



New measures governing transfers of state-owned assets in financial enterprises take effect

China's Administrative Measures for the Transfer of State-owned Assets in Financial Enterprises come into effect on 1 May 2009. This briefing outlines the main changes and how they may affect businesses.

The Administrative Measures for the Transfer of State owned Assets in Financial Enterprises 《金融企业国有资产转让管理办法》 (the Measures) were promulgated by the People's Republic of China (PRC) Ministry of Finance (MOF) on 17 March 2009. The Measures confirm, among others, the requirement that transfers of state-owned interests in unlisted financial institutions are subject to a mandatory public auction or tender process unless a special approval for transfer by private agreement is obtained from the State Council or the financial authorities. The Measures are to take effect from 1 May 2009, but the PRC authorities, in practice, are likely to require compliance with these Measures in the interim period.

Background

The MOF and the State-owned Assets Supervision and Administration Commission of the State Council (SASAC) jointly promulgated the Interim Administrative Measures for the Transfer of State-owned Assets on 31 December 2003 to regulate the transfer of state-owned assets, which came into effect on 1 February 2004 (the 2004 Measures). The 2004 Measures specifically excluded transfers of state-owned assets in financial enterprises from their scope of application by stating that such transfers should be subject to regulations to be separately promulgated by the state.

Under the current regulatory framework, the SASAC is responsible for the administration of state-owned non-financial assets and the MOF regulates state-owned financial assets. The MOF had in the past issued rules on the registration and appraisal of state-owned assets in

financial enterprises. However, there were no specific regulations in place to govern transfers of state-owned assets in financial enterprises. This has created a gap in the legal framework, which has now been filled by the new Measures.

Scope of application

The Measures govern the transfer of state-owned assets in financial enterprises by:

- the finance departments of local governments at the county level or higher;
- the authorised investment entities of local governments or finance departments at the county level or higher; or
- state-owned or state-controlled financial enterprises,

to domestic or foreign legal persons, individuals or other entities (see section 3 of the Measures).

'Financial enterprises' is defined in section 2 of the Measures as enterprises that hold a permit to conduct financial business and financial holding (group) companies. Financial enterprises would thus in practice include various types of financial institutions regulated by the banking, securities and insurance regulators, such as commercial banks, trust companies, financial asset management companies, finance leasing companies, securities companies, fund management companies and insurance companies.

'State-owned assets in financial enterprises' is defined as proprietary interests arising from various forms of investment in financial enterprises by governments at all levels and their authorised investment entities.

State-owned equity interests or assets in unlisted financial enterprises and transfers of state-owned shares in listed financial institutions all fall within the said definition.

It should be noted that sales of listed shares by state-owned or state-controlled financial enterprises for proprietary trading purposes are not governed by the Measures.

Methods of transfer and approval

Unlisted shares: equity exchange

The Measures require that, unless a special approval for transfer by private agreement is obtained from the State Council or the relevant financial authority, transfers of state-owned assets in unlisted financial enterprises shall be subject to a mandatory public auction or tender process conducted via an equity exchange at the provincial or a higher level.

In addition to the requirement of public auction or tender, transfers by state-owned or state-controlled financial enterprises of the assets held by their direct subsidiaries shall be subject to the approval of the financial authorities. The level of financial authority approving the transfer would differ depending on the level of state administration to which the financial enterprises are subject. Except for those that require the approval of the State Council, transfers by state-owned or state-controlled financial enterprises under direct central government administration of assets held by their direct subsidiaries shall be subject to MOF approval; and transfers of state-owned assets of financial enterprises under local administration shall be subject to the approval of the provincial financial authority (see section 12 of the Measures).

Listed shares: stock exchange

Section 28 of the Measures states that transfers of state-owned shares in listed financial enterprises and transfers by financial enterprises of state-owned shares in listed companies must be carried out via the trading systems of a legally established stock exchange (ie the Shanghai Stock Exchange or the Shenzhen Stock Exchange) unless a special approval for a transfer by private agreement is obtained. This in practice means that a transfer can be consummated through a block sale via the trading system of the stock exchanges.

The transfer of state-owned shares in a listed company by its controlling shareholder shall be subject to the approval of the financial authorities (see section 30 of the Measures). In the case of a non-controlling shareholder, the amount of shares transferred has an effect on the approval process: if the aggregate amount of shares to be transferred by a non-controlling shareholder (after adding on any reduction in shareholding and deducting any increase in shareholding of such shareholder; giving the aggregate transferred shares) in a listed company within a full financial year does not reach 5 per cent of the total issued shares in the listed company, the transfer only needs to go through the internal corporate approval procedures of the transferor (and be reported afterwards to the relevant financial authority). If the aggregate transferred shares reach or exceed the 5 per cent threshold, the prior approval of the financial authority must be obtained before carrying out the transfer(s) (see section 31).

Transfer by private agreement

There is an exception to the default position under the Measures that transfers of state-owned assets shall be carried out on a public platform (such as an equity exchange or stock exchange), in that a transferor may, subject to the special approval of the State Council or the relevant financial authority, directly transfer state-owned assets in financial enterprises by private agreement, if:

- there are in existence regulations setting out special requirements for the transferee;
- the proposed transfer is part of the internal asset re-organisation of a holding (group) company; or
- there exist other special circumstances.

(See section 35 of the Measures.)

The first and third grounds set out above are couched in vague terms, which in the absence of further clarification could potentially give rise to room for differences in interpretation and regulatory discretion.

Effects of the Measures on future transactions

The Measures are of a rather technical nature and are likely to introduce greater complexity to the process for domestic and foreign investors in acquiring or disposing of interests in financial enterprises. Their effects are particularly likely to be felt in the following respects.

A more complicated process for the acquisition of shares in PRC financial institutions

In the past few years, a number of foreign investors have acquired shares in unlisted PRC financial institutions such as banks and trust companies from existing state-owned shareholders by way of private agreement. However, after the Measures come into effect, such transactions will have to go through a public auction or tender process via an equity exchange, unless the relevant financial authority is of the view that the transaction falls within one of the above-mentioned exceptions under which a special approval for transfer by private agreement may be granted. In practice, however, such special approvals are likely to be rarely granted. If such a special approval is not available, in order to improve both deal and price certainty, a foreign investor may wish to consider investing through the subscription of new shares issued by the target financial institution, which would not trigger the public auction or tender procedure. The subscription of new shares in an unlisted financial institution would, however, still be subject to a mandatory value appraisal process and the appraisal results must be either verified by or filed with the relevant financial authority. The appraised value must be used as the basis for determining the subscription price of the new shares.

Exercise of pre-emptive rights and call options

Foreign investors in PRC financial institutions are commonly entitled (whether under law, articles of association or shareholders' agreement) to a pre-emptive right or right of first refusal over a proposed sale of equity or shares in the financial institutions held by other shareholders, who are often state-owned entities. In addition, some foreign investors (who are now subject to various statutory caps on their shareholdings) may have negotiated contractual call option rights over shares in the financial institution held by other shareholders, which would become exercisable upon lifting of the foreign ownership caps. While there have always been doubts over whether such contractual pre-emption or call option rights would be automatically enforceable in a PRC context, the foreign investor's ability to take advantage of such rights is likely to be further undermined by the public auction or tender process required under the Measures.

Determining sale price of listed shares

The Measures lay down restrictions on the prices at which listed shares may be transferred. For instance, in the case of a transfer by private agreement, the transfer price shall not be lower than the higher of:

- the weighted average price of the daily weighted average prices of the shares over the 30 trading days preceding (i) the date on which the public announcement of the transfer is made by the listed company or (ii) (if a special waiver of the public announcement requirement has been obtained) the date of execution of the share transfer agreement ((i) and (ii) are reference dates); or
- the weighted average price of the shares on the day preceding the applicable reference date.

(See section 45 of the Measures.)

If the share transfer is effected via a block sale, the transfer price may not be lower than the weighted average trading price of the shares on (i) the date of the sale or (ii) the preceding trading day if there were no transactions involving such shares on the date of sale (see section 33).

The above indicates that the Measures require the transfer price of listed shares to be largely based on market price, which would have the effect of exposing the transaction parties to potential fluctuations and volatilities in the stock market.

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