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# China News Alert Issue 240

## Capital Markets

### China tightens rules on listed companies' management incentives

China's securities regulator has issued rules on listed companies' incentive plans in an effort to prevent management officials from making improper gains arising from favorable timing.

Companies must not introduce share option schemes shortly before announcing major decisions, according to two notices issued by the China Securities Regulatory Commission (CSRC).

A listed company must not carry out major actions such as new stock issues, asset injections or bond offerings within 30 days of announcing an incentive plan and obtaining shareholder approval, the CSRC said.

Likewise, companies must not introduce an incentive plan during and / or within a 30-day period after the announcement and completion of major decisions, it said.

The regulation also prohibits shareholders from directly awarding or transferring shares to the object of the incentive plan (i.e. management officials), as some companies have done in order to avoid regulatory scrutiny.

Controlling and major shareholders who hold 5 per cent or more of a company's shares may not be offered incentive plans, except with the approval of shareholders, the memorandum said.

Media reports said that the CSRC's action was taken in response to several companies' recent attempts to introduce incentive plans immediately before disclosing positive information.

"This action will benefit both listed companies and their shareholders, as it improves the regulation of the market," said Li Feng, a Galaxy Securities analyst.

[Source: Xinhua](http://news.xinhuanet.com/english/2008-05/06/content_8116778.htm) ([see archive](China_tightens_rules_on_listed_companies_management_incentives.pdf))

### 66 listed firms cease trading after earthquake

The strong earthquake which hit southwest China's Sichuan Province on 12th May has caused 66 listed companies to cease trading as of 13th May.

These Sichuan and Chongqing-based companies include 45 Shanghai listed companies and 21 Shenzhen listed companies, including Sichuan Road and Bridge Company, Huiyuan Optical Communications Company and Datong Gas Development Company. The stock exchange failed to contact the companies after the earthquake.

People close to the Shanghai Exchange said some of the companies may contact the exchanges in the next few days and relevant information will be published on 14th May.

A 7.8-magnitude earthquake rocked Wenchuan County in Sichuan Province at 2:28 pm on 12th May, and over 1,000 aftershocks have been recorded.

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2008-05/13/content_6680317.htm) ([see archive](66_listed_firms_stop_trading_after_quake.pdf))

### Bank reserve ratio raised for fourth time

The central bank recently announced that it will raise the reserve requirement ratio, or proportion of money banks must set aside in reserves, by half a percentage point.

The move, in a quick response to rising inflation in April, will push the ratio to 16.5 per cent. It is the fourth such increase this year and will take effect as from 20th April.

The increase in ratio will absorb up to 200 billion yuan based on the current lending volume of banks and will affect small banks more seriously, said Zhao Xijun, finance professor of Renmin University of China.

"The move, shortly after the release of April CPI data, was not surprising," Liang Hong and Song Yu, economists with Goldman Sachs (Asia), said in a research note.

The National Bureau of Statistics said April inflation hit 8.5 per cent year-on-year, 0.2 per cent higher than in March. Analysts said part of the reason for such high inflation is excess liquidity in the market, which the latest central bank move can help mop up.

Excess liquidity has been a serious problem since 2007 and many economists have said the authorities may need to raise the ratio to as high as 18 per cent to solve the problem.

But even if it is raised to 18 per cent, it may not effectively curb inflation, said Gao Shanwen, chief economist with Essence Securities.

Liang and Song agreed: "While the move demonstrates the central bank's tightening stance, small hikes in the ratio are not sufficient to control monetary expansion and inflation."

They said the authorities may have to take more measures to curb inflation. "The central bank may implement further tightening measures, including regular hikes to the reserve requirement ratio and benchmark interest rates, continued credit rationing in commercial lending, as well as faster appreciation of the currency."

Some analysts, however, said raising interest rates won't be necessary.

"Food price rises may ease in May, which will slow down overall inflation growth," said Zhao Jianxing, an analyst with China Merchant Securities.

Moreover, since major developed economies, such as the US, are not in an interest rate increase cycle, if China raises interest rates, more speculative money could flood in, he said.

[Source: China Securities Journal](http://www.cs.com.cn/english/ei/200805/t20080513_1456189.html) ([see archive](Bank_reserve_ratio_raised_for_fourth_time.pdf))

### Rules tightened on the trading of non-tradable shares

In order to implement the "Guiding suggestions on the transfer of non-tradable shares of listed companies", the Shenzhen Stock Exchange (SZSE) has recently curbed the trading of previously non-tradable shares to ensure the proper running of the securities market.

The SZSE amended the "Detailed rules on transaction restrictions" by changing the term "transaction restriction not exceeding 15 trading days" to "transaction restriction not exceeding 3 months, and for serious cases the duration will be extended". The amended rules were officially announced on 9th May.

The SZSE also issued the "Notice on regulation of sales of non-tradable shares" which requires members to improve their understanding and promotion of the guiding suggestions and rules, and to become knowledgeable about non-tradable shares.

Effective measures must be taken with over-the-counter transaction systems to monitor illegal trading of non-tradable shares. Yesterday, the SZSE sent a list of 806 companies who hold more than 1 per cent of non-tradable shares to its member companies for reference and implementation.

SZSE also launched an "Announcement urging shareholders to comply with the Guiding suggestions on the transfer of listed companies' non-tradable shares," requiring listed companies to alert and encourage their shareholders to read and understand the guiding suggestion.

Shareholders of non-tradable shares should be guided to sell shares through a bulk transaction system. There are a total of 9 shareholders from 5 listed companies trading their shares through the system.

The operation introduction to the "Guiding suggestions" must be framed to specify the requirements for investors and the relevant regulatory measures to members, listed companies and shareholders.

Principals from the SZSE expressed that strict punishment will be imposed for the illegitimate trading of non-tradable shares. For shareholders who had such deeds, no application for new trading of non-tradable shares will be accepted within a certain duration.

The extended transaction restriction period will last from between six months to one year.

China Securities Regulatory Commission (CSRC) will investigate such cases, capital accounts will be frozen, exceeded shares must be bought back and illegitimate benefits must be turned in.

It was also revealed that the SZSE has announced the decision regarding the punishment of Fujian Henglian Stock Company Limited following the transaction restriction imposed on the company on 6th May 2008. Such actions will be kept in a credit report and CSRC will undertake further investigation of the case. Fujian Henglian Stock Company Limited made a public apology and promised not to sell any shares of Guanfu Modern Household Wares (SZSE: 002102) before 31 December 2008.

[Source: Shenzhen Stock Exchange](http://www.szse.cn/main/en/aboutsse/marketnews/2008050912490.shtml) ([see archive](Tighten_rules_on_trading_of_non-tradable_shares.pdf))

## Corporate & Commercial

### Illegal disclosure may result in prosecution

If corporations and enterprises that are obliged to disclose information, provide false financial statements or conceal important facts from their shareholders and the public, which result in direct economic loss by shareholders, debtors or other parties of over 5 million yuan, they will be prosecuted.

The Supreme People's Procuratorate and the Ministry of Public Security have specified standards for prosecution over the following violations: illegal information disclosure; non disclosure of important information; perfidious damage of the interests of listed firms; insider trading; revealing inside information; manipulation of the securities and futures markets; and the perfidious use of entrusted property.

These standards are contained in the 'Supplementary Provisions on the Standards of Prosecution of Cases of Economic Crimes' jointly released by the two authorities on 12th May.

Also, people aware of inside securities and futures trading information will be prosecuted if they purchase or sell securities, or disclose inside information to other parties who then purchase or sell securities, prior to the disclosure of significant information, resulting in an accumulative value of over 500,000 yuan.

[Source: Lexis Nexis](http://hk.lexiscn.com/latest_message.php?id=3811) ([see archive](Illegal_Disclosure_May_be_Prosecuted.pdf))

### State firms get help to enter into key economic sectors

China's state asset regulator has expanded the businesses of three large government-owned groups in key economic sectors, including energy, food and mining, to boost the competitiveness of state-owned enterprises (SOEs) against a possible economic slowdown.

A slowdown is feared due to weaker external demand and tight monetary policies to tame inflation.

China Guodian Group will enter the coal mining business for power generation purposes, the State-owned Assets Supervision and Administration Commission (SASAC) said in a notice recently posted on its website.

The regulator also permitted Cofco, China's largest grain trader, to start the processing and sale of livestock products as well entering the food packaging business, according to the notice.

China Poly Group, the country's largest state-owned property developer, will diversify into mineral resource exploration, the notice said.

''These companies should increase efforts to build up strategic management and bolster their core businesses while controlling investment in other non-core sectors,'' the SASAC said in the notice.

''The new businesses will help these companies open new revenue channels,'' said Lin Wenyi, a China Securities analyst. ''The mining business will help Guodian cut costs.''

Li Rongrong, director of the SASAC, said late last month that SOEs should try to prevent possible capital shortages from disrupting normal business operations and that they must prepare for two years of tight monetary policies.

Although combined revenue of the 150 large SOEs jumped 27.1 per cent to 2.6 trillion yuan (US$371 billion) in the first three months of 2008, their combined profit fell 2.9 per cent to 203.4 billion yuan.

Companies in the oil and power sectors suffered greater profit losses than other sectors because government policies prevented them from passing on higher costs to consumers.

[Source: Shanghai Daily](http://www.shanghaidaily.com/news/20080508/358719) ([see archive](State_firms_get_help_to_enter_into_key_economic_sectors.pdf))

### China's FDI surges though fewer foreign-funded companies approved

China saw US$35.02 billion worth of foreign direct investment (FDI) utilised in the first four months of 2008, up 59.32 per cent from the same period of 2007, the Ministry of Commerce (MOC) said recently.

The number of newly approved foreign-funded enterprises, however, shrank by 23.15 per cent to 9,490 in the January-April 2008 period.

Zhang Hanya, director of the Research Institute of Investment with the National Development and Reform Commission, said the latest figure showed that China remained a favorite destination for overseas investment, especially big investors like the top 500 multinationals, which saw market potential as the most important priority.

China's new policies on foreign investment and rising labour costs may have deterred the establishment of some small-scale foreign-funded companies, but large companies have accelerated their investment in China recently to beat the appreciation of the yuan, Zhang said.

China's FDI utilisation has been rising steadily this year, despite a fall in the number of newly approved foreign-funded enterprises, since a series of new measures were introduced to regulate foreign investment.

The country has leveled corporate income tax rates for foreign companies with that for domestic companies. It also published a new catalogue to encourage overseas investors to invest in high-tech, or environment-friendly projects.

The actual use of FDI in January 2008 jumped 109.78 per cent from a year earlier, and the figure rose by 61.26 per cent in the first quarter.

Foreign direct investment has contributed to China's excess liquidity and massive build-up in foreign exchange reserves, which were the world's largest (US$1.68 trillion) at the end of March 2008.

[Source: Xinhua](http://news.xinhuanet.com/english/2008-05/12/content_8154150.htm) ([see archive](Chinas_FDI_surges_fewer_foreign-funded_companies_approved.pdf))

### Chinese mainland firms to lead M&As in Asia

Chinese mainland financial firms are likely to be the most active in merger and acquisition activity in Asia, despite the United States credit crisis, an industry survey said recently.

Asian firms are undaunted by the credit crisis and 40 per cent of respondents believe the credit crisis will actually increase the volume of M&A activity, PricewaterhouseCoopers (PwC) said in a survey.

The figure rose to 50 per cent on the Chinese mainland for possible mergers and acquisitions this year. The figure increased to 71 per cent when talking about possible M&A activities in five years, the accounting firm said.

The US subprime crisis has led to sizable write-downs among big-name financial firms like Citigroup and UBS. However, it also created opportunities for companies with ample capital to buy stakes at relatively low values in firms involved in the crisis.

More M&A cases are expected this year on the Chinese mainland, though the value of deals may drop, PwC said.

"Cross-industry M&A activity has developed into a trend as financial companies are seeking to grow as all-around financial institutions," said Nelson Lou, a PwC partner.

More M&A activity is likely in the retail banking sector, among brokerages, asset management companies and private banking, the report said.

In the first quarter of 2008, about 70 per cent of financial M&As were made in the trust and fund industries, with the remaining in the banking and insurance industry.

The findings were based on a survey of 281 senior executives in Asia with 22 per cent of respondents on the mainland and Hong Kong.

The Chinese mainland is the second biggest active market in Asia for financial services, with M&A deals valued at US$16.2 billion in 2007, up from US$11 billion in 2006.

About 86 per cent of respondents on the mainland said their institution had been involved in an M&A deal in the past three years.

[Source: CRI](http://english.cri.cn/3130/2008/05/13/1461%40356808.htm) ([see archive](Chinese_Mainland_Firms_to_Lead_Mhttp%3A//english.cri.cn/3130/2008/05/13/1461%40356808.htm) ([see archive]As\_in\_Asia.pdf))

## Other

### Draft implementation regulations for labour law issued

China's Legislative Affairs Office of the State Council has recently published the draft of implementation regulations for the Labour Contract Law in order to solicit public opinion.

The draft mainly addresses terms of labour contracts, and economic compensation after a labour contract is terminated.

The Labour Contract Law, which took effect on 1st January 2008, entitles employees of at least 10 years' to sign labour contracts with no fixed termination date.

The term caused some confusion amongst the general public and employers. Some people said it would weaken enterprise vitality.

Legal experts, however, said the term aims to promote a sense of stability among employees and a harmonious relationship between employees and employers. A labour contract with no fixed termination date did not amount to a lifetime contract. Termination of such contracts are possible if there are legitimate reasons.

The draft stipulates that under circumstances including an employee's incompetence to meet job requirements during the trial period, serious violation of regulations and dereliction of duty, employers could terminate a labour contract with no fixed termination date.

Bankruptcy would also justify the termination of contract, according to the draft.

The draft stipulates that employers should double the amount of compensation if they terminate the contract at their own will.

After the implementation of the Labour Contract Law in January, a string of staff-sacking scandals in many companies followed. The most infamous of these is the "voluntary resignation" scheme implemented by the Guangdong-based Huawei Technologies Co Ltd, China's telecom network equipment giant.

Huawei asked staff who had worked for eight consecutive years to hand in "voluntary resignations". Staff would have to compete for their posts, and sign new labour contracts with the firm once they were re-employed.

[Source: China.com](http://english.china.com/zh_cn/news/china/11020307/20080509/14831129.html) ([see archive](Draft_Regulations_for_Labor_Contract_Law_Issued.pdf))

### China launches first research center for the WTO dispute settlement mechanism

A research center for the World Trade Organisation (WTO) dispute settlement mechanism was set up in Shanghai recently, the first of its kind in the country.

The China-WTO Dispute Settlement Mechanism Center will offer suggestions and solutions to government and businesses involved in trade disputes, said Gong Baihua, deputy director of the center.

The center was jointly founded by the Shanghai Institute of Foreign Trade and the Shanghai WTO Affairs Consultation Center, a non-governmental organisation.

"Such a research institute will help Chinese government and businesses further familiarise themselves with WTO rules and learn how to resolve disputes using the dispute settlement mechanism," said Zhang Yuejiao, one of the five counselors for the center.

In November last year, Zhang was appointed by the WTO Dispute Settlement Body (DSB) as a member of the seven-person Appellate Body, which issues final rulings in trade disputes. She is the first Chinese judge in the WTO's highest court.

China has faced a number of trade disputes in the seven years since the country joined the WTO.

[Source: People's Daily Online](http://english.peopledaily.com.cn/90001/90776/90884/6408352.html) ([see archive](China_launches_first_research_center_on_WTO_dispute_settlement_mechanism.pdf))

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