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Financial Holding Companies Are Now Regulated in China

On 13 September 2020, the State Council published the *Decision of the State Council on Implementing Access Administration of Financial Holding Companies* (the ***Decision***). On the same day, the People's Bank of China (***PBoC***), as authorised by the Decision, issued the *Trial Measures for the Supervision and Administration of Financial Holding Companies* (the ***Measures***). Both the Decision and the Measures will enter into force on 1 November 2020.

These regulations are the first of its kind in China to regulate financial holding companies (***FHCs***). In the past two decades, a number of *de facto* financial holding entities (including Ping An, CITIC, Everbright) have emerged in the China market, though their activities and functions remained largely unregulated. According to the Decision, these existing financial holding entities are now required to apply for a license from PBoC by no later than 31 October 2021, and failure to do so could result in them being required to dispose of their existing holdings in financial institutions. [1]

Notably, the Decision and the Measures currently apply to 'domestic non-financial enterprises, natural persons or recognised legal persons' only [2]. Its scope therefore leaves out two types of institutions: first, regulated financial institutions that hold interests in other financial institutions (e.g. banks holding shares in insurance companies, or vice versa). The Measures indicate that separate regulations will be promulgated to regulate financial institutions with cross-holdings, but at present they will continue to be regulated by their respective sector regulators under the relevant rules. Notwithstanding this, the Measures remain relevant to these financial institutions as it is explicitly provided that the regulatory principles in the Measures apply by reference to cross-holding financial institutions.

Second, directly foreign owned FHCs. [3] As of today, Allianz (China) Insurance Holding Company Limited remains the only foreign-owned financial services holding company in China, and its scope of investment is mainly limited to insurance businesses under the supervision of the China Banking and Insurance Regulatory Commission (***CBIRC***). It is not yet clear how directly foreign-owned FHCs will be regulated going forward (e.g. by PBoC or the sector regulators).

However, in view of the broad scope of the FHC regulations as well as other market liberalisation measures being introduced in the Chinese financial services sectors, it is expected that the authorities will provide a clarification in this regard in the not too distant future.

When is an FHC license required?

According to the Decision, if any domestic non-financial enterprise, natural person or recognised legal person 'effectively controls' two or more financial institutions having different business lines (regardless of jurisdiction) and meets the applicable size tests (see details below), it must apply to the PBoC for an FHC license.

'Effective control' includes a controlling stake in, or actual control over the relevant financial institution. An FHC will be deemed as having effective control if it (i) holds more than 50% of the voting shares in the financial institution, or (ii) holds no more than 50% of the voting shares but is practically capable of exercising more than 50% of the voting power, or controls the board or the activities of the financial institution, or the financial institution meets the criteria of consolidated subsidiary under PRC accounting rules. Where two or more persons could each independently determine certain decision-making, managerial or operational activities of a financial institution, the person that is able to determine decisions or activities with the most significant impact on the financial performance of the financial institution would be deemed as having effective control.

Under the Measures, 'financial institutions' are categorised based upon business lines as follows:

1. commercial banks (excluding village and township banks), financial leasing companies;
2. trust companies;
3. financial asset management companies;
4. securities companies, public fund management companies, futures companies;
5. life insurance companies, property insurance companies, reinsurance companies, insurance asset management companies; and
6. other institutions as determined by the relevant financial regulators.

The above list notably does not cover certain types of financial services companies, such as consumer and automotive finance companies, insurance brokerage and agency companies, micro-lending companies. It is possible that the regulators may in the future deem these types of institutions as falling into the last category of 'other institutions'.

The relevant size tests for FHCs are:

a. if a person controls one or more commercial banks, (i) the total assets of the controlled financial institutions are not less than RMB 500 billion, (ii) the total assets of the controlled financial institutions other than commercial banks are not less than RMB 100 billion, or (iii) the total assets under management by the controlled financial institutions other than commercial banks are not less than RMB 500 billion; or

b. if a person does not control any commercial bank, (i) the total assets of the controlled financial institutions are not less than RMB 100 billion, or (ii) the total assets under management by the controlled financial institutions are not less than RMB 500 billion.

Where a person does not meet any of the above tests, but the PBoC deems it necessary based on macro-prudential regulatory considerations that an FHC be established, then such person could also be required to obtain an FHC license.

In addition, if a non-financial enterprise or a recognised legal person has 85% or more of its consolidated total assets in the form of financial assets and meets one of the above size tests, even if it does not control two or more financial institutions having different business lines, it may (though there is no obligation) apply to obtain an FHC license.

How to apply for an FHC license?

Under the Decision, the applicant of an FHC license must meet the following requirements:

a. it has a paid-in registered capital of not less than RMB 5 billion and the paid-in registered capital is not less than 50% of the total registered capital of the financial institutions which it directly controls;

b. its shareholders and actual controllers possess good reputation and have complied with relevant laws and regulations;

c. its directors, supervisors and senior management meet the prescribed qualification requirements;

d. it is capable of providing capital funding to the controlled financial institutions continuously; and

e. it has a sound organisational structure, effective risk management and internal control systems, and meets other relevant prudential requirements.

The Measures contain some further detailed requirements. For example, it divides the shareholders of an FHC into three categories: controlling shareholders, major shareholders (i.e. holding 5% or more shares or otherwise capable of materially influencing its operations and management) and other shareholders, and each category of shareholders is subject to different qualification criteria. Actual controllers of an FHC shall meet the same requirements as the controlling shareholders.

Notably, a single investor (including its affiliates and parties acting in concert) cannot control more than one FHC, and shall not be a 'major shareholder' in more than two FHCs.

Applications for FHC licenses shall be submitted to the PBoC, which would decide whether or not to grant the approval within 6 months after the acceptance of the application. If the application is approved, PBoC will issue an FHC license and only an approved FHC may use the words 'financial holding' or 'financial group' in its name. Save for the *de facto* financial holding entities that are already in existence during their transitional periods to obtain the FHC licenses, no investment in regulated financial institutions may be made by any person that should obtain an FHC license under the Measures before it actually obtains the license.

What regulatory requirements apply to FHCs?

PBoC is the primary regulatory authority of FHCs, while the financial institutions which FHCs invest in are subject to the jurisdictions of their respective sector regulators and potentially in the future, joint regulation by the key financial regulators (i.e. PBoC, Ministry of Finance, China Securities Regulatory Commission, CBIRC, and State Administration of Foreign Exchange) under a collaborative regulatory scheme currently under consideration by the Chinese government.

According to the Measures, FHCs shall only engage in equity investments and management activities relating to such investments, and shall not directly conduct commercial operational activities. Furthermore, the Measures set out a long and detailed list of requirements and restrictions on FHCs, which are intended to ensure that FHCs maintain clear and transparent shareholding structures, monitor and control the overall risks of the groups, and that the independent operation of the controlled financial institutions are preserved (including with regard to related party transactions), and clients' interests are properly protected.

The key requirements and restrictions include:

- An FHC must have a clear and transparent shareholding structure.
- Investors shall invest in an FHC only with their own funds rather than using borrowed or off-balance sheet funds; similarly, an FHC may only invest in financial institutions with its own funds.
- There shall be not more than three tiers of holding between a newly established FHC and its controlled financial institutions; for an existing FHC whose group structure is not in compliance with this requirement, it shall rectify the existing structure so as to achieve compliance in a timely manner.
- The financial institutions controlled by an FHC must not invest into each other or invest upstream into the FHC.
- The directors, supervisors, and senior management personnel of an FHC shall be filed with PBoC, and such individuals shall meet the qualification requirements to be prescribed by PBoC.
- Senior management personnel of an FHC may serve concurrently as directors or supervisors, but not as members of senior management, in its controlled financial institutions; the senior management personnel of a financial institution controlled by an FHC must not hold concurrently a senior management position in another financial institution controlled by the same FHC.
- An FHC, its controlled financial institutions and the group as a whole shall maintain a level of capital commensurate with the scale of assets and relevant risks determined on a consolidated basis.
- An FHC shall adopt and shall procure that their controlled financial institutions adopt in a timely manner, a comprehensive risk management system to identify, quantify, assess, monitor, control, and mitigate the relevant risks, and to introduce measures to prioritise and segregate risks, as well as to handle external credit risks.

Last but not least, if an FHC intends to undergo any significant change, such as changing of its name, place of domicile, registered capital, or any change of shareholder holding of 5% or more shares, change of actual controlling person, amendment to its articles of association, acquiring control over or ceasing to control any financial institution, merger, division, liquidation or dissolution, it shall seek prior approval from the PBoC which would in principle make a decision within 3 months.

[1] According to the Measures, existing unregulated financial holding companies may be granted a grace period, subject to approval, to comply with the requirements under the Measures.

[2] 'Recognised legal persons' are commonly understood to refer to governmental and quasi-governmental institutions and non-profit organisations.

[3] If an FHC is indirectly foreign-owned through a foreign invested enterprise or its subsidiaries, literally speaking, such FHC would still be deemed as being controlled by a 'domestic enterprise' and subject to the Measures.

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