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COMMENTARY

China Further Opens Up to Foreign Banks

Following the recent announcement of several crucial economic reforms by the People's Republic of China ("PRC") leadership, and eight years since the promulgation of China's Administrative Regulations on Foreign-Invested Banks (the "foreign banks regulations"), the PRC State Council issued several amendments to the foreign banks regulations, effective from January 1. These amendments further open access to the market by foreign banks through the following changes.

Foreign Invested Banks Are No Longer Required to Allocate Minimum RMB100 Million Working Capital to Their China Branches

Before the amendments, wholly foreign invested banks and Chinese–foreign jointly invested banks (collectively, "foreign invested banks") were required to unconditionally allocate at least RMB100 million (or other freely convertible currencies of equivalent value) of working capital to each of their branches in China.

Removing the minimum working capital requirement provides foreign invested banks significant flexibility in allocating working capital among their branches and will in turn increase the financial efficiency of foreign banks having operations in China. More importantly, the removal of the minimum capital requirement encourages foreign invested banks to expand their business presence in China through more geographic locations with relatively smaller-scale branches.

A Representative Office Is No Longer Required as a Precondition for Setting Up a Foreign Invested Bank or Branch

Previously, before incorporating a wholly foreign invested bank in China, the sole or controlling shareholder had to have set up a representative office in China for two years or longer. Similarly, the sole or major foreign shareholder had to have had a representative office in China before it could set up a Chinese–foreign jointly invested bank with a Chinese partner. Also, a foreign bank was required to have operated a representative office in China for at least two years before setting up its first branch in China.

The removal of the preconditions mentioned above signals the PRC government's desire to encourage foreign banks to have more footholds in China by easing the incorporation process of foreign invested banks and branches.

The Prerequisites for Foreign Banks' Application to Carry Out Renminbi Business Are Relaxed

Foreign invested banks and branches of foreign banks that wish to engage in renminbi business were required to have operated in China for three years with profits for two consecutive years before applying for such business. The amendments reduced the three-year requirement to one year and dropped the profitability requirement. In addition, the amendments provide that if a branch of a foreign bank has already been approved by the authorities to engage in renminbi business, such foreign bank may engage local currency business through its other branches in China without being subject to the one-year operation requirement. We believe that these relaxed requirements further reflect China's efforts to proceed with the renminbi internationalization, and foreign banks are encouraged to participate in this process.

Implications

Branch networks are one of the major factors that attribute to the market share of domestic and foreign banks in China. Under the RMB100 million working capital and two-year existing representative office requirements, foreign banks faced impediments to efficiently expanding their geographic scale in China. According to media reports, the total number of bank outlets of all major foreign invested banks in China is much smaller than that of any of the big-four national banks in one province on the east coast. Pursuant to the 2013 Annual Report issued by the China Banking Regulatory Commission, the market share of foreign invested banks and branches of foreign banks based on total asset value was kept lower than 2 percent during the years of 2009 through 2013.

Through the issuance of the amendments, the Chinese government is allowing foreign banks to set up foreign invested banks and branches and engage in renminbi business much more easily. Given that the financial markets in China are becoming increasingly complex and diverse, foreign banks, especially those sophisticated and experienced multinational banks, are welcome to take part in the growth and reform of China's financial industries.

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