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# China News Alert Issue 234

## Capital Markets

### Chinese banks allowed to trade gold futures

Chinese commercial banks will be allowed to trade gold futures on the domestic market, according to a notice recently released on the regulator's official website.

China gold futures trading was launched in January 2008, but domestic banks were barred from trading by the China Banking Regulatory Commission.

According to the notice, domestic banks that meet certain requirements, such as having a capital adequacy ratio of more than 8 per cent, can apply for a trading permit.

"This is great news for the gold futures market, which is not operating as well as it could," said Hu Yuyue, an expert with Beijing Technology and Business University.

"Commercial banks can provide more liquidity and stability to the market, after all, they hold huge capital," said Hu.

"Gold futures trading can also help domestic banks improve their competitiveness against overseas banks as financial derivatives are supposed to be the largest revenue sources for leading banks," he said.

Non-interest income usually accounts for at least 50 per cent of banking revenue in developed countries and the proportion can reach 80 per cent for some banks. However, Chinese banks depend heavily on the margin between deposits and loans.

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2008-03/25/content_6563720.htm) ([see archive](Chinese_banks_allowed_to_trade_gold_futures.pdf))

### CSRC to extend the pilot program for direct investment by securities firms

The China Securities Regulatory Commission (CSRC) has recently made further arrangements regarding direct investment by securities firms.

It will extend the pilot program, and will allow qualifying securities companies to apply for direct investment business.

The CSRC requires that securities companies engaged in the pilot scheme have net assets valued at no less than 2 billion yuan, mature internal control and risk management systems and a qualifying capacity for investment banking business.

They must have acted as the major underwriter for stocks and convertible bonds on over 10 projects in the past three accounting years, or the sum of the underwriting work must exceed 15 billion yuan.

In September 2007, the CSRC allowed the CITIC Securities Company Limited and the China International Capital Corporation Limited to launch a pilot direct investment business.

The two companies used their own capital valued at less than 15% of their net assets to establish directly-invested subsidiaries. The subsidiaries have been investing their own capital under a well-established management system for decision making, internal control and risk control.

The CSRC will strengthen the monitoring of the pilot program, and resolve any problems in a timely manner.

[Shinese source: Xinhua](http://news.xinhuanet.com/finance/2008-03/28/content_7872173.htm) ([see archive](CSRC_to_extend_the_pilot_program_for_direct_investment_by_securities_firms.pdf))

### Tighter monetary policy to stay

China's central bank said recently that it will maintain its tight monetary policy to keep inflation under control, despite a possible global slowdown that may depress China's economy.

The People's Bank of China said in a statement that although economic growth is stable, the country faces increasing pressure from a potential investment upswing and excessive lending and liquidity. Meanwhile, global uncertainties and risks are rising as the US subprime crisis worsens.

"The pressure from rising prices is evident," the statement said. The central bank also urged the government to take measures to increase the supply of goods and anchor inflationary expectations to ease pressure.

The central bank suggested multiple tools be used to keep lending under control. The nation's new yuan loans in the first two months amounted to 1.05 trillion yuan, 69.2 billion yuan more than the same period last year.

But it said regulators should exercise flexibility in carrying out a tighter monetary policy and increase lending for sectors like agriculture, employment and small business to help rebalance the economy.

It also said it will continue to let the yuan be guided more by market forces and develop exchange rate policy in a proactive way.

[Source: English People's Daily Online](http://english.people.com.cn/90001/90776/90884/6384496.html) ([see archive](Tighter_policy_to_stay.pdf))

### China reiterates call for risk assessment in financial product sales

China's banking supervisor reiterated that banks should evaluate fully investors' risk tolerance after difficult market conditions led to the liquidation of an investment fund product.

The China Banking Regulatory Commission (CBRC) said that it requires risk warnings to be highlighted in manuals and agreements for investment products.

The statement followed China Mingsheng Banking Corporation's liquidation of a qualified domestic institutional investor (QDII) fund, which raised concerns about a wider failure of QDII products. QDIIs were set up to allow Chinese investors to invest in overseas capital markets.

Minsheng sold 100 million shares in its QDII product at 1 yuan (US$0.14) each last October. The product was attached to a Hong Kong-based Baring fund, which plunged amid the global credit crisis.

On 19th March, Minsheng said that it would liquidate the fund and repay investors, as required if the fund's assets fell below 50 per cent of their initial value.

The CBRC said that banks should be more scrupulous about dealing with clients, notably the elderly and those with lower incomes.

Sources within the commission said that it was developing detailed rules to standardise financial product sales, noting that banks failing to seriously consider investors' risk tolerance would face penalties.

Financial products mushroomed in 2007 as the mainland capital markets experienced an unprecedented boom. Many Chinese banks have emphasised high yields and low risks when selling these products, irrespective of clients' risk tolerance.

Chinese commercial banks have offered 1,302 Renminbi-dominated products and 1,760 foreign currency-dominated products, raising nearly 1 trillion yuan, according to a research paper released by the China Academy of Social Sciences.

The domestic financial markets, however, turned sour as the U.S. credit crisis began to unfold and spread, pushing many QDII funds and products into a loss.

The sluggish mainland share market, whose value has fallen more than 40 per cent since October, also made it difficult for many banks to provide the stable returns promised to buyers of various financial products.

Further risks are surfacing in the commercial banks' financial product business, according to the director of the Banking Research Center at the Central University of Finance and Economics, Guo Tianyong, who said that banks should provide timely information and banking regulators should tighten control.

As early as 2005, the CBRC stipulated that banks should carefully weigh investors' risk tolerance. Existing regulations, however, are not explicit enough, said Guo.

[Source: Xinhua](http://news.xinhuanet.com/english/2008-03/28/content_7875872.htm) ([see archive](China_reiterates_call_for_risk_assessment_in_financial_product_sales.pdf))

## Corporate & Commercial

### Service enterprises supported to raise funds on capital markets

25th March 2008 may be a memorable day for the prosperous Chinese service sector. A policy to accelerate the growth of the service sector through support from financial institutions was released by the People's Bank of China, the China Banking Regulatory Commission, the China Securities Regulatory Commission and the China Insurance Regulatory Commission.

The policy requires that financial support be provided to the service sector, especially to key areas or vulnerable segments.

China will positively support qualifying service enterprises to raise funds, via offering stocks and corporate bonds, on domestic and offshore capital markets. It will give priority to the approval of service enterprise groups to set up non-banking financial institutions such as financial companies.

China will encourage various venture capital institutions to provide services to small and medium-scale service enterprises that have good development potential and support the development of service outsourcing.

[Source: China.com.cn](http://www.china.com.cn/economic/txt/2008-03/26/content_13549455.htm) ([see archive](Service_enterprises_supported_to_raise_funds_on_capital_markets.pdf))

### China defines conditions for foreign takeovers of banks

China's banking regulator has for the first time defined conditions under which foreign financial institutions may acquire control of domestic banks.

According to a draft released for comment by the China Banking Regulatory Commission (CBRC) recently, "controlling shareholder" will refer to any corporation that "directly or indirectly holds more than 25 per cent" of a bank's voting shares, including foreign financial institutions.

"Controlling shareholder" can also mean those who are entitled to manage a bank's financial and operational affairs, hold the right to dismiss and appoint members of the board or similar bodies, have majority voting rights on the bank's board, or any other condition the CBRC defines as having a controlling influence, it said.

Overseas financial institutions that wish to take control of Chinese banks must comply with prudential regulations, the draft stated without elaborating.

Other requirements include solid management, sufficient experience and a good record over the past three years.

Funds used in the acquisition must be internally generated.

Foreign financial institutions must also follow rules imposed by other Chinese financial regulators, it said.

[Source: English. China.com](http://english.china.com/zh_cn/business/news/11021613/20080328/14754612.html) ([see archive](China_defines_conditions_for_foreign_takeovers_of_banks.pdf))

### One third of audited foreign-aided projects in China have accounting flaws

A recent report from China's National Audit Office said the financial management or accounting methods of 42 foreign-aided projects were below standard or invalid.

Last year the office audited 117 projects, of which 89 were supported by foreign aid and 28 by foreign loans, said a report released on the office's official website.

Out of the 42 foreign-aided projects, some had failed to set up standard accounting books, some had incomplete account management and some had failed to complete accounts on time, said the report without giving further details.

However, it said that all the flaws had been corrected by the end of November 2007.

Among the 117 audited projects, 23 projects fell behind schedule, while domestic funds failed to support 11 projects as promised making a total shortfall of 1.4 billion yuan. The report added that 70 per cent of the funds had been allocated by November 2007.

Local authorities or project contractors withheld the funds for four projects, involving 31.3 million yuan, while another four projects had substandard tender processes, involving 27.8 million yuan.

About 88 per cent of withheld funds had been released by November 2007, the report said.

The report stated that some projects had a combination of problems.

The total investment for the 117 projects, ranging from agriculture to environment protection, is expected to hit 173.3 billion yuan (US$ 24.6 billion).

[Source: China Securities Journal](http://www.cs.com.cn/english/ei/200803/t20080325_1408935.html) ([see archive](13_of_audited_foreign-aided_projects_in_China_have_accounting_flaws.pdf))

## Taxation

### Trial measures adopted for recording tax prior to external service trade payments

The Chinese State Administration of Foreign Exchange (SAFE) and the State Administration of Taxation (SAT) jointly issued a circular stating that, beginning from 1st April, a tax record must be filed before a payment to an overseas service provider is made in Tianjin, Shanghai, Jiangsu, Sichuan, Fujian and Hunan.

Under the circular, domestic firms registered in the aforementioned regions must submit one copy of the relevant contract to their local taxation authority and file a record in advance if they intend to make an overseas service payment for over US$50,000 or equivalent. No record must be made for overseas service payments under US$50,000 or equivalent.

The circular also stipulates that domestic firms must record their tax before each payment where the same contract requires several payments. Domestic firms shall claim and file their tax with tax authorities within a certain time limit in accordance with relevant laws and regulations.

[Source: Sina](http://finance.sina.com.cn/stock/t/20080331/05342111147.shtml) ([see archive](Trial_measures_adopted_for_recording_tax_prior_to_external_service_trade_payments.pdf))

## Real Estate

### Land use and property tax payments to be checked

China's State Administration of Taxation, Ministry of Finance and Ministry of Land and Resources have jointly issued a notice to regulate land taxation.

Various tax authorities and land authorities are required to strengthen collaboration and establish a long-term mechanism for cooperation.

Tax authorities and land authorities will jointly check and investigate land use and land tax payments.

Enterprises located in urban-rural fringes or those covering a large area will be strictly monitored. Foreign-invested enterprises and foreign enterprises will be inspected thoroughly.

Land and resource authorities will provide relevant data to tax authorities in a timely manner.

Where the registered area is inconsistent with the actual area used, tax shall be collected according to the latter.

[Source: China.com.cn](http://www.china.com.cn/economic/txt/2008-03/29/content_13842385.htm) ([see archive](Land_use_and_property_tax_payments_to_be_checked.pdf))

### Shanghai local banks told to exercise caution over mortgage lending

Shanghai's banks have been told to exercise caution over mortgage lending to help combat speculation and stabilise property prices.

Shanghai's banking regulator has said that all local banks must abide by strict mortgage lending policies and that spot checks will be conducted.

The statement is in response to recent media reports that domestic banks were lowering lending standards to second-home buyers in order to boost mortgage sales, which contribute a large amount to bank profits.

Analysts said the government will maintain its policy to cool the overheated property market, although an investment slowdown and falling house prices have been seen in major cities like Shanghai, Beijing and Shenzhen.

The central bank and the China Banking Regulatory Commission (CBRC) raised the requirement for mortgage deposits last year for second-home buyers to at least 40 per cent, with a 10 per cent premium on the interest rate.

China Construction Bank, one of the nation's Big Four lenders, said recently that second-home buyers will get favourable policies and a lower interest rate if family members have a living area of less than 26.6 sq m (280 sq ft) in their first home.

Other banks have followed suit. The move is seen as a relaxation of the housing policy that could reactivate the property market at a time when transactions are falling. Authorities investigated but found no policy violations.

"Domestic banks in Shanghai are following policy regulations in their mortgage lending to second-home buyers," the CBRC's Shanghai office said. "No relaxation of the standards was found."

But the regulator is monitoring the situation, warning banks of potential risks in a liquidity-driven property boom.

It said most banks have adjusted their mortgage lending, distinguishing between genuine homebuyers and speculators.

[Source: China Securities Journal](http://www.cs.com.cn/english/ei/200804/t20080401_1416110.html) ([see archive](Local_banks_told_to_put_brakes_on_mortgages.pdf))

## Other

### Move to 'Go West' reaps encouraging rewards

China's "Go West" policy to develop lagging western regions is gaining ground, a United Nations report has shown.

The positive signs come largely from government efforts to improve trade and investment, the UN Economic and Social Commission for Asia and the Pacific (ESCAP) said in its latest annual survey of the region.

The report highlighted that trade, specifically exports, in western regions has shown a more rapid rise than that in coastal regions.

"A particularly encouraging trend for China's neighbours is the relatively rapid export growth seen in many western regions," the survey said. "The government is encouraging this trend through extensive projects to improve cross-border transportation."

The country's Xinjiang Uygur Autonomous Region, which shares borders with Afghanistan, Kazakhstan, Kyrgyzstan, Mongolia, India, Pakistan, Russia and Tajikistan, is being seen as China's gateway to Central Asia. The region's trade with Central Asia has tripled since 2002, reaching a record US$9 billion in 2006, the report said.

In the Guangxi Zhuang Autonomous Region, cross-border trade has also grown with neighbouring Vietnam, rising by close to 50 per cent in 2006 to US$1.8 billion. Similarly, Yunnan province's trade links have reportedly expanded with Laos, Myanmar and Vietnam, while Mongolia and Russia have reported rapid increases in trade with the Inner Mongolia Autonomous Region.

The "Go West" policy, launched in 1999, is aimed at narrowing per capita gross domestic product income disparities, currently considered to be among the highest in the world, ESCAP reported.

Priorities for the western development strategy include infrastructure construction, environmental protection, industrial upgrading, human capital accumulation, and science and technology research.

The report added that growth in western regions was supported by greater foreign direct investment and backed by research and development. "Foreign direct investment, a focus of the 'Go West' policy, increased substantially in a quarter of western provinces," the survey added.

ESCAP said that growth was reported for Tibet, Qinghai, Gansu, Xinjiang, Ningxia, Guangxi, Chongqing and Yunnan, along with a recent rapid increase in foreign direct investment in Sichuan, Inner Mongolia and Shaanxi.

Research and development spending also reportedly grew more rapidly in four of the 12 western regions, Ningxia Hui, Tibet, Inner Mongolia and Xinjiang Uygur, than in most coastal provinces. These, ESCAP said, helped final consumption increase more "in a quarter of western provinces than in the majority of coastal provinces".

The country will see a moderate slowdown in growth this year, but it remains underpinned by strong domestic demand and government social spending despite a slowing United States economy, ESCAP also reported.

The report expected an easing in growth to 10.7 per cent from 11.4 per cent in 2007, the fastest for China in 13 years, as a result of a slowdown in exports and government measures to cool growth.

"Investment continues to be the main driver of growth, remaining resilient despite government cooling measures and with support from low real interest rates," ESCAP said. "A slowdown in exports and the government's measures to cool the economy are the main reasons for the moderation," the survey said.

ESCAP also downplayed any significant impact on China's economy resulting from a downturn in the US economy due to the ongoing subprime credit crisis. "In a worse-case scenario, where the United States economy goes into a recession, the impact on China will not be as great as on other Asia-Pacific countries," it reported.

In terms of China's overall trade, the country witnessed increasing exports to the European Union last year, a shift which compensated for a steady fall in exports to the US, China's second-largest export market, the report said.

The country also witnessed a boom in trade with Africa.

Growth also came in service exports, which rose globally by an average of 16 per cent between 1995 and 2006.

"China had the best performance in transport service exports of all Asia-Pacific countries, growing at 34 per cent per year between 2000 and 2006," ESCAP reported.

However, the country is facing an increasing challenge from inflation. Last year, inflation rose dramatically to 4.8 per cent, the highest in a decade, and three times the 1.5 per cent reported in 2006.

Higher international oil and food prices were identified as chief inflationary concerns. "Rising food prices are a bigger inflationary concern than oil prices because food accounts for a far higher proportion of consumer spending. Food price inflation particularly hits low-income households," ESCAP said in the survey.

The country's fast-paced growth is coming at an increasing cost to the environment, while the loss of arable land to manufacturing also raises concerns, the ESCAP warned.

"The destabilising effect of growth on the environment is becoming more apparent. Air pollution, especially in large cities, is increasing the incidence of lung disease," it said.

[Source: China Securities Journal](http://www.cs.com.cn/english/ei/200803/t20080328_1412952.html) ([see archive](Move_to_Go_West_reaps_encouraging_rewards.pdf))

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