Regional updates

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CHINA

Investing in Chinese Commercial Banks Under New Rules

On December 11, 2006, China's commitments to liberalize foreign participation in financial services in the context of its accession to the World Trade Organization became fully effective. Foreign-invested banks (i.e., banks with 25% or more foreign ownership) may now provide Renminbi banking services to individual Chinese clients in addition to corporate and foreign clients.

To implement this liberalization, the State Council has promulgated the Foreign Invested Banks Administration Regulations, for which the China Banking Regulatory Commission ("CBRC") has issued the Implementing Rules (the "Implementing Rules"). The new rules define more clearly what types of foreign entities may invest in foreign-invested banks, and thereby significantly affect foreign investment in this industry.

The controlling shareholder of a wholly foreign-owned bank and the "main" foreign shareholder of a Chinese-foreign joint venture bank must, among other requirements, be a commercial bank with total assets of at least US$10 billion. Thus, the lead foreign investor in a foreign-invested bank must be a sizeable commercial bank; any other type of financial services firm or investment fund could not be the lead investor.

The Implementing Rules stipulate several alternative tests for determining which of the foreign investors in a joint venture bank is the "main" shareholder. These tests give foreign and Chinese investors some latitude in structuring equity and management control of a Chinese-foreign joint venture bank. However, the "main" foreign shareholder must consolidate the joint venture bank in its financial statements. This rule effectively prevents the creation of joint venture banks controlled by Chinese investors.

The other foreign shareholders of foreign invested banks must be financial institutions licensed and supervised by the financial services regulatory authority in their home jurisdiction. This rule bars investors that do not belong to the financial services industry. As a result, private equity investors may not qualify unless they invest through a portfolio company that provides financial services or the regulatory regime home jurisdiction of the fund's investment vehicle otherwise allows it to be considered a "financial institution" licensed and supervised by a financial services regulator.

The Implementing Rules allow CBRC to exclude investors on the basis of their unclear shareholding structure, multiple or unusual connected transactions, lack of core business or other circumstances. The language of the Implementing Rules is very vague and could be used by CBRC to weed out a variety of potential investors, from financial services conglomerates to private equity funds.

While these qualification requirements are technical, CBRC can use them to make or break a deal. As the recent bidding war for Guangdong Development Bank has shown, identifying a consortium of qualifying investors can be a delicate task for both CBRC and potential acquirors.

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