Charltons - China News Alerts Newsletter - 30 June 2011

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# China News Alert Issue 356

## Securities

### Backdoor listings to come under tighter scrutiny

The China Securities Regulatory Commission (CSRC) issued a draft regulation in late May calling for a closer monitoring of merger and asset restructurings of listed companies.

The aim is to make sure such listings come under the same scrutiny that Initial Public Offerings are subject to and to ultimately improve the quality of all listed companies. The standards for making a backdoor listing are lower than those required for companies listing by way of an IPO leading many to comment that the quality and performance of some listed companies are not the same as those listed via IPO. Tighter regulations would better protect the interests of the investor.

The hope is that through better supervision of poorly-performing companies, insider trading and accounting fraud can be prevented.

The draft proposes that private companies aiming for backdoor listings must have been in business for three years and have recorded a gross profit of Rmb20 million (US$3.07 million) in the last two fiscal years. This means that if selecting a shell company, a private company will have to take into consideration its own interests and the performance of the company in the long term after its listing.

Additionally, companies that are already listed but are performing poorly now run the risk of being delisted if certain requirements are not met. The draft does not detail these requirements but the CSRC are considering adding them.

[Source: China Law and Practice](http://www.chinalawandpractice.com/Article.aspx?ArticleID=2836242&LS=EMS529276) ([see archive](Backdoor_listings_to_come_under_tighter_scrutiny.pdf)), [Source: Global Times](http://business.globaltimes.cn/industries/2011-05/655377.html) ([see archive](CSRC_eyes_backdoor_listings.pdf))

### China Securities Regulatory Commission sets forth rules on the violation of information disclosure laws

Sponsors and investment consultants may be liable for disclosure violations after amendments in the PRC Administrative Penalties Law.

If the sponsor, the securities service organisation and its personnel do not act with due diligence or if they 'formulate or issue documents with fraudulent entries, misleading statements or major omissions' they are liable to have administrative penalties imposed upon them as far as the CSRC deems them liable.

Other additions include a clarification that if a party objects to a matter already deemed a violation of disclosure laws and has voted against the related resolutions in the minutes of board of directors meetings or supervisory board or business meetings, he/she will not be subject to any administrative penalties.

In addition to the objective criteria used to judge whether or not an act constitutes a violation of disclosure laws (criteria such as whether or not the act results in a loss or other change in profit) more subjective criteria will also be considered. Among such subjective areas are the attitude of the directors, supervisors and senior management and whether they have continued to cover the act up or have taken appropriate steps to remedy the situation. Personnel will have the opportunity to submit any relevant records to prove they are not at fault.

[Source: China Law and Practice](http://www.chinalawandpractice.com/Article/2839130/Issue/8508/China-Securities-Regulatory-Commission-Rules-for-Determining-the-Administrative-Liability-for-Acts-of.html) ([see archive](China_Securities_Regulatory_Commission_sets_forth_rules_on_the_violation_of_information_disclosure_laws.pdf))

## Real estate

### 23% of all foreign investment went into property in 2010

Beijing's foreign exchange regulator states that 23% of foreign capital invested in China throughout 2010 has gone into the real estate sector.

This leaves the ratio of foreign investment in property at 10% over the last decade according to figures from the State Administration of Foreign Exchange in its 2010 annual report. The report also stated that foreign investment in property has been on a rapid increase since 2006.

Small volumes of "hot money" were detected slipping into the real estate sector under the cover of trade. The increased monitoring of cross-border capital flows (see above) will however make it more difficult for large sums of "hot money" to flow in and out of the country.

In November the Ministry of Urban-Rural Development and SAFE issued a notice declaring their intent to restrict foreign investment in property, citing the exact same issue of "hot money" influxes.

[Source: China Daily](http://www.chinadaily.com.cn/business/2011-06/17/content_12720592.htm) ([see archive](23_of_foreign_investment_went_in_to_property_in_2010.pdf)), [Source: Forex Pros](http://www.forexpros.com/news/financial-news/china-to-restrict-foreign-investment-in-property--paper-173852) ([see archive](China_to_restrict_foreign_investment_in_property_-paper.pdf))

## Investment

### Concerns of "hot money" influx may trigger new control measures

Renminbi (Rmb) repatriation may cause problems for Mainland investors soon as concern over "hot money" flooding into China could cause regulators to introduce tighter control mechanisms.

The Rmb-denominated cross-border trade settlement, in place by way of a limited scale trail run since 2009, is expected to stretch across the whole country later this year. The speed and amount of incoming Rmb are expected to cause problems for the market which may cause regulators to implement measures to supervise the inflow.

Under these expected measures foreign investors will have to confirm with the State Administration of Foreign Investment (Safe) and the Foreign Investment Department of the Ministry of Commerce (Mofcom) what the source of their Rmb is, i.e. whether it has been raised from cross-border trade or lawfully obtained from overseas.

One of the regulations that could be imposed would allow for a bank account to be opened designated by Safe to receive Rmb. These accounts would be supervised by the bank and Safe and would require those who wish to withdraw money from the account to provide transaction documents from Safe and the bank.

In addition to this, foreign investors would have to obtain a certificate of approval from Mofcom stating the currency type and amount of capital contribution.

[Source: China Law and Practice](http://www.chinalawandpractice.com/Article.aspx?ArticleID=2845115&LS=EMS534490) ([see archive](Concerns_of_hot_money_influx_may_trigger_new_control_measures.pdf)), [Source: China Daily](http://www.chinadaily.com.cn/cndy/2011-05/21/content_12552684.htm) ([see archive](Yuan_may_be_fully_convertible_in_3-5_yrs.pdf))

### Private equity investment rules to be eased soon

China is set to loosen restrictions around the rules governing domestic securities brokerages engaging in private equity (PE) investment.

The regulator plans on turning the pilot program of PE investments by securities firms into one of their regular businesses. China Securities Regulatory Commission (CSRC) announced the changes on Saturday (18th June), commenting that the new rules would be coming into effect 'very soon'

As it stands, domestic brokerages are not permitted to use more than 15% of their own capital for PE investment. There are also not allowed to raise funds through investors in the market to invest in unlisted companies. A relaxing of these laws will allow securities firms to diversify their revenue streams so they are not so reliant on their main source of income, traditional trading commissions. It would also, it is hoped, lessen the way in which foreign capital has come to dominate China's private equity industry.

According to China Daily's figures, global investment banks like Goldman Sachs and Morgan Stanley 'derive 20 to 30% from the business of asset management, which includes PE investment. The number is less than 5% for Chinese securities firms.'

However, concerns have been raised that securities firms could use the looser regulations to manipulate the market by pushing up IPO prices to their benefit as prefloat investors. It is also feared that investors could lower IPO standards or whitewash financial reports of their clients in order to make huge gains from PE investments.

In response to these concerns the regulator has made it a requirement that firms set up a 'firewall' so that investment banking teams cannot keep contact with PE investment teams. A rule blocking a securities firm from investing in an unlisted company after they become said company's underwriter is also being considered.

[Source: China Daily](http://www.chinadaily.com.cn/business/2011-06/21/content_12742754.htm) ([see archive](PE_investment_rules_to_be_eased_soon_regulator_says.pdf))

## Other

### Ministry of Commerce recommends self-assessment for business concentration risks

Beijing's Ministry of Commerce (Mofcom) has recommended that companies considering M&A should conduct a self-assessment on potential business concentration risks.

The anti-monopoly bureau released a draft on the 3rd of June detailing their [proposals](http://fldj.mofcom.gov.cn/aarticle/zcfb/201106/20110607585023.html) and solicited comments from the 3rd to the 13th.

Mofcom, China's sole antitrust review regulatory body, will take into consideration an entity's ability to control the market and degree of market concentration among other factors in an effort to determine whether or not business concentration would end up disrupting healthy competition and development.

Companies are advised to use the pre-notification contact with Mofcom to identify possible competition concerns. Preparatory work can be completed with the aid of industry professionals. The draft states that companies are offered the opportunity to make the case that the positive effects of the proposed business concentration outweigh the negative. Where this can be proved, Mofcom can conditionally clear the transaction.

[Source: China Law and Practice](http://www.chinalawandpractice.com/Article.aspx?ArticleID=2848441&LS=EMS536962) ([see archive](Ministry_of_Commerce_recommends_self-assessment_for_business_concentration_risks.pdf)), [Source: China Ministry of Commerce](http://fldj.mofcom.gov.cn/aarticle/zcfb/201106/20110607585023.html) ([see archive](Ministry_of_Commerce_recommends_self-assessment_for_business_concentration_risks_A.pdf)), [Source: China Daily](http://www.chinadaily.com.cn/bizchina/2011-06/04/content_12641788.htm) ([see archive](Public_input_sought_on_business_concentration_draft.pdf))

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