liability, such as Citibank, HSBC and Standard Charter Bank. On the other hand, some foreign banks only set up branches and representative offices in China. If such branches and representative offices of foreign banks meet the relevant legal requirements, they can be transformed into wholly foreign owned limited liability companies.

Foreign-invested banks in the form of WFOEs with limited liability must appoint a board of directors, board of supervisors or sole supervisor, and the senior management, according to the provisions of the PRC Company Law.

Authorisation or licensing

6. **What licences or authorisations are required to provide financial services in your jurisdiction?**

Banking institutions

An approval and banking licence issued by the CBIRC and a business licence are required to provide banking services in China.

Insurance institutions

An approval and insurance licence issued by the CBIRC and the business licence are required to provide insurance services in China.

Investment institutions

Establishing a security investment company requires prior approval of the CSRC. Once approval is obtained, the securities company must apply for its business licence. After obtaining the business licence, the security investment company must apply to the CSRC for a further licence to operate investment business in China.

For the set-up and operation of private equity funds, both the institution and fund managers must complete the registration formalities with the Asset Management Association of China.

The approval of the CBIRC is a requirement for companies wishing to provide trust investment services. Trust investment refers to that trust companies will set up trusts to raise funds from investors to carry out the investments.

To grant the above approvals and licence, key factors of the institutions that will be considered include:

- Registered capital.
- Financial status and credit status of shareholders.
- Legal structure.
- Management system and qualification of directors and executives.

In China, the fundraising and investment activities of investment institutions offered for the public and private qualified investors must be licensed.

7. **What approvals or licences are required for persons performing key roles at authorised**

financial institutions in your jurisdiction?

Banking institutions

The approval of the CBIRC is required to appoint key roles such as directors and senior executives at authorised banking institutions.

To obtain approval, candidates must generally have a sound credit and compliance record, suitable expertise and a specific number of years' experience (depending on the position) in banking or in another financial field.

Insurance institutions

The approval of the CBIRC is required for the appointments of directors and senior executives at authorised insurance institutions. Candidates must generally have a sound credit and compliance record, suitable expertise and the required amount of experience (depending on the specific position) in insurance or in another financial field. Candidates must also have the relevant insurance qualification.

Investment institutions

The approval of the CBIRC is required to perform key roles at authorised trust investment companies, and for the security investment companies, the approval of the CSRC is required. Key roles refer to the directors and senior executives. Candidates must generally have a sound credit and compliance record, suitable expertise and the required amount of experience (depending on the specific position) in insurance, investment or in another financial field and must hold a relevant investment qualification.

In the private equity funds, the senior executives (including legal representatives\executive partners (appointed representatives), general managers, deputy general managers, and persons in charge of compliance/risk control, among others) must have a fund practising qualification.

8. **Are there any alternatives to authorisation available for entities carrying on financial services in your jurisdiction?**

No, there are no alternatives to authorisation available for entities carrying on financial services in China.

Restrictions on ownership or control

9. **Are there any restrictions on the ownership or control of financial institutions in your jurisdiction?**

Banking institutions

Any entity or individual that holds more than 5% shares in a bank needs to provide its credit certification and relevant materials to the CBIRC for examination and approval.

Foreign banks are able to set up wholly-owned subsidiaries in China and must obtain approval from the CBIRC to do the business.

Insurance institutions

Domestic enterprises, domestic limited partnerships and overseas financial institutions can become the controlling shareholder of an insurance institution. The controlling shareholder of an insurance institution must have:

- A good reputation, stable investment and prominent core business.
- Sound financial conditions and have consecutively made profits in the last three fiscal years.
- Total assets of at least CNY10 billion.

- A sound tax payment record and no record of tax evasion in the last three consecutive years.
- Sound credit record and no record of major dishonest conduct in the last three consecutive years.
- Sound compliance status and no record of material violation of laws and regulations in the last three consecutive years.

In addition, its amount of equity investment must not exceed the net assets and its net assets of the past financial year must not be less than 30% of its total assets.

To set up subsidiaries in China, foreign insurance companies can set up a joint venture with local partners. The shareholding percentage of the foreign insurance companies must not be more than 51%. This restriction on the shareholding percentage will be lifted in 2021.

Investment institutions

Trust Investment Companies. There are no specific restrictions on the ownership or control of a trust investment company. However, a company cannot be a capital contributor of a trust investment company if:

- The corporate governance structure and management mechanism are evidently defective.
- It has a large number of affiliated enterprises, a complicated and non-transparent equity structure and frequent and abnormal transactions with its affiliated enterprises.
- The core business is not prominent and its business scope involves too many sectors.
- Its cashflows are substantially affected by the economic climate.
- The liability/asset ratio and financial leverage ratio are higher than the average level of the industry.
- It holds equities in the trust company on behalf of others.
- There are other circumstances that significantly adversely impact on the trust company.

Foreign trust investment companies can set up wholly-owned subsidiaries in China.

Security Investment Companies. Any entity or individual cannot be the controller of the company or hold more than 5% shares of a security investment company if:

- Less than three years have elapsed since the individual completed a prison sentence for a criminal offence.
- Its (or his/her) net assets are equal to less than 50% of its paid-in capital, or its debts reach 50% of its net assets.
- It/he/she cannot pay off its due debts.
- There are other circumstances stipulated by the CBIRC.

To set up subsidiaries in China, foreign security investment companies can set up a joint venture with local partners, however, the shareholding percentage of the foreign security companies must not be more than 51%. This restriction will be lifted in 2021.

Private Equity Funds. The main restrictions on the controllers of private equity funds are mostly the same as those of security investment companies.

Taxation

10. **What main taxes are financial institutions subject to in your jurisdiction?**

The main taxes that financial institutions are subject to are:

- Value-added tax (VAT).
- Enterprise Income Tax (EIT)

- Enterprise Income Tax (EIT).
- Stamp duty.
- Urban maintenance and construction fees.

11. **What is the tax position when profits are remitted abroad?**

Before the remittance abroad of profits of financial institutions, the companies must file the tax return for the shareholders and pay the income tax for the revenues generated in China.

The EIT and VAT on bond interest income gained by overseas institutions by investing domestic bonds are lifted until 6 November 2021.

Proposals for reform

12. **Are there any impending developments or proposals for significant reform?**

Fintech is being widely used by financial institutions. Big data, artificial intelligence, blockchain and other tools being introduced into financial institutions are affecting the market in financial services in China.

On 21 May 2018, the CBIRC issued the Guidelines for the Data Management of Banking Financial Institutions.

In addition, the Cyberspace Administration of China issued Provisions on the Administration of Blockchain Information Services on 10 January 2019. The legislature plans to formulate more rules and regulations on Fintech.

Contributor profiles

Henry Liao, Managing Partner

Schinders Law

T +8620 38103699
F +8620 38103692
E *henry.liao@schinderslaw.com*
W *www.schinderslaw.com*

Professional qualifications. PRC, lawyer; New York, US, lawyer

Areas of practice. Securities; mergers and acquisitions; intellectual property; arbitration and litigation.

Languages. Mandarin, Cantonese, English

Professional associations/memberships. Advisor, International Advising Board, McGeorge School of Law; Special Advisor, China Chamber of International Commerce; Editor, Michigan Journal of International Law; Deputy Chairman, Security Law Committee of Guangdong Lawyer's Association; Part-time Lecturer, HKU SPACE; Visiting Professor, Law School of Jinan University; Visiting Professor, Lingnan College, Sun Yat-Sen University; Advisor, China National Furniture Association; Arbitrator, Guangzhou Arbitration Commission; Non-executive Director, Guangdong Huaxing Bank.

William Deng, Senior Associate

Schinders Law

T +8620 38103699
F +8620 38103692
E *william.deng@schinderslaw.com*
W *www.schinderslaw.com*

W *www.schindersllaw.com*

Professional qualifications. PRC, lawyer

Areas of practice. Intellectual property; mergers and acquisitions; foreign direct investment; general corporate practice.

Languages. Mandarin, Cantonese, English