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# China News Alert Issue 260

## Capital Markets

### China to launch securities margin trading soon

China's securities regulator announced recently that it will soon launch margin trading business for securities firms, which has long been expected by the market.

The business, allowing traders to borrow part of the money necessary to buy a security or borrow security to sell, and practiced in most bourses across the world, would change the current one-way trade on both Shanghai and Shenzhen stock markets and serve as a risk aversion tool for investors.

Sources with the China Securities Regulatory Commission (CSRC) identified the principle of starting the business as "test run first and to be extended gradually".

Securities firms are only allowed to use its own capital and securities for the experiment margin trading in China. The initial margin will be set at 50 percent of the purchase price when buying eligible securities or 50 percent of the proceeds of a short sale.

The maintenance margin, or the sum required to be maintained on deposits at all times in case of liquidity crunches, will be at least 30 percent of the financed equity value.

Although margin trading would expand the business and broaden the use of capital and securities of securities firms, a CSRC official said on the background that window guidance or moral persuasion by the regulators would alert securities firms to be more conservative with their investment.

They could ward off the risks in line with their actual situations by raising the threshold of their clients and lifting up moderately the margin requirements, said the official.

The financial leverage, or the degree to which a business is utilizing borrowed money or securities to fund its operation would only be twice as much as its own equity, the official said.

The CSRC will handpick the first batch of eligible securities firms by scrutinizing their net capital, a key measurement for solvency and operation capability, track of records in compliance audit, current risk of control indexes and their plans for the upcoming test run.

A CSRC statement released on the same day said that the experimental project was open to all kinds of securities firms across the whole country.

If the experiment proves smooth, margin trading would be normalized in all securities firms, it said.

The CSRC will clarify the qualifications and criteria later and promise to bring in an expert panel to handle applications in an open and transparent manner.

As the business can multiply both profits and losses, CSRC officials urged securities firms not to jump at the project before acquainting themselves with the rules and thinking well of the potential risks.

The CSRC sources told that the authorities would tighten supervision to forbid any individual or institution to start margin trading without authorization.

Given that the business will amplify capital and securities demand as well as turnover, analysts regard the move as a latest incentive from the regulators to activate the market.

The new move came after the country scraped the tax upon share purchases and allowed Central Huijin, a government investment arm, to buy in the stocks of the country's three biggest banks, namely the Industrial and Commercial Bank, China Construction Bank and Bank of China.

The lift of restrictions preventing controlling shareholder to buy back shares also gave a boost to the mainland stock markets shrouded by lingering fear over economic uncertainties.

The CSRC Sources did not expect massive short sales to come but instead regard the trading as a tool to secure "rational prices" by optimizing the pricing mechanism of stock markets.

A CSRC official told on anonymity that the risks of margin trading experiment were "controllable" because margin lending would outweigh short selling.

"Massive short sales were barely possible considering the large proportion taken by money in the assets of securities firms. "The securities eligible for sale are relative small," said the official.

Director Cheng Wenwei of the Research Institute of the Hongyuan Securities said that stronger upward momentum would depend on government policies and the performance of peripheral markets.

Attributing the market tumbling over past months to insufficient demand and gloomy expectation over business profits, he said that the rising prices of raw materials, strengthening Yuan, slowing exports, higher labor costs and credit tightening had concurred to cause the rapid decline in corporate net profits.

"Once reasonable returns come in sight, long-term capitals would be lured into the market while the current oversupply on the second market would be reversed," he said.

If the $850-billion rescue package of the United States government could spur local and peripheral markets, mainland A-share market would also feel the positive ripple effect, he said.

[Source: China Securities Journal](http://www.cs.com.cn/english/ei/200810/t20081006_1612666.html) ([see archive](China_to_launch_securities_margin_trading_soon.pdf))

### Short selling set to benefit stockbrokers

The proposed introduction of margin trading and short selling on a trial basis is widely seen as part of government efforts to diversify financial instruments available to market participants and is expected to benefit domestic stockbrokers as their business range is expanded, analysts said.

The expected move follows recent measures aimed at boosting market sentiment, including a reduction in stamp duty on September 18 and State-owned enterprises being encouraged to purchase shares in their listed units.

The China Securities Regulatory Commission (CSRC) said recently it would launch margin trading and short selling on a trial basis, with further details on approval procedures for qualified stockbrokers to be announced in the coming weeks.

Economists and industry analysts said the introduction of new trading mechanisms would mark a further maturing of the mainland's securities market, allowing for the addition of complex trading strategies.

"The new instruments will serve to increase overall market liquidity and the effectiveness of the market's price-setting mechanism," said Jing Ulrich, managing director and chairwoman of China Equities of JP Morgan. "The new trading mechanism will fundamentally change the 'one-sided' nature of the A-share market, allowing investors to profit from falling as well as rising markets."

"Investors will be able to utilize more sophisticated trading strategies, moving beyond simple buy-and-hold," Ulrich added.

The new financial instruments will first be unitized among a small number of qualified securities brokers and will be limited to a few stocks at the initial stage. Securities firms will be required to only use their own capital and stocks for lending to investors.

Zhou Liang, head of investment &advisory, China, Thomson Reuters, said the limitations would minimize the impact of the new measures in the trial period. Nevertheless, the proposal will have far-reaching consequences for the securities industry in general, particularly the business models of stock brokerages. "The introduction of the new services will of course help to diversify the income of securities firms," said Zhou Liang. But "the new services are not expected to make too great a contribution to their earnings, because the business they can do will be limited by their capital and in-house stock holdings".

By the end of 2007, the combined net capital of domestic securities firms totaled about 300 billion yuan ($43.81 billion), less than 6 percent of the market value of China's A shares, according to a report published by Industrial Securities Co.

The report showed that the combined share portfolios of all stock brokerages totaled 14.9 billion yuan by June 30, accounting for a mere 0.3 percent of the total market capitalization of the A share market.

Zhou and other analysts agreed that the first batch of qualified stockbrokers are expected to lend capital and stocks only to their core clients, mainly large fund management companies, corporate investors and high net-worth individuals.

In margin trading, investors borrow money from their stockbrokers to buy shares or fixed-income securities. In short selling, an investor sells shares he or she has borrowed from a stockbroker.

Brokers and analysts warned investors should not neglect the leverage effect of both types of transactions, which could magnify potential risks. Such a leverage effect is also seen as a reason why regulators have so far been cautious about introducing them on a trial basis.

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2008-10/07/content_7083866.htm) ([see archive](Short_selling_set_to_benefit_stockbrokers.pdf))

### Firms to disclose share-stabilizing moves in report

In an effort to boost market transparency and investors' confidence, the mainland's two stock exchanges have asked listed-companies to disclose major profit variations and measures to stabilize share prices in the upcoming quarterly report.

According to directives released recently, the Shanghai and the Shenzhen stock exchange will require listed companies to disclose their third-quarter financial results before October 31.

During the accounting period, if a company's major accounting entries or financial indicators fluctuated more than 30 percent from a year ago, it should include reasons behind the variations in its report, according to the exchanges.

For the small-enterprise-board companies in the Shenzhen market, a forecast is due before October 15 if they see major profit changes in the first nine months. The companies should also present an estimation of full-year results in the third-quarter reports.

Shareholders of companies which have completed share-split reform should clarify whether they have fulfilled commitments in terms of share sale restriction. If shareholders have vowed to take measures to stabilize shares prices after they become tradable, they should disclose how the moves were carried out.

The quarterly report also welcomes additional share-holding commitments and moves by large shareholders or actual controllers of the listed companies to convince investors, the Shenzhen bourse said.

Affected by a series of negative impacts and uncertainties, major stock indices in China have plunged more than 60 percent from last year's peak. During the market slide, shares of many promising companies became attractive -- even to their owners, as many shareholders vowed not to sell their holdings and some began to buy back stocks of listed units in the past few months.

Recently, the Central Huijin Investment Co Ltd, an investment arm of the Chinese government, increased shareholdings of 2 million shares for each of the three State owned lenders -- the Industrial and Commercial Bank of China, the Bank of China and the China Construction Bank. Huijin added it will buy more within the coming 12 months.

Statistics show that between August 28 and September 25, shareholders of 41 listed companies bought back altogether 238 million shares worth some 1.85 billion yuan.

To propel the momentum, the securities regulator revised rules recently cutting shareholders' no-trading period from 30 days to 10 days before the earnings release.

Given this revision, market analysts believe more share repurchases will happen before the quarterly report boom next month, as long as share prices of good companies remain at historic lows.

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2008-09/26/content_7063925.htm) ([see archive](Firms_to_disclose_share-stabilizing_moves_in_report.pdf))

### SSE revises bond trading rules to expand application scope

Shanghai Stock Exchange (SSE) has just revised two bond trading rules to expand their application scope.

After the amendments, the application scope of the Implementing Rules on Bond Trading is widened from "government bonds and corporate bonds" to "Treasury bonds, corporate bonds, enterprise debentures and warrant bonds".

The revised Implementing Rules also require members of SSE to ensure that the bond trading orders they quote on the exchange are legitimate, authentic, accurate and complete, and they should be obliged to take corresponding legal liabilities.

In addition, SSE revised the Tentative Measures for Fixed Income Securities Trading on Integrated Electronic Trading Platform, and renamed it as Provisional Regulations on Fixed Securities Trading on Integrated Electronic Trading Platform.

After this revision, the original restriction on the qualifications of traders on the integrated electronic platform, which required that a securities brokerage firm who applies to be a trader of fixed income securities should have got proprietary securities trading qualifications and a net capital of at least 200 million yuan, is scrapped.

Besides, the original stipulation that "a primary trader shall make market for at least one benchmark T-bond among all key-term T- bonds listed on the SSE electronic trading platform" is revised to "make market for key-term T-bonds designated by SSE".

The new Provisional Regulations also add new requirements of no more than 20 basis points for the spread of bilateral quotes for corporate bonds, enterprise debentures and warrant bonds, and a quantity for single quote of no less than 1,000 lots.

The aforesaid new rules took effect on the date of promulgation on September 27.

[Source: zibb.com](http://www.zibb.com/article/4057009/SSE%2Brevises%2Bbond%2Btrading%2Brules%2Bto%2Bexpand%2Bapplication%2Bscope) (Link no longer active)

## Corporate & Commercial

### New rules on foreign investment in ad firms takes effect

China's newly-revised administrative regulations on foreign investment in advertising enterprises came into effect recently.

The regulations, jointly promulgated by the State Administration for Industry and Commerce (SAIC) and Ministry of Commerce (MOC), were set to replace the former regulations issued by SAIC and MOC on March 2, 2004.

Under the new regulations, foreign-invested advertising enterprises can engage in design, production, publication and some other types of advertising businesses for both domestic and overseas costumers after receiving official approval.

A Sino-foreign advertising joint venture can be established on the condition that all investing parties are the enterprises engaging in advertising business and having been operating for more than two years.

For the establishment of a wholly foreign-owned advertising enterprise, the investor is required to be an enterprise with advertising as its main business and also has been in operation for over three years.

A foreign-invested advertising enterprise is qualified to apply the establishment of a branch in China, only if it has the full amount of its registered capital paid up, and with a minimal annual operating turnover of 20 million yuan ($2.9 million).

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2008-10/03/content_7075449.htm) ([see archive](New_rules_on_foreign_investment_in_ad_firms_takes_effect.pdf))

### China punishes 12 financial institutions for money laundering

The People's Bank of China punished 12 financial institutions involved in money laundering in the first half of this year with fines totaling 2.25 million yuan (328,654 U.S. dollars), the central bank revealed recently.

"We have checked a total of 1,084 financial organizations, which include 907 banking institutions, 71 securities and futures institutions and 106 insurance institutions," said head of the bank's anti-money laundering bureau, Tang Xu.

Tang would not name any of these organizations but did say he has seen more money flowing in and out of underground private banks through questionable dealings in recent years.

Those banks make illegal transactions by collecting idle capital and then promising high interest rates. They then lend money at even higher interest rates to reap profits.

"This illegal foreign currency dealing, money laundering, money lending at high interest and illegal fund raising has disturbed the country's economic stability," Tang said.

The central bank branches and foreign exchange regulators have helped police crack 42 money laundering cases involving about 84.4billion yuan since last September.

China initiated anti-money laundering checks in the banking sector. The country set up an anti-money-laundering bureau in the central bank in 2003 and passed its first anti-money-laundering law in 2006.

Financial institutions violating the law could be fined as much as five million yuan. Co-conspirators face fines of up to 500,000 yuan.

Tang said China will strengthen anti-money-laundering checks insecurities and insurance sectors as criminals began to shift their focus.

[Source: People.com](http://english.people.com.cn/90001/90778/6507735.html) ([see archive](China_punishes_12_financial_institutions_for_money_laundering.pdf))

## Other

### Workers' rights get new boost

Workers in Guangdong province, under a new regulation, will now have the right to claim compensation for work-related injures or sickness within two years of ceasing employment.

Zhang Xiang, a publicity official of the provincial labor and security department, said yesterday the introduction of the new regulation "is partly due an illness suffered by a woman worker in Shunde district, Foshan city".

The worker, Ye Biqiong, was employed by a packaging factory in Foshan in 1993.

Ye's employer purchased insurance against injury for her in 2000.

Ye quit her job in 2006 because of illness.

In 2007, Ye was diagnosed with serious benzene poisoning, which had been certified as being caused by her work at the factory.

Ye and her former employer tried to claim work injury compensation from the social insurance fund bureau of Shunde, but they were turned down.

The reason being Ye had left the factory before she was diagnosed with the disease.

In May this year, Ye and her former employer brought the bureau to court.

The case drew wide media attention, and the provincial government began to realize that many other people in Guangdong province were in a similar position to Ye, Zhang said.

The director of the Guangdong prevention and treatment center for occupational diseases, Huang Hanlin, the attorney of Ye, Huang Shumei, and a law professor of Sun Yat-sen University, Huang Qiaoyan, also jointly sent a petition letter to the provincial government suggesting that it require the labor and social security department improve its injury compensation regulation.

Under the new regulation a worker who has been diagnosed as having contracted an occupational disease can claim insurance compensation from the labor and social security department even though no longer employed.

The only precondition is that the claim must be made within two years.

The provincial labor and social security department said it released an official announcement on Saturday, and the new regulation would take effect from that day.

"The Shunde branch of the Foshan social insurance fund bureau has accepted Ye's case and we have withdrawn our lawsuit," attorney Huang Shumei said.

[Source: China Daily](http://www.chinadaily.com.cn/business/2008-10/07/content_7083179.htm) ([see archive](Workers_rights_get_new_boost.pdf))

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