

domestic companies and foreign-invested companies contributes to the unfairness and discrimination in regulating companies' activities.

Stringent registered capital requirements for incorporation

The 1993 *Company Law* set a rather high requirement on registered capital. Article 23 provided different minimum capital requirements for registration according to the business nature of a company. The minimum registered capital for a company engaged in science and technology development and consultancy was RMB100,000 and for company engaged in production was RMB500,000.

In addition, Art 23 of the 1993 *Company Law* required the registered capital to be fully paid up one-off at the registration. Such high requirements posed difficulties for incorporation and limited the capital raising. In practice, many entrepreneurs bribed company registration officers and forged capital certificates so as to successfully register companies.

High threshold for companies to get listed

The share capital requirement of RMB50 million for a company to get listed was too difficult to meet (Art 151 of the 1993 *Company Law*). This frustrated those companies in urgent need of capital raising and indirectly led to the false disclosure in company registration process, packaging listing in China and red-chip overseas listing.

Doubts about the accountability of the management

The 1993 *Company Law* had provided the respective powers and responsibilities of the board of directors, the board of supervisors and shareholders' general meeting. However, lack of relevant enforcement procedures undermined the application of these provisions. For example, Art 45 designated the chairman of the board of directors to be the sole representative of a company. In China, the chairman often is also the chief executive director concurrently. Power concentrated in the hands of one single party without effective supervision caused the chairman to abuse his executive power in the management of the company.

Furthermore, the directors of a company are often appointed by majority shareholders or the government. Lack of independent directors in the decision-making process raised doubts about independence of the board deliberation and fulfilment of fiduciary duty of the directors.

Ineffective internal supervision

Supervisory board or supervisors had notoriously few functions in managing and overseeing company businesses. Pursuant to Art 52 of 1993 *Company Law*, limited liability companies with a relatively large-scale business operation are required to set up a board of supervisors, while limited liability company with a relatively small number of shareholders and of a relatively small scale may have one or two supervisors. Yet, the Law did not clarify the criteria of "relatively large-scale". In practice, many large limited liability companies did not even set up a board of supervisors. Even in those

companies that have a board of supervisors or supervisors in place, Art 54 provided the board of supervisors or supervisors very limited statutory power. The means for exercising such powers was insufficient as well. Consequently, their function in managing and overseeing company business operation was greatly undermined.

For listed companies, most of them were transformed from SOEs. The State acts as the largest shareholder in about 60% of listed companies and usually appoints the members from the relevant government authorities or public organisations as supervisors. The absence of supervisory independence and technical capacities of the supervisory roles, as well as inadequate regulations on supervisory powers and implementing procedures, ultimately affected the management and performance of company business.

Light punishment for management malpractice

The 1993 *Company Law* had provisions on the duties of directors, supervisors and senior management personnel of the company (Art 59–63) and liabilities for breaches of their duties (Art 63). Despite this, these duties were incomplete and the corresponding civil compensation liability was missing. Many company directors, especially those appointed by the government, did not perform their duties properly but bore no liabilities for corporate business failure.

No effective mechanism to protect minority shareholders

Article 111 allowed shareholders to bring an action against the company when shareholders' interests were infringed upon by a resolution passed in the shareholders' general meeting, however, lack of statutory procedural rules for bringing such actions led to the failure to accept this type of law suits by the courts. Although the Supreme People's Court was pressured to release judicial interpretations to respond to the repeated calls for minority shareholders protection, its change of attitude in judicial interpretations from 2001 to 2003 demonstrated the reluctance of move by the courts.

No effective means to ensure the integrity of auditing reports

SOEs often appointed accounting firms in their favour. Some accounting firms even gave false accounting information purely for profits. This is partly because no severe punishment had been imposed on the accounting firms and their employees for giving false reports. In addition, there were no clear provisions obliging companies to provide true information to accounting firms, nor were there provisions granting accounting firms the right to request true information about audited companies. In fact, even if some accounting firms subjectively wanted to do their jobs properly, the chance of getting accurate information for auditing could not be guaranteed objectively.

No limits of external investment

There were no provisions to restrict the company from purchasing and selling its major assets, or providing security to the related parties. The board of directors hence had a chance to abuse their power to deal with the company's assets for their own interests.

- (b) strict segregation between banking, insurance, securities and trust industries. This was consistent with the stages of the economic reform then, yet it no longer severs the current reform in the banking and insurance industries;
- (c) no effective mechanisms for the protection of minority shareholders;
- (d) narrow connotation of “securities”. Only shares and corporate bonds were allowed to be traded on stock exchanges and could only be traded on a stock exchange under the 1998 *Securities Law*. Trading over the counter was prohibited;
- (e) unnecessary restriction on business scope of securities companies. It was unreasonable to distinguish comprehensive securities companies and brokerage securities companies;
- (f) no effective civil liability provisions; and
- (g) unclear duty of information disclosure imposed on securities companies, securities clearing and settlement institutions.

In recent years, there were many calls from diverse fields in China to amend the 1998 *Securities Law*. According to the Legislative Plan of the Tenth NPC Standing Committee, the Fiscal and Finance Committee of the NPC formed a group to lead drafting of the *Securities Law*. The group included members of the Fiscal and Finance Committee, the LAC, the State Development and Reform Commission, the Legal Affairs office of the State Council, the CSRC and the Supreme People’s Court. A working group was also set up, consisting of members of these institutions, whilst eight experts were appointed to form an advisory committee.³ To tackle the problems in the China’s securities market, the Fiscal and Finance Committee drafted the *Securities Law Amendments Bill* after many revisions. Investigations were widely conducted in China. Seminars took place involving economics and law experts, listed companies, stock exchanges, securities firms, securities investment institutions, and medium and small sized investors. International symposia were held with foreign experts from the US, the UK, Germany, Korea and Hong Kong.⁴ On 20 April 2005, the *Securities Law Amendments Bill* was sent to the NPC Standing Committee for the first review. After that, the LAC sent the Bill to the departments of the State Council and local governments, as well as other relevant institutions and experts for comments and suggestions. A revised Bill was later sent to the 18th Plenary Meeting of the Tenth NPC Standing Committee for a second review and was subsequently passed in this meeting.

The *Securities Law Amendments Bill* was drafted in accordance with the guidelines from the Resolution of the Third Plenary Meeting of the 16th CCP Congress. This Resolution requires the government to “greatly improve capital and other markets, to further reform and stably develop the capital market, to broaden direct investment, [and] to establish a multi-level capital system”.⁵ It also requires the adoption of the principles of “openness, fairness and justice” in addition to those of “legalisation, supervision,

³ Fiscal and finance Committee, Explanatory Speech on the *Securities Law Amendments Bill*, 20 April 2004. This speech was published in Li F (ed) *Annotation of the PRC Securities Law*, Beijing: Law Press, 2005, p 415–424.

⁴ Li, F, p 416.

⁵ Ibid.

self-regulation and standardisation”.⁶ The legislative goals of the 2005 *Securities Law* include:

- (a) to regulate and standardise the issue and trading of securities;
- (b) to protect the rights of investors; and
- (c) to maintain socialist economic order and socialist public interest and strengthen the development of a socialist market economy.⁷

The major changes to the 1998 *Securities Law* can be summarised as follows.

¶3-002 Improved supervisory mechanism of listed companies

Many corporate failures and irregularities were caused by lack of effective supervision. The 2005 *Securities Law* aims to improve the supervision by the following means:

- (a) Establishing a listing sponsor system in the issuance of securities (Art 11). A listing sponsor system was recognised in the Law in accordance with the requirements of the State Council’s *Several Opinions on Further Improvement of the Share Issue System and Adoption of a Listing Sponsor System*. Only institutions can act as sponsors. Listing sponsors are imposed on duty of honesty and trust, duty of care and diligence. If a sponsor violates its duties, it shall be subject to reprimand, confiscation of profits, fine, suspension of business and cancellation of business license. The employees of this sponsor directly responsible for a violation may be subject to personal liabilities (Art 192).
- (b) Enhancing the duties imposed on controlling shareholders, *de facto* controllers, directors, and senior managerial officers of listed companies (Art 67, 69).
- (c) Establishing a pre-disclosure system to enhance transparency of listings (Art 21).

¶3-004 Strengthened supervisory framework of securities companies

The capital requirement for setting up a securities company has been significantly reduced from RMB500 million to RMB200 million. Other requirements have also been rewritten (Art 124). It is clearly stated that securities companies must have articles of association that are in accordance with the *Securities Law* and *Company Law*.

The 2005 *Securities Law* allows securities companies to expand their business overseas. However it leaves the CSRC to make detailed rules in this respect.

Securities companies are no longer classified as brokerage securities companies or comprehensive securities companies. With the approval of the CSRC, any securities company can conduct part or all of the securities business (Art 125).

Management personnel of securities companies shall meet certain employment qualifications. Both positive and negative qualifications are provided in the

⁶ Ibid.

⁷ Ibid, p 3–4.

Chapter VI — Qualifications and Duties of Company Directors, Supervisors and Senior Management Personnel

Chapter VII — Corporate Bonds

Chapter VIII — Finance and Accounting of Companies

Chapter IX — Merger, Division, Increase in Capital and Capital Reduction of Companies

Chapter X — Dissolution and Liquidation of Companies

Chapter XI — Branches of Foreign Companies

Chapter XII — Legal Liability

Chapter XIII — Supplementary Provisions

CHAPTER I — GENERAL PRINCIPLES

Article 1. This Law is formulated for the purposes of standardising the organisation and activities of companies, protecting the legal rights and interests of companies, shareholders and creditors, safeguarding social and economic order and promoting the development of socialist market economy.

[Annotation:

This Article contains three legislative purposes of the 2005 *Company Law*. The purpose of “meeting the need of establishing a modern enterprise system” in Art 1 of the 1993 *Company Law* has been deleted since the goal of establishing a modern enterprise system was viewed to have been already achieved.

Company is a widely used business structure in a market-orientated economy. It is a separate legal entity that offers greater business flexibility and shields shareholders from corporate liabilities for business failures and claims. As a basic governing law, the *Company Law* should clarify the rights and duties of companies, regulate the internal relationship between the company management and its shareholders, adopt civil and administrative penalties and profoundly protect the interests of the company, the shareholders and the creditors.

After some 20 years of corporate practice since the establishment of modern company regime, there still are areas of concern, particularly as regards poor corporate governance structure, frequent infringement of the interests of minority shareholders by controlling shareholders, lack of the sense of trust and honesty as a whole, weak protection of stakeholders’ interests. When amending the 1993 *Company Law*, the legislators were more focused on how to address these existing problems in practice.]

Article 2. Companies referred to in this Law shall mean limited liability companies and companies limited by shares established in China in accordance with the provisions of this Law.

[Annotation:

The *Company Law* allows only two types of companies to be established in China: limited liability company and company limited by shares. The former refers to a company in which shareholders’ liability is limited to their subscribed registered capital when the company is wound up. The latter refers to a company in which shareholders assume liability within the limit of their subscriptions to the company shares capital. Since China opened its door in the late 1970s, the number of Chinese companies has been increasing at a tremendous pace. By the end of 2004, more than 1.2 million companies have been incorporated, among which nearly 10,000 are in the form of companies limited by shares and the rest are limited liability companies.

The 2005 *Company Law* once again excludes the establishment of unlimited liability companies, partnership and individual investment enterprises. The latter two are governed by other laws. Based on foreign experience, China allows natural persons or legal persons, apart from the State and foreign investors, to establish one-person limited liability companies.

As for the wholly State-invested companies, there have been some changes following their development and further management. The 2005 *Company Law* for the first time clearly designates the State-owned Assets Supervision and Administration Commission and their provincial branches to represent the State to perform the rights and responsibilities as investors.

In terms of companies limited by shares (most of them will be listed on a stock exchange later), there had been serious concerns especially regarding the frequent infringement of the interests of minority shareholders by controlling shareholders. New provisions pertaining to the organisational structure of listed companies have been stipulated in the 2005 amendments to tackle this problem, eg listed companies are now required to appoint independent directors.]

Article 3. A company is an enterprise legal person which owns independent legal person property and enjoys legal person property rights.

The liability of a company shall be limited to its entire assets. The liability of a shareholder of a limited liability company shall be limited to the amount of its capital contribution. The liability of a shareholder of a company limited by shares shall be limited to the number of its subscribed shares.

[Annotation:

This Article recognises the fundamental principle of modern company mechanism under which company is an organisation with independent legal person property right and with independent civil liability. It for the first time clarifies the independent legal person status and shareholders’ limited liabilities.

Article 3 of the 1993 *Company Law* formerly read:

“Limited liability companies and companies limited by shares are enterprises with legal person status.

[Annotation:]

This new provision puts the brakes on related party transactions by imposing severe civil compensation liability on the party who has conducted related party transactions.

Related party transactions are also called affiliated transaction or connected transactions. They refer to the transactions between the company and other parties who have investment or shareholding relationships with the company. Not all affiliated transactions are prohibited. Some affiliated transactions may help share business risks and maintain the stability of the company business. Nevertheless, as most of the related party transactions are usually hidden deep in the contractual documents where investors will not notice, it might create potential conflicts of interests among company shareholders.

In China, the majority shareholders, the actual controllers and the management of the company often put their interests ahead of shareholders' interests through various arrangements such as misappropriating company funds to provide guarantee or loan for themselves or their relatives or friends, entering contracts with their own companies, transferring the profits of the company to affiliated parties or robbing the company of a advantageous business relationship etc. As the 1993 *Company Law* had no provision on affiliated transactions, the CSRC and the Ministry of Finance had to release some administrative directives to regulate such transactions. Due to complication and diversification of affiliated transactions in practice, Article 21 is added to curb the increasing contraventions.

Further read Art 125 and 217 of the 2005 *Company Law*.]

Article 22. A resolution passed by the meeting of shareholders or a shareholders' general meeting or the board of directors which violates laws and administrative regulations shall be void.

Where the convening procedures and voting method of a shareholders' meeting or a shareholders' general meeting or the board of directors violates laws and administrative regulations or the articles of association of the company, or the contents of the resolution violate the articles of association of the company, the shareholders may apply to a people's court within 60 days from the date of resolution for rescission of the resolution.

Where the shareholders file for a lawsuit in accordance with the preceding paragraph, the people's court may, upon a request of the company, ask the shareholders to provide the corresponding guarantee.

Where a company has completed change of registration formalities in accordance with a resolution passed by a shareholders' meeting, or a shareholders' general meeting, or the board of directors and upon nullification or rescission of such resolution by a people's court, the company shall apply to the Company Registration Authorities for rescission of the change of registration.

[Annotation:]

This Article creates a new juridical remedy for the protection of shareholders. Pursuant to this Article, when a resolution of the company contravenes laws or

administrative regulations or the articles of association, any shareholder has the right to sue to the court for rescission of such resolution.

Under the Company Law, the meeting of shareholders or the shareholders' general meeting is the body of supreme authority; the board of directors is the body which implements the resolutions passed by the shareholders' meeting or the shareholders' general meeting and decides on the day-to-day business operation of the company. The resolution of the shareholders' meeting, or the shareholders' general meeting, or the board of directors will have a great impact on overall interests of the shareholders. If a resolution is passed with a defect either in contents or in formality, the interests of shareholders may thus be trespassed upon. Therefore, most jurisdictions allow a lawsuit to invalidate the resolution to be brought by any shareholder either when the contents of the resolution, or when the proceedings of passing such resolution contravene law, administrative regulations or the articles of association of the company.

To preclude the company from being burdened by unnecessary lawsuits, Art 22 provides three safeguards:

- The right to sue is only delegated to shareholders.
- The shareholder will need to commence a suit within certain period of time before the right to sue is lost.

The shareholder should provide the relevant guarantee on the request of the company in order for the action to proceed.]

CHAPTER II — ESTABLISHMENT AND ORGANISATION OF LIMITED LIABILITY COMPANIES

Section 1 — Incorporation

Article 23. Incorporation of a limited liability companies shall satisfy the following requirements:

- (1) the quorum of shareholders shall be met;
- (2) the capital contribution of shareholders shall meet the minimum statutory capital requirement;
- (3) the articles of association of the company shall be jointly drafted by the shareholders of the company;
- (4) a company name shall exist and the organisation shall satisfy the requirements of a limited liability company; and
- (5) a company address shall exist.

[Annotation:]

Further read Art 7(2), 10, 24, 25 and 26(2) of the 2005 *Company Law*.]

Article 24. Limited liability companies shall be incorporated by not more than 50 shareholders contributing to the capital.

The board of directors shall appoint one chairman and may appoint a deputy chairman. The appointment of chairman and a deputy chairman shall be stipulated by the articles of association of the company.

Article 46. The term of appointment of a director shall be stipulated by the articles of association of the company, but each term shall not exceed three years.

Upon expiry of the term of appointment, a director may be re-elected. Where no new appointment is made upon expiry of the term of appointment of a director or a director has resigned during his/her term of appointment and causes the number of directors that constitutes the board of directors to fall below the quorum, the original director shall, prior to the new director taking office, continue to perform his/her duties as a director in accordance with the provisions of laws and administrative regulations and the articles of association of the company.

Article 47. The board of directors shall be accountable to the shareholders' meeting and shall exercise the following duties and powers:

- (1) convene shareholders' meetings and report to the board of shareholders;
- (2) execute the resolutions passed by the board of shareholders;
- (3) decide on the business plans and investment schemes of the company;
- (4) formulate the annual financial budget and financial accounting plan of the company;
- (5) formulate the profit distribution plan and loss recovery plan of the company;
- (6) formulate the plan for increase or reduction of registered capital and issue of corporate bonds;
- (7) formulate the plan for merger, division, dissolution or change of company structure;
- (8) decide on the set-up of internal management organisation of the company;
- (9) decide on appointment or dismissal of company managers, and their remuneration, and decide on appointment or dismissal of deputy managers and finance controller of the company based on the nomination by the managers;
- (10) formulate the basic management system of the company; and
- (11) other duties and powers stipulated by the articles of association of the company.

[Annotation:

As discussed above, the board of directors in Chinese companies is a body under the shareholders' meeting. This organisation structure is emphasised in Art 47. The board of directors being responsible to the shareholders' meeting determines the low efficiency of business operation in Chinese companies.]

Article 48. Meetings of the board of directors shall be convened and chaired by the chairman; where the chairman is unable or fails to perform his/her duties, the deputy chairman shall convene and chair the meeting; where the deputy chairman is

unable or fails to perform his/her duties, a director appointed by half or more of the board of directors shall convene and chair the meeting.

Article 49. The rules of procedure and voting procedures of the board of directors shall be stipulated by the articles of association of the company, unless otherwise provided in this Law.

The board of directors shall record minutes of meeting and the directors present at the meeting shall sign on the minutes of meeting.

The board of directors shall exercise one vote per person for passing of resolutions.

Article 50. Managers of limited liability companies may be appointed or dismissed by the board of directors. The managers shall be accountable to the board of directors and shall exercise the following duties and powers:

- (1) manage the production and business operations of the company and organise and implement resolutions passed by the board of directors;
- (2) organise and implement the annual business plan and investment scheme of the company;
- (3) draft the plan for setting up of internal management organisation of the company;
- (4) draft the basic management system of the company;
- (5) formulate company rules and policies;
- (6) recommend appointment or dismissal of deputy manager and financial controller of the company;
- (7) decide on appointment or dismissal of management staff other than those positions which are to be decided by the board of directors; and
- (8) other duties and powers granted by the board of directors.

Where there are provisions in the articles of association of the company on the duties and powers of managers, such provisions shall prevail.

Managers shall attend meetings of the board of directors.

[Annotation:

Managers in Chinese companies play a much more important role than their counterparts in common law countries. They have been given special management powers under China's Company Law. In Australia, managers are not given specific powers in the *Companies Act*.]

Article 51. Limited liability companies with relatively fewer shareholders or of a relatively smaller scale may appoint an executive director instead of establishing a board of directors. An executive director may hold the post of company manager concurrently.

The duties and powers of the executive director shall be stipulated by the articles of association of the company.

a notice stating the date, venue and agenda of the meeting shall be given 30 days in advance.

A shareholder who holds 3% or more of the shares of the company, or several shareholders who hold 3% or more of the shares of the company jointly, may submit a written proposal of an interim agenda item ten days before the shareholders' general meeting is convened to the board of directors; the board of directors shall inform the other shareholders of such proposal within two days from receipt of the proposal and table the proposal at the shareholders' general meeting for review. The contents of the proposed agenda item shall be within the scope of duties and powers of the shareholders' general meeting and shall contain a specific topic and a specific resolution.

The shareholders' general meeting shall not resolve on matters which are not set out in the notice of meeting.

Holders of bearer shares attending the shareholders' general meeting, shall deposit their share certificates with the company from five days prior to the meeting to the conclusion of the shareholders' general meeting.

[Annotation:

The significance of this new provision is that it provides detailed procedures for convening shareholders' general meetings and grants shareholders the right to submit proposals to general meetings.

The right to submit proposals is one of the new rights given to shareholders in the 2005 *Company Law*. However, this right must be exercised according to promulgated conditions and procedures. As a matter of fact, very few shareholders individually hold 3% or more of the company shares. It hence will not be very common for shareholders to exercise the right to submit proposals.

To ensure the fairness at the shareholders' general meeting, Art 103 also requires that any item, which is not listed in the notice of the company meeting or the shareholders' proposal, must not be resolved at the meeting.]

Article 104. Shareholders attending the shareholders' general meeting shall have one vote for one share held. Company shares held by the company shall not carry voting rights.

Resolutions of the shareholders' general meeting shall be passed by a simple majority of votes cast by shareholders present at the meeting. Resolutions of the shareholders' general meeting on amendment to the articles of association of the company, increase or reduction in registered capital, merger, division, dissolution or change of company structure shall be passed by a two-thirds majority of votes cast by shareholders present at the meeting.

[Annotation:

This Article maintains the principle of "one share, one vote" as provided under Art 106 of the 1993 *Company Law*. It also maintains that the resolution of the shareholders' general meeting must be passed by a more than 50% majority of votes. Amendments are made to these two aspects:

- Passing of the resolution on major business transactions such as merger, division or dissolution. The resolution as such can only be passed by the shareholders holding more than two-thirds of the shares with voting rights.
- Shares without voting rights. In general, a shareholder in a company limited by shares has equal voting right on each share he holds. This reflects the tenet of shareholder democracy. The articles of association can provide no exception. However, when a company is holding shares of its own, the shares are without voting rights. This provision is intended to avoid confusion of the company identity and its shareholders identity.

In addition, as the issues to be discussed at the shareholders' general meeting are of different importance, the 2005 *Company Law* provides two different methods to pass a resolution:

- An ordinary resolution is only required to be passed by a more than 50% majority. Shares without voting right must not be counted.
- A special resolution must be passed by a two-thirds majority on the special issues, including merger, division, dissolution or change of the company.

Some jurisdictions set a much higher requirement for passing important resolution. One example can be that special resolutions in Australia must be passed by shareholders holding more than 75% of the shares with voting rights, and the meeting shall have a special advance notification.

The 2005 *Company Law* does not provide the quorum for the shareholders' general meeting because companies limited by shares are required to notify all shareholders of the general meeting within a prescribed time limit. A quorum refers to the minimum required number of shareholders attending the meeting for holding a valid meeting. A shareholder who fails to attend the meeting on schedule is deemed to have given up his voting rights at the general meeting; thus the other shareholders may vote to pass a resolution. At best, such arrangement facilitates resolution to be made and increases the efficiency of the meeting; at worst, the resolution does not represent the will of majority of the shareholders.]

Article 105. Where the provisions of this Law and the articles of association of the company require a resolution of the shareholders' general meeting for the transfer of major assets to others or vice versa or provision of guarantee to external parties etc, the board of directors shall convene a shareholders' general meeting promptly for the passing of a resolution on the aforesaid matter.

Article 106. A cumulative voting system may be implemented for the election of directors and supervisors at a shareholders' general meeting in accordance with the provisions of the articles of association of the company or a resolution of the shareholders' general meeting.

The cumulative voting system referred to in this Law shall mean that the voting rights carried by each share shall correspond to the number of directors or supervisors to be elected, and shareholders may use their voting rights collectively for election of directors or supervisors at a shareholders' general meeting.

shareholders, it may not be practically enforceable. Matters involving affiliated transaction are usually important and urgent business operation, yet it is not very easy to call a shareholders' general meeting. Leaving matters involving affiliated transactions with a shareholders' general meeting may miss the business opportunity.]

CHAPTER V — SHARE ISSUES AND SHARE TRANSFERS OF COMPANIES LIMITED BY SHARES

Section 1 — Share Issues

Article 126. The capital of a company limited by shares is divided into shares of equal par value.

Shares of the companies shall be in script form. Share certificates are the proof issued by a company for the shares held by the shareholders.

[Annotation:

Further read Art 129 and 130 of the 2005 *Securities Law*.]

Article 127. Share issues shall comply with the principles of fairness and equity. Shares of the same type shall rank *pari passu*.

The terms and price shall be the same for all shares of the same type in a share issue. An organisation or individual shall pay the same price for each share subscribed.

Article 128. Shares may be issued at the par value or at a premium but shall not be issued below par value.

Article 129. Shares shall be issued in script form or other forms stipulated by the securities regulatory authorities of the State Council.

A share certificate shall state the following:

- (1) name of the company;
- (2) date of incorporation of the company;
- (3) type of shares, par value and number of shares; and
- (4) serial number of the share certificate.

Share certificates shall be signed by the legal representative and affixed with the company seal.

Share certificates for promoter's shares shall state the wordings "promoter's shares".

Article 130. Shares issued by a company may be in the form of registered shares or bearer shares.

Shares issued by a company to promoters or legal persons shall take the form of registered shares and the share certificates shall state the name of the promoter or legal person and shall not state another name or the name of a representative.

Article 131. Companies issuing registered shares shall keep a register of shareholders which records the following:

- (1) name and address of the shareholder;
- (2) number of shares held by each shareholder;
- (3) serial number of the share certificate of each shareholder; and
- (4) date of acquisition of shares of each shareholder.

Companies issuing bearer shares shall record the number of shares, serial number of share certificates and date of issue.

Article 132. The State Council may formulate separate regulations on companies issuing other types of shares which are not provided in this Law.

[Annotation:

In other words, except for registered shares or bearer shares, other types of shares such as preference shares, ordinary shares and non-voting shares etc are to be regulated by the State Council.]

Article 133. A company limited by shares shall deliver share certificates to their shareholders upon its incorporation. A company shall not deliver share certificates to its shareholders prior to its incorporation.

Article 134. A resolution on the following matters shall be passed in accordance with the provisions of the articles of association of the company for issue of new shares:

- (1) type and number of new shares;
- (2) issue price of new shares;
- (3) date of commencement and cut-off date for issue of new shares; and
- (4) type and number of new shares issued to existing shareholders.

Article 135. Companies approved by the securities regulatory authorities of the State Council to issue new shares shall announce the prospectus of the new shares and financial report and prepare a subscription form.

The provisions of Article 88 and 89 shall apply to issue of new shares.

Article 136. A company may determine the pricing scheme in accordance with its business and financial status for issue of new shares.

Article 137. A company shall complete change of registration formalities with the company registration authorities and make an announcement after all the new shares being issued are fully subscribed.

Section 2 — Share Transfers

Article 138. Shareholders may transfer their shares in accordance with the provisions of the law.

The corporate bond certificates for convertible corporate bonds shall state the wordings “convertible corporate bonds” and the balance of convertible corporate bonds shall be recorded in the corporate bond counterfoil record book.

[Annotation:

Further read Art 2, 9, 10 and 15 of the *Interim Measures on Administration of Convertible Corporate Bonds*.]

Article 163. Companies which have issued convertible corporate bonds shall convert such corporate bonds into shares for the bondholders in accordance with the method of conversion; however the bondholders shall have the right to opt for conversion of such corporate bonds into shares or not to convert.

CHAPTER VIII — FINANCE AND ACCOUNTING OF COMPANIES

Article 164. Companies shall establish their finance and accounting system in accordance with the provisions of the laws and administrative regulations and the rules of the finance authorities of the State Council.

Article 165. Companies shall prepare financial accounting reports at the end of each accounting year and such financial accounting reports shall be audited by an accounting firm in accordance with the provisions of the law.

Preparation of financial accounting reports shall comply with the provisions of laws and administrative regulations and the rules of the finance authorities of the State Council.

Article 166. Limited liability companies shall deliver their financial accounting reports to all shareholders by the deadline stipulated in the articles of association of the company.

The financial accounting reports of a company limited by shares shall be made available at the company at least 20 days before the date of the annual general meeting for inspection by the shareholders; companies limited by shares, which have made public offering of shares, shall announce their financial accounting reports.

Article 167. Companies shall contribute 10% of the profits into their statutory surplus reserve upon distribution of their post-tax profits of the current year. A company may discontinue the contribution when the aggregate sum of the statutory surplus reserve is more than 50% of its registered capital.

Where the balance of the statutory surplus reserve of a company is insufficient to make good its losses in the previous year, the company shall make good such losses using its profits of the current year before making contribution to the statutory surplus reserve in accordance with the provisions of the preceding paragraph.

Upon contribution to the statutory surplus reserve using its post-tax profits, a company may make further contribution to the surplus reserve using its post-tax profits in accordance with a resolution of the board of shareholders or a shareholders' general meeting.

The provisions of Article 35 shall apply to the limited liability companies for making good of losses and contribution to the surplus reserve using post-tax profits; companies limited by shares shall make contributions based on the shareholding ratio of the shareholders, unless their articles of association provide otherwise.

Where the board of shareholders, board of shareholders or board of directors violates the provisions of the preceding paragraphs to make profit distribution to the shareholders before making good the losses and contributing to the statutory surplus reserve, the shareholders shall return such distributed profits to the company.

Companies, which have made a share buyback, shall not make profit distributions on bought-back shares.

Article 168. The proceeds from shares of a company limited by shares issued at a premium and other income which are required to be contributed to the statutory surplus reserve as provided by the finance authorities of the State Council shall be contributed to the statutory surplus reserve accordingly.

Article 169. The surplus reserve of a company shall be used to make good the losses of the company or expand the business and production of the company or converted into additional capital. However, the statutory surplus reserve shall not be used to make good the losses of the company.

In the event of a conversion of statutory surplus reserve into additional capital, the balance of the statutory surplus reserve after the conversion shall not be less than 25% of the registered capital of the company before the increase.

Article 170. Appointment or removal of the auditor of a company shall comply with the provisions of the provisions of the articles of association of the company and decided by the board of shareholders, a shareholders' general meeting or the board of directors.

The board of shareholders, a shareholders' general meeting or the board of directors shall allow the auditor to make a representation when passing a resolution on the removal of the auditor.

Article 171. Companies shall provide accurate and complete accounting vouchers, accounting books, financial accounting reports and other accounting information to their auditor and shall not refuse to provide information, hide or provide false information.

Article 172. Companies shall not establish separate accounting books other than statutory accounting books.

Company assets shall not be deposited in accounts opened and maintained in the name of an individual.

CHAPTER IX — MERGER, DIVISION, INCREASE IN CAPITAL AND CAPITAL REDUCTION OF COMPANIES

Article 173. Mergers of companies may take the form of mergers by absorption or mergers by new establishment.

- suspension of business;
- revocation of qualification certificates; and
- revocation of business license.

Among these five penalties, (a) and (b) are compulsorily imposed on the institutions. The penalties under (c), (d) and (e) may be chosen by the company registration authority. The penalties under (a), (b), (c) and (e) are imposed on the company. The penalty under (d) is imposed on individuals who are directly responsible.

The liabilities under Art 208(2) only apply in certain circumstances. If the gross omissions in the documents are made by negligence, the relevant institution will be ordered to make corrections; if the gross omissions are made on purpose, other liability such as criminal liability will be imposed as well. If the situation is not serious, corrections can be enough; if serious, a fine between one to five times of the amount of the illegal profits will be imposed. "The situation is serious" means that such misconduct has caused gross economy loss or very bad effect, and has disrupted the market order or caused chaos in society. At the same time, the relevant authority may order the institution to suspend its business and/or revoke the qualification certificates of the individuals involved, and/or revoke the business license of the institution.

Further read Art 229 of the 1999 *Criminal Law*.]

Article 209. Where the company registration authorities grant registration to applicants which do not satisfy the requirements stipulated in this Law or reject registration applications which satisfy the requirements stipulated in this Law, the person-in-charge and other personnel who are directly responsible shall be subject to administrative punishment in accordance with the provisions of the law.

Article 210. Where the higher company registration authorities order the company registration authorities to grant registration to applicants which do not satisfy the requirements stipulated in this Law or to reject registration applications which satisfy the requirements stipulated in this Law or to cover up illegal registration, the person-in-charge and other personnel who are directly responsible shall be subject to administrative punishment in accordance with the provisions of the law.

Article 211. An entity which is not duly registered as a limited liability company or a company limited by shares but uses the name of a limited liability company or a company limited by shares or an entity which is not duly registered as a branch company of a limited liability company or a company limited by shares but uses the name of a branch company of a limited liability company or a company limited by shares shall be ordered by the company registration authorities to make correction or to be closed down and may be imposed a fine of not more than RMB100,000.

Article 212. A company which fails to commence operations after six months from its incorporation or cease operations for more than six months after commencement of operations arbitrarily without any justification shall have its business licence revoked by the company registration authorities.

A company which fails to complete change of registration formalities for a change in company registration details in accordance with the provisions of the Law shall be ordered by the company registration authorities to complete the registration formalities by a stipulated deadline; if the registration formalities are not completed by a stipulated deadline, a fine ranging from RMB10,000 to RMB100,000 shall be imposed.

Article 213. A foreign company which violates the provisions of this Law in establishing a branch company in China shall be ordered by the company registration authorities to make correction or to be closed down and may be imposed a fine ranging from RMB50,000 to RMB200,000.

Article 214. A company which uses the name of a company to engage in activities which compromise national security or public interest shall have its business licence revoked.

Article 215. A company which violates the provisions of this Law shall bear civil compensation liability and pay fines and penalties; where its assets are insufficient for payment, civil compensation shall take precedence.

Article 216. Where a violation of the provisions of this Law constitutes a criminal offence, criminal liability shall be pursued in accordance with the provisions of the law.

CHAPTER XIII — SUPPLEMENTARY PROVISIONS

Article 217. The following terms used in this Law shall take the following definitions:

- (1) Senior management personnel shall mean the manager, deputy manager, financial controller, board secretary of a listed company and other personnel stipulated in the articles of association of the company.
- (2) Controlling shareholder shall mean a shareholder who contributes to 50% or more of the capital of a limited liability company or a shareholder who holds 50% or more of the shares of a company limited by shares or a shareholder who is able to exercise significant influence on the resolutions of the board of shareholders or a shareholders' general meeting even though it contributes to less than 50% of the capital or holds less than 50% of the shares.
- (3) Actual controlling party shall mean a party which exercises actual control over a company as investor or through other agreements or arrangements even though it is not a shareholder of the company.
- (4) Related parties shall mean controlling shareholders, actual controlling party, directors, supervisors, senior management personnel of a company and those enterprises which have a direct or indirect control over a company or whose relationship with the company may result in a transfer of the company's interests. However, fellow State-controlled enterprises shall not be deemed as related parties merely for this affiliation.

The securities regulatory authorities of the State Council may establish representative offices based on the actual needs to perform supervision and administration duties as authorised.

Article 8. Under the prerequisite of unified State supervision and administration on issuance and trading of securities and the securities industry association shall be established in accordance with the provisions of the law to implement self-governance.

Article 9. State audit authorities shall carry out audit and supervision over stock exchanges, securities companies, securities registration and settlement organisations and securities regulatory authorities in accordance with the provisions of the law.

CHAPTER II — ISSUANCE OF SECURITIES

[Annotation:

Significant changes have been made to this chapter. The number of Articles has been increased from 20 to 26. The previous requirements for issuing securities as provided in chapter II of the 1998 *Securities Law* was widely criticised for being too general and insufficient. In addition, some important provisions such as listing requirements, requirements for initial public offering and corporate bonds issuance, were stipulated in the 1993 *Company Law* rather than in the 1998 *Securities Law*. The 2005 amendments to the *Company Law* and *Securities Law* help such relevant provisions find their way back in the *Securities Law*.]

Article 10. Public offering of securities shall satisfy the criteria provided in the laws and administrative regulations and obtain the approval of the securities regulatory authorities of the State Council or authorised department(s) of the State Council in accordance with the provisions of the law. No organisation or individual shall issue securities for public offering without obtaining prior approval in accordance with the provisions of the law.

The following situations shall be deemed as a public offering:

- (1) offering of securities to non-specific targets;
- (2) offering of securities to more than 200 specific targets cumulatively; and
- (3) other offerings provided by the laws and administrative regulations.

Private placement of securities shall not carry out advertising, open solicitation and disguised publicity campaigns.

[Annotation:

This Article adopts the verification and approval system for securities issuance in lieu of the examination and approval system under the 1998 *Securities Law*. Under the old system, share issuance and corporate bonds issuance were subject to different approval procedures. Share issuance was only subject to the verification and approval of the CSRC. The CSRC conduct procedural examination and would approve the application for share issuance so long as the application documents comply with the

formal requirement and are without obvious error. While for public offering of corporate bonds, however, the CSRC had the right and obligation to conduct substantial examination on the issuer's application prior to the approval. Thus it raised criticism that the CSRC should be partly responsible for the fraud or false disclosure of the information provided in application documents given that the CSRC had examined the bonds issue application in substance. The 2005 *Securities Law* has abandoned different approaches to the applications for share issuance and corporate bonds issuance and establishes a unified verification and approval system. Under this new system so long as the application documents for share issuance or bonds issuance satisfy the prescribed conditions, the CSRC will approve such application. In other words, the CSRC no longer ensures the authenticity, accuracy and completeness of the information in the application documents.

This Article also sets out a definition of public offering of securities. Securities in China can be legally issued either by way of public offering or private placement. The State normally exercises stricter regulation on securities public issuance than private placement since the former involves public investors and has deep impact on public interest, while the latter involves a relatively small group of designated people and thus has a small impact on general public. The concept of "specific targets" in item (2) mainly refers to the investors especially targeted by the company, including the existing shareholders, employees of the company and their relatives and friends, as well as designated institutional investors such as investment funds and insurance companies.¹ The requirement for a minimum number of 200 investors cumulatively is to prevent companies from conducting a series of small private issuances separately to evade the strict information disclosure requirements of public offering. Such small issues may indirectly constitute public issuing.

Item (3) is a flexible provision which delegates the laws and administrative regulations to make alternative provisions regarding the concept of public issuing.]

Article 11. Issuers applying to make a public share offering or to issue convertible corporate bonds by way of underwriting in accordance with the provisions of the law or to make a public offering of other securities which require a sponsor as provided by the laws and administrative regulations shall appoint a qualified organisation to act as a sponsor.

A sponsor shall comply with business rules and industry norms and the principles of honesty and trustworthiness and due diligence to conduct due diligence review on the application documents and information disclosure of the issuer and supervise the conduct of the issuer.

The qualifications of sponsors and the relevant administrative measures on sponsors shall be provided by the securities regulatory authorities of the State Council.

[Annotation:

The sponsorship system was initially introduced by the CSRC in its *Provisional Measures on the Securities Issuance and Listing Sponsorship System*. Article 11

¹ Li, F., *Annotation of the New Securities Law*, Law Press, 2005, Beijing, p 16.

[Annotation:

The 1998 *Securities Law* only allowed spot transaction, which means the buyers and sellers of the same kind of securities must purchase securities and pay money on the spot. Trading in futures and options was banned under the 1998 *Securities Law*. In response to the recent development in the China's securities market, the 2005 *Securities Law* removes the barriers on futures and options trading in an attempt to enrich the securities trading. For the purposes of financial risks control and investors protection, other forms of securities trading must be approved by the CSRC.]

Article 43. The personnel of stock exchanges, securities companies, securities registration and settlement organisations and the securities regulatory authorities and other personnel prohibited by the laws and administrative regulations from trading in shares shall not buy and sell shares directly or using an alias or hold shares in the name of another person or accept gifts of shares from others during their term of appointment or the statutory period.

The aforesaid personnel shall transfer such shares held by him/her in accordance with the provisions of the law prior to taking up an appointment of the aforesaid posts.

Article 44. Stock exchanges, securities companies and securities registration and settlement organisations shall keep information of accounts opened and maintained by their customers confidential in accordance with the provisions of the law.

Article 45. A securities service organisation and its personnel involved in the issuance of an audit report, an asset valuation report or a legal opinion etc for a share issuance shall not buy or sell such shares within the underwriting period of the shares and within six months from the expiry of the underwriting period.

With the exception of the provisions in the preceding paragraph, a securities service organisation and its personnel involved in the issuance of an audit report, an asset valuation report or a legal opinion for a listed company shall not buy or sell the shares of the listed company during the period from its acceptance of the appointment by the listed company to the 6th day after the announcement of the aforesaid document(s).

Article 46. Securities transaction fees shall be reasonable and the fee items, rates and payment method shall be made public.

Fee items and rates of and administrative measures on securities transaction fees shall be standardised and stipulated by the relevant department(s) of the State Council.

Article 47. The gains made by a director, supervisor or senior management personnel of a listed company holding 5% or more of the shares of the listed company from selling shares of the company within six months from the purchase of such shares or buying shares of the company within six months from the sale of such shares shall belong to the company; the board of directors of the company shall collect such gains. However, an underwriter, which holds 5% or more of the shares of a listed company from buying the unsold shares in accordance with the

underwriting agreement, shall not be subject to the six-month moratorium for selling of such shares.

Where the board of directors of the company fails to perform the duties stipulated in the preceding paragraph, the shareholders shall have the right to demand that the board of directors perform the duties within 30 days. Where the board of directors of the company fails to perform the duties within the aforesaid period, the shareholders shall have the right to file a lawsuit directly in their own name with a people's court to protect the interests of the company.

Where the board of directors of the company fails to perform the duties in accordance with the provisions of the first paragraph, the directors who are accountable shall bear joint liability in accordance with the provisions of the law.

[Annotation:

This Article prohibits certain employees in the issuer from trading in company securities within a short period of time. These people include directors, supervisors, senior management personnel and shareholders holding 5% or more of the company shares.

Senior management personnel include the manager or deputy manager, the responsible accountant, the secretary to the board of directors and other company officers designated in the articles of association. Senior management personnel, directors and supervisors have direct knowledge about the company and company business.

The shareholders holding more than 5% of the company shares are the majority shareholders under the Chinese law. They have more effective channel to acquire information about the company. Their trading in the company securities needs to be restricted so as to maintain the fairness in securities market.

Article 47 on the one hand prevents short-term trading in company shares, and on the other hand provides an exception allowing underwriting securities companies to trade in the company securities left in their hands after the underwriting period under the circumstance of firm commitment underwriting.

To enhance the protection for minority investors, this Article employs several approaches to regulate the short-term transactions of company share by:

- imposing a mandatory duty for the board of directors to collect the illicit profits;
- introducing an avenue for judicial redress to shareholders if the board fails to respond to the request for collection of the profits. This is a special type of shareholder representative actions which is provided under Art 152 of the 2005 *Company Law*;
- requiring the responsible directors together with the board of directors to assume a joint and several liability if the board fails to respond to the request for collection of the profits; and apart from the civil liability; and
- imposing administrative liability including a warning and/or a fine between RMB30,000 and RMB100,000 on the director, the supervisor, senior management

Article 79. Securities companies and their personnel shall not engage in the following activities which are harmful to the interests of their clients:

- (1) carry out securities trading against the orders of clients;
- (2) fail to provide written confirmation of transaction within the stipulated period;
- (3) misappropriate securities bought or sold on behalf of a client or funds in a client's account;
- (4) buy or sell securities arbitrarily without a client's authorisation or buy or sell securities under the pretext of a client's name;
- (5) induce a client to carry out unnecessary securities transactions so as to earn commission;
- (6) use the media or other means to provide or distribute information which misleads the investors; and
- (7) act against the true intention of the clients and commit other acts which are harmful to the interests of the clients.

Where a client suffers damages as a result of such fraud, the doer shall bear compensation liability in accordance with the provisions of the law.

Article 80. Legal persons shall be prohibited from illegal use of others' accounts to carry out securities trading; legal persons shall be prohibited from lending their own account or others' accounts.

[Annotation:

This Article prohibits trading in securities by illegal use of trading accounts. In the past many companies conducted illegal securities trading by illegal use of their own or others' securities trading accounts. This had seriously negative impact on the securities market and investors' confidence. Thus Art 80 clearly prohibits these misconducts.

Notably, the legal liability for contravene of the above provision is introduced for the first time in Art 208 of the 2005 *Securities Law*.

Article 74 of the 1998 *Securities Law* previously read:

"In the course of securities trading, it is prohibited for legal persons to open accounts in the name of natural persons and thereby purchase and sell securities."

Article 81. Widening of financing channels for listing shall be conducted in accordance with the provisions of the law and illegal capital inflow into the stock market shall be prohibited.

Article 82. Misappropriation of public funds for buying and selling of securities shall be prohibited.

Article 83. State-owned enterprises and State-controlled enterprises shall comply with the relevant State provisions on buying and selling of listed shares.

[Annotation:

This provision leaves room for SOEs or State-holding enterprises to invest in securities exchanges. The 2005 *Securities Law* no longer strictly prohibits them from trading in securities.]

Article 84. Stock exchanges, securities companies, securities registration and settlement organisations, securities service organisations and their personnel shall report prohibited trading behaviour to the securities regulatory authorities promptly.

CHAPTER IV — ACQUISITION OF LISTED COMPANIES

Article 85. Investors may acquire listed companies through acquisition offers or by way of negotiated acquisition or via other legitimate means.

Article 86. Where an investor has attained a 5% shareholding in a listed company through securities trading on a stock exchange or holds 5% of the shares of a listed company as a joint shareholder through an agreement or other arrangements, the investor shall submit a written report to the securities regulatory authorities of the State Council and stock exchange within three days, notify the listed company and make an announcement; the investor shall not buy or sell the shares of the listed company within the aforesaid period.

Where an investor has attained a 5% shareholding in a listed company through securities trading on a stock exchange or holds 5% of the issued share capital of a listed company as a joint shareholder through an agreement or other arrangements, the investor shall make a report and announcement in accordance with the aforesaid provisions each time for a change of 5% in shareholding. The investor shall not buy shares of the listed company during the reporting period and within two days after making the report and announcement.

Article 87. The written report and announcement made in accordance with the provisions of the preceding article shall include the following contents:

- (1) name and address of the shareholder;
- (2) description and quantity of the shares held; and
- (3) the date on which the shareholding or change in shareholding reaches the statutory ratio.

Article 88. Where an investor which has attained a 30% shareholding in a listed company through securities trading on a stock exchange or holds 30% of the issued share capital of a listed company as a joint shareholder through an agreement or other arrangements, continues to acquire shares in the listed company, the investor shall make an offer to all shareholders of the listed company in accordance with the provisions of the law for a complete or partial acquisition of shares of the listed company.

An offer for partial acquisition of a listed company shall state that in the event that the number of shares undertaken to be sold by the shareholders of the company exceeds the proposed number of shares to be acquired, the offeror shall make an acquisition based on the ratio.

trading account with the securities company and instruct the securities company to buy and sell securities on its behalf through telephone instructions or other means.

Article 112. Securities companies shall submit a declaration of securities transaction based on the order of an investor and in accordance with the securities trading rules, participate in centralised trading on the stock exchange and assume the corresponding liability for settlement and delivery based on the trading outcome.

The securities registration and settlement organisations shall carry out settlement and delivery of securities and funds with the securities companies based on the trading outcome and in accordance with the settlement and delivery rules, and handle registration and transfer formalities for the clients of the securities companies.

Article 113. Stock exchanges shall ensure secured and equitable centralised trading, announce real time market information for securities trading, and formulate and publish a market chart for each market day.

No organisation or individual shall publish real time securities trading information without the consent of the stock exchange.

[Annotation:

This Article provides the powers and duties of stock exchanges to make securities trading information public. It also prohibits any individual or institution from making securities trading information public without permission of a stock exchange.

Stock exchanges must ensure the centralised securities trading. They must promptly announce quotations concerning securities trading, compile and make public the securities market quotation tables for each day of trading. The prompt information about securities trading is currently made public by electronic systems, including the names and codes of securities being traded on the stock exchanges, the opening and closing prices of each trading day, the maximum and minimum prices of each trading day.]

Article 114. Where the occurrence of a sudden event affects the normal conduct of securities trading, the stock exchange may take measures to suspend trading for technical failure; in the event of a force majeure event or as a bid to safeguard the normal order of securities trading, the stock exchange may decide to suspend the market temporarily.

A stock exchange which decides on a suspension of trading for technical failure or a temporary suspension of the market shall report to the securities regulatory authorities of the State Council promptly.

Article 115. Stock exchanges shall monitor securities trading at all times and submit reports on irregular trading behaviour in accordance with the requirements of the securities regulatory authorities of the State Council.

Stock exchanges shall supervise prompt and accurate information disclosure by listed companies and the relevant persons liable for making information disclosure in accordance with the provisions of the law.

Stock exchanges may, based on the actual need, impose restrictions on trading by securities accounts which display significant irregularity in trading and file records with the securities regulatory authorities of the State Council accordingly.

[Annotation:

This Article empowers stock exchanges to carry out real-time monitoring of securities trading, supervise information disclosure given by listed companies, and limit the trading of securities in the trading accounts with major abnormal trading.

As stock exchanges are the organisers for the securities markets, they have the opportunity to directly face investors, listed companies, securities companies and other securities institutions. Therefore they are able to play a vital role to supervise all the participants in securities trading. In addition to provide securities trading venues, the stock exchanges in China also play the same regulatory role as that of their counterparts in other countries.

Disclosure is an important means to reflect the basic principles of the securities market, namely, openness, fairness and justice. The stock exchanges have a responsibility to enhance the level of information disclosure in securities market because of its specific function in this market. The 2005 *Securities Law* gives more powers to the stock exchanges in this regard.

As organiser and regulator of the securities market, stock exchange has a unique part in preventing illegal trading. To protect the participants in securities market, stock exchange has been given the power to restrict major abnormal trading. As restricting trading is one of the forms of exercising regulatory power and has material impact on the securities market, stock exchanges are required under Art 115 to report their restrictions to the CSRC for records.]

Article 116. Stock exchanges shall contribute a certain percentage of the trading fees, membership dues and fees for trading seats collected to establish a risk fund. The risk fund shall be managed by the council of the stock exchange.

The specific ratio for contribution to the risk fund and its usage shall be formulated jointly by the securities regulatory authorities of the State Council and the finance administration authorities of the State Council.

[Annotation:

This is the same provision as Art 111 of the 1998 *Securities Law* which adopted the risk fund system. Risk fund is a special fund used to compensate the major economic loss of the stock exchanges, to prevent gross risks related to business activities of the stock exchange, and to maintain the normal trading activities. This fund however, cannot be used to recover investors' loss suffered from market fraud or God of Act.

The money for risk fund comes from a proportion of the following resources:

- the securities trading management fees paid by the traders;
- membership fee; and
- trading seat fee.

formulated jointly by the securities regulatory authorities of the State Council and the relevant authorities.

Article 150. Where the net assets or any other risk control indexes of a securities company do not comply with the provisions, the securities regulatory authorities of the State Council shall order the securities company to make correction within a stipulated period; where correction is not made within the stipulated period or the non-compliance has a serious impact on the steady operations of the securities company or the rights and interests of the clients, the securities regulatory authorities of the State Council may adopt the following measures based on the circumstances:

- (1) impose restrictions on the business activities; order suspension of some of the businesses and suspend the approval for new businesses;
- (2) suspend approval for establishment or acquisition of new business branches;
- (3) impose restriction on distribution of bonus shares and impose restriction on payment of remuneration and provision of incentives to the directors, supervisors and senior management personnel;
- (4) impose restriction on transfer of assets or creation of other rights on the assets;
- (5) order that the directors, supervisors and senior management personnel be changed or impose restrictions on their rights;
- (6) order that the controlling shareholders transfer their shareholding or impose restriction on exercise of shareholder's rights; and
- (7) revocation of the relevant business permit(s).

Upon restructuring of a securities company, the securities company shall submit a report to the securities regulatory authorities of the State Council. The securities regulatory authorities of the State Council shall remove the relevant measure(s) stipulated in the preceding paragraph within three days from acceptance and examination if the securities company complies with the relevant risk control index(es).

Article 151. A shareholder of a securities company who made false capital contribution or withdrew capital contribution shall be ordered by the securities regulatory authorities of the State Council to make correction and may be ordered to transfer his/her shareholding in the securities company.

Prior to correction of the illegal act or transfer of shareholding by the aforesaid shareholder, the securities regulatory authorities of the State Council may impose restriction on his/her shareholder's rights.

Article 152. Where a director, supervisor or senior management personnel of a securities company fails to perform due diligence and causes the securities company to commit a major violation or be exposed to significant risks, the securities regulatory authorities of the State Council may revoke his/her qualifications and order the company to remove the director, supervisor or senior management personnel.

[Annotation:

This Article delegates the CSRC to disqualify directors, supervisors or senior management personnel of a securities company and make recommendations for removal if these people have breached the duty of care and diligence and their breach has caused the company to commit gross illegal conduct or to incur major risks.

Although the duty of care and diligence has been recognised as a major duty of directors, supervisors and senior management personnel in many countries, it is not until recent years that this notion was introduced into China. The 2005 *Company Law* and 2005 *Securities Law* for the first time formalises this duty in a form of legislation. To be appointed as directors, supervisors or senior management personnel, they must acquire the certificate for appointment by the CSRC. The CSRC may cancel this certificate for appointment and recommend a replacement. The purpose for delegating this power to the CSRC is to strengthen the management of the company. However, it may be seen as excess administrative interference with the company business.]

Article 153. Where a securities company engages in illegal operations or is exposed to significant risks which brought a serious impact on the order of the securities market or harm to the rights and interests of the investors, the securities regulatory authorities of the State Council may order the securities company to suspend operations for restructuring and appoint a receiver for the securities company or order dissolution of the securities company or take other control measures.

Article 154. During the period in which the operations of a securities company is suspended for restructuring or the period in which the securities company is placed under receivership or being liquidated in accordance with the provisions of the law or when a securities company is subject to significant risks, the securities regulatory authorities of the State Council may take the following measures on the directors, supervisors and senior management personnel and other personnel who are directly accountable:

- (1) inform the outbound Customs to stop such persons from leaving China; and
- (2) apply to the judicial authorities to prohibit removal or transfer of assets or disposal of the assets in other means or creation of other rights on the assets.

[Annotation:

This Article is about how the CSRC will deal with directors, supervisors, senior management personnel or other directly responsible individuals of a securities company when the securities company is ordered to stop operation, or when a trust or receiver is appointed, or when the securities company is in the process of liquidation or incurs major risks.]

ordered to make correction and be subject to a warning and a fine ranging from RMB300,000 to RMB600,000. The person-in-charge and other personnel who are directly accountable shall be subject to a warning and a fine ranging from RMB30,000 to RMB300,000.

Issuers, listed companies or other persons liable for making information disclosure which/who fail to submit the relevant report in accordance with the provisions or submit a report which contains fraudulent information, misleading representation or major omission shall be ordered to make correction and be subject to a warning and a fine ranging from RMB300,000 to RMB600,000. The person-in-charge and other personnel who are directly accountable shall be subject to a warning and a fine ranging from RMB30,000 to RMB300,000.

The controlling shareholders and actual controlling party of the aforesaid issuers, listed companies or persons liable for making information disclosure who instructed the aforesaid violations shall be punished in accordance with the provisions of the preceding paragraphs.

[Annotation:

This Article provides the non-disclosure liabilities for issuer, listed company and others with the duty of disclosure. An order to make corrections, a warning or a fine may be imposed. It also provides liabilities for non submission of disclosure documents, or provides liabilities for false or misleading or gross omission in the documents.]

Article 194. Issuers and listed companies which change the usage purpose of the funds raised in a public offering of securities arbitrarily shall be ordered to make correction. The person-in-charge and other personnel who are directly accountable shall be issued a warning and be subject to a fine ranging from RMB30,000 to RMB300,000.

The controlling shareholders and actual controlling party of the aforesaid issuers and listed companies who instructed the aforesaid violations shall be issued a warning and be subject to a fine ranging from RMB300,000 to RMB600,000. The person-in-charge and other personnel who are directly accountable shall be punished in accordance with the provisions of the preceding paragraph.

Article 195. Directors, supervisors, senior management personnel of a listed company and shareholders holding 5% or more of the shares of a listed company who buy and sell the company's shares in violation of the provisions of Article 47 shall be issued a warning and may be subject to a fine ranging from RMB30,000 to RMB100,000.

Article 196. Securities trading premises which are established illegally shall be closed down by a people's government of county level and above; the illegal income shall be confiscated and a fine ranging from one to five times of the amount of illegal income shall be imposed; where there is no illegal income or the amount of illegal income is below RMB100,000, a fine ranging from RMB100,000 to RMB500,000 shall be imposed. The person-in-charge and other personnel who are directly accountable shall be issued a warning and be subject to a fine ranging from RMB30,000 to RMB300,000.

Article 197. Securities companies established without prior approval or illegal securities operations shall be closed down by the securities regulatory authorities; the illegal income shall be confiscated and a fine ranging from one to five times of the amount of illegal income shall be imposed; where there is no illegal income or the amount of illegal income is below RMB300,000, a fine ranging from RMB300,000 to RMB600,000 shall be imposed. The person-in-charge and other personnel who are directly accountable shall be issued a warning and be subject to a fine ranging from RMB30,000 to RMB300,000.

Article 198. Parties which violate the provisions of this Law in employing unqualified persons to engage in securities businesses shall be ordered by the securities regulatory authorities to make correction and be issued a warning and may be subject to a fine ranging from RMB100,000 to RMB300,000. The person-in-charge and other personnel who are directly accountable shall be issued a warning and may be subject to a fine ranging from RMB30,000 to RMB100,000.

Article 199. Persons prohibited by laws and administrative regulations from carrying out trading of shares who hold or buy and sell shares directly or in the name of others shall be ordered to dispose of the shares held illegally; the illegal income shall be confiscated and a fine of not more than the equivalent value of the shares shall be imposed; where the person is a civil servant, administrative punishment shall be imposed in accordance with the provisions of the law.

[Annotation:

This provision amended Art 180 of the 1998 *Securities Law*. It prohibits certain people from trading in securities by taking undue advantage of their positions to acquire inside information. These peoples include the staff of stock exchanges, securities companies, securities registration and clearing institutions, the CSRC and other people prohibited by law and administrative regulations. These people are prohibited from trading in securities either on behalf of themselves or on behalf of others. If they are in breach of this provision, they shall be ordered to make corrections, their illegal profits will be confiscated, and a fine will be imposed. Public servants breaching this provision will be subject to administrative penalty as well.]

Article 200. The employees of stock exchanges, securities companies, securities registration and settlement organisations, securities service organisations or the personnel of securities industry association who deliberately provide fraudulent information or conceal, forge, tamper with or destroy trading records to induce investors to buy and sell securities shall have their employment certificates for the securities industry revoked and be subject to a fine ranging from RMB30,000 to RMB100,000; where the person is a civil servant, administrative punishment shall be imposed in accordance with the provisions of the law.

[Annotation:

This provision amended Art 181 of the 1998 *Securities Law* by increasing the fine on stock exchanges, securities companies, securities registration and clearing institutions and professional in securities trading and staff of the CSRC for forging, altering or destroying false securities documents from between RMB30,000 and