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# China News Alert Issue 250

## Capital Markets

### China to strengthen fund sales monitoring

China's securities regulator has recently announced that it will launch on-the-spot inspections and monitoring of fund companies in a bid to standardise fund transaction activities.

The 36 dispatched institutions under the China Securities Regulatory Commission (CSRC) will focus their inspections on commercial banks, security companies and fund management companies.

Capital safeguards, information management, publicity material and human resources are among the inspection criteria.

Inspections are due to take place between September and December 2008, according to the CSRC.

Statistics released by the Galaxy Securities Company Limited listed the country's fund market value at 1.99 trillion yuan (US$284 billion) as of June 2008, a decrease of 1.2 trillion yuan from last year's 3.2 trillion yuan.

[Source: People's Daily Online](http://english.people.com.cn/90001/90776/90884/6453764.html) ([see archive](China_to_strengthen_fund_sales_monitoring.pdf))

### Smaller insurers get stocks approval

China's insurance regulator is drafting rules concerning the evaluation of small and medium-sized insurance companies' investment abilities, paving the way for their direct investment in equities, officials from the regulator confirmed recently.

"Though it may still take some time for the rule to be made public, major criteria include the number of professional employees, internal risk controls and supporting IT systems," an official from the China Insurance Regulatory Commission said.

Currently, small and medium-sized insurance companies have to put their money under asset management firms launched by the leading insurers if they wish to make investments.

In 2007, the regulator approved 14 smaller insurance companies to run stock investment through insurance asset management companies.

"This move means we could soon make direct investments into the stock market and reduce investment costs," said an investment department head of a medium-sized insurance company. "But the impact of this move on small and medium-sized insurers may differ, depending on the regulator's detailed requirements for the evaluation of insurance companies' investment abilities." For instance, if they have a threshold on the company's overall investment ability, some insurers who have a very focused business may find it difficult to meet the demand, he added.

"We will soon expand our investment channels, probably within two to three months," said Dean Richards, CEO of Skandia-BSAM, a Sino-Sweden joint venture insurer specialising in unit-linked insurance.

However, as the company is still waiting for the go-ahead from the industry regulator, Richards declined to reveal which other investment channels they are looking at. Currently, Skandia-BSAM runs funds instead of getting involved in stock investment directly.

Since 2007, the regulator has been striving to expand investment channels for insurance companies to boost their investment returns. Insurance firms now can directly invest 10 per cent of their capital in the stock market, an increase from 5 per cent. Meanwhile, insurance companies can also buy foreign reserves to invest overseas, and their investment choices can be extended to financial derivatives.

"Compared with big firms, small and medium-sized insurance companies are faced with similar systemic risks in the capital market. What makes things different is their investment abilities," said Wang Xiaogang, an analyst with Shanghai-based Orient Securities.

[Source: People's Daily Online](http://english.people.com.cn/90001/90776/90884/6450939.html) ([see archive](Smaller_insurers_can_get_stocks_nod.pdf))

### CBRC regulates private equity business by trust companies

Trust companies may now invest, through trust plans, in unlisted corporate equities; limited tradable shares of listed companies; or other equity-based trust products approved by the China Banking Regulatory Commission (CBRC).

The CBRC has recently released 'Guidelines for the Operation of Trust Companies' Private Equity Investment Trust Business' ('Guidelines') to further regulate the private equity activities of trust companies and guarantee the legal rights and interests of all parties involved.

Under the Guidelines, if trust companies participate in private equity investment trust plans with their own capital, the investment must not exceed 20% of the property of the trust plan.

During a lock-up period, trust companies can not transfer the beneficiary rights of the investment, nor raise funds by the use of these rights.

Trust companies must prepare reports detailing factors such as the trust plans' investment concepts, strategies and directions. These reports must be approved by the companies' trust committees.

Trust companies are also required to conduct due diligence on the specific companies targeted for investment, and investment may be carried out only after reports are prepared based on this due diligence and approved in line with decision-making procedures.

[Source: Lexis Nexis](http://hk.lexiscn.com/latest_message.php?id=4340)([see archive](CBRC_Regulates_PE_Business_by_Trust_Companies.pdf))

### China's security fund sets two-year plan for returns

China's social security fund will stabilise its stock investments to create a foundation for better returns during the next two years, according to Dai Xianglong, chairman of the National Council for Social Securities Fund.

"We will stabilise the investment percentage in stocks and increase investments in fixed-income products, corporate and private equity funds," Dai said recently.

The fund is allowed to invest in domestic and overseas markets, including bank deposits, treasury bonds, corporate bonds, trust funds, stocks and other forms of securities.

Dai said the fund's realised profit in the first half of 2008 did not cover the losses in stocks. He said it was a big challenge to keep the fund profitable this year, but its declined value was less than the 48-per cent slump in the Shanghai Composite Index.

The market value of Shanghai stocks decreased by about 12 trillion yuan (US$1.75 trillion) in the first half of 2008. "I believe our fund-management firms are capable of handling risk in investments, which can not only maintain the stability of the stock market, but also secure the fund's interests," Dai said. He said the fund would stick to its asset-allocation plans and long-term investment approach.

Investment returns for the country's social security fund jumped nearly six-fold last year from a year earlier to 112.92 billion yuan due to a then buoyant stock market, boosting the total value of the fund to 516.15 billion yuan.

Dai expects the value of the fund to exceed 1 trillion yuan by 2010 and the regulator is looking forward to hiring more fund-management firms to manage the investments.

The fund, which was allowed to invest up to 10 per cent of its assets in private equity, recently approved Hony Capital and CDH Venture Partners to manage its investment in private equity funds, each with a capital pool of 2 billion yuan.

Dai advocated a rule to improve the management systems of private equity investment funds, including registration, trade and tax.

[Source: China Daily](http://www.chinadaily.com.cn/china/2008-07/22/content_6866670.htm) ([see archive](Chinas_security_fund_sets_two-year_plan_for_returns.pdf))

## Corporate & Commercial

### New rule tightens watch on State-owned enterprises

Managers of China's listed State-owned Enterprises (SOEs) can be expelled from the Communist Party of China (CPC) for insider trading under a new regulation.

The Central Commission for Discipline Inspection of the Communist Party of China has issued a rule detailing penalties for offenses pertaining to the work of SOE managers.

All SOE heads are banned from taking advantage of their access to inside information concerning plans for listings, refinancing moves, and mergers and acquisitions, to profit either themselves or those they have special relationships with.

Other prohibited activities include:

* corruption in the process of asset integration and the introduction of strategic investors; ・
* providing advantages for their business partners to engage in business activities; ・
* forcing or masterminding accountants and auditors to make false fiscal reports; and ・
* setting salary standards for themselves, profiting from part-time jobs or arbitrary bonus sharing.

Under the new rule, SOE managers can be demoted, sacked or even expelled from the CPC if they commit such offenses.

Despite relevant rules and laws targeting corruption among SOEs, their supervision has become more difficult as their assets and profits have soared in recent years, Li Rongrong, chairman of the State-owned Assets Supervision and Administration Commission, said.

"It is also more complicated to oversee the State's shareholding in listed companies, as many shares have been released from their lock-up periods and have now entered the market," Li was quoted by the Xinhua news agency as saying.

Li said SOEs should improve their corporate governance while authorities should set more specific rules to prevent insider trading and other illegal activities.

The new regulation "makes penalties more feasible and improves the system", Wang Yukai, professor with the National School of Administration, said.

However, Zhao Jie, a researcher with the Party School of the CPC Central Committee, said the key factor lies in strengthening corporate and board governance for these companies. "The chronic illness of highly concentrated power in the hands of a single SOE head still exists in this country, " Zhao said. "This could breed corruption if this power is left unchecked."

He said the offences mentioned in the new regulation are prominent ones that have evolved with the country's incomplete restructuring of SOEs. If a proper corporate governance system was set up, with proper auditing bodies disclosing information regularly, these problems could have been overcome, Zhao said.

Several corrupt SOE managers have been arrested in recent years.

Experts said that unchecked power was the root cause of extravagant lifestyles using company funds.

In one case, Chen Shuangquan, the former chairman of the Shaanxi Freeway Construction Group Company, was sentenced to death in April for taking bribes amounting to 14.73 million yuan (US$2.1 million).

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2008-07/17/content_6853827.htm) ([see archive](New_rule_tightens_watch_on_SOEs.pdf))

### China to enhance foreign investment management

China will further strengthen the management of foreign investment projects and check foreign exchange inflow in a bid for better control. This is according to the country's top economic regulator.

The move will also safeguard the country's economic security, protect the ecological environment, optimise development and reform, and prevent industrial monopolisation, said the National Development and Reform Commission (NDRC) in a circular recently.

Projects that are not approved by the government, provide fake application materials, or use foreign exchange improperly, will be punished.

Local governments will also investigate and supervise programmes involved with foreign enterprise, including joint ventures, wholly foreign owned enterprises, bilateral cooperation projects, and mergers and acquisitions.

Meanwhile, regional economic regulators will look at projects, monitor foreign exchange inflow channels, and improve the financal management of foreign enterprises.

Projects with severe environmental contamination, high energy consumption and high resource consumption require stricter inspection and supervision.

China's cumulative foreign exchange reserve stood at US$1.809 trillion by the end of June 2008, up 35.73 per cent year on year, while foreign direct investment rose 45.6 per cent to US$52.4 billion in the first half of 2008 compared with a year earlier.

[Source: People's Daily Online](http://english.people.com.cn/90001/90776/6453994.html) ([see archive](China_to_enhance_foreign_investments_management_regulate_forex_inflow.pdf))

### Car parts tariff ruling upheld

The World Trade Organisation (WTO) has ruled that China's tariffs on imported car parts goes against the organisation's rules. This is the first time China has lost a trade dispute in the WTO since joining the organisation in 2001.

According to WTO regulations, China can still appeal against the verdict. But if it loses, which experts say is the most likely scenario, China will have to remove the current measures.

However, even if Beijing lowers tariffs over some car parts as per the ruling, analysts say the effect on the domestic automobile industry will be minimal. "Many international assemblers have already localised car part manufacturing, and changing the tariffs won't make any major difference," said Zhong Shi, an independent automobile analyst.

According to a report by Galaxy Securities, most multinational carmakers have already started making more car parts in China to cut costs. Honda and Volkwagen, for instance, make over 80 per cent of their components in China.

Jack Perkowski, CEO of ASIMCO Technologies Limited, one of China's major car part makers, said the ruling will not make a big difference to China's car part industry because of the country's price competitiveness. For foreign carmakers, localisation of car parts in China brings down the prices of vehicles and helps them make larger profits, said Perkowski.

A WTO dispute panel recently confirmed an interim judgment in February which upheld complaints by the US, EU and Canada that China was violating fair trade rules by discriminating against imported parts.

Under the current regulation, Beijing taxes imported car parts at the same rate as completed automobiles if more than 60 per cent of parts from the finished vehicles are imported. The tariff on a whole car is 28 per cent, while that on parts ranges from 10 to 14 per cent.

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2008-07/22/content_6866855.htm) ([see archive](Auto_parts_tariff_ruling_upheld.pdf))

## Other

### RMB 300,000 required for establishing ordinary partnership law firms

Beginning on 18th July 2008, at least four or more partners must act as the establishers of an ordinary partnership law firm. Such an establishment must have assets valued at over RMB 300,000.

Under the 'Administrative Measures for Law Firms' ('Measures') released on 18th July by China's Ministry of Justice (MOJ), law firms can be established by lawyers in the form of a partnership, by lawyers as individuals or be funded by the State. Partnership law firms can adopt the form of an ordinary partnership or a special partnership. Partnership law firms are eligible to establish branches if they have been established for more than three years and employ over 20 lawyers.

The MOJ also released the 'Administrative Measures for Lawyer Practice', stipulating that personnel who apply for lawyer status must have worked as an intern in a law firm for more than one year, and must participate in training activities organised by professional legal associations.

Personnel applying for part-time lawyer status must be engaged in legal education and research at universities or scientific research institutions.

[Source: Lexis Nexis](http://hk.lexiscn.com/latest_message.php?id=4377) ([see archive](RMB_300000_Must_be_Provided_for_Establishing_Ordinary_Partnership_Law_Firms.pdf))

### China seizes 46 million illegal publications

China has confiscated more than 46.1 million illegal publications in the first half of 2008, including 1.6 million pornographic publications and 50,000 smuggled compact discs.

Most of the confiscated publications are pirated books, and audio and visual productions. About 1.07 million copies of illegal newspapers and magazines were among the confiscated items, according to the national anti-pornography and anti-piracy office.

In addition, the office recently reported four copyright infringement cases, three of which involved pirated CDs.

In one case in south China's metropolis of Guangzhou, three illegal audio and visual production warehouses on the fifth floor of a business centre were spotted on 20th May, and 3.24 million pirated CDs were confiscated. It is said to be the biggest illegal publication case in Guangzhou so far this year.

In another case in southern Shenzhen city, police held up a truck with 182 boxes of pirated CDs on a highway.

China has attached great importance to IPR protection, which has been considered a national strategy to help build an innovative country.

According to official statistics, China has, in the past 20 years, closed down 238 pirated disc production lines, solved more than 400,000 cases of IPR infringement and confiscated more than 1.3 billion illegal publications.

[Source: China Daily](http://chinadaily.com.cn/bizchina/2008-07/17/content_6855457.htm) ([see archive](China_seizes_46m_illegal_publications.pdf))

### Manoeuvre on labour law faces block

The efforts of the country's largest producer of telecommunications equipment to terminate employment contracts with more than 7,000 workers before a new labour contract law comes into effect may face an invalidation ruling by the courts, according to local media.

The actions of Huawei Technologies Company are being described as one of four invalid moves by corporations that "maliciously dodge" signing employment contracts with no fixed termination dates―or open-ended contracts―that come under a new set of regulations jointly issued by the higher people's court of Guangdong province and the Guangdong arbitration committee of labour disputes.

The new regulations stipulate that employers who force workers to resign and sign new labour contracts with the intention of erasing their employment history with the company could be subject to the invalidation of the new contracts.

So far, no Huawei employee is said to have brought the issue to mediation centres or law enforcement bodies.

"The regulations do not specially target this incident, but now it can restrict and invalidate actions similar to Huawei's," an official of the Guangdong labour department said.

The other invalid moves or malpractices stipulated include signing contracts with workers in the name of an associate company, illegally outsourcing human resources and other behaviour that is said to breach the principles of fairness and credibility.

The new regulations are part of the authorities' efforts to provide judging criteria and standardise procedures for handling labour disputes between the courts and labour arbitration agencies.

Shenzhen-based Huawei has been under the spotlight for launching a controversial "voluntary resignation" scheme last October. It involved asking more than 7,000 of its workers, who had been with the company for the past eight years or more, to terminate their original contracts in return for a considerably large compensation payout and a chance to reapply for their previous positions.

Before the new regulations, which came into effect on 7th July, the labour department said the company did not violate the Labour Contract Law, which came into effect on 1st January, because the moves were a result of voluntary negotiations between the employer and employees.

More companies are reportedly getting involved in labour arbitration with the implementation of the Labour Contract Law, which many see as greatly improving workers' awareness of their rights in the workplace.

The number of cases involving labour disputes that were handled by all-level labour arbitration agencies in the first half of 2008 in Guangdong tripled year on year.

During the same period, Guangdong courts handled about 40,000 labour dispute cases, up 157.7 per cent from last year. Those from the labour-intensive Pearl River Delta area accounted for 96.5 per cent of all cases.

[Source: People's Daily Online](http://english.people.com.cn/90001/6455167_txt.html) ([see archive](Maneuver_on_labor_law_faces_block.pdf))

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