PRACTICAL GUIDE TO MERGER CONTROL IN CHINA
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1. INTRODUCTION
The Anti-Monopoly Law (AML) was enacted by China’s National People’s Congress and came into force on 1 August 2008. It is broadly based on EU competition law principles and contains, for the most part, provisions on merger control, anti-competitive agreements and abuse of dominance. In addition to the AML, implementing regulations and guidance are designed to provide more details on how the AML is to be implemented and enforced by the different Chinese competition authorities.

China’s State Council has designated three agencies to enforce the AML, namely the National Development and Reform Commission (NDRC), which has jurisdiction over price-related infringements; the State Administration for Industry and Commerce (SAIC), which has jurisdiction over non price-related infringements and lastly, the Anti-Monopoly Bureau of the Chinese Ministry of Commerce (MOFCOM) which has the exclusive power to enforce AML’s merger control provisions.

To date, enforcement of the non-merger related parts of the AML has been limited. This Practical Guide focuses on merger control and is designed to outline the main features of the AML provisions applicable to companies with substantial interests in China.

2. HOW TO TELL IF YOUR TRANSACTION IS CAUGHT BY CHINA’S MERGER CONTROL RULES?
Where companies, either Chinese or foreign, have significant turnover in China, many of their M&A or joint venture transactions will trigger the Chinese merger filing thresholds and require a mandatory filing with MOFCOM, even if the transaction itself has little or no nexus with the Chinese domestic market.

(1) Triggers for notification
An obligation to notify a transaction to MOFCOM will be triggered when
- the transaction is considered as a “concentration of undertakings” under the AML; and
- the parties to the transaction meet the relevant turnover thresholds.

(2) INITIAL QUESTIONS TO BE ASKED
(A) Is my transaction a “concentration”? In other words, will there be a change in the “control” of a company or business?

According to the AML, a change in “control” will be considered to occur when (i) two or more companies merge, (ii) when a company acquires control over one or more companies by acquiring equity interests or assets or (iii) when a company acquires control or is able to exert decisive influence over one or more companies by agreement or other means.

Based on MOFCOM’s current practice, a concentration will occur each time a company acquires a majority stake in another company. There is no formal guidance however as to the circumstances in which a minority stake acquisition can be considered as a concentration. Based on a previous draft of MOFCOM’s Notification Measures of Proposed Concentration, veto rights on strategic decisions of the target company such as the appointment of board members or senior management, the adoption of the annual budget or strategic key investments are likely to give rise to a change of control. However, since these examples have been withdrawn from the last version of the draft Notification Measures, the parties are advised to consult MOFCOM on a case by case basis for more legal certainty.

Creation of joint ventures between independent enterprises (whether or not the joint venture would fulfill all the necessary conditions of a full function joint venture) will also be considered as concentrations under the AML. Furthermore, changes in the control of an existing joint venture entity will also be considered as concentrations, for example where one shareholder takes over the share of another joint venture partner and thus acquires “sole control” over the entity/venture. Similarly, in a 50/50 joint venture, where one joint venture partner is replaced by another new joint venture partner, there will also be a change in control and thus a concentration, because although the venture will still be jointly-controlled by two partners, the identity of one of the partners will no longer be the same.

As mentioned above, acquisition of equity or assets is not indispensable for establishing control. MOFCOM may consider that one party has actual control over another party through other means, for example, contracts, management rights, or even intellectual property licensing.

However, a corporate restructuring involving a change in the shareholding of a company between holding companies within the same group would not be considered as a concentration as it will not entail a change of ultimate control.
(B) Do the parties involved in my transaction meet the turnover thresholds?

A merger notification will have to be filed with MOFCOM if either of the following two sets of thresholds is triggered:

- The total **worldwide** turnover in the previous accounting year of all undertakings to the transaction (in most simple cases it will be the acquirer company and the target company or the parent companies of a newly created joint venture) exceeds RMB10 billion (approximately US$1.5 billion or €1 billion or £947 million), and
- at least two of such undertakings each has a turnover of more than RMB400 million (approximately US$62 million or €42 million or £37 million) **within China** in the previous accounting year;

OR:

- The total turnover **in China** in the previous accounting year of all undertakings to the concentration transaction exceeds RMB2 billion (approximately US$310 million or €214 million or £189 million), and
- at least two of such undertakings each has a turnover of more than RMB400 million (approximately US$62 million or €42 million or £37 million) **within China** in the previous accounting year.

“Turnover” will normally include all turnover in the previous fiscal year less all taxes and associated charges.

For the calculation of turnover of an undertaking, one has to take into account all the turnover realized by companies belonging to the same group, i.e. controlled by the same person or parent company, except that intra group turnover (sales between companies of the same group) should be ignored.

Under MOFCOM’s current practice, where only part of a business group is being acquired, only the turnover of the target business will be taken into account in the calculation of the turnover on the seller’s side.

On the other hand, where a joint venture is formed by two independent groups, the total turnover of all the businesses of both groups should be taken into account.

With respect to geographic location, the general rule requires the allocation of turnover to the place where the customer is located (e.g. turnover generated from cross-border sales has, generally, to be allocated to the country of final destination).

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1 Exchange rates as of July 28, 2011.

Financial Institutions

The thresholds applicable to transactions involving financial institutions or those involving non-financial enterprises are the same (as set out above). However, where Financial Institutions are involved, specific rules are to be applied for the calculation of the turnover pursuant to which only a fraction of said “turnover” is taken into account for the purpose of the thresholds assessment. For the detailed rules, please refer to the attached Annex.

**MOFCOM’s discretionary power**

Even if the above-mentioned turnover thresholds are not met, MOFCOM has the discretionary power to investigate any concentration if it considers that the concentration may result in the elimination or restriction of competition in the Chinese domestic market. Therefore, where a transaction, falling below the applicable turnover thresholds, would result in high market shares in China, particularly in technology markets where important intellectual property rights are involved, or where Chinese national interests (widely interpreted by MOFCOM) would be involved, it may be prudent for the parties to consult with MOFCOM to avoid an unexpected investigation which may delay or put in jeopardy the transaction. It is worth noting that MOFCOM has not used these discretionary powers to date.
3. WHAT ARE THE MAIN FEATURES OF THE NOTIFICATION PROCESS?

(1) Filing Party

In principle, the party who is acquiring the control through the proposed transaction has the obligation to make the filing. In some cases, even if the target company has no obligation to file, participation by the target in the filing has proved useful, as it allows the target to be involved in the entire notification process alongside the acquiring party. With respect to “full” mergers (i.e. a merger of the entire buying and selling groups) or the creation of joint ventures, all the parties to the transaction are required to make a joint filing.

(2) Timing of Filing

The filing should be made before the closing of the transaction. The proposed transaction should not be closed before MOFCOM grants its approval. Prior to clearance, parties to the transaction should be very careful to avoid taking certain steps for the completion or closing of the transaction before the approval is granted, such as the transfer of assets or management, information sharing, etc. Such steps may be considered by MOFCOM as implementing the concentration before clearance (or “gun-jumping”), which is a violation of the AML and subject to sanctions by MOFCOM.

(3) Pre-Filing Consultation

While not compulsory, it is highly recommended that the filing party makes at least one pre-filing consultation with MOFCOM (in certain cases, two or more consultations may be necessary). It is a very useful step for the filing party to explain the transaction to MOFCOM’s officials informally and understand MOFCOM’s particular concerns on the specific transaction, so that the filing party can prepare the formal filing submission in the most effective way.

(4) Preparation of Filing Submission

MOFCOM requires comprehensive information including:

(a) Information of parties involved in the transaction (including affiliated companies);
(b) Information of the proposed transaction;
(c) Relevant market involved and the competition situation in the relevant market;
(d) Analysis of the market access (factual and legal barriers or limitations); and
(e) Possible efficiency generated from the proposed transaction; etc.

Based on our experience, the actual submission requires gathering a great deal of detailed and specific data, information, competition analysis and supporting documents even where the partners have small market shares. The data gathering process is very time-consuming especially for companies making their first merger control filing.

4. WHAT TIMETABLE SHOULD BE EXPECTED FOR CLEARANCE?

According to the AML, the timetable for MOFCOM’s review is as follows:

(1) Phase 1

MOFCOM will review the transaction and render a decision within 30 days from the date of receipt of the filing. If MOFCOM does not issue any decision within 30 days, the transaction is considered as being approved. If MOFCOM decides to conduct a further in-depth investigation, it may extend the review into Phase 2. Based on our experience, while most of the transactions without substantial competition issues can be approved within Phase 1. However, in some cases MOFCOM has extended the review process into Phase 2 for purely administrative reasons.

In our experience, MOFCOM tends to ask many questions on the parties’ initial filing, and requires the parties to supply further information (this process may take at least one to two months). Until MOFCOM is satisfied with the parties’ initial filing, it will not consider the filing complete and start the clock of the review period mentioned above. In consequence, the lead time required for obtaining a clearance is, in practice, much longer than the statutory period provided for in the text of the AML typically 60 to 90 days.

(2) Phase 2

If a review is extended into Phase 2, MOFCOM shall render its decision within 90 days from the date of extension decision. Under exceptional circumstances, Phase 2 reviews can be further extended by another 60 days.

The length of time needed to obtain MOFCOM’s approval varies from transaction to transaction. However, good preparation of the initial filing documents can certainly shorten the process. It is essential to consult legal counsel at a very early stage to prepare the necessary information that will need to be submitted.

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2 Please note that pursuant to the circular on the establishment of a security review system for mergers and acquisitions of domestic enterprises by foreign investors (“Circular 6”) issued by the State Council’s general office on 3 February 2011 and its Implementing Regulations, some M&A transactions realised by foreign investors are subject to a security review handled by a ministerial joint committee led by MOFCOM and the National Development and Reform Commission.
5. WHAT ARE MOFCOM’S MAIN ASSESSMENT CRITERIA?

According to the AML, if a proposed transaction will “have or may have the effect of eliminating or restricting competition”, MOFCOM shall prohibit such transaction, unless:

(1) the positive effects of the concentration significantly outweigh the negative effects; or

(2) the concentration is in the public interest.

When reviewing whether a transaction will eliminate or restrict competition, MOFCOM usually considers the following factors:

- Market shares in the relevant market, plus ability to control the market
- Degree of concentration in the relevant market
- Effect on future market entry and technological progress
- Effect on consumers and other related enterprises e.g. suppliers, distributors, downstream customers, competitors, users etc.
- Effect on the development of the Chinese economy, including industrial policy considerations

When reviewing these factors, MOFCOM will not only rely on the information submitted by the filing parties, but also the information and comments provided by, or obtained from competitors, downstream or upstream players, industry and trade associations, as well as other interested parties (even including other ministries governing relevant industries, such as Ministry of Industry and Information for the telecoms industry). On the basis of MOFCOM’s recent decisions, comments from Chinese domestic competitors, downstream Chinese users or Chinese trade associations, are a key factor in MOFCOM’s review. Therefore, it is important for the parties to try to estimate the reactions of other market participants when they plan a transaction.
6. WHAT TYPE OF RISKS/SANCTIONS ARE COMPANIES SUBJECT TO?

(1) Prohibition or clearance subject to conditions

According to the AML, if a proposed transaction will have the effect of eliminating or restricting competition, MOFCOM may:

- block such transaction; or
- approve such transaction subject to restrictive conditions.

The parties are not allowed to close the transaction if MOFCOM decides to block the deal.

If MOFCOM has serious competition concerns on a particular transaction, the parties may propose remedies such as divestiture of certain assets or restriction of certain activities. From our past experience, MOFCOM is fairly open and pragmatic in considering such proposals and has accepted behavioural as well as structural remedies.

(2) Sanctions in case of gun-jumping (early implementing of the transaction without approval)

According to the AML, in case of gun-jumping, MOFCOM may order the parties to stop the transaction, to dispose of shares or assets or transfer businesses within a specified period, or even to unwind the deal. The parties may also be subject to a fine of up to RMB 500,000.

7. CAN MOFCOM’S DECISIONS BE CHALLENGED BEFORE CHINESE COURTS?

If the transaction parties are not happy with MOFCOM’s decision – either in case of a prohibition of the merger or a clearance with conditions – they may request a further administrative review within 2 months following MOFCOM’s decision. The review will be handled by MOFCOM’s Law and Treaty Department. If the parties remain unsatisfied with the result of the administrative review, they may then submit the case for judicial review to a Beijing Intermediate Court within 15 days following the review decision, with the possibility of an appeal to the Beijing High Court. To our knowledge, there has been no action brought before the Beijing Courts to date.

8. SUMMARY OF MOFCOM’S MAIN DECISIONS

From the time the AML took effect in August 2008 to the end of May 2011, MOFCOM has completed review of 241 merger filings of which 233 were cleared unconditionally. While most of these cases have been cleared without any conditions, seven have had conditions imposed and one case was prohibited (i.e. Coca-Cola/Huiyuan). Nearly 65% of the cases have been cleared within Phase 1 (30 days), and about 30% of the cases were subject to Phase 2 review (further 90 days). Some of these Phase 2 cases were caused by administrative delays rather than any substantial competition issues. About 5% of the cases faced an extended Phase 2 review (further 60 days) where as a result, the total review process took about six months – 180 days.

While 62% of all cases were horizontal mergers, 14% of them were vertical mergers. The remaining 23% involved complementary products e.g. carbonated soft drink and beer. In line with China’s current growth in manufacturing, 70% of all cases focus on the manufacture sector.

A summary of the most significant cases is set out below.

1. Inbev/Anheuser Busch (MOFCOM decision dated 18 November 2008)

Inbev N.V./S.A.’s proposed US$52 billion acquisition of Anheuser-Busch Companies Inc. was considered by MOFCOM as having potential anti-competitive effects on China beer market and cleared on conditions that (1) Anheuser-Busch may not increase its current shareholding of 27% in the Tsingdao Brewery Co., Ltd.; (2) Anheuser-Busch shall notify MOFCOM in advance in case of any change of controlling shareholders or the shareholders of such shareholders; (3) Anheuser-Busch may not increase its current shareholding of 28.56% in the Guangzhou Zhujiang Brewery Co., Ltd.; (4) Inbev may not acquire any shareholding in China Resources Breweries Co., Ltd. and Beijing Yanjing Beer Co., Ltd.

2. Coca-Cola/Huiyuan (MOFCOM decision dated 18 March 2009)

Coca-Cola’s proposed US$2.4 billion acquisition of Chinese juice maker China Huiyan Juice Group Ltd. (a HK-listed company with 42% share of Chinese juice market, “Huiyuan”) was prohibited due to a number of competition concerns and the failure of the parties to reach an agreement on a remedy with MOFCOM.

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1 In the InBev/Anheuser Busch decision, there is virtually no market analysis at all. The decision text simply refer to massive scale of the merger and a high market share that the post-merger entity will possess. We noticed a gradual improvement in later cases on the analysis, but generally, the analysis remains short in comparison with EU or US conditional merger decisions.
The main competition concerns identified by MOFCOM were: (1) The proposed acquisition would have enabled Coca-Cola to leverage its dominant position in the carbonated soft drinks market reportedly 60% market share on to the neighbouring juice market; (2) it would also have given Coca-Cola an effective control over the Chinese juice market via two well-known brands, i.e. its own Minute Maid brand and the Huiyuan brand from the seller, which would have increased the entry barriers to the juice market; (3) it would have limited the ability of middle and small-sized juice companies to compete and to innovate, which would result in an unhealthy market structure for juice products. Though MOFCOM did not disclose the content of remedies it had discussed with Coca-Cola, it has been reported in the press that Coca-Cola was requested to relinquish one of the seller’s brands after the acquisition. However Coca-Cola was not ready to accept that.

3. Mitsubishi/Lucite (MOFCOM decision dated 24 April 2009)

The proposed acquisition of Mitsubishi Rayon Co., Ltd. (“Mitsubishi”) of the British chemicals producer Lucite International Group Limited (“Lucite”) was considered by MOFCOM to raise competition concern in the Methylmethacrylate (“MMA”) market, where the parties would have market share of 64% after the merger. As Mitsubishi had business in both the MMA market and the downstream markets, Mitsubishi would have been able to foreclose downstream competitors by leveraging its dominant position in the MMA market. MOFCOM finally cleared the merger with conditions that: (1) Lucite China would divest 50% of its annual MMA production capacity for a period of five years; (2) during the time between closing of this merger and the completion of divesture, both parties agreed to run their respective MMA businesses in China independently; and (3) during this period Mitsubishi agreed not to invest in the MMA monomer, PMMA polymer or cast sheet businesses in China by way of either a new acquisition or creation of a green field plant.

4. GM/Delphi (MOFCOM decision dated 28 September 2009)

US auto maker General Motor’s (“GM”) proposed acquisition of US auto parts manufacturer Delphi Corporation (“Delphi”) involved foreclosure concerns in China – post-transaction GM would have the ability to foreclose its competitors on the auto manufacturing market as Delphi was the exclusive supplier for various Chinese auto manufacturers. MOFCOM was also concerned about increased difficulty for other Chinese auto parts suppliers to sell their products to GM. However, MOFCOM cleared the transaction subject to the conditions that (1) GM/Delphi would continue to supply Chinese auto manufacturers on a non-discriminatory basis; (2) GM and Delphi would not exchange confidential information relating to any third party, (3) GM/Delphi would cooperate with its customers to achieve a smooth transition when they switch to other auto parts suppliers; and (4) GM would continue its diversified and non-discriminatory purchase policy of purchasing auto parts from multiple suppliers.

5. Pfizer/Wyeth (MOFCOM decision dated 29 September 2009)

US pharmaceutical company Pfizer’s proposed acquisition of US pharmaceutical company Wyeth was considered by MOFCOM to have substantial anti-competitive effects on the swine mycoplasma pneumonia vaccine (SMPV) market in China. Post-transaction, Pfizer/Wyeth would possess a 49.4% market share in an increasingly concentrated SMPV market in China. According to MOFCOM, this would enable Pfizer/Wyeth to enlarge their market share and consequently increase the price of SMPV and raise entry barriers to the SMPV market. To reduce the anti-competitive effects of the proposed transaction, MOFCOM ordered a divestiture of Pfizer’s SMPV business in China. Pfizer had to find a third party buyer approved by MOFCOM within six months and ensure that the divested business included all tangible and intangible assets necessary for the survival and competitiveness of the divested business. Pfizer was obliged to provide reasonable assistance in terms of technical support, purchase of raw material and staff training at the request of the potential buyer.

6. Panasonic/Sanyo (MOFCOM decision dated 30 October 2009)

The proposed acquisition of Japanese company Sanyo Electric Co., Ltd. (“Sanyo”) by Japanese company Panasonic Corporation (“Panasonic”) was considered to have anti-competitive effects in the highly concentrated button battery, civil battery and vehicle battery markets on a global basis. Post-transaction, Panasonic/Sanyo would have market shares of 61.6%, 46.3% and 77% respectively in these three markets. MOFCOM considered that the high market shares in already concentrated markets would easily enable the parties to raise prices. Therefore, the transaction was approved with an order to divest substantial businesses in all three markets. Sanyo and Panasonic were to spin off their relevant businesses within six months (extendable for another six months) to an independent third party approved by MOFCOM. In case of the civil battery business, a divestiture of one party’s business was considered sufficient. MOFCOM left the decision with the parties regarding whose business would be divested. In addition to the spin-offs, Panasonic had to reduce its shareholding in Panasonic EV Energy Co., Ltd., a joint venture between Panasonic and Toyota which holds 77% of the vehicle
battery market, from current 40% to 19.5%, and would waive its voting rights at joint venture’s Shareholder’s Meeting as well as its right to appoint directors to the Board. Panasonic also had to waive its veto rights regarding the joint venture’s battery business.

7. Novartis/Alcon (MOFCOM decision dated 13 August 2010)

The proposed acquisition of Swiss pharmaceutical company Alcon by Swiss pharmaceutical company Novartis was identified by MOFCOM as raising anti-competitive concerns in the ophthalmological anti-infective, anti-inflammatory/anti-infective combinations market and contact lenses care products market. Alcon had over 60% of the ophthalmological anti-infective, anti-inflammatory/anti-infective combinations market in China. Even though Novartis had less than 1% of the China market and stated its intention to exit the market globally, MOFCOM considered it insufficient to ensure future competition in the market. With respect to contact lenses products, Novartis/Alcon would reach 60% in the global market and 20% in the China market post-transaction. It was revealed during the merger review that Novartis had a distribution agreement with Hydron Contact Lens Co., Ltd (“Hydron”), the largest contact lenses producer in the China market with a market share of 30%. As a result of this agreement, Hydron became the exclusive supplier for Novartis’ contact lens care products. MOFCOM was of the view that post-transaction Novartis/Alcon would be able to coordinate with Hydron on price, quantity and sales territories of contact lenses care products. Therefore, the transaction was cleared on conditions that Novartis would cease sales of its ophthalmic anti-inflammatory/anti-infective combinations under its current brands in China and would not sell any of these products under the same or different brands in China in the next five years. Furthermore, Novartis would terminate its distribution agreement with Hydron within 12 months.

8. Uralkali/Silvinit (MOFCOM decision dated 2 June 2011)

MOFCOM approved the merger of two Russian fertiliser companies subject to several conditions.

In the course of its assessment, MOFCOM noted that the potassium chloride market was highly concentrated with the top three producing countries accounting for more than 80% of the world’s total reserves. It further noted that the proposed transaction would create the second largest exporter of potassium chloride with a over a third of the global market. MOFCOM also stressed that China relies heavily on imports of which more than 50% are from Uralkali, Silvinit or their affiliated companies.

MOFCOM considered that the transaction will further increase the level of concentration in the market and that the merged entity will benefit from an increased market power through the ownership of more potassium resources and stronger production capabilities. It further considered that the transaction will also further increase the risk of anticompetitive coordinated behaviour between the few remaining global suppliers. It finally considered that new entry into the potassium chloride market is difficult due to the scarcity of exploitable potassium deposits and the considerable amount of exploration and time required to bring on stream new mines.

As a result of these competition concerns, MOFCOM imposed several conditions, the general aim of which is to maintain a stable level of imports of potassium chloride into China. Inter alia, the merged entity will have to continue to provide the whole range of potassium chloride products to the Chinese market in sufficient quantity and maintain the current methods, processes, the existing customary negotiations procedures as well as take into full account the history and status with Chinese customers and the specific characteristics of the Chinese market in relation to price negotiations.

A trustee has to be appointed to monitor the compliance with the commitments and report to MOFCOM the correct implementation of the commitments.

9. Conclusions

MOFCOM’s approach is reasonably practical and pragmatic and business oriented. So the climate for foreign investment in China is quite favorable. However, filing requires the parties to assemble a great deal of data and MOFCOM habitually asks many preliminary questions which have to be answered before the filing is considered complete. This lengthens the process. Also, in recent months, we have seen that even in cases where there are no “substantive competition issues”, there have been administrative delays in Phase 1. This has resulted in some cases being pushed into Phase 2 while these administrative issues have been resolved. So, timing is currently somewhat uncertain and parties should allow for such possible delays when planning transactions.

In addition, MOFCOM’s wide interpretation of the concept of national security or the development of the Chinese national economy can give rise to unexpected issues which have to be overcome in order to obtain a swift clearance, particularly when a well known Chinese company or brand is being acquired.

In a recent case, MOFCOM made its approval conditional upon the prior divestment of a well known Chinese spirits brand, which was considered to be a national heritage brand and therefore off limits to foreign investors.
**ANNEX**

**MERGER FILING THRESHOLDS FOR FINANCIAL INSTITUTIONS**

Financial institutions are defined as including: (1) banking institutions, (2) securities companies, (3) futures companies, (4) fund management companies, and (5) insurance companies.

The respective items shall be counted into their turnovers are set out below.

The turnover of these financial institutions should be calculated as follows:

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\text{(aggregate of the items of turnover – business taxes and surcharges)} \times 10\%
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<th>BANKING INSTITUTIONS</th>
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<th>FUTURES COMPANIES</th>
<th>FUND MANAGEMENT COMPANIES</th>
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<td>Net interest income</td>
<td>Net interest income</td>
<td>Net service charges and commissions</td>
<td>Management fee income</td>
<td>Premium income (= premium income from primary insurance + any premium income from reinsurance – any ceded-out premium)</td>
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<td>Net service charges and commissions</td>
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