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# China News Alert Issue 246

## Capital Markets

### CSRC tightens scrutiny of companies

China will tighten its supervision of listed companies in order to fight insider trading, false information and misuse of funds, said Fan Fuchun, vice chairman of the China Securities Regulatory Commission.

During a recent meeting, Fan demanded that senior executives and large shareholders improve internal supervision and said the regulator would introduce harsher punishments in order to protect investors, according to the commission's website.

Fan also briefed media about alleged fund misappropriations by Zoje Sewing Machine Company Limited and Shandong Jiufa Edible Fungus Company Limited.

According to earlier reports, 13 senior executives with Zoje Sewing Machine have been punished after the misappropriation of more than 169.8 million yuan (US$24.6 million). The assets of Shandong Jiufa's biggest shareholder have been frozen after more than 500 million yuan was discovered missing.

Fan said the two cases have been transferred to police for further investigation.

Fan asked listed firms to increase training and organise special seminars for their board members, senior managers and accountants to familiarise them with regulations.

His remarks came as China's stock markets continued to plunge, and the regulator issued statements to boost confidence among investors.

Shang Fulin, chairman of the commission, said on 22nd June that China will spare no efforts to facilitate the stable growth of the country's capital market.

Li Deshui, former director of the National Bureau of Statistics, said recently that China's overall economic situation was healthy, so recent market tumbles should be a temporary phenomenon.

He said the corrections wouldn't last long and China's markets won't let down mature investors.

[Source: China Securities Journal](http://www.cs.com.cn/english/ei/200806/t20080625_1504496.html) ([see archive](CSRC_tightens_scrutiny_of_companies.pdf))

### Shorter lockup time for foreign firms

China has agreed to shorten the lockup period for the capital of more overseas institutional investors in its stock market in the latest move to open the capital industry to foreign participation.

Overseas governments, monetary authorities, charity funds and donation funds are now subject to a three-month lockup period for the invested principal, reduced from one year, a joint statement issued by China and the United States said.

The statement, which was issued after the fourth Sino-US Strategic Economic Dialogue, said that open-end funds established by foreign institutions to buy yuan stocks will also have their lockup period cut from a year to three months.

The statement did not say when the change will happen.

In 2006 China's stock watchdog shortened the lockup period for repatriation to overseas pension, insurance and mutual funds to three months from one year.

"The process to open the market is gradual but it's proceeding," said Wu Ke, a Zhongtian Investment Consulting Company analyst. "It will help boost foreign interest in local stock investment now that they can get their money back more quickly."

China introduced the Qualified Foreign Institutional Investor scheme in 2003, under which selected overseas institutions are allowed to trade yuan-denominated shares under specific quotas.

Amid lobbying from foreign financial firms to open the market more, China agreed in late 2007 to raise the combined QFII quota to US$30 billion after the initial US$10 billion was used up.

China will also allow non-deposit-taking foreign financial institutions to provide consumer finance to local retail customers on the mainland, according to the joint statement. China will permit qualified foreign firms to list on its stock exchanges through issuing shares or depository receipts and will allow qualified foreign incorporated banks to issue subordinated yuan-backed bonds, the statement said.

The Shanghai Stock Exchange has said it's looking to set up an international board to ease local listings by overseas-incorporated firms.

[Source: China.org.cn](http://www.china.org.cn/business/news/2008-06/20/content_15859987.htm) ([see archive](Shorter_lock-up_time_for_foreign_firms.pdf))

### Spotlight on cross-border trade

China will improve the management of cross-border capital flow to prevent short-term "speculative capital" investments damaging China's economy, the nation's top foreign exchange regulator said.

The forex regulator will increase efforts to ensure forex transactions are based on real trade activities, said the State Administration of Foreign Exchange on its website recently, citing Hu Xiaolian, the head of regulation.

The US subprime crisis and the trend of major forex rates, together with international energy and food prices are affecting the flow and scale of international capital.

China faces bigger challenges under such conditions to avoid the impact of international short term capital and keep its financial stability, Hu said.

She said there needed to be an improvement in trade credit management. "The management of short term foreign debt will also be strengthened," Hu said. She said China will stick to its tight monetary policy to prevent overheating and to fight inflation.

China's foreign exchange reserves were reported to have increased to US$1.76 trillion as of 30th April, the largest rise this year.

China's trade surplus topped US$16.68 billion in April while monthly foreign direct investment sat at US$7.6 billion.

Concerns over speculative capital, together with the decision to fight inflation, have already pushed the People's Bank of China to raise banks' reserve requirement ratio to a 23-year high, said Lu Zhengwei, an Industrial Bank chief economist.

[Source: China Securities Journal](http://www.cs.com.cn/english/ei/200806/t20080625_1504438.html) ([see archive](Spotlight_on_cross-border_trade.pdf))

### Shareholders of securities companies must promise a shareholding term

On 19th July the China Securities Regulatory Commission (CSRC) released two guidelines specifying the requirements for securities companies' shareholding terms if they expand their shares or modify their shareholders and actual controllers holding over 5% of shares in the company. They must promise to hold the stocks for three to five years.

According to the 'Securities Company Administrative Licensing Examination and Verification Guidelines No.10: Requirements on the Examination and Approval of Investment Increase and Share Expansion and Modification of Shareholders and Actual Controllers Holding over 5% of Equities of Securities Companies' if the major shareholders or actual controllers of a securities company increase their investment or accept equities, they must promise not to transfer their equities within 60 months, and other shareholders must promise not to transfer their equities within 36 months.

For securities companies without major shareholders or actual controllers, their shareholders must promise not to transfer their equities within 48 months.

According to the 'Guidelines for Record Filing of Securities Companies for the Modification of Shareholders Holding Less than 5% of Shares' when securities companies change their shareholders holding less than 5% of shares, they must file related documents with the local registration securities bureau in advance. The bureau then will review the documents by referring to the examination and verification requirements, focusing on the share participation of the parties accepting the shares and related work done by the securities company.

[Source: Lexis Nexis](http://hk.lexiscn.com/latest_message.php?id=4152) ([see archive](Shareholders_of_Securities_Companies_must_Promise_a_Shareholding_Term.pdf))

## Corporate & Commercial

### China to raise prices of refined oil and electricity

China's top economic planner recently announced that the country will raise the prices of gasoline, diesel oil, aviation kerosene and electricity, revealing an unprecedented plan to raise energy prices.

Beginning 20th June, benchmark gasoline and diesel oil retail prices will be raised by 1,000 yuan (US$144.9) per tonne, and the price of aviation kerosene will increase by 1,500 yuan per tonne.

The prices of natural gas and liquefied petroleum gas will be left unchanged, according to the National Development and Reform Commission (NDRC).

The benchmark retail prices of gasoline and diesel oil will be lifted to 6,980 yuan and 6,520 yuan per tonne, up more than 16 per cent and 18 per cent respectively.

The price rises translate into increases of 0.8 yuan and 0.92 yuan per litre, the measurement used at service stations in China, for gasoline and diesel oil respectively.

The commission said the oil price adjustment has been made to ensure supplies in the country by diminishing the gap between continuously rising international crude prices, especially since February, and state-set domestic oil prices.

The government-controlled oil prices on the domestic market can be blamed for a shortfall of supplies, as some refineries stopped or cut back on processing to avoid losses, said an unidentified NDRC official.

The commission said more subsidies will be offered to farmers, public transport, low-income families and taxi drivers to cushion the impact of the price rises.

For instance, farmers will receive an extra five yuan per mu (1/15 hectare) of farmland in subsidy; low-income families in cities will receive an extra 15 yuan per person every month starting from July, and 10 yuan for such families in rural areas.

The commission said fares for passenger travel by rail, urban and rural public transport and taxis will remain unchanged after the rise.

The official did not comment on the impact of oil price rises on the inflation rate, which eased to 7.7 per cent in May. In April, it rose 8.5 per cent after a 12-year high of 8.7 per cent in February.

The commission also said the average electricity tariff will be raised by 2.5 cents per kwh starting from 1st July, up an average of 4.7 per cent. It said the price rise was made in response to the rising costs of the country's power plants, including rising power coal prices, increased costs by desulphuration facilities and investment in grid upgrading.

More than 80 per cent of all the power generation companies suffered losses in the January-May period due to power coal price rises.

Official statistics showed that power coal prices have risen by more than 80 yuan per tonne over the past two years. Prices have risen by 60 yuan since the beginning of 2008.

The commission also announced that China will exercise a temporary price intervention on power coal as of 31st December, and power coal prices were capped below the price on 19th June.

The policy was adopted as the commission expected the power-coal price to rise further due to the gap between domestic and international prices and tight supplies.

The commission also said that urban and rural residents, sectors including farming and fertiliser production, as well as the earthquake-hit provinces of Sichuan, Shaanxi and Gansu, will be exempt from the price rise. Industrial and commercial ventures should only feel a limited impact, as power expenses usually account for a small portion of their total costs, it said.

"The price rise in electricity will not have a fundamental impact on the country's inflation rate," said the NDRC official.

[Source: People's Daily Online](http://english.people.com.cn/90001/90776/90884/6433675.html) ([see archive](China_to_raise_prices_of_refined_oil_electricity.pdf))

### Top economic planner calls for check on inflation

Two days after increasing fuel and electricity prices, the National Development and Reform Commission (NDRC) said regulators have to monitor prices more tightly and prevent the prices of industrial products from rising.

Manufacturers have to cut production costs, instead of raising the prices of their products, the NDRC said, and suggested that local governments cut administrative charges.

The retail prices of gasoline and diesel were raised by 0.8 yuan and 0.92 yuan per litre recently. Aviation fuel increased by 1,500 yuan a ton, with electricity tariffs for commercial establishments rising up by 0.025 yuan per kWh from 1st July.

The price rises, however, will not have any effect on public transport and taxi fares or household electricity charges.

Government departments must stick to the price adjustment policies, the NDRC said, and warned that people who push up prices illegally will face severe punishment.

Many economists are worried that the price rises could further push up the inflation rate, which showed signs of easing last month. The consumer price index (CPI), the main gauge to measure inflation, eased to 7.7 per cent in May, thanks to falling food prices. The figure was 8.5 per cent in April, up from 8.3 in March.

Before oil prices and electricity tariffs were raised, market analysts had expected the CPI to continue its fall in June and July.

It is likely to remain stable, Xu Kunlin, deputy head of NDRC's pricing department, said. This is because the prices of goods relating directly to people's lives remain unchanged.

[Source: China Daily](http://www.chinadaily.net/bizchina/2008-06/23/content_6785724.htm) ([see archive](Top_economic_planner_calls_for_check_on_inflation.pdf))

### M&A is the current key to expansion

Chief executives of China's domestic firms prefer to use mergers and acquisitions to expand, using the mechanism three times more often than their foreign counterparts, an International Business Machines survey shows.

M&A is necessary for Chinese home-grown firms to expand or hasten globalisation, but business leaders should not underestimate challenges such as talent, culture and legacy problems, the IBM Global CEO Survey report said.

About 78 per cent of Chinese firms prefer to expand through M&A compared with a global level of 24 per cent, according to the survey, which conducted face-to-face interviews with 1,130 CEOs in 40 countries. The majority of foreign firms (63 per cent) choose to expand through organic growth, according to Nigel Knight, managing partner of IBM China's global business services division.

The figures suggest it is the right time for Chinese firms to acquire companies to ensure leading positions and global expansion.

"Foreign firms also face strict regulation [on M&A] in China," Knight said.

Through M&A, especially global acquisition, Chinese firms can gain required technology, an overseas market footprint and to cut costs, said Gorden Xu, IBM China GBS partner.

In 2007, Chinese firms issued 37 cross-broad acquisition cases, including the country's biggest bank's acquisition in South Africa, compared with 17 in 2006. The Chinese M&A trend has "taken off," according to Zero2IPO, a Beijing-based investment consulting firm.

The Industrial and Commercial Bank of China last year reached an agreement to acquire a 20 per cent stake in South Africa's Standard Bank for US$5.46 billion.

[Source: China.org.cn](http://www.china.org.cn/business/news/2008-06/24/content_15879583.htm) (see archive ([see archive](M_and_A_is_the_current_key_to_expansion.pdf))

## Other

### China to publicise public bidding fraud

China's top economic planner said recently that it will publicise incidences of fraud in public bidding from next year.

The move was aimed at standardising the nation's public bidding market, cracking down on illegal activities and promoting self-discipline in public bidding, the National Development and Reform Commission (NDRC) said.

Under the provisional regulations for publicising fraudulent activities in public bidding, promulgated by the NDRC and nine other ministerial departments, records of criminal offences in public bidding will be a key reference in judging the qualification of the relevant public bidding agency and the tender winner.

The records will be made public via a planned national credit system of public bidding activities, according to the provisions.

Under Chinese law, public tenders must be carried out in selecting suppliers or contractors for major government procurement and infrastructure projects.

[Source: China Securities Journal](http://www.cs.com.cn/english/ei/200806/t20080624_1503049.html) ([see archive](China_to_publicize_public_bidding_fraud.pdf))

### State asset law under second review

China's top lawmakers recently began discussing key issues concerning the management of the country's 30-trillion-yuan (US$4.3 trillion) worth of State assets, after being presented with a revised draft law.

Li Shuguang, a professor at the China University of Politics and Law, who was involved in drafting the law on State assets, said the revision, which is having its second reading, includes major changes from the first draft, which was reviewed in late 2007.

One of the key changes is that if "malicious collusion" is found to have taken place in a deal involving State assets, leading to the loss of assets, the deal is deemed invalid, Li said.

"This is necessary to prevent irregularities that often lead to the loss of State assets," he said.

"However, it may also create uncertainties in the market, as people may become reluctant to get involved in State asset-related deals for fear they could be cancelled unexpectedly," Li said, adding that it is a dilemma for lawmakers.

Controversy could also arise over Article 24, he said, which allows board chairmen to also act as general managers if investor agencies or shareholders agree.

Board chairmen serving also as general managers is a reality in some local State enterprises, Hong Hu, deputy director of the Law Committee of the National People's Congress, told the ongoing third session of the 11th NPC Standing Committee, adding that the stipulation is in line with the existing Company Law. "But it is a basic principle of the modern market economy that the roles of board chairman and general manager should be separate," Li said.

The revised draft also clarifies the role of the State-owned Assets Supervision and Administration Commission (SASAC) as an investor in State assets.

The SASAC, which represents the State in more than 150 major State enterprises, has played a dual and often dueling role as both supervisor and investor, legal experts have said.

In a market economy, generally the roles of asset supervisor and investor are not mixed, Li said.

"It is right to make clear which role the SASAC plays, this is obvious progress," he said.

The draft law also stipulates that if needed, central and local governments can authorise other agencies to act as State asset investors. In this way, "it has left a loophole", Li said, adding that the government should be directly involved in investing in assets but leaves it to bodies such as the SASAC.

The draft law does not apply to State financial or resource assets, but Li said a law on the management of the former should be drawn up.

[Source: People's Daily Online](http://english.people.com.cn/90001/6436114_txt.html) ([see archive](State_asset_law_under_2nd_review.pdf))

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