China Releases Specific Rules on Calculating Turnover in the Financial Industry Concentration Notifications under the Anti-Monopoly Law

On July 22, 2009, the Ministry of Commerce of the PRC (MOFCOM), together with four central financial regulatory agencies, released the Method for Calculating the Turnover of Financial-Sector Business Operators (the Method). The Method, which will come into effect on August 15, 2009, is intended to guide business operators carrying out concentration transactions in the financial sector in China on the appropriate way to calculate turnover in order to determine whether notification thresholds are met. This, in turn, should facilitate compliance with the Anti-Monopoly Law of the PRC (AML). In this edition of the China Antitrust Update, we will introduce to you the details of the Method and its impact on China’s concentration notification practice.

Background

China’s AML requires parties to notify, and gain approval from the appropriate anti-monopoly enforcement authority (currently MOFCOM) before they proceed with a proposed transaction that meets thresholds prescribed by the State Council. This is known as a pre-concentration notification requirement. The State Council set forth the threshold for pre-concentration notifications in the Provisions on the Criteria for Notifications of Concentration Transactions between Business Operators (the Notification Criteria Provisions), which it issued on August 3, 2008.

According to the Notification Criteria Provisions, a pre-concentration notification must be filed with MOFCOM if a concentration meets any of the following criteria:

1. During the previous fiscal year, the total global turnover of all of the parties participating in the concentration exceeded RMB10 billion, and at least two of the parties each had a domestic turnover of more than RMB400 million within China; or

2. During the previous fiscal year, the total domestic turnover within China of all of the parties participating in the concentration exceeded RMB2 billion, and at least two of the parties each had a domestic turnover of more than RMB400 million within China.
While the Notification Criteria Provisions set forth specific threshold levels, they fail to provide a method for calculating turnover, leaving specific calculation measures to be promulgated by the reviewing authority and other competent authorities under the State Council. The Notification Criteria Provisions do state that the special practices and attributes of industries like banking, insurance, securities and futures should be taken into consideration in the calculation of turnover. The Method aims to elaborate on these provisions by providing an approach to the calculation of turnover that is specifically tailored to the financial industry.

Financial Business Operators Subject to the Method
The Method is only applicable to financial business operators engaged in determining whether or not they need to make a concentration notification. The Method further defines “financial business operators” as financial institutions involved in the banking, securities, futures, fund management and insurance businesses. Financial institutions in the banking sector include institutions that take deposits from the public, such as commercial banks, and urban and rural credit unions, as well as policy banks.

The Method’s rules for financial institutions in the banking sector are also applicable to the calculation of turnover for financial asset management companies, trust companies, finance companies, financial leasing companies, automobile financing companies, currency brokerage companies and other financial institutions established upon approval of the supervisory and administrative authorities of the banking industry.

General Method for Calculating the Turnover of Financial Business Operators
The Method sets out the formula for calculating the turnover of financial business operators other than insurance companies as follows:

Turnover = 10 percent * (sum of elements of turnover – business taxes and surcharges)

To make the above formula practicable, the Method outlines the elements of turnover for each type of financial business operator other than insurance companies. Specifically, the turnover elements for financial institutions in the banking sector include net interest income, net income from transaction fees and commissions, investment gains, gains from changes in fair value, exchange gains, and income from other businesses. For securities companies, the elements include net income from transaction fees and commissions, net interest income, investment gains, exchange gains, and income from other businesses. The turnover elements for futures companies include net income from transactions fees and commissions and net interest income from bank deposits, and the elements of turnover for fund management companies include income from management and transaction fees.

Special Method for Calculating the Turnover of Issuance Companies
Under the Method, a different formula applies to the turnover calculation for issuance companies:

Turnover = percent * (premium income – business taxes and surcharges), in which:

Premium income = premium income from original insurance contracts
+ inflow of reinsurance premiums – outflow of reinsurance premiums.
Since the Chinese government stepped up enforcement of the AML, an increasing number of business operators have submitted pre-concentration notifications to MOFCOM in order to obtain anti-monopoly clearance for proposed concentrations and avoid potential snags in the transaction process. According to MOFCOM’s official data, as of the end of June 2009, 58 notifications had been submitted to MOFCOM, and MOFCOM had completed its review of 46 notifications, among which 43 were approved unconditionally, two were approved with restrictions, and one was blocked.

On the whole, the Method provides specific rules to guide financial business operators in calculating their turnover, which will help them assess whether or not a proposed transaction requires a pre-concentration notification. This, in turn, will facilitate enforcement of the AML.

However, certain issues regarding the calculation of turnover remain unresolved. For example, the Method does not address whether or not the turnover of the affiliated companies of business operators carrying out a concentration transaction should be integrated in the aggregate turnover. Similarly, the Method does not shed light on whether or not parties engaging in a concentration transaction in one area of their business need to include the turnover of the rest of their business, which may be irrelevant to the proposed transaction. In addition, the Method does not provide a way to calculate the turnover of companies under the joint control of the merging operators. Given these gaps in the Method, the smooth and effective functioning of the AML’s pre-concentration regime will require further guidance and more rules.

In the January 23, 2009 edition of China Update, we briefed you on the Interim Measures for the Notification of Concentration Transactions Carried Out by Business Operators (the Draft Notification Measures). MOFCOM has finished soliciting public opinions on the Draft Notification Measures, and is in the process of finalizing them. The Draft Notification Measures contain certain rules for the calculation of turnover that may address the unresolved issues described above. Further provisions to clarify these rules and resolve the remaining issues are expected to follow.
Method for Calculating the Turnover of Financial-Sector Business Operators for Concentration Notifications

Article 1. This Method is formulated in accordance with the Anti-Monopoly Law and the Provisions on the Criteria for Notifications of Concentration Transactions between Business Operators issued by the State Council (hereinafter referred to as the Provisions) for the purpose of clarifying the notification criteria for concentration transactions carried out by business operators in the financial sector.

Article 2. This Method is applicable to the calculation of turnover, for the purposes of notifying concentration transactions between business operators, of financial institutions in the banking sector, securities companies, futures companies, fund management companies, and insurance companies.

Financial institutions in the banking sector include financial institutions that take deposits from the public, such as commercial banks, urban credit unions, and rural credit unions, as well as policy banks.

The rules for financial institutions in the banking sector as stipulated in this Method are applicable to the calculation of the turnover of financial asset management companies, trust companies, finance companies, financial leasing companies, automobile financing companies, currency brokerage companies, and other financial institutions established with the approval of the supervisory and administrative authorities for the banking sector.

Article 3. The elements of turnover for financial institutions in the banking sector include:

(a) net interest income;

(b) net income from transaction fees and commissions;

(c) investment gains;

(d) proceeds from changes in fair value;

(e) exchange gains; and

(f) income from other businesses.

Article 4. The elements of turnover elements for securities companies include:

(a) net income from transactions fees and commissions (including that from brokerage businesses, asset management, underwriting and sponsoring, and financial consulting);

(b) net interest income;

(c) investment gains;

(d) exchange gains; and
(e) income from other businesses.

Article 5. The elements of turnover for futures companies include:

(a) net income from transactions fees and commissions; and

(b) net interest income from bank deposits.

Article 6. The elements of turnover for fund management companies include:

(a) income from management fees; and

(b) income from transaction fees.

Article 7. The formula for calculating the turnover of the above-mentioned business operators for concentration notification purposes is:

\[ \text{Turnover} = 10\% \times (\text{sum of the elements of turnover} - \text{business taxes and surcharges}) \]

Article 8. The formula for calculating the turnover of insurance companies for concentration notification purposes is:

\[ \text{Turnover} = 10\% \times (\text{premium income} - \text{business taxes and surcharges}), \text{among which} \]

\[ \text{Premium income} = \text{premium income from original insurance contracts} + \text{inflow of reinsurance premiums} - \text{outflow of reinsurance premiums}. \]

Article 9. The above method for calculating turnover is applicable only for the purpose of concentration notification of business operators.

Article 10. This Method shall take effect thirty days after its issuance date.