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# China News Alert Issue 84

## Headlines

### Launch of IPO book building in 2005

The China Securities Regulatory Commission (CSRC) has released a Circular on trial operation of IPO book building together with a related memorandum on the approval of IPO book-building institutions. The IPO book building system will come into effect on 1 January 2005.

According to the circular, once IPO applications have been approved by the CSRC, issuers can open prospectuses to the public, and commence promotion and book building. Book building is divided into two stages: "preliminary" book building and "accumulative" book building. IPO issuers and their sponsors set the issuing prices range through preliminary book building, while actual issuing prices are determined through accumulative book building.

Public investors will not be entitled to participate in IPO book building and placement, which will be limited to securities investment fund management companies, securities companies, trust investment companies, financial companies, insurance institutional investors and QFIIs, as well as other institutional investors recognized by the CSRC.

At least 20 institutional investors must be involved in preliminary book building. Issuers will set price ranges and corresponding ranges of price to earning ratios based on quotations given by the institutional investors. If the IPO relates to 400 million or more shares, the number of institutional investors involved in preliminary book building must be not be less than 50.

If an IPO relates to less than 400 million shares, shares issued to institutions should not exceed 20% of the total amount issued. For IPOs of 400 million or more shares, shares issued to the institutions should not exceed 50% of the total amount issued. On application to the CSRC, issuers and their sponsors can adjust the above ratios to the actual market situation. Institutional investors must undertake to "lock-in" purchased shares for three months.

### Regulations on strengthening protection of public shareholders

The CSRC has adopted Regulations on strengthening protection of public shareholders' rights and interests, which came into effect on 7 December 2004.

The regulations will not apply in the case of shareholder resolutions adopted and announced prior to the release of the regulations. However, the regulations will apply where companies have issued notices on shareholders' meetings but the relevant shareholders' meetings have not yet been held.

The main aspects of the regulations are as follows:

* listed companies must implement public shareholder voting systems for major issues; the following actions require to be approved by more than one half of voting public shareholders at a shareholders meeting:
  1. additional offerings, convertible bonds issues and right issues,
  2. major asset restructuring, where the assets premium reaches or exceeds 20% of the net audited book value of assets purchased,
  3. where a shareholder proposes to repay debts owed to a listed company with stock rights,
  4. where a company affiliated to a listed company (and which is "significant" to the listed company's operations) makes an IPO overseas,
  5. other events that have a significant impact on the interests of public shareholders;
* when holding shareholders' meetings, a listed company must provide an online voting platform in addition to voting at the meeting (spot voting); listed companies must also actively pursue a system of cumulative voting when electing directors and supervisors which fully takes into account the opinions of minority shareholders;
* for events that have significant impact on public shareholders' interests, the regulations require listed companies to re-announce notices of the relevant shareholders' meetings within three days after the date of confirming all shareholders' identities for the purposes of the vote (the share right recording date);
* when declaring resolutions passed at shareholders' meetings, listed companies must set out the number of public shareholders who have participated in the vote, the number of shares held by them and the proportion of total tradable shares represented by those shares; companies must also announce how the ten largest shareholders voted;
* the regulations also aim to improved the independent director system; in particular, independent directors will have special duties in relation to connected transactions and the employment of accounting, auditing and consulting firms;
* the regulations aim at the strengthening of investor relations management, and the enhancement of disclosures by listed companies; company secretaries will be responsible for companies' investor relation management;
* listed companies must adopt active profit distribution methods and prescribe such methods in their articles of association; companies which have not distributed cash dividends in the previous three years will not be permitted to launch additional offerings, convertible bonds issues or rights issues;
* under the regulations, controlling shareholders (whether direct or indirect) may not illegally use the capital of listed companies or provide guarantees for affiliated parties; in addition, they may not use affiliated transactions, profit distributions, asset restructurings or investments to damage legal rights and interests of shareholders;
* the regulations require senior management of listed companies to faithfully perform their duties and safeguard the interests of the companies and all shareholders

### New rules for fund custodians

The CSRC and the China Banking Regulatory Commission (CBRC) have jointly released the Rules on Qualification Management for Securities Investment Fund Custody, which will come into effect on 1 January 2005. The main provisions of the new rules include the following:

* banks applying to provide fund custodial services must have net assets of not less than RMB2 billion in each of the last three financial years (the previous admittance threshold was paid-up capital of RMB8 billion);
* the capital adequacy ratio of applicant banks must meet the thresholds set out in related regulations;
* fund custody departments must be set up and kept independent of other business departments;
* designated senior managers must meet related legal requirements;
* at least 5 appropriately qualified and experienced personnel must be responsible for businesses such as fund clearing, accounting, investment supervision, information disclosure and internal monitoring;
* commercial banks must meet the conditions for safe custody of fund properties and implement secure clearing systems.

## Corporate & Commercial

### New rules on auction management

The Ministry of Commerce (MOC) has adopted Rules on Auction Administration, which will come into effect on 1 January 2005. The Rules contain detailed provisions relating to, among other things, establishment, change and termination of auction enterprises, foreign investment in auction enterprises, qualifications for employees of auction enterprises, supervision and administration of auctions and related.

### Establishment of small businesses in Mainland China by Hong Kong and Macau residents

The State Administration for Industry & Commerce (SAIC) has issued the Opinions on Registration and Management of Applications for Establishing Small Business of Industry and Commerce in Mainland China by Hong Kong and Macau Residents. Under the Opinions, Chinese citizens of Hong Kong and Macau permanent residents will be entitled to establish small businesses of industry and commerce in Mainland China without first obtaining approval for the foreign investment.

The types of businesses covered by the Opinions include retailing (apart from tobacco products), catering, hairdressing, cosmetics, and the repair of household electrical appliances and other commodities. Businesses benefiting from the new rules will be required to have a maximum of eight personnel, and the business area may not exceed 300 square metres.

## Funds

### Shanghai Stock Exchange issues new rules on listing of funds

The Shanghai Stock Exchange (SSE), with the approval of the CSRC, has issued Rules on SSE Securities Investment Funds in order to standardize the listing of exchange traded funds (ETFs). The Rules provide that when an ETF is listed on the SSE, the fund manager must submit to the SSE, in addition to documents required for all funds, a list of securities companies which subscribe and redeem certain shares of the fund, and related trust agreements. Listing and transactional announcements must also set out details of fund subscriptions, redemptions and other transactions. The Rules also provide that the method for announcing the Net Asset Value (NAV) and Net Asset Value per Share of the ETF will be will be prescribed by the SSE.

## Trusts

### Prohibition on trust invest companies offering minimum return guarantees

The CBRC has released a Circular on Prohibiting Trust Investment Companies offering Minimum Return Guarantees. The Circular provides that trust investment companies must set up separate accounts for the trust investment company and the trustor. Trust investment companies must distribute profits based on actual trust income earned on the management of trust properties, and may not misappropriate one trust property as set-off against the losses or profits of other trust properties. In addition, trust investment companies may offer investors loss-free or minimum guaranteed returns.

The Circular further requires trust investment to keep at its business address a notice addressing the relevant provisions prohibiting minimum guaranteed returns, and to notify such provisions in writing to interested parties. When promoting trust products or handling trust services, trust investment companies may not represent to interested parties that the trust properties will be loss-free or subject to certain minimum guaranteed returns.

## Real Estate

### New circular on payment of land use fees

The Ministry of Land Resources and the People's Bank of China have jointly issued the Circular on Strengthening the Collection, Use and Management of Fees on Using New Construction Land. The Circular provides that approvals on agricultural land diversion or land requisition will not be granted until land use fees have been fully paid. The relevant authorities will examine all new construction land approved between 2003 and April 2004 to ensure that the appropriate land use fees have been paid. If land use fees have not been fully paid, persons liable for payment will be instructed by the appropriate authority to make payment within a specified period of time. Until actual payment is made, the relevant state land and resources authority will not accept any application for agricultural land diversion or land requisition approval.

## Capital Markets

### New measures on online voting at listed companies' shareholders' meeting

The CSRC has released Guidelines on Online Voting at Listed Companies' Shareholders' Meetings, which came into effect on 8 December 2004. Under the Guidelines, listed companies are encouraged to offer the choice of online voting to public shareholders in addition to traditional spot voting. All shareholders will be entitled to exercise voting rights through online voting. The guidelines provide that online votes shall carry the same weight as votes cast by traditional means.

The guidelines require listed companies to clarify the timing and procedures for online voting and meeting agendas in notices on shareholders' meetings. Online voting must commence no earlier than 3:00 p.m. on the day before the holding of the shareholders' meetings, and not later than 9:30 a.m. on the day of the meeting. The deadline for online voting must not be earlier than 3:00 p.m. on the day on which the shareholders' meeting ends. Temporary proposals must be announced by the board of directors at least 10 days before the shareholders' meeting. Casual proposals advanced on the spot at the shareholders' meeting, or those not announced, may not be listed on the voting agenda.

In addition to the Guidelines, the China Securities Depositary and Clearing Corporation (CSDCC) has issued the Detailed implementing rules for online voting at listed companies' shareholders' meetings and Detailed implementing rules for verifying identification of investors using online services which set out the technical operating procedures for online voting. The two implementing measures also came into effect on 8 December 2004.

The rules provide that listed companies entering into an agreement with the CSDCC will obtain online usernames, passwords and electronic identification cards. Persons soliciting shareholders' voting rights through the system must submit required materials at least five days before soliciting. Such persons must also apply to the CSDCC for temporary custody of the relevant shares.

During the period of online vote soliciting, if several persons are openly soliciting voting rights at a particular shareholders' meeting, shareholders may entrust different persons to vote on different proposals. However, they may not entrust their voting right on one proposal to two or more persons. In addition, shareholders may not amend their vote through the online voting system after directly voting online or entrusting other persons to do so on their behalf.

### Supreme Court regulates freezing of cash deposits

The Supreme Court has released a Circular on freezing and withholding settlement funds in securities transactions. The main issues dealt with in the Circular include the following:

* when executing an order against a securities company, the courts will only freeze and withhold funds owned by the securities company, and will not freeze funds in savings accounts specifically opened for client settlement funds;
* in relation to settlement standby reserves, the courts will freeze only own-business standby reserves exceeding certain minimum amounts, and will not freeze and withhold standby reserves for customer settlements deposited by securities companies with depository and clearing companies;
* the courts will not freeze and withhold funds in special IPO capital verification accounts which are opened by depository and clearing companies with settlement banks;
* in relation to execution against tradable securities, the circular provides that the courts will first confirm whether the relevant tradable securities belong to the target of execution; the courts will order outlets of securities companies where the target of execution has opened an account to sell the securities within 30 transaction days, and directly to remit the money realized from the sales to accounts designated by the court.

## Foreign Investment

### Renminbi business licences for foreign-invested banks

Mr. Lai Xiaomin, the director of the Beijing Banking Regulatory Bureau, has disclosed that three foreign-invested banks which initially applied for licences to engage in renminbi business on 1 December 2004 will be granted renminbi business licenses by the end of this month. Mr. Lai stated that currently 7 foreign-invested banks have applied for licences to engage in renminbi business.

## WTO

### Cancellation of import quotas on Chinese textile products

From 1 January 2005, the EU, the USA, Canada and Turkey will be required under WTO rules to cancel all quota restrictions on certain textile imports from China. Exporters will no longer be required to present export licenses when applying to Chinese customs authorities to export the relevant categories of textile products. In addition, the customs authorities of import countries will no longer examine textile export certificates issued by the competent Chinese authorities. Textiles exported before 1 January 2005 are still subject to export licenses.

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