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# China News Alert Issue 249

## Capital Markets

### China's securities regulator advances time of IPO pre-disclosure

According to the latest rule by China's securities watchdog, information regarding initial public offerings (IPOs) awaiting approval will be disclosed earlier, a step towards more transparency in the IPO approval procedure.

Starting from 1st July, the China Securities Regulatory Commission (CSRC) will release an online preliminary prospectus within five work days after an IPO-seeking company and underwriters receive feedback from the CSRC and make revisions.

Before the new rule came into effect, there was no definite requirement on how quickly the IPO prospectus should be published after revisions. The CSRC only ordered that such a disclosure should be made five days before the CSRC meeting for formal approval. This meant that a long period could have passed after a company had revised its prospectus.

The move is aimed at strengthening the supervision of IPOs, enhancing underwriters' awareness of responsibility, and improving the quality of listed companies.

China began to require companies applying for IPOs to pre-disclose their prospectuses before approval in 2006, in an effort to make IPO procedures more transparent and market-oriented.

[Source: China Securities Journal](http://www.cs.com.cn/english/ei/200807/t20080714_1525215.html) ([see archive](Chinas_securities_regulator_advances_time_of_IPO_pre-disclosure.pdf))

### "Hot money" may not be that hot

China's foreign exchange reserve rose by US$11.9 billion to US$1.8 trillion last month, the central bank said yesterday.

The world's largest foreign exchange reserve, however, has raised worries over foreign speculative capital, or "hot money," being pushed into China to cash in on the expected further rise of the yuan.

Economists have given several estimates as to the amount of "hot money" circulating in the country, with the most controversial being US$1.75 trillion, about the same as the total foreign exchange reserve.

But the general estimate is between US$300 and US$400 billion.

It is very hard to say how much of the reserve can be considered "hot money," Li Huafang, an economist with the Shanghai Institute of Finance and Law, said. "So it makes little sense to suspect that a large part of the reserve is made up of "hot money.""

"The increase in the reserve has largely been normal because trade surplus and foreign investments continue to increase," Li said. "And even if there have been unexplained capital inflow, it is hard to define which is speculative and which is for long-term investment."

Some researchers have simply deducted the trade surplus and foreign direct investment from the foreign exchange reserve and cited the difference as "hot money." If that were the case, then the flow of "hot money" in April would have been US$50 billion, a figure many experts shrug off as highly exaggerated.

Li said "hot money" could change into long-term investment if a country's economy is stable. That's why the government should improve its investment environment to encourage incoming capital to stay in the country as long as possible.

"The authorities, however, are capable of monitoring and checking capital flow as China's capital accounts remain under effective control," Li said.

The currency regulators, and the commerce and customs departments have already decided to join together to check the influx of "hot money" by sharing information.

"In the next phase, they should coordinate with banking regulators to monitor capital arriving in the form of foreign direct investment, which too could be a source of 'hot money'," said Zhang Ming, an economist at the Chinese Academy of Social Sciences. It is Zhang who estimated that US$1.75 trillion in "hot money" could have accumulated in the past five years.

The central bank also said yesterday that growth in the broad measure of the country's money supply, or M2, which includes cash and all types of deposits, fell from 18.07 per cent in May to 17.37 per cent in June. The narrow measure of money supply, which includes cash and demand deposits, dropped 3.74 per cent to 14.19 per cent in June.

The two figures prove the government's tightening measures are yielding results, analysts said.

[Source: China.com](http://english.china.com/zh_cn/business/finance/11021621/20080715/14969961.html) ([see archive](Hot_money_may_not_be_that_hot.pdf))

### Securities companies must appoint chief compliance officers

The China Securities Regulatory Commission (CSRC) has outlined in a document released on 14th July that beginning on 1st August, securities companies must appoint a chief compliance officer (CCO). CCOs will be responsible for the examination, supervision and inspection of business management compliance and the practice of securities companies and their working personnel.

According to the 'Trial Provisions on the Compliance Management of Securities Companies', the CSRC will appraise the effectiveness of compliance management in securities companies. Appraisal results will form the base for supervision classifications imposed on the securities company.

In addition, CCOs must not take positions or manage departments conflicting with their compliance management responsibilities. Securities companies are required to guarantee the independence of CCOs and the full exercising of their right to know and right to investigate, which are necessary for the performance of their duties.

[Source: Lexis Nexis](http://hk.lexiscn.com/latest_message.php?id=4331) ([see archive](Securities_Companies_Must_Appoint_Chief_Compliance_Officers.pdf))

## Taxation

### Tax arrangement between the Mainland and Hong Kong is modified

The second protocol on the tax arrangement between the mainland and Hong Kong was recently released by the State Administration of Taxation (SAT).

Residents of one jurisdiction may be taxed on income generated from shares or other rights of the capital of companies in the other jurisdiction if, within 12 months prior to this transaction, the vendor owned, directly or indirectly, 25% of the capital of the company.

In addition, for enterprises from one jurisdiction providing services directly or via their employees or by employing other personnel in the other jurisdiction, including consulting services, the time limit before tax must be paid has been modified from 6 months to 183 days continuously or accumulatively within a 12 month period. This gives a clear and simple definition of the time limit.

The protocol also states that tax may be levied on income gained in the transfer of shares if the company owned at least 50% immovable property within 3 year prior to the transfer of shares.

[Source: Lexis Nexis](http://hk.lexiscn.com/latest_message.php?id=4311) ([see archive](Tax_Arrangement_between_the_Mainland_and_Hong_Kong_Modified.pdf))

## Corporate & Commercial

### China Merchants to open branch in New York

China Merchants Bank has become the first Chinese bank since the adoption of the Foreign Bank Supervision Enhancement Act of 1991 to receive a banking license in the United States and will open a branch in New York this year, the lender said recently.

Merchants Bank, the sixth-biggest bank in China, received the license by New York State Superintendent of Banking, Richard H. Neiman, on 14th July in New York,.

Merchants Bank set up a representative office in New York in 2002 and applied to establish a branch last year. It received regulatory approval from the New York State Banking Department and the Federal Reserve Board of Governors in late 2007.

"The New York branch will facilitate trade and other business activities between the United States and China by providing trade services, financing, dollar clearing and other services to businesses from both countries," said Fang Hui, the

New York branch president of Merchants Bank, in a release dispatched by Business Wire.

Bank of China and Bank of Communications have branches in the US, which were approved in the 1980s, before the Foreign Bank Supervision Enhancement Act of 1991 took effect.

The Beijing-based China Minsheng Banking Corporation has bought a stake in UCBH to strengthen its position in the US.

Industrial & Commercial Bank of China and China Construction Bank have also applied to open branches in the US, but are still waiting for approval from regulators.

[Source: Shanghai Daily](http://www.shanghaidaily.com/sp/article/2008/200807/20080715/article_366886.htm) (Link no longer active)

### Rising FDI reflects inflow of hot money

Foreign direct investment (FDI) in China rose 45.5 per cent in the first half of 2008, deepening worries that the inflow of "hot money" could lead to higher inflation.

The Ministry of Commerce said recently that foreign investors spent US$52 billion in China between January and June. In the same period last year, FDI increased only 12 per cent.

The ministry did not provide figures for June, but based on data published for the first five months of 2008, the June figure is estimated at US$9.6 billion, up from US$6.6 billion dollars a year ago.

Gene Ma, macroeconomic analyst at Beijing-based economic research firm China Economic Business Monitor, said: "The inflow increase is fast, but we don't know where the money has gone."

Despite rising FDI, foreign investment in fixed assets and the real estate sector both fell over the first five months of the year, and no major merger and acquisition deals were signed. Therefore, the destination of a large part of the money cannot be explained, he said.

Analysts have said the rising yuan against the U.S. dollar and high interest rates in China have attracted the "hot money".

The central bank said in its first-quarter monetary policy report that given the interest rate gap between China and the U.S., and the uncertain global economic situation, the influx of speculative capital may continue to increase in the short term, compromising the country's tightening monetary policy.

Shi Lei, an analyst at Bank of China, said FDI has been one of the major channels for "hot money" influx since 2007.

"Speculators can always find a way to circumvent government rules," Shi was quoted by Bloomberg as saying.

The government has been working to stop the inflow of "hot money".

The State Administration of Foreign Exchange issued a new rule last week, which asks traders to report advance payments for exports and deferred payments for imports, because both of these channels can be used to bring in "hot money."

[Source: China Securities Journal](http://www.cs.com.cn/english/ei/200807/t20080715_1526455.html) ([see archive](Rising_FDI_reflects_inflow_of_hot_money.pdf))

### Auditors to strengthen audit on foreign aid and loans projects

The National Audit Office (NAO) announced recently that it would step up efforts for auditing projects funded by foreign aid or loans, especially those concerning environmental protection, people's livelihoods and sustainable social development.

The NAO said in its five year work plan running between 2008 and 2012 that it would also carry out audits on the country's dispatched overseas agencies to improve its financial and accounting management system.

"The country should endeavour to improve auditing of activities including product purchase for aiding foreign countries, construction and capital management, in a bid to raise capital use efficiency," said the document.

The NAO also vowed to undertake regular auditing of the country's banking, securities and insurance industries within the next five years.

Chinese auditors also plan to set up a resource and environmental audit and assessment system by early 2012.

[Source: People's Daily Online](http://english.people.com.cn/90001/90776/90882/6448807.html) ([see archive](Chinese_auditors_to_strengthen_audit_on_foreign_aid_loans_projects.pdf))

## Other

### China to push forward household contract system for collective forestland

China is set to promote a household contract system in the nationwide management of collective forestland and the ownership of wood. This is seen as an important reform to boost the enthusiasm of farmers and increase their income.

The system comes into effect immediately, and has been recognised as another milestone in the country's transformation of rural production after it adopted the system for collective farmland more than two decades ago.

In the reform, forestry production and management will be entrusted to farmers through 70-year contracts, while the nature of collective ownership will remain unchanged, according to a State Council statement published recently.

The reform aims to get farmers more involved in the planting and growing of trees, inspire production initiative, increase their income and promote a conservation culture, it said.

It called for ensuring equal access to operating rights among farmers and guaranteeing their right to know about and participate in the decision-making process.

Users of forestland can transfer, lease or mortgage the land use rights within the tenure, the statement said.

Financial institutions must extend services to forest farmers and speed up the establishment of forestry insurance to protect farmers from natural disasters, it said.

The government plans to complete the reform within five years and form a sound development mechanism for collective forests based on the reform, it said.

The system has been implemented in Fujian, Jiangxi, Liaoning and Zhejiang provinces since 2003, with 878 million mu (58.5 million hectares) of collective forestland contracted to farmers.

The trial has turned into a win-win situation―farmers are getting richer and forests are receiving better protection.

In Jiangxi Province, which implemented the system in 2004, farmers' earnings from the forestry industry grew 41 per cent year on year in 2005. The are of forestland hit a record high of 3.3 million mu, and is expected to top five million mu this year.

The practice of the household contract system for collective farmland was initiated by a group of farmers in a small village in the central Anhui Province in 1978. The system was later adopted nationwide, helping to boost the country's agricultural production and enable the 1.8 billion mu of farmland to feed its 1.3 billion population.

The government expects the system to work again for collective forestland, promote the development of the forestry industry and improve the living standards of farmers.

China has 2.55 billion mu of forestland under collective ownership, accounting for 60 per cent of the country's total. More than half of its population live in these areas.

As one of the country's pillar industries, the forestry industry realised an output of 1.17 trillion yuan (US$167.1 billion) last year, up 9.85 per cent year on year.

[Source: China.com](http://english.china.com/zh_cn/business/economy/11021617/20080715/14967906.html) ([see archive](China_to_push_forward_household_contract_system_for_collective_forestry_land.pdf))

### Hearings on price setting to be more transparent

China's top economic planner recently began to solicit public opinion on a revised draft regulation aimed at improving the transparency of public hearings on price setting.

The number of consumers is required to be no less than one third of the total attendance in a public hearing on price setting, according to the revised version recently released on the website of the National Development and Reform Commission.

The current regulation has no lower limits on the proportion of consumers in a public hearing on prices.

In addition to a price setting plan, a report on the cost of pricing is also now demanded from the price fixer.

The draft regulation also states that, for the first time, public hearings must allow media coverage and the presence of observers.

Government staff who neglect their duty, abuse power or cheat in the organisation or proceeding of the hearings will be punished, with criminal penalties for serious cases, said the draft.

"The public hearing system for pricing has played a big role in making the government's decision making more scientific, democratic and transparent," said the commission. "But it has also exposed some problems in practice as this is new in China and still needs improvement."

China started to implement its first regulation on public hearings for price making in 2001, stipulating that prices of electricity, railway and flight tickets, among others, should be determined after a hearing. The latest revised version will solicit public opinion until 23rd July.

Beijing held a public hearing on 2nd July on the cost of the city's new metro linking the city with the airport. A hearing was also held on charging over plastic bags in supermarkets after China decided to ban free plastic shopping bags on 1st June.

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2008-07/15/content_6848048.htm) ([see archive](Hearings_on_price_setting_to_be_more_transparent.pdf))

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