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# China News Alert Issue 300

## Capital Markets

### SSE issues guidelines for continuous supervision over listed companies

The Shanghai Stock Exchange (SSE) has recently issued the ‘SSE Guidelines for Continuous Supervision over Listed Companies' (the Guidelines) to urge sponsors and financial advisors to improve continuous supervision of companies after listing, takeover and reorganisation, equity division reform and relisting

With the development of the securities market in recent years, intermediaries are playing an increasingly important role in the market. The continuous supervision information disclosure and corporate governance of listed companies, and the fulfillment of promises by relevant shareholders. Continuous supervision has a direct influence on information disclosure and the corporate governance of listed companies' as well as on the lawful rights and interests of investors.

The Guidelines are based on experience and previous research with a view to strengthening the continuous supervision carried out by sponsors and financial advisors.

The Guidelines, summarising present regulations on continuous supervision, provides sponsors and financial advisors with an overview of requirements regarding continuous supervision. The Guidelines prescribe that sponsors and financial advisors are required to submit annual and final reports on continuous supervision to the SSE on a regular basis.

The Guidelines also set specific rules if problems occur in current continuous supervision practices. If shareholders make promises about transfer prices in equity division reform, sponsors should work out continuous supervision plans together with relevant shareholders and their designated securities brokers to ensure that the relevant shareholders do not break their promises.

The Guidelines also cover possible failures in due diligence by sponsors and financial advisors. The Guidelines specify relevant supervision measures including interview and the issuance of supervisory attention letters etc. The SSE may circulate its criticism and make public censure towards relevant sponsors, representatives of sponsors, financial advisors and responsible officers for serious violations.

According to an SSE official, the next stage for the SSE is to detail the content and format of annual and final reports on continuous supervision.

[Source: Shanghai Stock Exchange](http://english.sse.com.cn/aboutsse/news/c/28634.shtml) ([see archive](SSE_Issues_Work_Guide_for_Continuous_Supervision_over_Listed_Companies.pdf))

### Banking regulator to ensure loans enter the real economy

On 27th July, the China Banking Regulatory Commission (CBRC) formally issued ‘Provisional Measures on Fixed-asset Loan Management' to ensure that bank loans enter the real economy. The measures will take effect three months after the date of release.

The measures will apply to loans issued for four major types of investment project: infrastructure, upgrades and renovation, real estate development and miscellaneous fixed-asset investment projects.

The measures will be implemented by managing the entire loans process to enhance banks' risk management capabilities, and ensuring that loans enter the accounts of contracted parties and that the money is used for the specified purpose.

The tightened lending regulations are unlikely to increase the cost to banks and borrowers. The CBRC explained that the implementation of the measures will guarantee normal financing demand by enterprises and ensure this after contracts are signed.

The loans will be gradually issued to borrowers in line with the progress of investment projects, which will reduce the interest costs for enterprises. In addition, banks will also benefit from this procedure because of lowered lending risks.

Apart from requiring borrowers to provide loan guarantees and collateral, banks should also become the first party to claim compensation from commercial insurance policies under which the projects are insured, or take other steps to effectively control insurance rights and interests.

[Source: People's Daily](http://english.people.com.cn/90001/90778/90857/90862/6712365.html) ([see archive](Banking_regulator_ensure_loans_enter_real_economy.pdf))

### CBRC issues guide to project finances

The China Banking Regulatory Commission (CBRC), China's banking industry regulator, recently published the ‘Business Guidance for Project Finance' (the Guidance) with the aim of improving risk management within the financing business.

Project finance is a generally utilised financing method in infrastructure construction and large resource development projects in China, and plays an important role in China's economic structure.

The Guidance explains procedure management for loans in project finance; clarifies definitions of project finance; offers guidance for risk management; and gives the principal requirements on consortium loans for a project.

The promulgation of the Guidance will help control and prevent unnecessary risks in project finance, promote the sound development of financial institutions in the banking industry and facilitate stable economic development at a relatively fast pace.

On the same day, the banking regulator also issued another document to regulate fixed asset loans. The two new regulations are aimed at guiding the flow of credit funds into the real economy and projects essential to the national economy and people's livelihood, as well as to prevent the misuse of loans and bank risks resulting from rapid loan growth.

However, the regulator said they would not raise the thresholds for enterprises to obtain bank loans.

[Source: Trading Markets](http://www.tradingmarkets.com/.site/news/Stock%20News/2444539/?relatestories=1) (Link no longer active)

### CIRC may tighten supervision over the establishment of insurance institutions

The China Insurance Regulatory Commission (CIRC) on 28th July began to seek public comments on the ‘Draft Amendment to the Administrative Regulation on Insurance Companies' (the Draft), with a deadline scheduled for 14th August. Compared with the existing regulation, the Draft tightens supervision over the establishment of insurance institutions.

The Draft adds some new requirements for the establishment of insurance companies. The major investor is required to

1. be continuously profitable;
2. have a good reputation and no major violation of laws and regulations within the previous three years; and
3. have a net asset of no less than RMB 200 million yuan.

The establishment of an insurance company should be feasible and the insurance company must have a clear business scope, development program, business strategy, organisational structure and risk management rules.

After obtaining approval from the CIRC, the applicant is required to complete their preparation for establishment within one year of the approval. Under the existing regulation, if the preparation fails to be completed within prescribed time, the applicant may apply to the CIRC for an extension period of three months.

The Draft also adds new requirements for the establishment of branches of insurance companies.

The insurance company applying for establishment of branches should

1. have complete internal control and risk management measures;
2. have sound corporate governance where the parent insurance company is the applicant;
3. have sufficient solvency in the previous four quarters;
4. where the insurance company applies to establish a branch below province-level in the province outside its premise, the insurance company should have at least one province-level branch operating for over six months;
5. have received no administrative punishment in the past two years and be under no current investigation by the CIRC or its dispatched offices for violation of laws and regulations; and
6. where the insurance company applies to establish a branch below province-level, the existing branches in the same province must have had no violations within the previous six years.

The Draft, if passed, is also applicable to the establishment of branches by wholly foreign owned insurers and Sino-foreign joint venture insurers.

In case of any inconsistencies between the prior regulation and the new one, the new regulation should prevail.

Business operations by branch companies of foreign insurance companies are restricted to the province where the branches are incorporated. Branch companies of foreign reinsurance companies may carry out reinsurance business in the whole nation.

[Source: Stock Star](http://money.stockstar.com/JL2009072900001491.shtml) ([see archive](CIRC_may_tighten_supervision_over_the_establishment_of_insurance_institutions.pdf))

### Regulator plans steps to plug IPO loopholes

The securities watchdog is considering further measures to plug loopholes that have been discovered in the latest round of initial public offerings (IPO), according to Shang Fulin, chairman of the China Securities Regulatory Commission (CSRC).

The CSRC is generally satisfied with the results of the recent reforms, but did identify a number of areas that need to be improved.

One such area is the lack of a provision to prevent institutional investors from taking advantage of the new allotment system by masquerading as personal investors in their IPO applications. "Some institutional investors were known to have circumvented the subscription limits on their accounts by making applications through personal investor accounts opened with borrowed ID cards," said Lu Junlong, analyst at China Finance Online. "Stockbrokers keen on earning commission fees usually turn a blind eye to such irregularities," he said.

This has defeated, to some extent, the primary objective of the reforms, which was to increase the allotment of new shares to personal investors. In the past, the deluge of applications from well-financed institutional investors had largely crowded out applications from individual investors.

Because of the loophole, the ratio of newly issued shares allocated to personal investors in the recent IPOs was still deemed too low. For example, the allocation ratio in the Guilin Sanjin Pharmaceutical IPO, one of the first companies to obtain a stock exchange listing after the lifting of the IPO suspension, was only 0.17 per cent.

The allocation ratio in the Sichuan Expressway IPO was 0.26 per cent, while it was 2.83 per cent for China State Construction Engineering Corporation's public float.

"The ratio of allocation of shares to personal investors is at a low level, similar to the lottery system in the past," said Zhu Hongbin, an investor with over ten years experience in the market.

Considering the wide price gap between the primary and secondary markets, many institutional investors borrowed heavily from banks to subscribe to new shares.

Easy credit and cheap money have given institutional investors a much greater edge over small investors in the fight for IPO allotments.

"As long as the interbank seven-day repurchase rate stays below 3 to 4 per cent, we can make profits by subscribing to new shares," a Shanghai-based fund manger said, who refused to be named.

The investors' feverish penchant for newly listed stocks saw Sichuan Expressway Company soar 202 per cent on debut. The bourse suspended trading in the stock two times to allow a cooling off period on the first day.

The company's issue price was 3.6 yuan, nearly 20 times the PE (price-to-earnings) ratio. After collective bidding, the opening price soared to 7.6 yuan and the shares finally closed at 10.9 yuan after touching a high of over 15 yuan. The high price was beyond the expectation of many analysts.

According to the reports from 23 securities firms, most analysts thought the reasonable price could be around 5 yuan. Guotai Junan Securities Company was the most optimistic, which estimated the shares could be worth around 7 yuan.

The shares subsequently began to slump and closed at 9.81 yuan.

According to the Shanghai Stock Exchange, individual investors were the main buyers of the new shares of Sichuan Expressway on its first trading day. Among the 74,000 accounts that bought shares on that date, about 99.9 per cent were personal accounts. Institutional investors, including fund mangers, securities firms and insurance companies, did not join the speculation.

According to CSRC Chairman Shang Fulin, the regulators are working on a plan to educate individual investors and are also exploring effective mechanisms to protect investors' rights.

[Source: Xinhua](http://news.xinhuanet.com/english/2009-07/30/content_11795825.htm) ([see archive](Regulator_plans_steps_to_plug_IPO_loopholes.pdf))

## Corporate & Commercial

### China revises rules on foreign M&A of Chinese companies

A new version of the rules on foreign investors' mergers and acquisitions of Chinese companies was issued by the Ministry of Commerce on 23rd July, effective from 22nd July 2009.

The Ministry of Commerce explained that the revision meant that the new rules would be in compliance with the Anti-monopoly Law, which took effect on 1st August 2008, and the State Council's regulations on business concentration.

The revision includes the deletion of Chapter Five on "anti-monopoly review". An additional item has been put into the appendix, which provides that according to the Anti-monopoly Law, foreign investors have to file an application for their deals to the Ministry of Commerce if their proposed deals reach the threshold set by the regulations on business concentration.

The State Council issued the documents on the declaration threshold in August 2008 immediately after the Anti-monopoly Law took effect. A business concentration should be reviewed if it involves a global trade of 10 billion yuan (about US$1.46 billion) by all related parties and if the total domestic trade volume of at least two of the related parties exceeds 400 million yuan in the previous fiscal year.

A concentration case with a domestic trade over 2 billion yuan by all related parties in the last fiscal year and a trade volume of at least two of those parties within China exceeding 400 million yuan is also subject to the anti-monopoly review.

The term "actual controllers" replaces the term "ultimate controllers" in Article 42 and 44 in the revised version of the rules on foreign investors' M&A of Chinese companies.

Minor alterations are also made to some of the wording in the rule.

The previous rule had been effective since 8th September 2006.

[Source: People's Daily](http://english.people.com.cn/90001/90778/90857/90860/6709623.html) ([see archive](China_revises_rules_on_foreign_MA_of_Chinese_companies.pdf))

### China pushes audio & visual publishing houses to compete

China's press regulator has told state-owned audio and visual publication houses to become self-supporting and more competitive in the market. The move also aims to make the industry more creative.

Audio and visual publication houses affiliated to higher learning institutions and local governments - except non-profit organisations - should complete the process before the end of this year, the General Administration of Press and Publications (GAPP) said recently.

Companies attached to central government departments are required to complete the transformation before 2010.

Enterprises which refuse to take part in the process will be closed, according to the regulator.

The move aims to solve problems that have hampered the development of the industry in recent years. These include a lack of creativity and competitiveness, and slack supervision.

The administration is also to encourage the formation of larger regional and trade audio and visual companies. It says large state-owned newspapers and publication groups are welcome to incorporate audio and visual enterprises through acquisition.

State-owned companies in the field will also be urged to expand cooperation with private enterprises as long as they can ensure "a correct development orientation" and state ownership.

In addition, companies are being encouraged to diversify publication channels through cooperation with telecom and network operations. Those targeting rural areas, minors and ethnic minorities will be more strongly supported, the GAPP said.

[Source: People's Daily](http://english.people.com.cn/90001/90776/90884/6714902.html) ([see archive](China_pushes_audio_visual_publishing_houses_to_compete.pdf))

## Taxation

### China to stop tax evasion by multinationals

China's State Administration of Taxation has recently issued a "Circular on Strengthening the Monitoring and Investigation of Cross-border Affiliated Transactions" to prevent multinational companies from transferring their overseas losses to affiliated domestic enterprises amid the global financial crisis, leading to a drain on domestic tax revenue.

The circular requires local tax departments to intensify monitoring on cross-border transactions, focusing on multinational companies which seek to transfer their overseas operating losses, including potential losses, to China, and shift profits made in China to overseas tax havens. Local tax departments should also step up functional risk analysis and comparative analysis to choose a reasonable approach for transfer pricing in order to ascertain the profitability of each enterprise.

According to the circular, enterprises established by multinational companies within China which have limited functions and bear limited risk, such as sole manufacturers, distributors or contracted research and development enterprises, should not bear marketing, decision making or other risks which are related to the global financial crisis. Under the principle of transfer pricing, functional risks should be proportional to their profits; these enterprises should maintain a reasonable level of profit.

Transfer pricing is a means often adopted by multinational companies to evade taxes. Companies (such as subsidiary companies) in high-tax regions often transfer their products and services at a price lower-than-cost to their affiliated companies (such as parent companies) in a lower-tax region, which subsequently sells these same products and services at high prices. As a result, the subsidiary company records losses, leaving profits to the parent company. Or the subsidiary company buys raw materials, services or licenses at higher-than-average prices from the parent company in order to transfer their profits to the parent company.

Since the 1990s when foreign investment increased in the Chinese market, the problem of foreign-invested enterprises transferring profits through cross-border transactions has become more prominent. This has been shown by their large losses.

According to statistics, before 2005, 55 per cent of foreign-invested enterprises in China reported losses in their annual reports. A survey conducted by the National Bureau of Statistics in 2007 showed that two thirds of foreign-invested enterprises which reported losses evaded tax under the guise of reduced revenue and increased expenditure, transfer pricing and false costs, leading to China's tax losses of 30 billion yuan.

The severe tax situation this year is also a factor driving China's fiscal and tax departments to strictly control the transfer pricing behaviour of foreign-invested enterprises.

The State Administration of Taxation issued a notice in May demanding that tax departments in different regions strengthen their administration of major taxes including individual income tax, enterprise income tax and value-added tax.

[Source: People's Daily](http://english.people.com.cn/90001/90778/90857/90861/6713537.html) ([see archive](China_to_stop_tax_evasion_for_multinationals.pdf))

## Other

### Identification procedures for work-related injuries to be simplified

The Legislative Affairs Office of the State Council on 24th July publicised the ‘Draft Decision Concerning Revision of the Regulation on Work-Related Injuries of the State Council' (the Draft Decision) for public comment and further investigation.

The Draft Decision simplifies identification of work-related injuries and the procedures for appraisal and dispute settlement. 30 per cent of the existing procedures may be cut according to the Draft Decision.

The Draft Decision adds rules regarding the timely reporting of injuries and prescribes a one year time limit for the identification of work-related injuries to guarantee the legitimate rights of employees.

In practice some employers and employees make identification applications long after the occurrence of accidents by which time the relevant evidence has been lost, causing great difficulties in evidence collection and failure to issue an identification decision by the labour departments.

The Draft Decision requires employers to submit a report within 24 hours of major accidents.

The Draft Decision provides two proposals for public comment in relation to whether the labour department should attend the site for investigation and evidence collection.

The Draft Decision abolishes the prior requirement for administrative review. The existing regulation requires a prior administrative review before any administrative litigation. For the quicker provision of work-related injury treatment to employees, the Draft Decision abolishes such requirements and prescribes that employers and employees may apply for administrative review or directly file the case to court during work-related injury disputes.

The Draft Decision simplifies work injury identification procedures for disputes with any employment relationship problems.

In practice, before an application for injury identification is made, the applicant is required to apply for arbitration on the existence of any employment relationship issues. With complicated procedures and a long identification period, such cases have aroused conflict among the public. To solve such problems, the Draft Decision prescribes that in the case of any refusal by the labour department to accept the identification application due to employment relationship problems, relevant parties may directly file the case to court without prior labour arbitration or administrative review.

[Source: People's Daily](http://politics.people.com.cn/GB/1026/9717649.html) ([see archive](Identification_procedures_for_work-related_injuries_to_be_simplified.pdf))

### China publicises regulation to implement Food Safety Law

Chinese food producers must record all information on raw material procurement and food processing procedures and keep the records for at least two years, under a new regulation to ensure food safety.

The requirement is detailed in the ‘Regulation on the Implementation of the Food Safety Law', which was published recently.

The regulation, effective on 20th July, details the requirements for food manufacturers and wholesalers in food processing and distribution, and the importance of supervision by health authorities highlighted in the Food Safety Law, which took effect on 1st June.

Passed on 8th July at a meeting of the State Council, the regulation also gives specifics on food safety risk assessments.

[Source: China.org](http://www.china.org.cn/government/central_government/2009-07/24/content_18199715.htm) ([see archive](China_publicizes_regulation_to_implement_Food_Safety_Law.pdf))

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