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# China News Alert Issue 292

## Capital Markets

### Brokers' rules likely to help bigger players

The new classification rules that apply to China's securities brokers are likely to sharpen the divide between large and small players, experts say.

The rules, which have been in the pipeline since June 2007, seek to divide brokers into 11 classes under five categories, based on risk management capabilities.

This is to facilitate the "rational allocation of supervisory resources" and "improve supervisory efficiency", the China Securities Regulatory Commission, or CSRC, said in a statement released recently.

Industry experts said the classification was an important part of the industry reform, which is going through major restructuring. The changes have resulted in a number of mergers and acquisitions among different firms.

According to the CSRC, the rating guidelines include risk management ability based on a broker's capital adequacy, administration and compliance management, dynamic risk monitoring, the safety of information systems, the protection of clients' rights and interests, and information disclosure.

The ratings criteria also include brokers' market competitiveness in accordance with their performance in their core business area, cost management, and innovation.

The securities watchdog and its nominated agencies will implement the classification process, but the results will not be publicly disclosed as per the international standards.

"The CSRC's new regulations, coming at the same time as the upcoming resumption of initial public offerings, sends a signal to stabilise and maintain the upward trend in the domestic bourses," said Shen Cheng, a securities lawyer from Jun He Law Offices based in Shanghai.

He said the new ratings would strengthen the in-house management and information discourse systems of brokers. This will also help investors to obtain more information, and in the long run, will result in a healthier stock market.

The CSRC said the classification results would be taken as "prudential conditions" for brokers' applications for new business, outlets, and listings. In addition, the scale and order of new business will also be partly dependent on the brokers' assigned level.

"The new ratings will help large securities brokers carve out bigger shares in the market while pushing small players out of the industry," said Song Yixin, a lawyer from Shanghai Banner Lawyers. He predicted more mergers and acquisitions in the industry.

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2009-06/02/content_7963548.htm) ([see archive](Brokers_rules_likely_to_help_bigger_players.pdf))

### China launches war against securities insider trading

China needs to improve legislation and take more comprehensive measures to crackdown on malpractice in its securities market, experts have said recently.

In less than six months, six executives with securities trading firms and one local bank were either arrested or put under investigation for market malpractice in the latest move by the Chinese government to clean up the securities markets.

China Galaxy Securities Company Limited, one of the country's largest securities firms, confirmed on 15 May that its former chief executive, Xiao Shiqing, was arrested on 13 May on unspecified criminal charges connected to his former job as a securities regulator.

It was also confirmed on 13 May that Lei Bo, head of Guo Jin Securities, is under investigation for personal malpractice in the market.

Additionally, the China Securities Regulatory Commission (CSRC), the country's securities watchdog, announced on 12 May that they were investigating three insider trading cases, which involved fraudulent securities issuance, leaking of important information concerning listed companies and insider trading.

A local bank manager and a deputy manager of an industrial company in Shandong province were accused of profiteering from handling merger deals in 2007. The CSRC did not disclose the company name or the individuals involved in the case. Specific illegal earnings are under further investigation, according to the CSRC.

As of March 2009, the CSRC had transferred 19 cases of securities malpractice to public security departments for criminal investigation since 2008, including six cases involving listed companies, eight cases of insider trading, two cases of market manipulation, two cases of illegal investment consulting, and one case of embezzlement by financial institution staff.

Li Jing, a researcher with Securities and Futures Institution of China's Central University of Finance and Economics, said in an interview with Xinhua on Friday that most of the malpractice cases in China's securities market were related to insider trading, which made small and individual investors victims of stock price manipulation,

Experts attribute the violations to an inadequate legal system and slack law enforcement.

"The lack of a specific definition for fraudulent securities dealing leaves loopholes for controlling shareholders of listed companies, relevant parties involved in mergers and acquisitions, and securities brokers to conduct malpractice," said Li Jing.

A lawyer in Beijing who declined to be named told Xinhua that insider dealers, once discovered, usually get a “slap on the wrist” at a civil misconduct tribunal, or at worst, a fine or a professional disqualification, which is not tough enough to curb the malpractice in this industry.

The lawyer also blamed lax and inefficient self-supervision within the industry for impeding the establishment of a sound market.

The nation's securities watchdog has made continuous efforts to safeguard a clean market order and the interests of investors through strengthening legislation and law enforcement in recent years.

The latest amendment to the Criminal Law in February reinforces punishment for "mouse storehouse" activities, from which securities brokers gain huge profits by trading shares through insider news. Offenders will face five- to ten-year jail sentences, and fines of up to ten times their illegal earnings, according to the amendment regulation.

However, experts believe the regulators need to make further improvements to the rules promptly in light of changes in the market, and reinforce the punishment of offenders.

"Instead of solely resorting to Criminal Law, Civil Laws and administrative regulations should be comprehensively applied. A more explicit definition of securities misconduct will help target offenders in the future," said Li.

Li also suggested the industry establish a more efficient self-regulation system to guarantee a prompt and reliable channel for the disclosures of listed companies.

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2009-05/22/content_7933916.htm) ([see archive](China_launches_war_against_securities_insider_trading.pdf))

## Corporate & Commercial

### Regulator asks banks to keep tabs on risky loans

Chinese banks should strengthen their financial and risk management while supporting the nation's economic growth, the country's banking watchdog said, as there are mounting concerns that the credit explosion may pose risks for the financial sector.

In a guideline jointly released by the China Banking Regulatory Commission and the Ministry of Finance on 7 June, Chinese banks have been urged to improve their capability to identify and tackle risk, closely monitor borrowers' financial conditions and carefully assess risks when extending loans for mergers and acquisitions.

The call comes after Chinese banks extended a record number of new loans to help finance government-led stimulus projects, indicating that policymakers are increasingly feeling the potential risks of a galloping credit growth, analysts said.

China's new yuan loans totaled 5.17 trillion in the first four months, sparking concerns that bad loans may start to pile up.

In a bid to spur private investment, the nation last week relaxed the minimum financial requirement to start a number of fixed asset projects, including commercial property, which means banks may be exposed to more risk as they are now allowed to finance projects with less initial capital than before.

"It is necessary to pay close attention to the risk accumulated from the burst of lending and regular checks must be conducted to ensure that loans are not misused," said Zhao Xijun, financial professor with the Renmin University of China.

In another guideline issued recently, CBRC required commercial banks to set up a sound mechanism to identify, supervise and control potential information technology risks and safeguard customer data security.

Analysts said the banking regulator's call is far from signaling a tightened bank lending policy, though the momentum of lending has eased recently.

In April, Chinese banks extended 591.9 billion yuan in new loans, a drastic slowdown from more than 1 trillion yuan in each of the first three months of 2009. Analysts expect new bank loans in May to touch 500 billion yuan at the most.

"The surging credit growth in the first quarter is not sustainable, and the new loan growth in May will be broadly in line with that of April," said Zhao.

Guo Tianyong, professor with China's Central Finance University, said the relaxed monetary policy environment has not changed.

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2009-06/02/content_7963293.htm) ([see archive](Regulator_asks_banks_to_keep_tabs_on_risky_loans.pdf))

## Real Estate

### Commercial property norms relaxed

The government's decision to slash the minimum financial requirement for commercial property investment for the first time in 13 years, will help ease property developers' capital strain and stabilise housing prices, analysts said.

The minimum amount of capital needed to start a new commercial property or an affordable housing project has been lowered from 35 per cent of the total project cost to 20 per cent, the State Council said in a statement recently.

The move was taken as a key adjustment in the government's macroeconomic measures to slow the economic downturn and revitalise the ailing property market.

This latest adjustment goes back five years, when the government raised the minimum capital requirement ratio to 35 per cent to cool down the sizzling real estate market. At that time, Chinese commercial banks were not allowed to extend loans to real estate developers who had initial capital of less than 35 per cent of the property project's total investment.

Analysts said the current financial requirement reduction indicated a lowered threshold for real estate developers to apply for bank loans.

The country's real estate sector began to slow as the global financial crisis took a bigger than expected toll on the Chinese economy.

Real estate investment, a key driver of China's domestic expansion, contributing a quarter of the country's total fixed assets investment (FAI), is quite weak, which is in stark contrast to the country's galloping FAI growth this year.

In the first quarter of 2009, China's real estate investment grew at a mild pace of 4.1 per cent, reaching 488 billion yuan, down 28.2 percentage points from a year earlier, when there was a 28.6 per cent FAI growth, or 2.36 trillion in value, for the same period.

Analysts said the contrasting figures reflected sluggish private investment and the adjustment aims to boost real estate developer's view of new investments and help stabilise commercial property supply.

Liu Yuanchun, deputy head of the school of economics at Renmin University of China, said real estate investment may start to pick up in the second half of 2009 thanks to government stimulus measures.

"The 15 percentage point reduction in the financial requirement ratio is expected to release 300 billion yuan for investment in new property projects," Liu said.

"The move will boost market vibrancy and increase property supply, and also help drag down property prices," he added.

Homebuyers, however, appear to hold a different view. According to a survey on Sina.com, the nation's largest portal website, over 60 per cent of the respondents believed the move will ease capital strain for real estate developers and increase property prices.

Nearly 50 per cent of the respondents felt that the measures would help the property market recover.

[Source: China.org](http://http://www.china.org.cn/business/2009-05/31/content_17856721.htm) ([see archive](Commercial_property_norms_relaxed.pdf))

## Other

### Inferior medicines targeted

Celebrities who endorse fake or substandard pharmaceutical products will face criminal and civil liability, following a judicial interpretation that took effect recently.

"If these people know the nature of fake and inferior drugs but still help promote them, they will be dealt with as the accomplices of producers and dealers of the products," the new interpretation by the Supreme People's Court (SPC) and the Supreme People's Procuratorate stated.

The regulations also cover people who provide loans and grant production licenses to the makers and dealers of inferior products, those who give support in the form of production and management venues, those involved in the delivery and storage of the products, and those who contribute production technologies, raw materials, and materials for packaging.

A number of major cases involving the production and sale of fake or substandard drugs have come to light in the past three years, SPC vice-president Xiong Xuanguo told a press conference jointly held by the two judicial bodies and the State Food and Drug Administration.

The cases seriously endanger people's health, as well as the country's international image, the official said.

The latest judicial interpretation sparked heated online debate soon after it was announced.

Among the almost 3,000 comments on the major portal Sina.com by 7 pm, most people applauded the efforts but many also focused on the fact that celebrities had to be aware of the dubious nature of the products they were endorsing before they could be made liable for punishment.

"Who will confess she or he has endorsed such products under the awareness of its fake and substandard nature?" asked a netizen from Jiangsu province. "If no one makes such a confession, no celebrity will be suitably punished then the law will be meaningless."

Han Yusheng, a law professor with Renmin University of China, suggested that judicial departments make such judgments based on the standard of "common sense".

"If most people can tell that the drug a celebrity endorses is fake or substandard, judicial authorities should not simply listen to a defendant's claim to be ignorant," Han told China Daily.

Many Chinese celebrities endorse drugs and healthcare products even without using the products themselves, the professor said.

A few have been involved in scandals when products turned out to be fake or inferior, but punishments often only called for celebrities to return part of their fee.

"Some should face civil and even criminal liability if the fake drugs they helped promote have a serious impact on consumers," said Han, adding that the Criminal Law has a clear stipulation for "false advertisement crime".

Qiu Baochang, dean of Beijing-based Huijia Law firm, agreed and urged newspapers and TV stations to also take more responsibility.

"They need to be more prudent and strict in examining the qualifications of drug advert applications," Qiu said. "Under the new stipulations they should also be dealt with as accomplices if they promote drugs that are easily distinguished as fake or inferior."

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2009-05/27/content_7947381.htm) ([see archive](Cancer_of_inferior_medicines_targeted.pdf))

### Shenzhen resumes government reform

After being at a standstill for six years, a reform concerning government administration in Shenzhen has been revived and is expected to bring big changes.

The "General Proposal of Shenzhen Comprehensive Reforms" will be carried out now that the State Council has approved it earlier this month. The government administration system reform has been given top priority.

Such administrative reform has been a topic under discussion since 2003. It aims to restructure government departments.

According to Le Zheng, the chief of Shenzhen Academy of Social Sciences, the existing government structure will be divided into three main parts: the policymaking department, executive department and supervision department. Professor Ma Jingren with the School of Management at Shenzhen University, who is also one of the designers of Shenzhen's reforms, confirmed Le's statement.

Interaction among the three branches will help the government run more efficiently and will also play a positive role in checking each branch to keep the government free from construction.

After Tianjin Binhai new area and Shanghai Pudong area, Shenzhen is the third area to carry out comprehensive systematic reforms. However, Shenzhen differs from Tianjin and Shanghai and will set a precedent by forming a new government structure.

#### Lessons learned from failed cases

Every failed reform provides learning opportunities, and this was no exception. Similar to the present plan, the Shenzhen government wanted to divide its departments into three parts.

In order to make it easier for the government to rule and make decisions, the plan had placed the policymaking department in a higher position than the other two departments. However, this caused government sections to want to be placed under the rule of the higher department. If the plan continued, at least one fifth of the departments at bureau level would have faced merging. Although the plan had been successful for both Hong Kong and Singapore, and met the requirements of the central authorities, the plan did not work for Shenzhen.

"At first the plan was to set up three policymaking departments, but the plan finally increased that number to 21," said Ma Jingren. "The plan couldn't go ahead with the initial scheme."

#### Difficulties lie in policy level division

Now, the time is ripe for change. During the past six years, the central government's structure has changed a lot, benefiting government reform at a local level.

Compared to other cities, Shenzhen is a mature enough city to separate policymaking, executive and supervision rights. There are two key reasons for this: firstly, as a special economic zone, Shenzhen needs a more advanced government system to match its market economic system; secondly, Shenzhen's government and citizens have had time to prepare for the reform over the past six years.

In order to operate the "Proposal", the Shenzhen government will develop a three-year work plan. More supporting details will be revealed in the plan.

According to a The Beijing News report, Ni Xing, director of the School of Government Affairs at Zhongshan University, explained how the administrative reform was originally arranged: one mayor and one deputy mayor will be appointed, other existing deputy mayors will take be responsible for setting up policymaking committees; executive bureaus will be assigned to match each policymaking committee; and the current supervision bureaus will be combined with accounting offices to form supervision committees.

But Ma Jingren and Le Zheng said at present this is only a draft and the final plan is still in discussion.

As with the previously failed reform's personnel arrangement problem, the biggest hurdle with the plan this time is deciding how many departments should be set up and how to define their level. It is assumed that policymaking departments and executive departments exist at the same level.

Previous experience shows that reducing the existing policymaking departments in one step is impossible. "Big reform can be achieved from small changes, so we plan to first merge the current 21 policymaking departments to 18 or 15 departments, and then to reduce that number later when possible. This is also a practical way to carry out the ‘Proposal'," Ma Jingren analyzed.

Splitting the levels is even harder. "Giving the policymaking department more rights will make it easier to make policy. It is also reasonable. But the other two branches are unwilling," Ni Xing explained.

To avoid making the same mistake, the Shenzhen government will more likely classify the three government parts on the same level. Ma Jingren believes the executive department will not refuse to carry out new rules made by the policymaking department if the division of labour is made clearer. "Policymaking department and executive department can sign a contract that contains that year's task. The supervision department will then inspect them according to the contract to judge their performance," said Ma.

#### Chain reactions

Restructuring government departments requires other changes to take place. The "Proposal" indicates Shenzhen should play the role of pioneer to develop an advanced city administration system. By making adjustments to district divisions and reducing administrative departments, a new motto of, "one level of city government, three levels of administration," will replace the current motto of, "two levels of government, four levels of administration".

The current "two levels of government, four levels of administration" includes the city government, district government, sub-district office and residential committee. The latter two are government agencies. According to the plan, the district government will become part of a government agency to fulfill the one level city government.

Although the new system sounds like there will be a lot of change, the biggest change is only in the district governor's title. According to Le Zheng, government workers will not lose their jobs and can even keep their political status level.

All these changes will work to make Shenzhen a public service-oriented government by 2013 - seven years earlier than the nation expected, said Liu Yupu, secretary of the Municipal Party Committee of Shenzhen.

Another new policy is extending the range of the "special economic zone" to include all of Shenzhen. It means the policy of two laws in one market, which has existed for 20 years in Shenzhen, will be abolished.

Le Zheng indicated that although this is an achievable policy, it is a long-term aim and cannot be put into effect soon.

[Source: China.org](http://www.china.org.cn/2009-05/27/content_17847032_2.htm) ([see archive](Shenzhen_resumes_government_reform.pdf))

### China vows to ensure food safety as new law takes effect

Chinese authorities have recently pledged to use the new Food Safety Law as a platform to intensify monitoring and law enforcement, hoping to curb repeated food scandals battering the industry's reputation and consumer confidence.

It aims to improve the efficiency of the food safety-monitoring network through tougher standards, strict supervision, a recall system for substandard products and severe punishment for offenders.

The state departments of health, agriculture, quality supervision, and industry and commerce, which shoulder different responsibilities, have made plans for the implementation of the law.

The Ministry of Health, the leading authority to coordinate implementation of the law, has drafted at least three supplementary government rules to regulate the making of food safety standards, the management of new products, and the control of food safety risks.

Two national panels of experts will be set up to oversee safety standards and safety risk control. A national risk control centre will also be established to improve the level of safety evaluation, the detection of toxic ingredients, and risk precautions, said Health Minister Chen Zhu. "We hope to complete a national surveillance network for food safety in two years, on the same basis as the disease control and medical service networks," he said.

Some old rules that are contradictory to the new law will be abolished or revised, he said.

Even before the new law was passed, the ministry has carried out nationwide campaigns to crack down on the illegal use of uncertified additives in food products since December 2008, he said.

The Ministry of Agriculture, which is responsible for monitoring the safety of farm products, has been formulating regulations concerning the proper use of feed, feed additives and pesticide, and the quarantine of animals, said Deputy Minister Chen Xiaohua.

The State Administration for Industry and Commerce vowed to improve the supervision of food circulation, particularly food retailers who are asked to ensure the safety of food they sell.

Bian Zhenjia, deputy head of the State Food and Drug Administration, said the department would increase awareness within the catering industry to guarantee food safety through a variety of steps, including a new certification system for restaurants.

Although China has had certain food quality control systems in place for many years, lots of loopholes have emerged in past years, mainly due to varied standards, a lack of a sense of social responsibility among some business people, too lenient punishment for violators and a weakness in testing and monitoring work.

China has a food hygiene law, which took effect in 1995, to regulate food safety. But it was outdated and the food monitoring system has long been critisised for lacking efficiency, which led to repeated scandals ranging from tainted dairy products to vegetables containing excessive pesticide.

The adoption of the new food safety law was widely hailed as a landmark move to tackle these problems.

[Source: China Daily](http://www.chinadaily.com.cn/bizchina/2009-06/01/content_7959485.htm) ([see archive](China_vows_to_ensure_food_safety_as_new_law_takes_effect.pdf))

### The Supreme People's Court clarifies issues regarding the application for retrial of civil cases

The Supreme People's Court has recently released “Several Opinions on Accepting and Examining the Application for Retrial of Civil Cases” (Opinions). According to an official from the Supreme People's court, the Opinions are of crucial importance for protecting rights of various parties and regulating the retrial work of the people's courts.

The Opinions are divided into two parts: acceptance and review. The first part mainly clarifies the documents and conditions required for retrial, while the second part clarifies details concerning organisation, range and method of retrial.

According to the Opinions, the courts shall accept the application for retrial within five days if the application fulfills the following four conditions:

1. The applicant is one party listed in the binding judgment or ruling, or other person prescribed by laws or regulations;
2. The court that accepts the application is one level higher than the court that made the judgment;
3. The judgment to be reheard shall fall within the range as prescribed by laws and regulations;
4. The reason for retrial should fall within the range as prescribed by Article 179 of Civil Procedural Law.

[Source: southcn.com](http://law.southcn.com/fzxw/content/2009-05/19/content_5166488.htm) ([see archive](The_Supreme_Peoples_Court_clarifies_issues_regarding_the_application_for_retrial_of_civil_cases.pdf))

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